SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68638; File No. SR-NYSEArca-2012-105)

January 11, 2013

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing of Amendment No. 2, and Order Granting Accelerated Approval for Proposed Rule Change, as Modified by Amendment No. 2, to Amend the Listing Rules for Compensation Comply with Securities Exchange Act Rule 10C-1 and Make Other Related Changes

I. Introduction

On September 25, 2012, NYSE Arca, Inc. ("NYSE Arca" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to modify the Exchange's rules for compensation committees of listed issuers to comply with Rule 10C-1 under the Act and make other related changes. The proposed rule change was published for comment in the Federal Register on October 15, 2012.[3] The Commission subsequently extended the time period in which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change, to January 13, 2013.[4] The Commission received one comment letter on the proposed rule change,[5] as well as a response to the comment letter from NYSE Euronext, Inc.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 68006 (October 9, 2012), 77 FR 62587 (October 15, 2012) ("Notice").

4 See Securities Exchange Act Release No. 68313 (November 28, 2012), 77 FR 71853 (December 4, 2012).

5 See Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Elizabeth M. Murphy, Secretary, Commission, dated November 1, 2012 ("CII Letter").

In addition, the Commission received seven comments on a substantially similar proposal by New York Stock Exchange LLC ("NYSE") by parties that did not specifically comment on the NYSE Arca filing. See Securities Exchange Act Release No. 68011

regarding the NYSE Arca proposal.[6] On December 4, 2012, the Exchange filed Amendment No. 1 to the proposed rule change, which was later withdrawn.[7] On January 8, 2013, the Exchange filed Amendment No. 2 to the proposed rule change.[8]

(October 9, 2012), 77 FR 62541 (October 15, 2012) (SR-NYSE-2012-49). The comment letters received on the NYSE filing were letters to Elizabeth M. Murphy, Secretary, Commission, from: Thomas R. Moore, Vice President, Corporate Secretary and Chief Governance Officer, Ameriprise Financial, Inc., dated October 18, 2012 ("Ameriprise Letter"); J. Robert Brown, Jr., Director, Corporate & Commercial Law Program, University of Denver Sturm College of Law, dated October 30, 3012 ("Brown Letter"); Dorothy Donohue, Deputy General Counsel, Securities Regulation, Investment Company Institute, dated November 1, 2012 ("ICI Letter"); Brandon J. Rees, Acting Director, Office of Investment, AFL-CIO, dated November 5, 2012 ("AFL-CIO Letter"); Carin Zelenko, Director, Capital Strategies Department, International Brotherhood of Teamsters, dated November 5, 2012 ("Teamsters Letter"); Wilson Sonsini Goodrich & Rosati, Professional Corporation, dated November 14, 2012 ("Wilson Sonsini Letter"); and Robert B. Lamm, Chair, Securities Law Committee, The Society of Corporate Secretaries & Governance Professionals, dated December 7, 2012 ("Corporate Secretaries Letter"). Since the comment letters received on the NYSE filing discuss issues directly related to the NYSE Arca filing, the Commission has included them in its discussion of this filing.

6 See Letter to Elizabeth M. Murphy, Secretary, Commission, from Janet McGinness, Executive Vice President and Corporate Secretary, NYSE Euronext, Inc., dated January 10, 2013 ("NYSE Response Letter"). In the NYSE Response Letter, NYSE Euronext, Inc., the parent company of NYSE Arca, states that, as the comments made by the letters submitted on the NYSE and NYSE Arca proposals are applicable in substance to NYSE, NYSE Arca and NYSE MKT LLC, its response will address the comments on behalf of all three exchanges.

7 Amendment No. 1, dated December 4, 2012, was withdrawn on January 8, 2013.

8 In Amendment No. 2 to SR-NYSEArca-2012-105, NYSE Arca: (a) revised the transition period for companies that cease to be Smaller Reporting Companies to comply with the full range of new requirements, see infra notes 73-76 and accompanying text; (b) changed references in the rule text from Regulation S-K, Item 10(f)(1) to Exchange Act Rule 12b-2 and made other non-substantive revisions to proposed rule text; (c) added commentary to state that the independence assessment of compensation advisers required of compensation committees does not need to be conducted for advisers whose roles are limited to those entitled to an exception from the compensation adviser disclosure rules under Item 407(e)(3)(iii) of Regulation S-K, see infra notes 49-52 and accompanying text; (d) added commentary to state that the independence assessment of compensation advisers required of compensation committees does not require the adviser to be independent, only that the compensation committee consider the enumerated factors

This order approves the proposed rule change, as modified by Amendment No. 2 thereto, on an accelerated basis.

II. Description of the Proposed Rule Change

A. Background: Rule 10C-1 under the Act

On March 30, 2011, to implement Section 10C of the Act, as added by Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"),[9] the Commission proposed Rule 10C-1 under the Act,[10] which directs each national securities exchange (hereinafter, "exchange") to prohibit the listing of any equity security of any issuer, with certain exceptions, that does not comply with the rule's requirements regarding compensation committees of listed issuers and related requirements regarding compensation advisers. On June 20, 2012, the Commission adopted Rule 10C-1.[11]

Rule 10C-1 requires, among other things, each exchange to adopt rules providing that each member of the compensation committee[12] of a listed issuer must be a member of the board of directors of the issuer, and must otherwise be independent.[13] In determining the independence standards for members of compensation committees of listed issuers, Rule 10C-1 requires the exchanges to consider relevant factors, including, but not limited to: (a) the source of

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before selecting or receiving advice from the adviser, see infra notes 53-55 and accompanying text; and (e) clarified that a foreign private issuer is required to provide a reason why it does not have an independent compensation committee. See infra note 70.

9 Pub. L. 111-203, 124 Stat. 1900 (2010).

10 See Securities Act Release No. 9199, Securities Exchange Act Release No. 64149 (March 30, 2011), 76 FR 18966 (April 6, 2011) ("Rule 10C-1 Proposing Release").

11 See Securities Act Release No. 9330, Securities Exchange Act Release No. 67220 (June 20, 2012), 77 FR 38422 (June 27, 2012) ("Rule 10C-1 Adopting Release").

12 For a definition of the term "compensation committee" for purposes of Rule 10C-1, see Rule 10C-1(c)(2)(i)-(iii).

13 See Rule 10C-1(a) and (b)(1).

compensation of the director, including any consulting, advisory or other compensatory fee paid by the issuer to the director (hereinafter, the "Fees Factor"); and (b) whether the director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer (hereinafter, the "Affiliation Factor").[14]

In addition, Rule 10C-1 requires the listing rules of exchanges to mandate that compensation committees be given the authority to retain or obtain the advice of a compensation adviser, and have direct responsibility for the appointment, compensation and oversight of the work of any compensation adviser they retain.[15] The exchange rules must also provide that each listed issuer provide for appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to any compensation adviser retained by the compensation committee.[16] Finally, among other things, Rule 10C-1 requires each exchange to provide in its rules that the compensation committee of each listed issuer may select a compensation consultant, legal counsel or other adviser to the compensation committee only after taking into consideration six factors specified in Rule 10C-1,[17] as well as any other factors identified by the relevant exchange in its listing standards.[18]

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14 See id. See also Rule 10C-1(b)(1)(iii)(A), which sets forth exemptions from the independence requirements for certain categories of issuers. In addition, an exchange may exempt a particular relationship with respect to members of a compensation committee from these requirements as it deems appropriate, taking into consideration the size of an issuer and any other relevant factors. See Rule 10C-1(b)(1)(iii)(B).

15 See Rule 10C-1(b)(2).

16 See Rule 10C-1(b)(3).

17 See Rule 10C-1(b)(4). The six factors, which NYSE Arca proposes to set forth in its rules, are specified in the text accompanying note 47, infra.

18 Other provisions in Rule 10C-1 relate to exemptions from the rule and a requirement that each exchange provide for appropriate procedures for a listed issuer to have a reasonable opportunity to cure any defects that would be the basis for the exchange, under Rule 10C-1, to prohibit the issuer's listing.

B. NYSE Arca's Proposed Rule Change, as Amended

To comply with Rule 10C-1, NYSE Arca, through its wholly-owned corporation, NYSE Arca Equities, proposes to amend two of its rules concerning corporate governance requirements for companies listed on the Exchange: NYSE Arca Equities Rule ("Equities Rule") 5.3(k), "Independent Directors/Board Committees;" and Equities Rule 5.3(n), "Listed Foreign Private Issuers." In addition, NYSE Arca proposes to make some other changes to its rules regarding compensation committees. To accomplish these changes, the Exchange proposes to replace current Equities Rules 5.3(k)(4) and 5.3(n) with new operative text that will be effective on July 1, 2013.

Current Equities Rule 5.3(k)(4) provides that each listed company have a compensation committee, and that such compensation committee be composed entirely of "Independent Directors"[19] and have a written charter.[20]

Under its proposal, NYSE Arca will retain its existing requirement that each listed company be required to have a compensation committee composed entirely of Independent Directors, as defined in NYSE Arca's Equities Rules.[21] Under the proposed amendment,

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19 "Independent Directors", as defined in Equities Rule 5.3(k)(1) and used herein, includes a two-part test for independence. The rule sets forth specific categories of directors who cannot be considered independent because of certain discrete relationships ("bright-line tests"); and also provides that a listed company's board make an affirmative determination that each independent director has no material relationship that, in the opinion of the board, would raise concerns about independence from management. Id.

