

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-81802; File No. SR-GEMX-2017-37)

October 3, 2017

Self-Regulatory Organizations; Nasdaq GEMX, LLC; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Adopt New Corporate Governance and Related Processes Similar to Those of the Nasdaq Exchanges

I. Introduction

On August 7, 2017, Nasdaq GEMX, LLC (“GEMX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> proposed rule changes to its corporate governance documents and trading rules to align its corporate governance framework to the structure of other exchanges owned by its ultimate parent company, Nasdaq, Inc. The proposed rule change was published for comment in the Federal Register on August 23, 2017.<sup>3</sup> The Commission received no comments on the proposal. On September 20, 2017, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> This order approves the proposed rule change, as modified by Amendment No. 1.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 81422 (August 17, 2017), 82 FR 40026 (“Notice”).

<sup>4</sup> In Amendment No. 1, the Exchange made a technical correction to a typographical error in proposed By-Law Article III, Section 5(c). When the Exchange filed Amendment No. 1 with the Commission, it also submitted Amendment No. 1 to the public comment file for SR-GEMX-2017-37 (available at: <https://www.sec.gov/comments/sr-gemx-2017-37/gemx201737.htm>). Because Amendment No. 1 does not materially alter the substance of the proposed rule change or raise unique or novel regulatory issues, it is not subject to notice and comment.

## II. Background

On June 21, 2016, the Commission approved a proposed rule change relating to a corporate transaction in which Nasdaq, Inc. would become the ultimate parent of GEMX (the “Nasdaq Acquisition”), Nasdaq ISE, LLC (“ISE”), and Nasdaq MRX, LLC (“MRX,” and together with GEMX and ISE, the “ISE Exchanges”).<sup>5</sup> On June 30, 2016, pursuant to this transaction, Nasdaq, Inc. acquired all of the capital stock of U.S. Exchange Holdings, Inc. (“Exchange Holdings”), and thereby became the indirect, ultimate parent of the ISE Exchanges.<sup>6</sup> Nasdaq, Inc. is also the ultimate parent of NASDAQ BX, Inc. (“BX”), The NASDAQ Stock Market LLC (“Nasdaq”), and NASDAQ PHLX LLC (“Phlx” and, together with Nasdaq and BX, the “Nasdaq Exchanges”).<sup>7</sup> The Commission notes that the corporate governance documents of GEMX, specifically its Second Amended and Restated Limited Liability Company Agreement (“Current LLC Agreement”) and its Constitution (“Current Constitution” and, together with the Current LLC Agreement, the “Current Governing Documents”) are rules of the Exchange, as are the governing documents of GEMX’s Upstream Owners,<sup>8</sup> which include certain provisions that

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<sup>5</sup> See Securities Exchange Act Release No. 78119 (June 21, 2016), 81 FR 41611 (June 27, 2016) (SR-ISE-2016-11; SR-ISEGemini-2016-05; SR-ISEMercury-2016-10) (“Nasdaq Acquisition Order”) (order approving Nasdaq, Inc.’s acquisition of ISE (f/k/a International Securities Exchange, LLC), GEMX (f/k/a ISE Gemini, LLC), and MRX (f/k/a ISE Mercury, LLC)).

<sup>6</sup> See Notice, supra note 3, at 40027 n.3. Exchange Holdings is the sole owner of ISE Holdings, Inc. (“ISE Holdings,” and together with Exchange Holdings and Nasdaq, Inc., the “Upstream Owners”), which is the sole owner of 100% of the Exchange’s limited liability company interests. See id. at 40027; see also Nasdaq Acquisition Order, supra note 5, at 41611. ISE Holdings is also the sole direct owner of ISE and MRX. See Nasdaq Acquisition Order, supra note 5, at 41611.

<sup>7</sup> See Notice, supra note 3, at 40027. See also Nasdaq Acquisition Order, supra note 5, at 41611. As a result of this transaction, the ISE Exchanges and the Nasdaq Exchanges became affiliates. See Nasdaq Acquisition Order, supra note 5, at 41611 n.8.

<sup>8</sup> See Nasdaq Acquisition Order, supra note 5, at 41612.

are designed to maintain the independence of GEMX’s self-regulatory functions (as well as the self-regulatory functions of the Upstream Owners’ other self-regulatory subsidiaries, i.e., the Nasdaq Exchanges).<sup>9</sup>

The Exchange intends to effect a merger with a newly-formed Delaware limited liability company (“Merger”) under Nasdaq, Inc. that would result in GEMX as the surviving entity with new corporate governance documents. In connection with that Merger, the Exchange proposes various changes to its corporate governance documents and rules (“Rules”).<sup>10</sup> Specifically, the Exchange proposes to: (1) delete the Exchange’s Current LLC Agreement in its entirety and replace it with the New LLC Agreement, which is based on the limited liability company agreement of Nasdaq;<sup>11</sup> (2) delete the Exchange’s Current Constitution in its entirety and replace it with the New By-Laws, which are based on the by-laws of Nasdaq;<sup>12</sup> and (3) amend certain of its Rules to reflect the replacement of the Current Governing Documents with the New Governing Documents.<sup>13</sup>

The Exchange represents that the proposed changes are designed to align the Exchange’s corporate governance framework with the existing structure of the Nasdaq Exchanges, particularly as it relates to the board and committee structure, nomination and election processes,

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<sup>9</sup> See, e.g., Nasdaq Acquisition Order, supra note 5, at 41612-13.

<sup>10</sup> The Rules as proposed to be amended pursuant to the proposed rule change are referred to herein as the “New Rules.”

<sup>11</sup> See Notice, supra note 3, at 40027 n.5.

<sup>12</sup> Id.

<sup>13</sup> The Exchange’s affiliates, ISE and MRX, have submitted nearly identical proposed rule changes. The Commission approved the ISE proposal, and the MRX proposal has been published for public notice and comment. See Securities Exchange Act Release Nos. 81263 (July 31, 2017), 82 FR 36497 (August 4, 2017) (SR-ISE-2017-32) (“ISE Governance Order”) and 81795 (October 2, 2017) (SR-MRX-2017-18).

and related governance practices.<sup>14</sup> The Exchange also represents that it is not proposing any amendments to its ownership structure. The Exchange does not propose any amendments to the governing documents of its Upstream Owners.<sup>15</sup> Thus, the provisions in the governing documents of these entities, which were designed to maintain the independence of GEMX's self-regulatory functions, would remain unchanged. The Exchange also represents that it is not proposing any amendments to its Rules at this time, other than minor clarifying changes and technical amendments to reflect the changes to its governing documents as described in more detail below.<sup>16</sup> The Exchange states that it intends to implement its proposed rule change no later than by the end of the fourth quarter of 2017.<sup>17</sup>

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>18</sup> Specifically, as discussed in more detail below, the Commission finds that the proposed rule change is consistent with Sections 6(b)(1) and 6(b)(3) of the Act,<sup>19</sup> which require, among other things, that a national securities exchange be so organized and have the capacity to carry out the purposes of the Act, and to comply and enforce compliance by its members and persons associated with its members, with the provisions of the Act,

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<sup>14</sup> See Notice, supra note 3, at 40027.

<sup>15</sup> See generally id.

<sup>16</sup> See id. at 40027 and 40041-42.

<sup>17</sup> See id. at 40027. The Exchange also states that it will alert its members in the form of a regulatory alert to provide notification of the implementation date. Id.

<sup>18</sup> In approving these proposed rule changes, the Commission has considered the proposed rules' impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>19</sup> 15 U.S.C. 78f(b)(1) and (b)(3).

the rules and regulation thereunder, and the rules of the exchange, and assure the fair representation of its members and persons associated with its members in the selection of its directors and administration of its affairs, and provide that one of more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer. Further, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>20</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in securities; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest.