20 See Equities Rule 5.3(k)(4).

21 See Equities Rules 5.3(k)(1) and 5.3(k)(4). Proposed Equities Rule 5.3(k)(4)(i)(a) reflects a renumbering of the existing requirement of Equities Rule 5.3(k)(4).

however, each compensation committee member must also satisfy additional independence requirements, as described in Section II.B.1 below.[22]

NYSE Arca will also retain the existing requirement that a listed issuer adopt a formal written compensation committee charter[23] that specifies the scope of the committee's responsibilities and how it carries out those responsibilities, including structure, operations and membership requirements.[24] The proposed amendment to the rule, which continues to require a charter to address the committee's duties and responsibilities, requires the issuer to specify additional responsibilities and authority for the compensation committee with respect to retaining its own advisers; appointing, compensating, and overseeing such advisers; considering certain independence factors before selecting and receiving advice from advisers; and receiving funding from the company to engage them, which are discussed in detail in Section II.B.2 below and set forth in proposed Equities Rule 5.3(k)(4).[25]

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22 See proposed Equities Rule 5.3(k)(4)(ii) (concerning the consideration of director compensation and affiliation).

23 See proposed Equities Rule 5.3(k)(4)(iii). Rule 10C-1 requires a compensation committee to have certain specified authority and responsibilities. See supra notes 15-17 and accompanying text. The existing NYSE Arca Equities rule already requires compensation committees of listed companies to have a charter setting forth specified responsibilities, and the proposed rule updates the language concerning this authority and set of responsibilities and adds the required content discussed infra at text accompanying notes 44-46.

24 See current Equities Rule 5.3(k)(4)(A)-(E). Existing Equities Rule 5.3(k)(4)(E), which NYSE Arca proposed to replace in relevant part with a comparable provision in proposed Equities Rule 5.3(k)(4)(iv)(I)-(III), currently provides that a written charter must address "[t]he committee's authority to retain and terminate a consultant to assist in the evaluation of a director, CEO or senior executive compensation. The committee shall have the sole authority to approve the consultant's fees and other retention items." See discussion infra at text accompanying notes 43-45.

25 See proposed NYSE Arca Equities Rule 5.3(k)(4)(iv)-(v). Because smaller reporting companies are not required to comply with the new compensation adviser independence considerations in proposed NYSE Arca Equities Rule 5.3(k)(4)(v), see infra notes 56-62

1. Compensation Committee Composition and Independence Standards

NYSE Arca proposes to retain Equities Rule 5.3(k)(1), which would continue to provide that no director qualifies as "independent" unless the board of directors of the listed company affirmatively determines that the director has no material relationship with the listed company. As noted above, NYSE Arca's rules currently require each member of a listed company's compensation committee to be an Independent Director, as defined in Equities Rule 5.3(k)(1).[26] Rule 10C-1, as discussed above, provides that exchange standards must require compensation committee members to be independent, and further provides that each exchange, in determining independence for this purpose, must consider relevant factors, including the Fees Factor and Affiliation Factor described above. In its proposal, NYSE Arca discussed its consideration of these factors,[27] and proposed the following:[28]

With respect to the Fees and Affiliation Factors, NYSE Arca proposes to adopt a provision stating that the board of directors of the listed company would be required, in affirmatively determining the independence of any director who will serve on the compensation committee of the board, to consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to: (A) the source of compensation of such director, including

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and accompanying text, such issuers would not be required to specify this consideration. See also proposed Commentary .02 to NYSE Arca Equities Rule 5.3(k)(4).

26 See supra note 19.

27 See Notice, supra note 3.

28 See Notice, supra note 3, for the Exchange's explanation of its reasons for the proposed change. See infra Sections II.B.3 and II.B.4 concerning entities that would be exempt from this requirement.

any consulting, advisory or other compensatory fee paid by the listed company to such director; and (B) whether such director is affiliated with the listed company, a subsidiary of the listed company or an affiliate of a subsidiary of the listed company.[29]

With respect to the Fees Factor, NYSE Arca also proposes to amend the rule to provide that the board should consider whether the director receives compensation from any person or entity that would impair his ability to make independent judgments about the listed company's executive compensation.[30]

With respect to the Affiliation Factor, NYSE Arca proposes, similarly, to amend the commentary to provide that the board should consider whether an affiliate relationship places the director under the direct or indirect control of the listed company or its senior management, or creates a direct relationship between the director and members of senior management, "… in each case of a nature that would impair his ability to make independent judgments about the listed company's executive compensation."[31]

Although Rule 10C-1 requires that exchanges consider "relevant factors" not limited to the Fees and Affiliation Factors, NYSE Arca states that, after reviewing its current and proposed listing rules, it concluded not to propose any specific numerical tests with respect to the factors specified in proposed Equities Rule 5.3(k)(4)(ii) or to adopt a requirement to consider any other specific factors. In its proposal, NYSE Arca stated that it did not intend to adopt an absolute prohibition on a board making an affirmative finding that a director is independent solely on the basis that the director or any of the director's affiliates are shareholders owning more than some

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29 See proposed Equities Rule 5.3(k)(4)(ii). See also Notice, supra note 3.

30 See proposed Equities Rule 5.3(k)(4)(ii).

31 See id.

specified percentage of the listed company.[32] Further, as stated in its filing, NYSE Arca believes that its existing "bright-line" independence standards, as set forth in Equities Rule 5.3(k)(1), are sufficiently broad to encompass the types of relationships which would generally be material to a director's independence for compensation committee service.[33] Additionally, NYSE Arca stated that Equities Rule 5.3(k)(1) already requires the board to consider any other material relationships between the director and the listed company or its management that are not the

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32 See Notice, supra note 3.

33 See Notice, supra note 3. The following are the "bright-line" tests set forth in Equities Rule 5.3(k)(1): (A) A director who is or has been within the last three years, an employee of the listed company, or whose immediate family member is or has been within the last three years an executive officer of the listed company; (B) (i) A director or a director who has an immediate family member who is a current partner of a firm that is the company's internal or external auditor; (ii) A director who is a current employee of such a firm; (iii) A director who has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance or tax compliance (but not tax planning) practice; or (iv) A director or a director who has an immediate family member who was within the last three years (but is no longer) a partner or employee of such a firm and personally worked on the listed company's audit within that time; (C) A director or a director who has an immediate family member who is, or in the past three years has been, part of an interlocking directorate in which an executive officer of the listed company serves or served on the compensation committee of another company that concurrently employs or employed the director; (D) A director who is an executive officer or an employee, or whose immediate family member is an executive officer, of a company that makes payments to, or receives payments from, the listed company for property or services in an amount which, in any single fiscal year, exceeds the greater of $200,000 or 5% of such other company's consolidated gross revenues, is not "independent" until three years after falling below such threshold; (E) A director who received, or whose immediate family member is an executive officer who received, during any twelve-month period within the last three years, more than $100,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service); (F) In the case of an investment company, in lieu of paragraphs (A)–(E) above, a director who is an "interested person" of the company as defined in section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee.

subject of "bright-line" tests from Equities Rule 5.3(k)(1)(A)-(F).[34] NYSE Arca believes that these requirements with respect to general director independence, when combined with the specific considerations required by proposed Equities Rule 5.3(k)(4)(ii), represent an appropriate standard for compensation committee independence.[35]

NYSE Arca proposes a cure period for a failure of a listed company to meet its committee composition requirements for independence. Under the provision, if a listed company fails to comply with the compensation committee composition requirements because a member of the compensation committee ceases to be independent for reasons outside the member's reasonable control, that person, only so long as a majority of the members of the compensation committee continue to be independent, may remain a member of the compensation committee until the earlier of the next annual shareholders' meeting of the listed company or one year from the occurrence of the event that caused the member to be no longer independent.[36] The proposed rule also requires a company relying on this provision to provide notice to NYSE Arca promptly.[37]

NYSE Arca modified the suggested cure period language contained in Rule 10C-1(a)(3) by limiting the cure period's use to circumstances where the committee continues to have a majority of independent directors, as NYSE Arca believes this would ensure that the applicable

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34 See Notice, supra note 3.

35 See id.

36 See proposed Equities Rule 5.3(k)(4)(ii).

37 See id.

committee could not take an action without the agreement of one or more independent directors.[38]

NYSE Arca's current rules relating to compensation committees include an exception that allows a director who is not an Independent Director to be appointed to such a committee under exceptional and limited circumstances, as long as that director is not currently an executive officer, an employee, or the family member of an executive officer.[39] The exception applies, however, only if the committee is comprised of at least three members and the board determines that the individual's membership on the committee is required by the best interests of the company and its shareholders.[40]

NYSE Arca proposes to amend Equities Rule 5.3(k)(4) to remove, except for smaller reporting companies, the availability of this exception for a director who fails the current requirements or the new enhanced director independence requirements proposed by NYSE Arca.[41] In effect, NYSE Arca proposes to retain the exception only for smaller reporting companies. Under the exception, a compensation committee member of a smaller reporting company may not serve longer than two years with this exception. In addition, a smaller

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38 See Notice, supra note 3. The Commission notes that while NYSE Arca does not provide any new procedures for an issuer to have an opportunity to cure any other defects with respect to its proposed compensation committee requirements, current NYSE Arca Equities rules provide issuers with an opportunity to cure defects, and appeal, before their securities are delisted for rule violations. See Equities Rule 5.5(a) ("Maintenance Requirements and Delisting Procedures") and Equities Rule 5.5(m) ("Delisting Procedures").