A. Ownership of the Exchange

GEMX is currently structured as a Delaware limited liability company (“Delaware LLC”)<sup>21</sup> and, as discussed above, is a wholly-owned subsidiary of ISE Holdings. ISE Holdings, in turn is a wholly-owned subsidiary of Exchange Holdings, which is wholly-owned by Nasdaq, Inc. Pursuant to the Current LLC Agreement, ISE Holdings is defined as the Sole LLC Member.<sup>22</sup> As the Sole LLC Member, ISE Holdings may assign all (but not less than all) of its

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<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> See Current LLC Agreement.

<sup>22</sup> See id. The Current Constitution also defines ISE Holdings as the Sole LLC Member of the Exchange and permits assignment of its LLC interest as provided in the Current LLC Agreement. See Current Constitution, Section 1.1.

interest in the Exchange, subject to prior approval by the Commission pursuant to the rule filing procedures under Section 19 of the Act.<sup>23</sup>

Pursuant to the proposed rule change, GEMX will be merged with a newly formed Delaware LLC, whereby GEMX will be the surviving entity, governed by the New Governing Documents. ISE Holdings will continue to be the direct owner of GEMX and will be defined as the “Company Member” or “Sole LLC Member” in the New LLC Agreement and New By-Laws.<sup>24</sup> Additionally, pursuant to the New LLC Agreement, ISE Holdings will not be permitted to assign, in whole or in part, its limited liability company interest in the Exchange, unless such transfer or assignment is filed with and approved by the Commission pursuant to the rule filing procedures under Section 19 of the Act.<sup>25</sup>

The Commission believes that the proposed restrictions on ISE Holdings’ assignment of its ownership interest in GEMX, taken together with restrictions on voting and ownership limitations in the governing documents of GEMX’s Upstream Owners that were previously approved by the Commission,<sup>26</sup> are designed to minimize the potential that a person could

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<sup>23</sup> See Current LLC Agreement, Section 7.1.

<sup>24</sup> See New LLC Agreement, Schedule A; and New By-Laws, Article I(f).

<sup>25</sup> See New LLC Agreement, Section 20. Pursuant to Section 7.1 of the Current LLC Agreement, ISE Holdings may only assign all (but not less than all) of its ownership interest, and any assignment of ISE Holdings’ interest in GEMX would similarly be subject to approval by the Commission pursuant to the rule filing procedures under Section 19 of the Act.

<sup>26</sup> See Nasdaq Acquisition Order, *supra* note 5, at 41612-17 (discussing provisions, including voting and ownership limitations, in the governing documents of Nasdaq, Inc. and other Upstream Owners that are designed to maintain the independence of their self-regulatory subsidiaries); Securities Exchange Act Release No. 53705 (April 21, 2006), 71 FR 25260, 25262-63 (April 28, 2006) (“ISE HoldCo Order”) (order approving SR-ISE-2006-04) (discussing voting and ownership limitations in the governing documents of ISE Holdings); Securities Exchange Act Release No. 70050 (July 26, 2013), 78 FR 46622, 46622-23, 46625, 46627-29 (August 1, 2013) (“GEMX Approval Order”)

improperly interfere with, or restrict the ability of, the Commission or GEMX to effectively carry out its regulatory oversight responsibilities under the Act. The Commission also notes that the restrictions on transfer of ownership interest in the Exchange will be similar to those currently in place. In this regard, the Commission believes the proposed rule change is consistent with Section 6(b)(1) of the Act<sup>27</sup> in particular, which requires that an exchange be organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange.

B. Governance of the Exchange

The Exchange proposes to replace certain provisions pertaining to governance of the Exchange with related provisions that are based on provisions currently in the Nasdaq LLC Agreement and Nasdaq By-Laws.<sup>28</sup> These changes include, among others, provisions governing: the composition of the Exchange’s board of directors (“Board” or “Board of Directors,” and each member of the Board of Directors a “Director”); the process for nominating, electing, and

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(granting GEMX’s application for registration as a national securities exchange and discussing the provisions in the governing documents of ISE Holdings and other Upstream Owners that are designed to preserve the self-regulatory function of GEMX); and Securities Exchange Act Release No. 76998 (January 29, 2016), 81 FR 6066, 6067, 6069, 6071-73 (February 4, 2016) (“Mercury Exchange Approval”) (approving the registration of ISE Mercury, LLC as a national securities exchange and discussing the provisions in the governing documents of ISE Holdings and other Upstream Owners that are designed to preserve the self-regulatory function of the national securities exchanges they control, which includes GEMX).

<sup>27</sup> 15 U.S.C. 78(b)(1).

<sup>28</sup> See Notice, supra note 3, at 40033-36.

removing Directors; the filling of vacancies on the Exchange’s Board; the Exchange’s board committee structure; and regulatory independence of the Exchange.<sup>29</sup>

1. Board of Directors: Powers and Composition

Under the New Governing Documents, and consistent with the Current LLC Agreement,<sup>30</sup> the business and affairs of the Exchange will be managed under the discretion of its Board, which will be vested with the power to do any and all acts necessary or for the furtherance of the purposes described in the New LLC Agreement, including fulfilling the Exchange’s self-regulatory responsibilities as set forth in the Act.<sup>31</sup> The new Board will also have the power to bind the Exchange and delegate powers,<sup>32</sup> as it does today.<sup>33</sup>

ISE Holdings, as the Sole LLC Member, may determine at any time, in its sole and absolute discretion, the number of Directors to constitute the Board of Directors.<sup>34</sup> However, at least 20% of the Directors must be “Member Representative Directors”<sup>35</sup> and the number of “Non-Industry Directors,” including at least one “Public Director” and at least one “issuer representative” (or if the Board consists of ten or more Directors, at least two issuer

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<sup>29</sup> See id.

<sup>30</sup> See Current LLC Agreement, Article II, Section 2.2 and Article V, Sections 5.1 and 5.7; and Current Constitution, Article III, Section 3.1.

<sup>31</sup> See New LLC Agreement, Sections 7, 8, and 9(a).

<sup>32</sup> See New LLC Agreement, Section 9(b).

<sup>33</sup> See Current LLC Agreement, Article II, Section 2.2; and Current Constitution, Article V, Section 5.1.

<sup>34</sup> See New LLC Agreement, Section 9(a).

<sup>35</sup> See id. A “Member Representative Director” will be defined as a Director who has been elected or appointed after having been nominated by the Member Nominating Committee or by an Exchange Member pursuant to the New By-Laws and may be, but is not required to be, an officer, director, employee, or agent of an Exchange Member. See New By-Laws, Article I(r).



representatives), must equal or exceed the sum of the number of Industry Directors and Member Representative Directors.<sup>36</sup> Additionally, up to two Staff Directors may be elected to the Board.<sup>37</sup> A Director may not be subject to a statutory disqualification.<sup>38</sup> A Director will be removed upon a determination by the Board, by a majority vote of the remaining Directors, that the Director no longer satisfies the classification for which the Director was elected and that the Director's continued service on the Board would violate the board composition requirements.<sup>39</sup>

As discussed in more detail below,<sup>40</sup> the current Board was elected at the Exchange's 2017 annual election of its Board (the "2017 Annual Election," and such Board the "2017 Board"), which was held on June 19, 2017, pursuant to the Current Governing Documents. When the New Governing Documents become operative, the 2017 Board will appoint a

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<sup>36</sup> See New By-Laws, Article III, Section 2(a). A "Non-Industry Director" will be defined as a Director (excluding an officer of the Exchange serving as a Director ("Staff Director")) who is (i) a Public Director; (ii) an officer, director, or employee of an issuer of securities listed on the Exchange; or (iii) any other individual who would not be an Industry Director. See New By-Laws, Article I(w). A "Public Director" will be defined as a Director who has no material business relationship with a broker or dealer, the Exchange or its affiliates, or FINRA. See New By-Laws, Article I(z). An "Industry Director" will be defined as a Director with direct ties to the securities industry as a result of connections to a broker-dealer, the Exchange or its affiliates, FINRA, or certain service providers to such entities. See Notice, supra note 3, at 40035 n.78. See also New By-Laws, Article I(m).

<sup>37</sup> See New By-Laws, Article I(m); see also Notice, supra note 3, at 40036 n.81 and accompanying text.

<sup>38</sup> See New By-Laws, Article III, Section 2(a).

<sup>39</sup> See New By-Laws, Article III, Section 2(b). If the remaining term of office of a removed Director is not more than six months, the Board will not be deemed to be in violation of the Article III, Section 2(a) composition requirements during the vacancy by virtue of such vacancy. See id.

<sup>40</sup> See infra notes 61-64, 66-67, and accompanying text.

Nominating Committee and a Member Nominating Committee.<sup>41</sup> The Member Nominating Committee will nominate candidates for each Member Representative Director position on the Board,<sup>42</sup> as well as nominate candidates for appointment by the Board for each vacant or new position on a committee that is to be filled with a “Member Representative member”<sup>43</sup> under the

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<sup>41</sup> See Notice, *supra* note 3, at 40037. The Nominating Committee will consist of no fewer than six and no more than nine members. The number of Non-Industry members on the Nominating Committee shall equal or exceed the number of Industry members on the Nominating Committee. If the Nominating Committee consists of six members, at least two shall be Public members, and if the Nominating Committee consists of seven or more members, at least three shall be Public members. The Member Nominating Committee shall consist of no fewer than three and no more than six members. All members of the Member Nominating Committee shall be a current associated person of a current Exchange Member, and the Board will appoint such individuals after appropriate consultation with representatives of Exchange Members. See New By-Laws, Article III, Sections 6(b)(i) and (iii). See also Notice, *supra* note 3, at 40040 (discussing the compositional requirements for, and responsibilities of, the Nominating Committee and Member Nominating Committee).

An “Industry member” will be a member of any committee appointed by the Board that is associated with a broker-dealer as defined in the New By-Laws, Article I(n). A “Non-Industry member” will be defined as a member of any committee appointed by the Board who is (i) a Public member; (ii) an officer or employee of an issuer of securities listed on the Exchange; or (iii) any other individual who would not be an Industry member. See New By-Laws, Article I(x). A “Public member” will be defined as a member of any committee appointed by the Board who has no material business relationship with a broker or dealer, the Exchange or its affiliates, or FINRA. See New By-Laws, Article I(aa).

<sup>42</sup> Pursuant to the New By-Laws, Member Representative Directors shall be elected to the Board on an annual basis. See New By-Laws, Article II, Section 1(a).

<sup>43</sup> Pursuant to the New By-Laws, a “Member Representative member” will be defined as a member of any committee appointed by the Board who has been elected or appointed after having been nominated by the Member Nominating Committee pursuant to the By-Laws. See New By-Laws, Article I(s). As discussed further below, the required inclusion of such representatives on certain committees, and the process by which they are to be selected, is designed to comply with the fair representation requirements of Section 6(b)(3) of the Act. See *infra* note 98 and accompanying text. See also Notice, *supra* note 3, at 40034-35, 40042.

New By-Laws.<sup>44</sup> If an Exchange Member<sup>45</sup> submits a timely and duly executed written nomination to the Secretary of the Exchange, additional candidates may be added to the List of Candidates<sup>46</sup> for the Member Representative Director positions.<sup>47</sup> These candidates, together with candidates nominated by the Member Nominating Committee, will then be presented to Exchange Members for election.<sup>48</sup> The Nominating Committee will nominate candidates for all other vacant or new Director positions on the Board.<sup>49</sup>

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The Exchange states that the new Member Nominating Committee is responsible for: (i) the nomination for election of Member Representative Directors to the Board and (ii) the nomination for appointment of Member Representative members to the committees requiring such members. See Notice, supra note 3, at 40040.

<sup>44</sup> See New By-Laws, Article III, Section 6(b).

<sup>45</sup> “Exchange Member” will be defined as any registered broker or dealer that has been admitted to membership in the national securities exchange operated by GEMX. See New By-Laws, Article 1(u).

<sup>46</sup> “List of Candidates” will be defined as the list of candidates for Member Representative Director positions to be elected on an Election Date. See New By-Laws, Article 1(p).

“Election Date” will be defined as a date selected by the Board on an annual basis, on which Exchange Members may vote with respect to Member Representative Directors in the event of a Contested Election. See New By-Laws, Article 1(k). See also infra note 48 for the definition of “Contested Election.”

<sup>47</sup> See New By-Laws, Article II, Section 1(b). See also Notice, supra note 3, at 40033.

<sup>48</sup> If there is only one candidate for each Member Representative Director position to be elected on the annual election date, the Member Representative Directors shall be elected by ISE Holdings as the Sole LLC Member. If, as a result of the nomination and petition process, there are more Member Representative Directors candidates than the number of positions to be elected, each Exchange Member shall have the right to cast one vote for each Member Representative Director, and the candidates who receive the most votes shall be elected to the Member Representative Director positions. An Exchange Member, however, either alone or together with its affiliates, may not cast votes representing more than 20% of the votes cast for a candidate. See New By-Laws, Article II, Section 1(c) and Section 2. See also New By-Laws, Article 1(g) (defining “Contested Election” as an election for one or more Member Representative Directors for which the number of candidates on the List of Candidates exceeds the number of positions to be elected).

Under the Exchange’s Current Governing Documents, at least 30% of the directors on the Board are officers, directors, or partners of Exchange members (currently, six directors),

The Commission believes that the proposed composition of the Exchange’s Board satisfies the requirements in Section 6(b)(3) of the Act,<sup>50</sup> which requires in part that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, or with a broker or dealer.<sup>51</sup> The Commission previously has stated that the inclusion of public, non-industry representatives on exchange oversight bodies is an important mechanism

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and are elected by a plurality of the holders of Exchange Rights (the “Industry Directors,” or, as referred to herein, “Exchange Directors”), of which at least one must be elected by holders of PMM Rights, one must be elected by holders of CMM Rights, and one must be elected by holders of EAM Rights; provided, however, that the number of each type of Exchange Director will always be equal to one another. See Notice, supra note 3, at 40029. See also Current Constitution, Article III, Section 3.2. The Exchange states that this current structure was adopted to comply with the fair representation requirements of Section 6(b) of the Act. See Notice, supra note 3, at 40029. Because they give members a voice in the Exchange’s use of its self-regulatory authority, the Exchange believes that Exchange Directors serve the same function as Member Representative Directors on the boards of the Nasdaq Exchanges. See id.

The Exchange notes that the Commission has previously found the Nasdaq LLC Agreement’s (1) 20% Member Representative Director requirement, and (2) election process, provide fair representation of Nasdaq members, consistent with the requirements of Section 6(b) of the Act. See Notice, supra note 3, at 40029 n.18 (citing Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550, 3553 (January 23, 2006) (“Nasdaq Exchange Order”) (granting the exchange registration of Nasdaq Stock Market, Inc.). The Commission notes that the Board compositional requirements and the process for electing Member Representative Directors in the New Governing Documents are based on the parallel requirements in the Nasdaq LLC Agreement and are identical to those recently approved by the Commission for ISE. See ISE Governance Order, supra note 13, at 36499-501.