39 See current Equities Rule 5.3(k)(4).

40 See id.

41 See proposed Equities Rule 5.3(k)(4)(i)(b). As noted below, smaller reporting companies are not subject to enhanced director independence requirements.

reporting company relying on the exception must make certain disclosures in its proxy statement regarding the nature of the relationship and the reasons for the determination.[42]

2. Authority of Committees to Retain Compensation Advisers; Funding; and Independence of Compensation Advisers

In its proposed rule change, NYSE Arca proposes to fulfill the requirements imposed by Rule 10C-1(b)(2)-(4) under the Act concerning compensation advisers by setting forth those requirements in its own rules and requiring issuers to provide these new rights and responsibilities to their compensation committees.[43] Thus, proposed Equities Rule 5.3(k)(4)(iv) proposes to adopt the requirements that NYSE Arca believes are required by Rule 10C-1(b)(2)-(3) that: (i) the compensation committee may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser; (ii) the compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, independent legal counsel or other adviser retained by the compensation committee;[44] and (iii) the listed company must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to a

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42 See id. See also Notice, supra note 3.

43 Rule 10C-1(b)(4), does not include the word "independent" before "legal counsel" and requires an independence assessment for any legal counsel to a compensation committee, other than in-house counsel. In providing Commentary .05 to proposed Equities Rule 5.3(k)(4), as modified by Amendment No. 2, NYSE Arca provides for two limited exceptions. See infra notes 49-52 and accompanying text.

44 The proposal also includes a provision, derived from Rule 10C-1, stating that nothing in the rule may be construed: (A) to require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant, independent legal counsel or other adviser to the compensation committee; or (B) to affect the ability or obligation of the compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee. See Commentary .06 to Equities Rule 5.3(k)(4).

compensation consultant, independent legal counsel or any other adviser retained by the compensation committee.[45]

Proposed Equities Rule 5.3(k)(4)(v), as amended, also sets forth explicitly, in accordance with Rule 10C-1, that the compensation committee may select, or receive advice from, a compensation consultant, legal counsel or other adviser to the compensation committee, other than in-house legal counsel, only after taking into consideration all factors relevant to that person's independence from management, including the following six factors set forth in Rule 10C-1 regarding independence assessments of compensation advisers.[46]

The six factors, which are set forth in full in the proposed rule, are: (I) the provision of other services to the listed company by the person that employs the compensation consultant, legal counsel or other adviser; (II) the amount of fees received from the listed company by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser; (III) the policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest; (IV) any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee; (V) any stock of the listed company owned by the compensation consultant, legal counsel or other adviser; and (VI) any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the listed company.[47]

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45 See Notice, supra note 3.

46 Rule 10C-1(b)(4).

47 See also Rule 10C-1(b)(4)(i)-(vi).

As proposed, Equities Rule 5.3(k)(4)(v) would not include any specific additional factors for consideration, as NYSE Arca stated that it believes the list included in Rule 10C-1(b)(4) is very comprehensive and the proposed listing standard would also require the compensation committee to consider any other factors that would be relevant to the adviser's independence from management.[48]

Proposed Commentary .05 to Equities Rule 5.3(k)(4), as modified by Amendment No. 2,[49] further states that, as provided in Rule 10C-1, a compensation committee is required to conduct the independence assessment outlined in proposed Equities Rule 5.3(k)(4)(v) with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than (i) in-house legal counsel[50] and (ii) any compensation consultant, legal counsel or other adviser whose role is limited to the following activities for which no disclosure would be required under Item 407(e)(3)(iii) of Regulation S-K: consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the listed company, and that is available generally to all salaried employees; or providing information that either is not customized for a particular company or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice.[51] NYSE Arca noted that this second exception is based on Item 407(e)(3)(iii) of Regulation S-K, which provides a limited

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48 See Notice, supra note 3.

49 See supra note 8. NYSE Arca's proposal as submitted originally only contained an exception for in-house legal counsel. As described below, the Exchange amended its proposal to add an exception for advisers whose role is limited to certain broad-based plans or to providing non-customized information.

50 See proposed Commentary .02 to Equities Rule 5.3(k)(4).

51 See Exhibit 5 to Amendment No. 2 (amending, in part, the proposed Commentary .02).

exception to the Commission's requirement for a registrant to disclose any role of compensation advisers in determining or recommending the amount or form of a registrant's executive and director compensation.[52]

Proposed Commentary .06 to Equities Rule 5.3(k)(4), as modified by Amendment No. 2, also clarifies that nothing in the rule requires a compensation consultant, legal counsel or other compensation adviser to be independent, only that the compensation committee consider the enumerated independence factors before selecting or receiving advice from a compensation adviser.[53] It further clarifies that compensation committees may select or receive advice from any compensation adviser they prefer, including ones that are not independent, after considering the six independence factors set forth in Equities Rule 5.3(k)(4)(v)(I)-(VI).[54] The Exchange clarified that, while the compensation committee is required to consider the independence of compensation advisers, the compensation committee is not precluded from selecting or receiving advice from compensation advisers that are not independent.[55]

3. Application to Smaller Reporting Companies

Rule 10C-1 includes an exemption for smaller reporting companies from all the requirements included within the rule.[56] Consistent with this Rule 10C-1 provision, NYSE Arca,

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52 See Amendment No. 2; see also 17 CFR 229.407(e)(3)(iii). The Exchange believes that its proposed exception from the independence assessment requirement is appropriate because the types of services excepted do not raise conflict of interest concerns, and noted that this is the same reason for which the Commission excluded these types of services from the disclosure requirement in Item 407(e)(3)(iii) of Regulation S-K.

53 See Exhibit 5 to Amendment No. 2, supra note 8.

54 See id.

55 See Amendment No. 2, supra note 8.

56 See supra Section II.A; see also Rule 10C-1(b)(5)(ii).

as a general matter, proposes that a smaller reporting company, as defined in Rule 12b-2[57] under the Act (hereinafter, a "Smaller Reporting Company"), not be subject to the new requirements set forth in its proposal specifically to comply with Rule 10C-1.[58] Thus, NYSE Arca proposes not to require Smaller Reporting Companies to comply with either the enhanced independence standards for members of compensation committees relating to compensatory fees and affiliation or the compensation adviser independence considerations.[59]

NYSE Arca proposes in Commentary .02 to Equities Rule 5.3(k)(4) that Smaller Reporting Companies are not required to comply with Equities Rule 5.3(k)(4)(ii) concerning the additional independence factors for members serving on the compensation committee.[60] A Smaller Reporting Company will be required to comply with proposed Equities Rule 5.3(k)(4)(iv) regarding the requirements concerning the compensation committee's authority, responsibility and funding of compensation advisers.[61] However, NYSE Arca proposes an exception from the proposed Equities Rule 5.3(k)(4)(v) that would otherwise require the Smaller Reporting Company's compensation committee to consider independence factors before selecting such advisers, which goes beyond NYSE Arca's existing requirements.[62] Finally, as noted above, NYSE Arca proposes to amend Equities Rule 5.3(k)(4)(i)(b) to clarify that only

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57 17 CFR 240.12b-2.

58 See proposed Commentary .02 to Equities Rule 5.3(k)(4).

59 See supra text accompanying notes 29 and 47.

60 See Notice, supra note 3.

61 See id.

62 See id. As noted above, NYSE Arca currently requires such authority, responsibility and funding be provided by all listed companies to compensation committees, including by Smaller Reporting Companies. See supra text accompanying note 24. As Smaller Reporting Companies will not be required to comply with the consideration of certain independence factors when selecting an adviser, such issuers will not be required to specify this provision.

Smaller Reporting Companies will be eligible to continue to avail themselves of the ability of the board, under exceptional and limited circumstances, to appoint a non-independent director to the compensation committee.

4. Exemptions

NYSE Arca proposes that its existing exemptions from the Exchange's compensation-related listing rules currently in place, which are set forth in Equities Rules 5.3 and 5.3(k), apply also to the new requirements of the proposed rule change and thereby will continue to provide a general exemption from all of the compensation committee requirements of Equities Rule 5.3(k)(4).[63] These include exemptions to the following issuers: any listed company of which more than 50% of the voting power for the election of directors is held by an individual, a group or another company (in other words, a controlled company); limited partnerships; companies in bankruptcy; closed-end and open-end management investment companies that are registered under the Investment Company Act of 1940; passive business organizations in the form of trusts (such as royalty trusts) or derivatives and special purpose securities; and issuers whose only listed equity stock is a preferred stock.[64] NYSE Arca states that these categories of issuers typically: (i) are externally managed and do not directly employ executives; (ii) do not by their nature have employees; or (iii) have executive compensation policy set by a body other than the board. [65] In light of these structural reasons why these categories of issuers generally do not have compensation committees, the Exchange believes that it would be a significant and unnecessarily

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63 See Notice, supra note 3. In addition, such exempt companies would also thereby be exempt from the enhanced independence requirements for compensation committee composition described in proposed Equities Rule 5.3(k)(4)(ii).