<sup>49</sup> See New By-Laws, Article III, Section 6(b).

<sup>50</sup> 15 U.S.C. 78f(b)(3).

<sup>51</sup> The Commission also notes that it previously found the compositional requirements for the board of directors of Nasdaq, upon which GEMX’s proposed requirements are based, to be consistent with Act. See Nasdaq Exchange Order, supra note 48, at 3553. See also ISE Governance Order, supra note 13, at 36500-01 (approving identical requirements for ISE).

to support an exchange's ability to protect the public interest,<sup>52</sup> and that they can help to ensure that no single group of market participants has the ability to systematically disadvantage others through the exchange governance process.<sup>53</sup> As it has previously stated, the Commission believes that public directors can provide unbiased perspectives, which may enhance the ability of the Board to address issues in a non-discriminatory fashion and foster the integrity of the Exchange.<sup>54</sup>

Section 6(b)(3) of the Act requires that “the rules of the exchange assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer.”<sup>55</sup> The Commission also believes that the proposed requirement that at least 20% of the Directors be Member Representative Directors, and the means by which they will be chosen by Exchange Members, is consistent with Section 6(b)(3) of the Act.<sup>56</sup> As the Commission previously has noted, this statutory requirement helps to ensure that members have a voice in the Exchange's use of its self-regulatory authority,

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<sup>52</sup> See, e.g., Regulation of Exchanges and Alternative Trading Systems, Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998).

<sup>53</sup> See, e.g., Securities Exchange Act Release No 68341 (December 3, 2012), 77 FR 73065, 73067 (December 7, 2012) (“MIAX Exchange Order”) (granting the exchange registration of the Miami International Securities Exchange LLC).

<sup>54</sup> See, e.g., Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251, 11261 (March 6, 2006) (order approving the New York Stock Exchange, Inc.'s business combination with Archipelago Holdings, Inc.); Nasdaq Exchange Order, supra note 48, at 3553; and Securities Exchange Act Release No. 62716 (August 13, 2010), 75 FR 51295, 51298 (August 19, 2010) (approving the application of BATS Y-Exchange, Inc. for registration as a national securities exchange); and ISE Governance Order, supra note 13, at 36501.

<sup>55</sup> Id.

<sup>56</sup> 15 U.S.C. 78f(b)(3).

and that the Exchange is administered in a way that is equitable to all those persons who trade on its markets or through its facilities.<sup>57</sup> In addition, the Commission believes that the requirement that at least one director be a Public Director and one an issuer representative satisfies the requirements of Section 6(b)(3) of the Act.<sup>58</sup>

## 2. Transition from Current Board Election Process to the New Election Process

In its filing, the Exchange states that, when it was acquired by Nasdaq, Inc., there were a number of harmonizing changes to its Board that resulted in a complete overlap of directors on the Boards of GEMX and the Nasdaq Exchanges (the “Post-Acquisition Board”).<sup>59</sup> GEMX also states its belief that the Post-Acquisition Board satisfied the composition requirements contained in both the Current Constitution and the New By-Laws.<sup>60</sup> The Exchange states that the terms of the Directors on the Post-Acquisition Board ended at the 2017 Annual Election,<sup>61</sup> and that all of the Directors on the 2017 Board are Directors that served on the Post-Acquisition Board. The Exchange believes that the 2017 Board satisfies both the board composition requirements in the Current Governing Documents, as well as in the New Governing Documents,<sup>62</sup> and that once the

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<sup>57</sup> See, e.g., Nasdaq Exchange Order, supra note 48; Securities Exchange Act Release No. 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (order granting the exchange registration of BATS Exchange, Inc.); and ISE Governance Order, supra note 13, at 36501.

<sup>58</sup> 15 U.S.C. 78f(b)(3).

<sup>59</sup> See Notice, supra note 3, at 40036.

<sup>60</sup> See id.

<sup>61</sup> The Exchange states that it held its 2017 Annual Election on June 19, 2017, in accordance with the nomination, petition, and voting processes set forth in the Current Governing Documents. See id.

<sup>62</sup> The Commission notes that if the Board of Directors in place at the time the New Governing Documents become effective does not satisfy the requirements in the New Governing Documents, the Exchange would need to comply with the procedures for

New Governing Documents become operative, no additional actions with respect to the 2017 Board will be required under the Delaware Limited Liability Company Act.<sup>63</sup> Pursuant to the proposal, the 2017 Board will serve until the Exchange’s first annual election of Directors in 2018 (“2018 Board”) in accordance with the processes under the New Governing Documents.<sup>64</sup>

The Commission believes the Exchange’s proposal to allow the 2017 Board to continue serving until the 2018 Board would be elected pursuant to the process in the New Governing Documents is consistent with the Act, and in particular Section 6(b)(3) of the Act.<sup>65</sup> The Exchange states that, although the 2017 Board was not nominated or voted upon in accordance with the New Governing Documents, it believes that the composition of the 2017 Board is consistent with the Act, as it still provides for the fair representation of members and has one or more directors that are representative of issuers and investors and not associated with a member of the exchange, broker, or dealer. Specifically, the Exchange states that six Directors are officers, directors, or partners of Exchange members, and were elected by a plurality of the holders of “Exchange Rights,” as required by Section 3.2(b) of the Current Constitution.<sup>66</sup> These

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removing Directors and filling vacancies pursuant to the New Governing Documents. See, e.g., supra notes 39, 42, and 47-49 and accompanying text.

<sup>63</sup> See Notice, supra note 3, at 40036. As discussed above, the Exchange proposes that, if approved, the New Governing Documents would be made effective no later than by the end of the fourth quarter of 2017. See id. at 40027; see also supra note 16 and accompanying text.

<sup>64</sup> See Notice, supra note 3, at 40037.

<sup>65</sup> See supra notes 50-58 and accompanying text (discussing the requirements of Section 6(b)(3) and the Commission’s belief that the compositional requirements for the Board of Directors, and the process for electing such Directors under the New Governing Documents, are consistent with those requirements).

<sup>66</sup> See Notice, supra note 3, at 40029 and 40032-33 (discussing the Exchange’s current process for the nomination and election of Directors, including the Exchange Directors). See also supra note 48.

Exchange Directors were subject to the full petition and voting process by membership in accordance with Articles II and III of the Current Constitution, which process the Commission previously found to satisfy the requirements of the Act.<sup>67</sup> The Exchange believes that the Exchange Directors serve the same function as the Member Representative Directors under the proposed board structure, as both directorships give Exchange members a voice in the Exchange’s use of its self-regulatory authority.<sup>68</sup> The Exchange also notes that only its corporate governance structure would change under the proposed rule change, and that its membership has remained substantially the same both before and after the 2017 Annual Election.<sup>69</sup> Additionally, the Commission notes that, under the Current Governing Documents, the 2017 Board is required to include one Director that is a “Public Director.”<sup>70</sup>

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“Exchange Rights” currently means, collectively, PMM Rights, CMM Rights, and EAM Rights, which are the trading and other rights associated with the Exchange’s three classes of membership. See Rule 100(a)(17); Current LLC Agreement, Article VI; and Current Constitution, Section 13.1(n). See also Rules 100(a)(12), 100(a)(15), and 100(a)(36); and Current Constitution, Sections 13.1(f), 13.1(j), and 13.1(y). Under the New Rules, “Exchange Rights” will be defined in New Rule 100(a)(20) as the PMM Rights, CMM Rights, and EAM Rights, which will be defined in New Rules 100(a)(41), 100(a)(12), and 100(a)(16), respectively, and as discussed further below. See infra Section III.C. (discussing amendments to the Exchange’s Rules).