64 See Equities Rules 5.3 and 5.3(k).

65 See Notice, supra note 3.

burdensome alteration in their governance structures to require them to comply with the proposed new requirements and that it is appropriate to grant them an exemption.[66]

Concerning foreign private issuers,[67] NYSE Arca's current Equities Rule 5.3(n) permit any such issuer to follow its home country practice in lieu of many of NYSE Arca's corporate governance listing standards, including the Exchange's compensation-related listing rules. Rule 5.3(n) currently provides that listed companies that are foreign private issuers are permitted to follow home country practice in lieu of the provisions of Equities Rule 5.3, but this allowance is granted on condition that the issuer discloses in its annual report any significant ways in which its corporate governance practices differ from those followed by domestic companies under NYSE Arca listing standards.[68] NYSE Arca proposes that this allowance continue to apply, generally, to the Exchange's compensation committee rules as revised by the instant proposal on the same condition, namely that the issuer discloses any significant ways in which its corporate governance practices differ from those followed by domestic companies under NYSE Arca listing standards in its annual report.[69] NYSE Arca also proposes an additional requirement to the disclosure requirement applicable to foreign private issuers – that the foreign private issuer explain the reason as to why the company does not comply with the compensation committee rules.[70]

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66 See id.

67 Under NYSE Arca's listing rules, "foreign private issuer" has the same meaning and is defined in accordance with the SEC's definition of foreign private issuer set out in Rule 3b-4(c) (17 CFR 240.3b-4). See Equities Rule 5.1(b)(3).

68 See Equities Rule 5.3(n). A foreign private issuer may provide this disclosure either on its website and/or in its annual report as distributed in shareholders to the United States.

69 See Notice, supra note 3.

70 See Exhibit 5 to the Notice, supra note 3 and Amendment No. 2, supra note 8; see also Commentary .03 to Equities Rule 5.3(k)(4).

5. Transition to the New Rules for Companies Listed as of the Effective Date

The proposed rule change provides that certain of the new requirements for listed companies will be effective on July 1, 2013.[71] NYSE Arca does not propose to provide any other transition periods by which listed companies would be required to comply with the new Equities Rule 5.3(k)(4)(ii) compensation committee director independence standards. NYSE Arca proposes that all proposed sections of the proposal would become effective on July 1, 2013 for purposes of compliance by currently listed issuers that are not otherwise exempted.[72]

6. Compliance Schedule: Companies that Cease to Qualify as Smaller Reporting Companies

NYSE Arca's existing rules do not permit companies listing on the Exchange to phase-in compliance with all of the Exchange's applicable independence requirements for compensation committees after the date that the company's securities first trade on NYSE Arca. NYSE Arca proposes to create a compliance schedule for companies that cease to be a Smaller Reporting Company. For a company that was, but has ceased to be, a Smaller Reporting Company, the proposed rule change, as modified by Amendment No. 2, establishes a compliance schedule based on certain dates relating to the company's change in status.[73] Pursuant to Rule 12b-2

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71 Existing compensation committee independence standards would continue to apply until that time.

72 As noted above, current NYSE Arca Equities rules require that the compensation committee charter give that committee sole authority to retain and terminate a consultant to assist in the evaluation of director, CEO or executive officer compensation, including sole authority to approve the firm's fees and other retention terms.

73 See proposed Commentary .02 to Equities Rule 5.3(k)(4), as amended. In the proposal as originally submitted, the compliance schedule was to require compliance with the enhanced standards for director independence six months after the company ceases to be a Smaller Reporting Company, but immediate compliance with all other requirements. In Amendment No. 2, NYSE Arca states that while the revised compliance schedule is different from what it originally proposed, the amended version will allow companies sufficient time to adjust to the differences, as many companies will likely not become

under the Act, a company tests its status as a Smaller Reporting Company on an annual basis as of the last business day of its most recently completed second fiscal quarter (the "Smaller Reporting Company Determination Date"). A company with a public float of $75 million or more as of the Smaller Reporting Company Determination Date will cease to be a Smaller Reporting Company as of the beginning of the fiscal year following the Smaller Reporting Company Determination Date. Under NYSE Arca's proposal, the day of this change in status is the beginning of the compliance period ("Start Date").[74]

By six months from the Start Date, the company will be required to comply with Equities Rule 5.3(k)(4)(v), which sets forth the provision described above relating to the requirement that the committee consider independence factors before selecting compensation advisers.[75] Six months from the Start Date, the company will begin to comply with the additional requirements in Equities Rule 5.3(k)(4)(ii) regarding member independence on the compensation committee. Under the proposal, as amended, a company that has ceased to be a Smaller Reporting Company will be permitted to phase in its compliance with the enhanced independence requirements for compensation committee members (relating to compensatory fees and affiliation) as follows: (i) one member must satisfy the requirements by six months from the Start Date; (ii) a majority of

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aware of their change in status until significantly after the determination date and would therefore not utilize the transition period as originally proposed to bring themselves into compliance with the enhanced requirements, and that such companies would have significant difficulty in becoming compliant within the transition period as originally proposed.

74 See Amendment No. 2.

75 In addition, this will require the company to act in order to reflect this additional requirement for the compensation committee. See proposed Equities Rule 5.3(k)(4)(iii).

members must satisfy the requirements by nine months from the Start Date; and (iii) all members must satisfy the requirements by one year from the Start Date.[76]

III. Comments on the Proposed Rule Change and NYSE Arca's Response

As stated previously, the Commission received one comment letter on the NYSE Arca proposal,[77] and seven comment letters on a related NYSE proposal.[78] The Commission is treating the comment letter submitted on the NYSE filing, for which a comparable letter was not submitted on the NYSE Arca filing, as also being applicable to the NYSE Arca filing since the NYSE and NYSE Arca filings address the same substantive issues. NYSE Euronext, Inc., on behalf of NYSE Arca, responds to these comment letters for the NYSE Arca proposal.[79]

Three commenters expressed general support for the proposal, although two believed that it needed to be amended before being approved.[80] Some commenters supported specific provisions of the proposal,[81] some opposed specific provisions,[82] and some sought clarification of certain aspects

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76 During the compliance schedule, a company that has ceased to be a Smaller Reporting Company will be required to continue to comply with the rules previously applicable to it.

77 See supra note 5.

78 See id.

79 See supra note 6. NYSE Euronext, Inc.'s response addresses comments received on both the NYSE and NYSE Arca proposals.

80 See Ameriprise Letter, which supported the proposal but believed that certain aspects were not sufficiently clear such that the proposal needed to be amended to provide additional clarity; ICI Letter, which urged approval of the proposal; and Corporate Secretaries Letter, which generally supported the proposal, but believed that certain of its aspects were unnecessarily burdensome or not sufficiently clear such that the proposal needed to be amended before being approved by the Commission.

81 See Brown Letter, CII Letter, and ICI Letter.

82 See AFL-CIO Letter, Brown Letter, and Wilson Sonsini Letter. See also CII Letter, which stated that it believed that specific aspects of the proposal were lacking.

of the proposal.[83] Some commenters believed that the proposal fell short of meeting the requirements of Rule 10C-1 and believed that it should have been more stringent.[84] These and other comments, as well as NYSE Arca's responses to some of the comments that raised issues with the proposal, are summarized below.

A. Definition of Independence

1. Consideration of Director Compensation

Three commenters believed that the proposal falls short of the requirements of Rule 10C-1, which, in their view, requires that fees paid to a director for service on the company's board also be considered.[85] Two of these commenters, after noting that the proposal did not require boards of directors to also consider the compensation paid to the directors for their service on the board in determining the independence of directors serving on the compensation committee, argued that the proposal falls short of the requirements of Rule 10C-1, which, in their view, requires that fees paid to a director for service on the company's board also be considered.[86] The other commenter argued that the language of Section 10C of the Act itself, as well as its legislative history, indicates Congress's intent that such fees be considered.[87] These commenters believed that compensation for board service can result in "the impairment of independence as a

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83 See Ameriprise Letter and Corporate Secretaries Letter.

84 See AFL-CIO Letter, Brown Letter, CII Letter, and Teamsters Letter.

85 See Brown Letter; AFL-CIO Letter; and Teamsters Letter. As noted above, the comment letters refer specifically to NYSE, but apply equally to the NYSE Arca proposal.

86 See AFL-CIO Letter and Teamsters Letter, noting that Rule 10C-1 requires the exchanges to consider a director's "source of compensation," and arguing that this phrase includes director fees.

87 See Brown Letter.

result of excessive fees,"[88] because "[h]igh director fees relative to other sources of income can compromise director objectivity,"[89] and "[h]ighly paid directors also may be inclined to approve large executive pay packages."[90] One of these commenters believed that the requirement of Section 10C of the Act and Rule 10C-1 to consider the source of compensation of a director goes further, and applies to all types of compensation that a director may receive, including compensation paid by any person, including non-issuers.[91]

In its response to comments, NYSE Arca stated that, as all non-management directors of a listed company are eligible to receive the same fees for service as a director or board committee member, NYSE Arca does not believe that it is likely that director compensation would be a relevant consideration for compensation committee independence.[92] NYSE Arca noted that, however, the proposed rules require the board to consider all relevant factors in making compensation committee independence determinations.[93] Therefore, NYSE Arca believes that, to the extent that excessive board compensation might affect a director's independence, the proposed rules would require the board to consider that factor in its determination.[94]

2. Personal or Business Relationships Between Directors and Officers

Some commenters believed that the proposed rules should explicitly require the board of a listed company, when considering affiliations of a director in determining eligibility for

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88 Id.