<sup>67</sup> See Notice, supra note 3, at 40036; GEMX Approval Order, supra note 26.

<sup>68</sup> See Notice, supra note 3, at 40036.

<sup>69</sup> See id.

<sup>70</sup> See Current Constitution, Section 3.2(b).

Pursuant to the Exchange’s Current Constitution, a “Public Director” means a non-industry representative who has no material relationship with a broker or dealer or any affiliate of a broker or dealer or the Exchange or any affiliate of the Exchange. See Current Constitution, Sections 3.2(b) and 13.1(z).

The term “non-industry representative” means any person who would not be considered an “industry representative,” as well as (i) a person affiliated with a broker or dealer that operates solely to assist the securities-related activities of the business of non-member affiliates, or (ii) an employee of an entity that is affiliated with a broker or dealer that does not account for a material portion of the revenues of the consolidated entity, and



### 3. Committees of the Board

Pursuant to the New By-Laws, the Exchange may establish committees composed solely of Directors. Specifically, the Exchange may establish an Executive Committee and a Finance Committee, and shall establish a Regulatory Oversight Committee (“ROC”).<sup>71</sup> The Exchange shall also establish certain committees not composed solely of Directors. Specifically, the Exchange shall establish a Nominating Committee and a Member Nominating Committee, which would be elected on an annual basis by ISE Holdings, as the Sole LLC Member,<sup>72</sup> and a Quality of Markets Committee (“QMC”).<sup>73</sup> The New LLC Agreement will provide that, to the extent provided in the resolution of the Board, any committee that consists solely of one or more Directors shall have and may exercise all the powers and the authority of the Board in the management of the business and affairs of the Exchange.<sup>74</sup> The powers of any such committee

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who is primarily engaged in the business of the non-member entity. See Current Constitution, Section 13.1(u).

The term “industry representative” means a person who is an officer, director, or employee of a broker or dealer or who has been employed in any such capacity at any time within the prior three (3) years, as well as a person who has a consulting or employment relationship with or has provided professional services to the Exchange and a person who had any such relationship or provided any such services to the Exchange at any time within the prior three (3) years. See Current Constitution, Section 13.1(r).

<sup>71</sup> See New By-Laws, Article III, Section 5.

The Exchange states that the proposed provisions relating to the standing committees are substantially similar to the provisions in Section 9(g) of the Nasdaq LLC Agreement with respect to standing committees. See Notice, supra note 3, at 40030.

<sup>72</sup> See New By-Laws, Article III, Section 6(b). See also supra note 41 (describing the compositional requirements of these committees).

The Board may also designate additional committees consisting of one or more Directors or other persons. See New LLC Agreement, Section 9(g).

<sup>73</sup> See New By-Laws, Article III, Section 6(c). See also infra note 98 and accompanying text (describing the compositional requirements of the QMC).

<sup>74</sup> See New LLC Agreement, Section 9(g)(v).

would, however, be limited with respect to approving any matters pertaining to the self-regulatory function of the Exchange or relating to the structure of the market the Exchange regulates.<sup>75</sup>

The Exchange proposes that the Executive Committee be an optional committee, to be appointed only if deemed necessary by the Board.<sup>76</sup> Because the Executive Committee will have the powers and authority of the Board in the management of the business and affairs of the Exchange between meetings of the Board, its composition must reflect that of the Board. Accordingly, if established, the number of Non-Industry Directors on the Executive Committee must equal or exceed the number of Industry Directors and the percentages of Public Directors and Member Representative Directors must be at least as great as the corresponding percentages on the Board as a whole.<sup>77</sup>

The Board would retain oversight of the financial operations of the Exchange instead of delegating these functions to a standing committee, but would have the option to appoint a Finance Committee at the Board's discretion.<sup>78</sup> The Finance Committee would advise the Board with respect to the oversight of the financial operations and conditions of the Exchange, including recommendations for the Exchange's annual operating and capital budgets and proposed changes to the rates and fees charged by the Exchange.

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<sup>75</sup> See id. See also Notice, supra note 3, at 40031. The Exchange notes that the proposed limitation is based on substantially similar language in Section 5.2(ii) of MRX's Constitution and is intended to assure the fair administration and governance of the Exchange. The Exchange does not have this limitation in Section 5.2 of its Current Constitution with respect to any Board committees set up by Board resolution, and is therefore proposing to follow the more current MRX standard. See Notice, supra note 3, at 40031 n.35.

<sup>76</sup> See New By-Laws, Article III, Section 5(a).

<sup>77</sup> See id.

<sup>78</sup> See New By-Laws, Article III, Section 5(b).

The Exchange proposes to eliminate its current Finance and Audit Committee and to have the committee's functions performed by Nasdaq, Inc.'s Audit Committee ("Nasdaq Audit Committee"), which is composed of at least three directors of Nasdaq, Inc., all of whom must satisfy the standards for independence set forth in Section 10A(m) of the Act<sup>79</sup> and Nasdaq's rules.<sup>80</sup> The Exchange notes that the Nasdaq Audit Committee has broad authority to review the financial information that will be provided to shareholders of Nasdaq, Inc. and others; systems of internal controls; and audit, financial reporting, and legal and compliance processes.<sup>81</sup> The Exchange states that, to the extent the current Finance and Audit Committee oversees the Exchange's financial reporting process, its activities are duplicative of the activities of the Nasdaq Audit Committee, which is also charged with providing oversight over financial reporting and independent auditor selection for Nasdaq, Inc. and all of its subsidiaries.<sup>82</sup> The Exchange also notes that the unconsolidated financial statements of the Exchange will still be prepared for each fiscal year.<sup>83</sup>

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<sup>79</sup> See U.S.C. 78j-1(m).

<sup>80</sup> See Nasdaq, Inc. By-Laws, Section 4.13(g).

The current Finance and Audit Committee must be composed of at least three (3) and not more than five (5) directors, all of whom must be non-industry representatives and must be "financially literate" as determined by the Board. See Current Constitution, Article V, Section 5.5.

<sup>81</sup> See Notice, supra note 3, at 40038.

<sup>82</sup> See id.

<sup>83</sup> See id. The Commission notes that registered national securities exchanges have an ongoing requirement to comply with the requirements of Form 1, which include filing audited financial statements with the Commission on an annual basis. See Form 1, General Instructions A.2 and Exhibit I, 17 CFR 249.1; and 17 CFR 240.6a-2(b)(1) (requiring a national securities exchange to file each year, as an amendment to its Form 1, Exhibit I (which requires a Form 1 applicant to file audited financial statements), as of the latest fiscal year of the exchange).

The Exchange will also have a Regulatory Oversight Committee (“ROC”) under the New Governing Documents, which will have broad authority to oversee the adequacy and effectiveness of the Exchange’s regulatory and self-regulatory responsibilities.<sup>84</sup> The ROC will consist of three members, each of whom must be a Public Director and an “independent director,” as defined in Nasdaq Rule 5605.<sup>85</sup>

Pursuant to the New By-Laws, the Exchange will also have a Chief Regulatory Officer (“CRO”), as it does currently.<sup>86</sup> The new CRO will have general responsibility for the supervision of the regulatory operations of the Exchange and will meet with the ROC in executive session at regularly scheduled meetings of the ROC, and at any time upon request of the CRO or any member of the ROC.<sup>87</sup>

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<sup>84</sup> See New By-Laws, Article III, Section 5(c). Currently, the Exchange’s regulatory oversight activities are performed by the Exchange’s Corporate Governance Committee, which will not exist under the new governance structure. See Notice, supra note 3, at 40039-40.

The Exchange also states that regulatory oversight functions formerly performed by the Finance and Audit Committee may be assumed by the ROC, and that like the ROCs of the Nasdaq Exchanges, the GEMX ROC, because of its broad authority to oversee the adequacy and effectiveness of the Exchange’s self-regulatory responsibilities, will be able to maintain oversight over controls in tandem with the Nasdaq Audit Committee’s overall oversight responsibilities. See id. at 40038.

<sup>85</sup> See New By-Laws, Article III, Section 5(c).

<sup>86</sup> See Notice, supra note 3, at 40041 (noting that, although not expressly in its Current Governing Documents, the position of chief regulatory officer has long existed at the Exchange). See also New By-Laws, Article IV, Section 7.

In addition to the CRO, pursuant to the New LLC Agreement, the Exchange’s officers will include: a Chief Executive Officer, a President, Vice Presidents, a Chief Regulatory Officer, a Secretary, an Assistant Secretary, a Treasurer, and an Assistant Treasurer. See New By-Laws, Article IV, Sections 4-11.

<sup>87</sup> See New By-Laws, Article IV, Section 7. The CRO may also serve as the General Counsel of the Exchange. Id.

The ROC will assess the Exchange’s regulatory performance, assist the Board in reviewing the regulatory plan and the overall effectiveness of the Exchange’s regulatory functions, review the Exchange’s regulatory budget and inquire into the adequacy of resources available in the budget for regulatory activities, and be informed about the compensation and promotion or termination of the CRO.<sup>88</sup>

The Exchange also proposes that the Internal Audit Department of Nasdaq, Inc. (“Nasdaq Internal Audit Department”) would report to the Board on all Exchange-related internal audit matters and direct such reports to the new ROC.<sup>89</sup> In addition, to ensure that the Board retains authority to direct the Nasdaq Internal Audit Department’s activities with respect to the Exchange, the Nasdaq Internal Audit Department’s written procedures will stipulate that the ROC may, at any time, direct the Nasdaq Internal Audit Department to conduct an audit of a matter of concern and report the results of the audit both to the ROC and the Nasdaq Audit Committee.<sup>90</sup>

The Exchange also proposes to eliminate its current Compensation Committee and its Corporate Governance Committee.<sup>91</sup> The Compensation Committee is primarily charged with reviewing and approving compensation policies and plans for the Chief Executive Officer and other senior executive officers of the Exchange.<sup>92</sup> Under the new governance structure, the functions of the Compensation Committee will be performed by Nasdaq, Inc.’s management

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<sup>88</sup> See New By-Laws, Article III, Section 5(c).

<sup>89</sup> See Notice, *supra* note 3, at 40039 & n.104 (citing the Regulatory Oversight Committee Charter of Nasdaq, Phlx, and BX, available at <http://ir.nasdaq.com/corporate-governance-document.cfm?DocumentID=1097>).

<sup>90</sup> See *id.* at 40039.

<sup>91</sup> See *id.* at 40039-40.

<sup>92</sup> See *id.* at 40039. See also Current Constitution, Section 5.6.

compensation committee or, to the extent that policies, programs, and practices must be established for any Exchange officers or employees who are not also officers or employees of Nasdaq, Inc., the full Board.<sup>93</sup> The Corporate Governance Committee is primarily charged with: (i) nominating candidates for all vacant or new non-industry representative positions on the Board, (ii) overseeing the Exchange's regulatory activities and program, and (iii) overseeing and evaluating the governance of the Exchange.<sup>94</sup> Under the new governance structure, the functions of the Corporate Governance Committee will be performed by the new Nominating Committee, the new ROC, or, if required, the full Board.<sup>95</sup>

As discussed above, the Nominating Committee and Member Nominating Committee will have responsibility for, among other things, nominating candidates for election to the Board. On an annual basis, the members of these committees will nominate candidates for the succeeding year's respective committees to be elected by ISE Holdings.<sup>96</sup>

Finally, the Quality of Markets Committee ("QMC") will have the following functions: (i) to provide advice and guidance to the Board on issues relating to the fairness, integrity, efficiency, and competitiveness of the information, order handling, and execution mechanisms of

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<sup>93</sup> See Notice, supra note 3, at 40039.

<sup>94</sup> See id. See also Current Constitution, Section 5.4.

<sup>95</sup> See Notice, supra note 3, at 40039-40.

<sup>96</sup> See New By-Laws, Article III, Section 6(b). See also supra notes 42-49 and accompanying text. Additional candidates for the Member Nominating Committee may be nominated and elected by Exchange Members pursuant to a petition process. See supra notes 45-48 and accompanying text.

The Commission notes that under the New By-Laws, the Member Nominating Committee shall nominate candidates for each Member Representative Director position to be elected by Exchange Members or the Sole LLC Member, and for appointment by the Board for each vacant or new position on any committee that is to be filled with a Member Representative member. See New By-Laws, Article III, Section 6.

the Exchange from the perspective of investors, both individual and institutional, retail firms, market making firms, and other market participants; and (ii) to advise the Board with respect to national market system plans and linkages between the facilities of the Exchange and other markets.<sup>97</sup> At least 20% of the QMC must be composed of Member Representative members, and the Non-Industry members on the QMC must equal or exceed the sum of Industry members and Member Representative members.<sup>98</sup>

The Commission believes that the Exchange's proposed committees, which are similar to the committees maintained by other exchanges,<sup>99</sup> are consistent with the Act, including Section 6(b)(1), which requires, in part, an exchange to be so organized and have the capacity to carry out the purposes of the Act.<sup>100</sup> The Commission further believes that the Exchange's proposed committees, including their composition and the means by which committee members will be chosen, are consistent with Section 6(b)(3) of the Act because relevant committees provide for the fair representation of members in the administration of the Exchange's affairs.<sup>101</sup>

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<sup>97</sup> See New By-Laws, Article III, Section 6(c)(i).

<sup>98</sup> See New By-Laws, Article III, Section 6(c)(ii). See also Notice, supra note 3, at 40040.

The Exchange also states that the function of Member Representative members on committees is to provide members a voice in the administration of the Exchange's affairs on certain committees that are responsible for providing advice on any matters pertaining to the Exchange's self-regulatory function or relating to its market structure. See Notice, supra note 3, at 40034. In order to ensure that its members have the opportunity to formally provide input on matters that are important to them, the Exchange states that at least 20% of the persons serving on any such committees will be individuals who will have been appointed by the Member Nominating Committee and will be representative of the Exchange's membership. See id.

<sup>99</sup> See, e.g., Nasdaq By-Laws Article III, Sections 5-6; BX By-Laws, Article IV, Sections 4.13-14; Phlx By-Laws, Article V, Sections 5-2 to -3; ISE By-Laws Article III, Sections 5-6.

<sup>100</sup> 15 U.S.C. 78f(b)(1).

<sup>101</sup> See 15 U.S.C. 78f(b)(3).

#### 4. Regulatory Independence

Certain provisions in GEMX's Current Governing Documents, and those of its Upstream Owners, are designed to help maintain the independence of the regulatory functions of the Exchange.<sup>102</sup> The New Governing Documents similarly include provisions designed to help maintain the independence of the regulatory functions of GEMX,<sup>103</sup> which provisions are substantially similar to those included in the governing documents of other exchanges.<sup>104</sup>

Specifically:

- The Exchange Board will be required, when evaluating any proposal, to take into account all factors that the Board deems relevant, including, without limitation, (1) the potential impact on: the integrity, continuity, and stability of the national securities exchange operated by the Exchange and the other operations of the Exchange; the ability to prevent fraudulent and manipulative acts and practices; and investors and the public, and (2) whether such proposal would promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, or assist in the removal of impediments to or the

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<sup>102</sup> See, e.g., GEMX Approval Order, supra note 26, at 46627-29, Nasdaq Acquisition Order, supra note 5, at 41613-16; Securities Exchange Act Release No. 56955 (December 13, 2007), 72 FR 71979 (December 19, 2007) (SR-ISE-2007-101) (order approving acquisition of ISE Holdings by Eurex Frankfurt); and ISE HoldCo Order, supra note 26, at 25263-64.