89 See AFL-CIO Letter and Teamsters Letter

90 Id.

91 See Brown Letter.

92 See NYSE Response Letter.

93 See id.

94 See id.

compensation committee membership, to consider personal or business relationships between the director and the company's executive officers.[95] As expressed by two of these commenters, "too many corporate directors have significant personal, financial or business ties to the senior executives that they are responsible for compensating."[96]

Some commenters believed that related party transactions should explicitly be included as a relevant factor in determining independence for members of compensation committees.[97] The additional requirements Disclosuresuggested by commenters also included, for example, disqualification of a director from membership on the compensation committee if an immediate family member of the director received compensation in excess of $120,000 a year from the company even if that family member was not an executive officer of the company;[98] or if the director has, or in the past five years has had, a personal contract with the company, with an executive officer of the company, or with any affiliate of the company.[99]

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95 See AFL-CIO Letter, Brown Letter, CII Letter, Teamsters Letter. As noted above, several of these comment letters refer specifically to NYSE, but apply equally to the NYSE Arca proposal.

96 AFL-CIO Letter and Teamsters Letter.

97 See AFL-CIO Letter and Teamsters Letter.

98 See id.. NYSE's definition of Independent Director already disqualifies a director from membership on the compensation committee if an immediate family member of the director receives in excess of $120,000 from the company or was an executive officer of the company.

99 See CII Letter. The commenter acknowledged, however, that NYSE Arca's existing director requirements implicitly require this consideration, but similarly recommended that the importance of the factor requires it be explicit in the proposal. Outside the scope of this proposal, the commenter also suggested NYSE Arca consider, at some future date, developing a more comprehensive and robust definition of independent directors that could be applicable to all board committees and provided a proposed definition for NYSE Arca's consideration.

One commenter acknowledged that the proposal would require consideration of all factors specifically relevant to determining whether a director has a relationship which is material to that director's ability to be independent from management, but argued that such requirement is not sufficient to ensure that boards weigh personal or business relationships between directors and executive officers.[100] In support, the commenter argued that: (1) such relationships were not technically with the "listed company" and therefore would at least create confusion as to whether it should be considered; (2) the omission of an explicit reference to this relationship was inconsistent with other approaches taken in the proposal that made reference to certain other relationships; and (3) legislative history makes it clear that Congress expected these relationships to be explicitly considered in determining director independence.[101]

In response, NYSE Arca noted that the existing independence standards of NYSE Arca require the board to make an affirmative determination that there is no material relationship between the director and the company which would affect the director's independence.[102] NYSE Arca further stated that commentary to Section 303A.02(a) of the NYSE Listed Company Manual explicitly notes with respect to the board's affirmative determination of a director's independence that the concern is independence from management, and NYSE MKT LLC and NYSE Arca have always interpreted their respective director independence requirements in the same way.[103] Consequently, NYSE Arca stated that it did not believe that any further clarification of this requirement is necessary.[104]

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100 See Brown Letter.

101 See id.

102 See NYSE Response Letter.

103 See id.

104 See id.

As to a requirement to consider related party transactions, NYSE Arca responded that it believes that this is unnecessary as the existing director independence standards require boards to consider all material factors relevant to an independence determination, as do the specific compensation committee independence requirements of the proposed rules.[105]

3. Sufficiency of Single Factor and Additional Comments on Independence

Two commenters explicitly sought clarification that a single factor can result in the loss of independence.[106] In its response letter, NYSE Arca confirmed that it has interpreted the existing general board independence standards as providing that a single relationship could be sufficiently material that it would render a director non-independent. NYSE Arca stated it was not aware that there has been any confusion with respect to this interpretation.[107] Consequently, NYSE Arca did not believe it is necessary to include in the proposed rules a statement that a single factor may be sufficiently material to render a director non-independent, as this is clearly the intention of the rules as drafted.[108]

Some of the above commenters expressed the belief, in general, that the definition of an independent director should be more narrowly drawn, that the bright-line tests of independence should be strengthened, and that the standards of independence should be uniform for all committees requiring independent directors.[109]

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105 See id.

106 See AFL-CIO Letter; Teamsters Letter. As noted above, the comment letters refer specifically to NYSE, but apply equally to the NYSE Arca proposal.

107 See NYSE Response Letter.

108 See id.

109 See CII Letter, AFL-CIO Letter, Teamsters Letter.

One commenter believed that the requirement that the board "must consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member" was vague and unnecessary in light of the comprehensive factors already required.[110] In responding to this commenter, NYSE Arca disagreed, noting that the requirement to consider all material relationships, not just those enumerated, was essential, as it is impossible to foresee all relationships that may be material.[111]

B. Compensation Adviser Independence Factors

The Commission received letters from four commenters relating to the provision of the proposed rule change that requires a compensation committee to take into consideration the factors set forth in the proposal in the selection of a compensation consultant, legal counsel, or other adviser to the committee.[112]

1. Additional Factors for Consideration

One commenter generally supported the proposal's requirement that a board consider six independence factors before engaging an adviser, but believed that at least one additional factor should be considered: "whether the compensation committee consultants, legal counsel or other advisers require that their clients contractually agree to indemnify or limit their liability."[113] The commenter believed that such contractual provisions, which the commenter indicated have

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110 See Corporate Secretaries Letter.

111 See NYSE Response Letter.

112 See Ameriprise Letter, Wilson Sonsini Letter, CII Letter, and Corporate Secretaries Letter. As noted above, several of these comment letters refer specifically to NYSE, but apply equally to the NYSE Arca proposal.

113 See CII Letter.

become standard practice for many consultants, "raise conflict of interest red flags" that every compensation committee should consider in determining the independence of the consultant.[114]

In response, NYSE Arca stated that it did not believe that this is an appropriate addition because a relationship would affect an adviser's independence from management only if it gave rise to a concern that it would subject the adviser to influence by management.[115] It was not apparent to NYSE Arca why the existence of contractual indemnification and limitation of liability provisions would subject an adviser to any influence by management and, therefore, it is not clear how they are relevant to an independence determination.[116] NYSE Arca expressed no view on the desirability of such agreements.[117]

2. Non-Independent Consultants

One commenter suggested that, although the portion of the proposal which relates to the compensation committee's use of a compensation consultant was thoughtfully drafted and accurately reflects the substance of Rule 10C-1, there was a possibility that a reader may not properly interpret the intended meaning of proposed Section 303A.05(c) of the NYSE Listed Company Manual concerning the use of compensation consultants, legal counsel and advisers that are not independent.[118] First, the commenter suggested the use of the example "independent legal counsel" might be read to require the compensation committee to only use independent legal counsel, when Rule 10C-1 would otherwise permit a compensation committee to receive advice from non-independent counsel, such as in-house counsel or outside counsel retained by

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114 See id.

115 See NYSE Response Letter.

116 See id.

117 See id.

118 See Ameriprise Letter.

management.[119] Second, the commenter suggested that the proposal could be revised to emphasize that a compensation committee is not responsible for advisers retained by management or other parties.[120] Third, the commenter suggested that the section addressing the funding of consultants should be revised to make clear that: (a) retained legal counsel need not be independent: and (b) expenses of an adviser, in addition to its compensation, would also be provided for by the issuer.[121] Fourth, the commenter suggested that the proposal be clarified to require a compensation committee to take into account the independence requirements only when selecting a consultant for matters related to executive compensation, rather than for consultants selected to assist with any other responsibilities the committee may have in addition to executive compensation.[122] In response, NYSE Arca noted that Amendment No. 2 amended the proposed rule text to provide that: (i) nothing in the proposed rules requires a compensation consultant, legal counsel or other compensation adviser to be independent, only that the compensation committee consider the enumerated independence factors before selecting a compensation adviser; and (ii) the compensation committee may select any compensation adviser they prefer including ones that are not independent, after considering the six independence factors outlined in the proposed rules.[123] In addition, NYSE Arca noted that Rule 10C-1 and the SEC's adopting release refer only to compensation advisers generally without

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119 See id.

120 See id.

121 See id.

122 See id. See also Corporate Secretaries Letter.

123 See NYSE Response Letter.

carving out compensation advisers retained by the compensation committee with respect to matters other than executive compensation.[124]

One commenter believed that the proposed rule could be read as requiring a compensation committee to consider the independence factors set forth in Rule 10C-1 when selecting any consultant providing advice to the compensation committee, including any outside legal counsel that might provide legal advice to a compensation committee.[125] The commenter argued that outside legal counsel often provides advice to compensation committees on matters other than how much a company should pay an executive.[126] The commenter suggested it would not be "necessary or a good use of resources for compensation committees to review independence factors for such attorneys providing advice to the compensation committee."[127] The commenter stated that no other rule requires a board committee to consider the independence of its regular legal counsel,[128] and noted that, while it may, at times, be appropriate for a board or a committee to consider independence factors, such a consideration should not be made part of a listing standard that singles out the compensation committee.[129] The commenter suggested that different language originally proposed by The NASDAQ Stock Market LLC reflected a more balanced rule that only required the compensation committee to consider the

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124 See NYSE Response Letter.