<sup>103</sup> See Notice, supra note 3, at 40042. The Commission notes that the Exchange did not propose any amendments to the governing documents of its Upstream Owners.

<sup>104</sup> See, e.g., Nasdaq Exchange Order, supra note 48; MIAX Exchange Order, supra note 53; Mercury Exchange Approval, supra note 26; ISE Governance Order, supra note 13.



perfection of the mechanisms for a free and open market and a national market system.<sup>105</sup>

- All books and records of GEMX reflecting confidential information pertaining to the self-regulatory function of the Exchange (including but not limited to disciplinary matters, trading data, trading practices, and audit information) shall be retained in confidence by GEMX and its officers, directors, employees and agents; shall not be made available to persons other than to those officers, directors, employees, and agents of GEMX that have a reasonable need to know; and will not be used for any non-regulatory purpose.<sup>106</sup>

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<sup>105</sup> See New By-Laws, Article III, Section 3. See also Notice, supra note 3, at 40037. Article III, Section 3 of the New By-Laws sets forth the factors to be considered by the Board when evaluating any proposal. See New By-Laws, Article III, Section 3. Further, the Exchange states that Article III, Section 3 of the New By-Laws recognizes the Exchange's status as a self-regulatory organization, and the provisions of Section 3, taken together, are designed to reinforce the notion that the Exchange is not solely a commercial enterprise, but rather a self-regulatory organization registered pursuant to, and subject to the obligations imposed by, the Act. See Notice, supra note 3, at 40037.

<sup>106</sup> The corresponding provision in GEMX's Current LLC Agreement prohibits the use of confidential information for any commercial purpose. See Current LLC Agreement, Article IV, Section 4.1(b). The Exchange proposes to modify the standard to prohibit the use of such information for any non-regulatory purpose. See Notice, supra note 3, at 40031 n.42; New LLC Agreement, Section 16. The Exchange states that this change is intended to replicate Section 4.1(b)(iii) of MRX's LLC Agreement, to emphasize the independence of the Exchange's regulatory function from its commercial interests. See Notice, supra note 3, at 40031 n.42.

The Exchange is not proposing that GEMX, and the Board on behalf of GEMX, shall not have the right to keep confidential from ISE Holdings, as the Sole LLC Member, any information that the Board would otherwise be permitted to keep confidential from the Sole LLC Member pursuant to Section 18-305(c) of the Delaware Limited Liability Company Act, 6 Del. C. §18-101. Additionally, the Exchange is not proposing that ISE Holdings, as the Sole LLC Member and the Exchange's authorized representative, shall have an explicit right to examine the Exchange's books, records, and documents during normal business hours. See Notice, supra note 3, at 40031. Although such provisions are in the Nasdaq LLC Agreement (see Nasdaq LLC Agreement, Section 16), they are not in the Current Governing Documents of GEMX.

- The Exchange proposes that, as is currently the case, the books and records of GEMX must be maintained in the United States<sup>107</sup> and are subject at all times to examination by the Commission pursuant to the federal securities laws and the rules and regulations thereunder.<sup>108</sup>

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The Commission believes that the proposed provisions relating to the books and records of the Exchange are designed to maintain the independence of GEMX's self-regulatory function, and are consistent with the Act. The Commission notes that these provisions are substantially similar to those the Commission has previously found to be consistent with the Act in the context of the corporate governance structures of other exchanges. See, e.g., MIA Exchange Order, supra note 53; Mercury Exchange Approval, supra note 26; ISE Governance Order, supra note 13.

The Commission also notes that the governing documents of GEMX's Upstream Owners provide that all books and records of GEMX reflecting confidential information pertaining to the self-regulatory function of the Exchange will be subject to confidentiality restrictions. See Certificate of Incorporation of ISE Holdings, Article Eleventh; Certificate of Incorporation of U.S. Exchange Holdings, Article Fourteenth; By-Laws of Nasdaq, Inc., Article XII, Section 12.1(b).

<sup>107</sup> See New LLC Agreement, Section 16; see also Current LLC Agreement, Article IV, Section 4.1.

<sup>108</sup> See New LLC Agreement, Section 16. The Commission notes that, as is currently the case, the requirement to keep such information confidential shall not limit the Commission's ability to access and examine such information or limit the ability of officers, directors, employees, or agents of GEMX to disclose such information to the Commission. See id. See also Current LLC Agreement, Article IV, Section 4.1(b).

The Exchange states that certain provisions in Section 16 of the New LLC Agreement are substantially similar to provisions in Section 16 of the Nasdaq LLC Agreement. See Notice, supra note 3, at 40031 n.40. The Exchange also states that it is retaining in the New LLC Agreement certain provisions from its Current LLC Agreement that are not in the governing documents of the Nasdaq Exchanges, such as those relating to where the Exchange's books and records must be maintained and who may access the books and records, in particular those books and records that contain confidential information pertaining to the self-regulatory function of the Exchange. See Notice, supra note 3, at 40031 & n.41.

GEMX also states that the Nasdaq Exchanges will separately file proposed rule changes to harmonize the books and records provisions in their respective governing documents with the language in Section 16 of the New LLC Agreement. See Notice, supra note 3, at 40031 n.41.

- Under the New LLC Agreement and New By-Laws, any amendments to those documents will not become effective until filed with, or filed with and approved by, the Commission, as required under Section 19 of the Act and the rules promulgated thereunder.<sup>109</sup>
- Additionally, as is currently the case pursuant to the Current LLC Agreement,<sup>110</sup> Section 15 of the New LLC Agreement would prohibit the Exchange from using Regulatory Funds to pay dividends.<sup>111</sup>

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<sup>109</sup> See New LLC Agreement, Section 27; New By-Laws, Article VIII, Section 1.

The Commission notes that, although the Current Constitution and Current LLC Agreement do not include a similar, explicit requirement regarding the filing of amendments pursuant to Section 19 of the Act, the Current Constitution and Current LLC Agreement, as rules of the Exchange, are nonetheless subject to the requirements of Section 19 of the Act and the rules and regulations thereunder.

Additionally, pursuant to the New By-Laws, either the Sole LLC Member or the vote of a majority of the whole Board may enact amendments to the By-Laws, and the Board may adopt emergency by-laws.

<sup>110</sup> See Current LLC Agreement, Article III, Section 3.3.

<sup>111</sup> Specifically, pursuant to Section 15 of the New LLC Agreement, Regulatory Funds shall not be used non-regulatory purposes, but rather shall be used to fund the legal, regulatory, and surveillance operations of the Exchange, and the Exchange shall not make a distribution to the Sole LLC Member using Regulatory Funds. See New LLC Agreement, Section 15.

Consistent with Section 3.3 of the Current LLC Agreement, Schedule A of the New LLC Agreement defines “Regulatory Funds” as fees, fines, or penalties derived from the regulatory operations of the Exchange. However, Regulatory Funds do not include revenues derived from listing fees, market data revenues, transaction revenues, or any other aspect of the commercial operations of the Exchange even if a portion of such revenues are used to pay costs associated with the regulatory operations of the Exchange. See New LLC Agreement, Schedule A.

GEMX states that the Nasdaq Exchanges will separately file proposed rule changes to harmonize the distribution provisions in their respective governing documents with the language in Section 15 of the New LLC Agreement. See Notice, supra note 3, at 40031 n.38.

The Commission believes that the provisions discussed in this section, which are designed to help ensure the independence of the Exchange's regulatory function and facilitate the ability of the Exchange to carry out its responsibility and operate in a manner consistent with the Act, are appropriate and consistent with the requirements of the Act, particularly with Section 6(b)(1), which requires, in part, an exchange to be so organized and have the capacity to carry out the purposes of the Act.<sup>112</sup>

The Commission finds that proposed process regarding amendments to the New Governing Documents is consistent with Section 6(b)(1) of the Act, because it reflects the obligation of the Board to ensure compliance with the rule filing requirements under the Act. Additionally, the Commission finds these changes to be consistent with Section 19(b)(1) of the Act and Rule 19b-4 thereunder,<sup>113</sup> which require that a self-regulatory organization file with the Commission all proposed rules, as well as all proposed changes in, additions to, and deletions of its existing rules. These provisions clarify that amendments to the New Governing Documents constitute proposed rule changes within the meaning of Section 19(b)(2) of the Act and Rule 19b-4 thereunder, and are subject to the filing requirements of Section 19 of the Act and the rules and regulations thereunder.

The Commission also finds that the prohibition on the use of regulatory fines, fees, or penalties to fund dividends is consistent with Section 6(b)(1) of the Act, because it will further the Exchange's ability to effectively comply with its statutory obligations and is designed to ensure that the regulatory authority of the Exchange is not improperly used.<sup>114</sup> This restriction

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<sup>112</sup> 15 U.S.C. 78f(b)(1).

<sup>113</sup> Id.; 17 CFR 240.19b-4.

<sup>114</sup> See, e.g., Securities Exchange Act Release No. 51029 (January 12, 2005), 70 FR 3233, 3241 (January 21, 2005) (SR-ISE-2004-29) (approving an ISE rule interpretation that

on the use of regulatory funds is intended to preclude the Exchange from using its authority to raise Regulatory Funds for the purpose of benefiting its shareholders.<sup>115</sup>

C. Related Rule Amendments

The Exchange proposes to amend its Rules to reflect the changes to its constituent documents through the adoption of the New Governing Documents to replace the Current Governing Documents. The Exchange states that it is amending its Rules to: (i) clarify any Rules that cross-reference the Current Governing Documents in the rule text, since those documents are being replaced by the New Governing Documents;<sup>116</sup> or (ii) relocate in the Rules the definitions for a number of defined terms used in the Rules that currently refer back to the Current LLC Agreement or the Current Constitution for their meanings.<sup>117</sup>

Specifically, the Exchange proposed changes to its Rules to, among other things:

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requires that revenues received from regulatory fees or regulatory penalties be segregated and applied to fund the legal, regulatory, and surveillance operations of the Exchange and not used to pay dividends to the holders of Class A Common Stock).

<sup>115</sup> See Notice, supra note 3, at 40031.

<sup>116</sup> The Exchange states that all such changes are non-substantive, primarily changing terminology, such as changing the term “Constitution” to “By-Laws” and removing references to the “Current LLC Agreement.” See id. at 40041.

<sup>117</sup> See id. at 40029. The Exchange provides that all the provisions governing the trading privileges associated with the Exchange Rights in the Current Governing Documents are substantially set forth in the Rules. See id. The Commission notes that, currently on GEMX, the Exchange Rights do not convey any ownership rights and only provide for voting rights for representation, through Exchange Directors, on the Board and the ability to transact on the Exchange. The Exchange represents that, under its Rules, the holders of Exchange Rights will continue to have the same trading privileges they currently hold as PMMs, CMMs, and EAMs, and the new Board structure of the Exchange will not change any trading privileges. Further, under the New Governing Documents, the holders of Exchange Rights will continue to have voting rights for representation on the Board through the election of Member Representative Directors. See id. at 40029-30.

- Relocate the concept of CMM Rights from the Current LLC Agreement<sup>118</sup> to New Rule 100(a)(12), which will state that the term “CMM Rights” means the non-transferable rights held by a Competitive Market Maker.<sup>119</sup>
- Relocate to New Rule 100(a)(13) the definition of “Competitive Market Maker,”<sup>120</sup> which is currently only defined in Section 13.1(f) of the Current Constitution.
- Relocate the concept of EAM Rights to New Rule 100(a)(16), which will state that the term “EAM Rights” means the non-transferable rights held by an Electronic Access Member.<sup>121</sup>
- Relocate to New Rule 100(a)(17) the definition of “Electronic Access Member,”<sup>122</sup> which is currently only defined in Section 13.1(j) of the Current Constitution.
- Relocate the definitions for “Exchange Transaction,” “good standing,” and “System” from the Current Constitution to the Rules,<sup>123</sup> and delete Rule 100(a)(22A), defining

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<sup>118</sup> See Current LLC Agreement, Article VI, Section 6.2(b).

<sup>119</sup> CMM Rights are non-transferable rights. The holders of CMM Rights may not lease or sell these rights. As discussed above, all Exchange Rights (i.e., PMM, CMM, and EAM Rights) convey only voting rights and trading privileges on the Exchange. See Notice, supra note 3, at 40041 n.120.

<sup>120</sup> The term “Competitive Market Maker” (referred to herein as “CMM”) will be defined to mean a Member that is approved to exercise trading privileges associated with CMM Rights. See New Rule 100(a)(13).

The term “Member” means an organization that has been approved to exercise trading rights associated with Exchange Rights. See current Rule 100(a)(23); New Rule 100(a)(28).

<sup>121</sup> See supra note 119.

<sup>122</sup> The term “Electronic Access Member” (referred to herein as “EAM”) will be defined to mean a Member that is approved to exercise trading privileges associated with EAM Rights. See New Rule 100(a)(17).

<sup>123</sup> “Exchange Transaction” would be relocated from Section 13.1(o) of the Current Constitution to New Rule 100(a)(21), “good standing” from Section 13.1(p) of the

“LLC Agreement,” as that term would no longer be used in the Rules, as amended by the proposed rule change.

- Relocate the concept of PMM Rights from Article VI of the Current LLC Agreement to New Rule 100(a)(41), which will state that the term “PMM Rights” means the non-transferable rights held by a Primary Market Maker.
- Relocate to New Rule 100(a)(42) the definition for “Primary Market Maker”<sup>124</sup> from Section 13.1(y) of the Current Constitution.

The Commission believes that the proposed changes to GEMX’s Rules are consistent with the Act and, in particular Section 6(b)(1) of the Act,<sup>125</sup> which requires among other things that a national securities exchange be so organized and have the capacity to carry out the purposes of the Act. The Commission notes that many of the proposed changes to GEMX’s Rules are technical in nature, such as renumbering of Rules or conforming terminology to reflect the replacement of the Current Governing Documents with the New Governing Documents. The Commission also notes that, as described above, the Exchange proposes to relocate definitions for a number of defined terms used in the Rules from the Current Governing Documents into the Rules.

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Current Constitution to New Rule 100(a)(24), and “System” from Section 13.1(dd) of the Current Constitution to New Rule 100(a)(55).

<sup>124</sup> The term “Primary Market Maker” (referred to herein as “PMM”) will be defined to mean a Member that is approved to exercise trading privileges associated with PMM Rights. See New Rule 100(a)(42).

<sup>125</sup> 15 U.S.C. 78f(b)(1).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>126</sup> that the proposed rule change (SR-GEMX-2017-37), as modified by Amendment No. 1, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>127</sup>

Robert W. Errett  
Deputy Secretary

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<sup>126</sup> 15 U.S.C. 78s(b)(2).

<sup>127</sup> 17 CFR 200.30-3(a)(12).