125 See Wilson Sonsini Letter.

126 See id.

127 See id.

128 See id.

129 See id.

independence when selecting independent legal counsel, not every outside attorney that provides advice to the compensation committee.[130]

In response, NYSE Arca stated that it believes that its proposal is dictated by Rule 10C-1, which excludes only in-house legal counsel from the requirement to conduct an independence analysis with respect to any legal counsel consulted by the compensation committee, including the company's regular securities or tax counsel.[131] NYSE Arca noted that the Rule 10C-1 Adopting Release provides that "[t]he exemption of in-house counsel from the independence analysis will not affect the obligation of a compensation committee to consider the independence of outside legal counsel or compensation consultants or other advisers retained by management or by the issuer."[132]

Another commenter, while generally supporting the proposal, maintained that the required independence assessment will be "time-consuming and burdensome" due to the scope of information that will need to be gathered in order to conduct the required independence assessment.[133] This commenter believed that uncertainty over the scope of the requirement could have a counterproductive effect of discouraging compensation committees from obtaining the advice of advisers subject to the rule, particularly in situations where quick action is required of

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130 See id. The Commission notes that The NASDAQ Stock Market LLC has since revised its proposed rule language and added commentary that makes clear its original intent that the compensation committee of an issuer listed on The NASDAQ Stock Market LLC, absent an exemption, must consider the independence of every adviser, other than in-house legal counsel, that provides advice to the compensation committee, including non-independent legal counsel. See SR-NASDAQ-2012-109, Amendment No. 1.

131 See NYSE Response Letter.

132 See id.

133 See Corporate Secretaries Letter.

the compensation committee, and further identified a number of specific issues that it believed NYSE should address to provide greater clarity regarding the standard.[134]

In response, NYSE Arca disagreed with the commenter, arguing that it was impossible to specifically enumerate every category of relationship which might be material to a compensation committee adviser's independence.[135] NYSE Arca believes that it is therefore necessary for a compensation committee to conduct a more flexible analysis.[136] NYSE Arca believes that it would not be appropriate for it to identify additional relevant factors in the rule, as it would be impossible to predict every category of relationship that might be material.[137]

C. Opportunity to Cure Defects

One commenter supported the rule proposed to permit issuers a period of time, under specified conditions, to cure failures to comply with the independence requirements for compensation committee members.[138] The commenter was concerned, however, that the proposed rules did not specify a cure period for any other form of non-compliance with the new rules.[139] The commenter believed that a company should be allowed to take corrective action within a reasonable time after the company's senior executives learn of the non-compliance.

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134 The Commission notes that NYSE Arca addressed some of the commenter's concerns in Amendment No. 2.

135 See NYSE Response Letter.

136 See id.

137 See id.

138 See Corporate Secretaries Letter. As noted above, the comment letter refers specifically to NYSE, but applies equally to the NYSE Arca proposal.

139 See id. The commenter mentioned, in particular, the requirement that the committee may obtain advice from a consultant or adviser only after assessing that individual's independence. The commenter believed that inadvertent violations of this requirement could arise, for example, if a person is appearing before a compensation committee solely to provide information or other services, and the individual then on a solicited or

In response, NYSE Arca noted that it had existing policies and procedures that govern non-compliance with rules generally and that these provisions would apply to any events of non-compliance under the proposed rules.[140] NYSE Arca believes these provisions provide it with the ability to grant a discretionary period for an issuer to return to compliance, and noted that the determination of a reasonable cure period can only be made in light of specific facts and circumstances.[141]

D. Exemptions

The Commission received one comment letter supporting the proposal to exempt investment companies from the Rule 10C-1 requirements.[142] As the commenter noted, although Rule 10C-1 exempts certain entities, including registered open-end management investment companies, from the enhanced independence requirements for members of compensation committees, it did not explicitly exempt other types of investment companies registered under the Investment Company Act of 1940 ("Investment Company Act"), including closed-end funds, from any of the requirements of Rule 10C-1. Under the proposal, both closed-end and open-end funds would be exempt from all the requirements of the rule. The commenter supported this aspect of the proposal, stating that both open-end and closed-end funds typically are externally managed and do not employ executives or, by their nature, have employees. The commenter agreed with the proposal that it would be significantly and unnecessarily burdensome to require

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unsolicited basis makes a statement that could be viewed as providing advice on executive compensation. In the absence of a cure mechanism, the commenter believed, the company would be in violation of the listing standard and have no recourse.

140 See NYSE Response Letter.

141 See id.

142 See ICI Letter. As noted above, the comment letter refers specifically to NYSE, but applies equally to the NYSE Arca proposal.

such entities to comply with the proposed requirements, and further noted that any conflicts with respect to compensation of investment advisers are governed by the Investment Company Act.[143]

E. Transition Period

As noted above, NYSE Arca does not propose a transition period. One commenter voiced support for the transition period proposed by NYSE for compliance with the new compensation committee independence standard, but believed that NYSE should provide a longer period for companies to satisfy proposed Section 303A.05 of the NYSE Listed Company Manual, relating to the authority of a compensation committee to retain compensation consultants, legal counsel, and other compensation advisers; the authority to fund such advisers; and the responsibility of the committee to consider independence factors before selecting such advisers.[144]

IV. Discussion

After careful review, the Commission finds that the NYSE Arca proposal, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.[145] In particular, the Commission finds that the amended proposed rule change is consistent with the requirements of Section 6(b) of the Act,[146] as well as with Section 10C of the Act[147] and Rule 10C-1 thereunder.[148] Specifically, the Commission finds that the

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143 See ICI Letter.

144 See Corporate Secretaries Letter. Here, the comment letter refers specifically to NYSE, and does not apply to the NYSE Arca filing, as NYSE Arca provides no transition period for currently listed companies.

145 In approving the NYSE Arca proposed rule change, as amended, the Commission has considered its impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

146 15 U.S.C. 78f(b).

147 15 U.S.C. 78j-3.

proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,[149] which requires that the rules of a national securities exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; 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; and not be designed to permit, among other things, unfair discrimination between issuers.

The development and enforcement of meaningful listing standards for a national securities exchange is of substantial importance to financial markets and the investing public. Meaningful listing standards are especially important given investor expectations regarding the nature of companies that have achieved an exchange listing for their securities. The corporate governance standards embodied in the listing rules of national securities exchanges, in particular, play an important role in assuring that companies listed for trading on the exchanges' markets observe good governance practices, including a reasoned, fair, and impartial approach for determining the compensation of corporate executives. The Commission believes that the NYSE Arca proposal will foster greater transparency, accountability, and objectivity in the oversight of compensation practices of listed issuers and in the decision-making processes of their compensation committees.

In enacting Section 10C of the Act as one of the reforms of the Dodd-Frank Act,[150] Congress resolved to require that "board committees that set compensation policy will consist

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148 17 CFR 240.10C-1.

149 15 U.S.C. 78f(b)(5).

150 See supra note 9.

only of directors who are independent."[151] In June 2012, as required by this legislation, the Commission adopted Rule 10C-1 under the Act, which directs the national securities exchanges to prohibit, by rule, the initial or continued listing of any equity security of an issuer (with certain exceptions) that is not in compliance with the rule's requirements regarding issuer compensation committees and compensation advisers.

In response, NYSE Arca submitted the proposed rule change, which includes rules intended to comply with the requirements of Rule 10C-1 and additional provisions designed to strengthen the Exchange's listing standards relating to compensation committees. The Commission believes that the proposed rule change satisfies the mandate of Rule 10C-1 and otherwise will promote effective oversight of its listed issuers' executive compensation practices.

The Commission notes that a number of the commenters generally supported substantially similar proposed rule changes, although some commenters offered suggestions to clarify or improve various provisions NYSE Arca's proposal or NYSE's substantially similar proposal. The Commission believes that the proposed rule change, as modified by Amendment No. 2, appropriately revises NYSE Arca's rules for compensation committees of listed companies, for the following reasons:

A. Compensation Committee Composition

As discussed above, under Rule 10C-1, the exchanges must adopt listing standards that require each member of a compensation committee to be independent, and to develop a definition of independence after considering, among other relevant factors, the source of compensation of a director, including any consulting, advisory or other compensatory fee paid by

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151 See H.R. Rep. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title IX, Subtitle E "Accountability and Executive Compensation," at 872-873 (Conf. Rep.) (June 29, 2010).

the issuer to the director, as well as whether the director is affiliated with the issuer or any of its subsidiaries or their affiliates.

The Commission notes that Rule 10C-1 leaves it to each exchange to formulate a final definition of independence for these purposes, subject to review and final Commission approval pursuant to Section 19(b) of the Act. As the Commission stated in the Rule 10C-1 Adopting Release, "given the wide variety of issuers that are listed on exchanges, we believe that the exchanges should be provided with flexibility to develop independence requirements appropriate for the issuers listed on each exchange and consistent with the requirements of the independence standards set forth in Rule 10C-1(b)(1)."[152] This discretion comports with the Act, which gives the exchanges the authority, as self-regulatory organizations, to propose the standards they wish to set for companies that seek to be listed on their markets consistent with the Act and the rules and regulations thereunder, and, in particular, Section 6(b)(5) of the Act.

As noted above, in addition to retaining its existing independence standards that currently apply to board and compensation committee members, which include certain bright-line tests, NYSE Arca has enhanced its listing requirements regarding compensation committees by adopting additional standards for independence to comply with the Fees Factor and Affiliation Factor, as well as the other standards set forth in Rule 10C-1. The NYSE Arca's proposal also adopts the cure procedures required in Rule 10C-1(a)(3) for compensation committee members who cease to be independent for reasons outside their reasonable control, so long as the majority of the members of the compensation committee continue to be independent, and retains the

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152 As explained further in the Rule 10C-1 Adopting Release, prior to final approval, the Commission will consider whether the exchanges' proposed rule changes are consistent with the requirements of Section 6(b) and Section 10C of the Exchange Act.

requirement that listed issuers have a compensation committee composed entirely of independent directors as required by Rule 10C-1.

In addition, as noted above, NYSE Arca eliminates, for all companies other than Smaller Reporting Companies, the ability of the board under exceptional and limited circumstances to appoint a non-independent director to the compensation committee.

Further, as discussed in more detail below, the NYSE Arca proposal retains the requirement that the compensation committee have a written charter that addresses the committee's purpose and responsibilities, and adds requirements to specify the compensation committee's authority and responsibilities as to compensation advisers as set forth under Rule 10C-1. Finally, to help in assuring that companies comply with these provisions, Exchange rules will continue to require that the compensation committee charter address an annual performance evaluation of the compensation committee. Taken as a whole, the Commission believes that these changes will strengthen the oversight of executive compensation in NYSE Arca-listed companies and further greater accountability, and will therefore further the protection of investors consistent with Section 6(b)(5) of the Act.

The Commission believes that the Exchange's proposal, which requires the consideration of the additional independence factors for compensation committee members, is designed to protect investors and the public interest and is consistent with the requirements of Sections 6(b)(5) and 10C of the Act and Rule 10C-1 thereunder.

With respect to the Fees Factor of Rule 10C-1, the Exchange rule text states when considering the source of a director's compensation in determining independence for compensation committee service, the board should consider whether the director receives compensation from any person or entity that would impair his ability to make independent

judgments about the listed company's executive compensation. In addition to the continued application of the NYSE Arca's current bright-line tests, NYSE Arca's new rules also require the board to consider all relevant factors in making independence determinations for compensation committee membership. The Exchange believes that these requirements of proposed NYSE Arca Equities Rule 5.3(k)(4)(ii), in addition to the general director independence requirements, represent an appropriate standard for compensation committee independence that is consistent with the requirements of Rule 10C–1 and the Fees Factor.

The Commission believes that the provisions noted above to address the Fees Factor give a board broad flexibility to consider a wide variety of fees, including any consulting, advisory or other compensatory fee paid by the issuer or entity, when considering a director's independence for compensation committee service. While the Exchange does not bar all compensatory fees, the approach is consistent with Rule 10C-1 and provides a basis for a board to prohibit a director from being a member of the compensation committee, should the director receive compensation that impairs the ability to make independent decisions on executive compensation matters, even if that compensation does not exceed the threshold in the bright-line test.[153] The Commission, therefore, believes that the proposed compensatory fee requirements comply with Rule 10C-1 and are designed to protect investors and the public interest, consistent with Section 6(b)(5) of the Act. The Commission notes that the compensatory fee consideration may help ensure that compensation committee members are less likely to have received fees, from either the issuer or another entity, that could potentially influence their decisions on compensation matters.

The Commission recognizes that some commenters did not believe that the proposal went far enough because the NYSE Arca did not adequately consider the compensation that directors

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153 See supra note 33, setting forth the existing bright-line tests.

receive for board or committee service in formulating its standards of independence for service on the compensation committee, and, in particular, the levels to which such compensation may rise,[154] or otherwise favored additional requirements.[155] The Commission notes, however, that to the extent a conflict of interest exists because directors set their own compensation, companies must disclose director compensation, and investors will become aware of excessive or non-customary director compensation through this means. In addition, as NYSE Arca states, a company's board of directors must consider all relevant factors in making compensation committee independence determinations, and if director fees could, in the opinion of the board, impair the director's independent judgment with respect to compensation-related matters, the board could therefore consider director compensation in that context.[156] The Commission believes that, based on the NYSE Arca's argument and the disclosure requirements noted above, these arguments are sufficient to find that NYSE Arca has complied with the requirements of Rule 10C-1 in this regard.

With respect to the Affiliation Factor of Rule 10C-1, NYSE Arca has concluded that an outright bar from service on a company's compensation committee of any director with an

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154 See AFL-CIO Letter, Brown Letter, and Teamsters Letter, maintaining that NYSE's proposal "falls short" of the Rule 10C-1 provision requiring exchanges to consider a director's source of compensation. See also supra notes 95-99 and accompanying text. As stated by commenters, "[h]igh director fees relative to other sources of income can compromise director objectivity" and "[h]ighly paid directors also may be more inclined to approve large executive pay packages." AFL-CIO Letter. See also Teamsters Letter. As noted above, the comment letters refer specifically to NYSE, but apply equally to the NYSE Arca proposal.

155 See, e.g., CII Letter.

156 See NYSE Response letter, supra note 6. The Commission also notes that in the NYSE Response Letter, the Exchange states that to the extent that excessive board compensation might affect a director's independence, the new rules would require the board to consider that factor in its independence determination.

affiliation with the company, its subsidiaries, and their affiliates is inappropriate for compensation committees. NYSE Arca's existing independence standards will also continue to apply to those directors serving on the compensation committee. NYSE Arca maintains that it may be appropriate for certain affiliates, such as representatives of significant stockholders, to serve on compensation committees as "share ownership in the listed company aligns the director's interests with those of unaffiliated shareholders, as their stock ownership gives them the same economic interest in ensuring that the listed company's executive compensation is not excessive." In spite of the argument of two commenters in favor of an outright ban on affiliations with the company,[157] the Commission believes that NYSE Arca's approach of requiring boards only to consider such affiliations is reasonable and consistent with the requirements of the Act.

The Commission notes that Congress, in requiring the Commission to direct the exchanges to consider the Affiliation Factor, did not declare that an absolute bar was necessary. Moreover, as the Commission stated in the Rule 10C-1 Adopting Release, "In establishing their independence requirements, the exchanges may determine that, even though affiliated directors are not allowed to serve on audit committees, such a blanket prohibition would be inappropriate for compensation committees, and certain affiliates, such as representatives of significant shareholders, should be permitted to serve."[158] In determining that NYSE Arca's affiliation

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157 See Teamsters Letter and AFL-CIO Letter. As noted above, the comment letters refer specifically to NYSE, but apply equally to the NYSE Arca proposal.

158 Rule 10C-1 Adopting Release. At the same time, the Commission noted that significant shareholders may have other relationships with the listed company that would result in such shareholders' interests not being aligned with those of other shareholders and that the exchanges may want to consider these other ties between a listed issuer and a director. While the Exchange did not adopt any additional factors, the current affiliation standard would still allow a company to prohibit a director whose affiliations "impair his ability to

standard is consistent with Sections 6(b)(5) and 10C under the Act, the Commission notes that NYSE Arca's proposal requires a company's board, in selecting compensation committee members, to consider whether any such affiliation would impair a director's judgment as a member of the compensation committee. The NYSE Arca Equities rule further states that, in considering affiliate relationships, a board should consider whether such affiliate relationship places the director under the direct or indirect control of the listed company or its senior management such that it would impair the ability of the director to make independent judgments on executive compensation. We believe that this should give companies the flexibility to assess whether a director who is an affiliate, including a significant shareholder, should or should not serve on the company's compensation committee, depending on the director's particular affiliations with the company or its senior management.[159]

As to whether NYSE Arca should adopt any additional relevant independence factors, the Exchange stated that it reviewed its rules in light of Rule 10C-1, and concluded that its existing rules together with its proposed rules are sufficient to ensure committee member independence. The Commission believes that, through this review, the Exchange has complied with the requirement that it consider relevant factors, including, but not limited to, the Fees and

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make independent judgment" as a member of the committee. See also supra notes 31-35 and accompanying text.

159 The Commission notes that one commenter suggested there was ambiguity as to whether boards must consider business or personal relationships between directors and senior management. See Brown Letter. In response, NYSE Arca noted that its existing independence standards require the board to make an affirmative determination that there is no material relationship between the director and the company which would affect the director's independence. NYSE Arca noted that Commentary to Section 303A.02(a) of the NYSE Listed Company Manual explicitly notes with respect to the board's affirmative determination of a director's independence that the concern is independence from management, and NYSE Arca has always interpreted their director independence requirements in the same way. Consequently, NYSE Arca does not believe that any further clarification of this requirement is necessary. See NYSE Response Letter.

Affiliation Factors in determining its definition of independence for compensation committee members. The Commission does not agree with the commenters who argued that the NYSE's substantially similar proposal falls short of "the requirements or intent" of Section 10C of the Act and Rule 10C-1. The Commission notes that Rule 10C-1 requires each exchange to consider relevant factors in determining independence requirements for members of a compensation committee, but does not require the exchange's proposal to reflect any such additional factors.

As noted above, several commenters argued that the proposal should require other ties between directors and the company, including business and personal relationships with executives of the company, be considered by boards in making independence determinations.[160] The Commission did emphasize in the Rule 10C-1 Adopting Release that "it is important for exchanges to consider other ties between a listed issuer and a director … that might impair the director's judgment as a member of the compensation committee,"[161] and noted that "the exchanges might conclude that personal or business relationships between members of the compensation committee and the listed issuer's executive officers should be addressed in the definition of independence." However, the Commission did not require exchanges to reach this conclusion and thus NYSE Arca's decision that such ties need not be included explicitly in its definition of independence does not render its proposal insufficient.

In explaining why it did not include, specifically, personal and business relationships as a factor, NYSE Arca cites its standards for Independent Directors, generally, which require the board of directors of a listed issuer to make an affirmative determination that each such director has no material relationship with the listed company with respect to their independence from

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160 See supra notes 95-105 and accompanying text. As noted above, several of the comment letters refer specifically to NYSE, but apply equally to the NYSE Arca proposal.

161 See supra note 11.

management.[162] All compensation committee members must meet the general independence standards under NYSE Arca's rules in addition to the two new criteria being adopted herein. The Commission therefore expects that boards, in fulfilling their obligations, will apply this standard to each such director's individual responsibilities as a board member, including specific committee memberships such as the compensation committee. Although personal and business relationships, related party transactions, and other matters suggested by commenters are not specified either as bright-line disqualifications or explicit factors that must be considered in evaluating a director's independence, the Commission believes that compliance with NYSE Arca's rules and the provision noted above would demand consideration of such factors with respect to compensation committee members, as well as to all Independent Directors on the board.

Notwithstanding the concern of some commenters, the Commission confirms that Rule 10C-1 does not mean that a director cannot be disqualified on the basis of one factor alone. Although NYSE Arca does not state this explicitly in its rules, in response to comments, the Exchange confirmed that they have interpreted their current rules as providing that a single relationship could be sufficiently material that it would render a director non-independent. The Commission believes that nothing in Rule 10C-1 or in NYSE Arca's current or proposed rules implies otherwise.

Finally, the Commission does not believe that NYSE Arca is required in the current proposed rule change to consider further revisions of its independence rules as suggested by some commenters, although it may wish to do so in the future after it has experience with its rules. The Commission notes that the NYSE Arca provision requires a board to further exercise

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162 See Equities Rule 5.3(k)(1). See also NYSE Response Letter.

appropriate discretion to consider all factors specifically relevant in determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member. The Commission notes that one commenter argues this provision is vague and unnecessary and should be deleted from the proposal.[163] The Commission does not agree with the commenter, however, that the consideration of the explicitly enumerated factors will be sufficient in all cases to achieve the objectives of Section 10C(a)(3), because it is not possible to foresee all possible kinds of relationships that might be material to a compensation committee member's independence. We therefore believe the flexibility provided in NYSE Arca's new compensation committee independence standards provides companies with guidance, while allowing them to identify those relationships that might raise questions of independence for service on the compensation committee. For these reasons, we believe the director independence standards are consistent with the investor protection provision of Section 6(b)(5) of the Act.

Under NYSE Arca's proposal, only Smaller Reporting Companies will be able to avail themselves of the "Exceptional and Limited Circumstances" provision that permits the board to appoint one non-independent director serve on a compensation committee under certain circumstances.. Accordingly, all listed companies, except Smaller Reporting Companies, will be required to have a compensation committee comprised of members that all meet the existing and enhanced independence requirements. We note that this change will ensure that, for all NYSE Arca-listed companies that are not Smaller Reporting Companies, executive compensation will only be considered by independent directors, which should help to ensure impartial executive compensation decisions.

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163 See Corporate Secretaries Letter.

The Commission believes that the discretion granted to each exchange by Rule 10C-1, generally, to determine the independence standards it adopts to comply with the Rule includes the leeway to carve out exceptions to those standards, as long as they are consistent with the Act. Regarding the justification for retaining this exception only for Smaller Reporting Companies, the Commission notes that it long ago approved as consistent with the Act the broader exception and concept in the context of NYSE Arca's definition of Independent Director under Equities Rule 5.3(k)(1) with respect to compensation committees. For these reasons, the Commission believes that retaining this provision for Smaller Reporting Companies is reasonable and consistent with Section 6(b)(5) of the Act and with Rule 10C-1. We note that Smaller Reporting Companies are already exempted out of the enhanced independence standards under NYSE Arca's proposal and Rule 10C-1. The provision was previously approved by the Commission as consistent with the Act, and finally, the Commission notes that a member appointed to a Smaller Reporting Company's compensation committee under this Exceptional and Limited Circumstances provision may not serve longer than two years.

B. Authority of Committees to Retain Compensation Advisers; Funding; and Independence of Compensation Advisers and Factors

As discussed above, NYSE Arca proposes to set forth explicitly in its rules the requirements of Rule 10C-1 regarding a compensation committee's authority to retain compensation advisers, its responsibilities with respect to such advisers, and the listed company's obligation to provide appropriate funding for payment of reasonable compensation to a compensation adviser retained by the committee. As such, the Commission believes these provisions meet the mandate of Rule 10C-1[164] and are consistent with the Act.[165]

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164 17 CFR 240.10C-1.

In addition, the Commission believes that requiring companies to specify the enhanced compensation committee responsibilities through official board action will help to assure that there is adequate transparency as to the rights and responsibilities of compensation committee members. As discussed above, the proposed rule change requires the compensation committee of a listed company to consider the six factors relating to independence that are enumerated in the proposal before selecting a compensation consultant, legal counsel or other adviser to the compensation committee. The Commission believes that this provision is consistent with Rule 10C-1 and Section 6(b)(5) of the Act.

As noted above, one commenter believed that Rule 10C-1 could be read as not requiring a compensation committee to consider the enumerated independence factors with respect to regular outside legal counsel and sought to have NYSE revise its substantially similar proposal.[166] This reading is incorrect, and NYSE Arca's rule language reflects the appropriate reading. The Commission notes that Rule 10C-1 includes an instruction that specifically requires a compensation committee to conduct the independence assessment with respect to "any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house counsel."[167] To avoid any confusion, NYSE Arca added rule text that reflects this instruction in its own rules.[168]

In approving this aspect of the proposal, the Commission notes that compliance with the rule requires an independence assessment of any compensation consultant, legal counsel, or other adviser that provides advice to the compensation committee, and is not limited to advice

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165 15 U.S.C. 78j-3.

166 See Wilson Sonsini Letter and supra notes 125-130 and accompanying text.

167 See Instruction to paragraph (b)(4) of Rule 10C-1.

168 See supra note 50 and accompanying text.

concerning executive compensation. However, NYSE Arca has proposed, in Amendment No. 2, to add language to the provision regarding the independence assessment of compensation advisers[169] to state that the compensation committee is not required to conduct an independence assessment for a compensation adviser that acts in a role limited to the following activities for which no disclosure is required under Item 407(e)(3)(iii) of Regulation S-K: (a) consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the company, and that is available generally to all salaried employees; and/or (b) providing information that either is not customized for a particular issuer or that is customized based on parameters that are not developed by the adviser, and about which the adviser does not provide advice. NYSE Arca states that this exception is based on Item 407(e)(3)(iii) of Regulation S-K, which provides a limited exception to the Commission's requirement for a registrant to disclose any role of compensation consultants in determining or recommending the amount and form of a registrant's executive and director compensation.[170]

The Commission views NYSE Arca's proposed exception as reasonable, as the Commission determined, when adopting the compensation consultant disclosure requirements in Item 407(e)(3)(iii), that the two excepted categories of advice do not raise conflict of interest concerns.[171] The Commission also made similar findings when it noted it was continuing such

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169 See proposed Commentary .05 to Equities Rule 5.3(k)(4), as amended by Amendment No. 2.

170 See 17 CFR 229.407(e)(3)(iii).

171 See Proxy Disclosure Enhancements, Securities Act Release No. 9089 (Dec. 19, 2009), 74 FR 68334 (Dec. 23, 2009), at 68348 ("We are persuaded by commenters who noted that surveys that provide general information regarding the form and amount of compensation typically paid to executive officers and directors within a particular industry generally do not raise the potential conflicts of interest that the amendments are intended to address.").

exceptions in the Rule 10C-1 Adopting Release, including excepting such roles from the new conflict of interest disclosure rule required to implement Section 10C(c)(2). The Commission also believes that the exception should allay some of the concerns raised by the commenters regarding the scope of the independence assessment requirement. Based on the above, the Commission believes these limited exceptions are consistent with the investor protection provisions of Section 6(b)(5) of the Act.

Regarding the belief of another commenter that the independence assessment requirement could discourage compensation committees from obtaining the advice of advisers,[172] the Commission notes that, as already discussed, nothing in the proposed rule prevents a compensation committee from selecting any adviser that it prefers, including ones that are not independent, after considering the six factors. In this regard, in Amendment No. 2, NYSE Arca added specific rule language stating, among other things, that nothing in its rule requires a compensation adviser to be independent, only that the compensation committee must consider the six independence factors before selecting or receiving advice from a compensation adviser.[173] Regarding the commenter's concern over the burdens that the Exchange proposal imposes, the Commission notes that Rule 10C-1 explicitly requires exchanges to require consideration of these six factors.[174] Moreover, five of the six factors were dictated by Congress itself in the Dodd-Frank Act. As previously stated by the Commission in adopting Rule 10C-1, the

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172 See Corporate Secretaries Letter and supra note 133 and accompanying text.

173 See supra notes 53-54 and accompanying text.

174 The Commission also does not agree with the argument of one commenter that NYSE Arca's proposal must require compensation committees to specifically consider, among the independence factors relating to compensation advisers, whether such an adviser requires that clients contractually agree to indemnify or limit their liability. See CII Letter. The Commission views as reasonable the Exchange's belief that the six factors set forth in Rule 10C-1 are sufficient for the required independence assessment.

requirement that compensation committees consider the independence of potential compensation advisers before they are selected should help assure that compensation committees of affected listed companies are better informed about potential conflicts, which could reduce the likelihood that they are unknowingly influenced by conflicted compensation advisers.[175]

Finally, one commenter requested guidance "on how often the required independence assessment should occur."[176] This commenter observed that it "will be extremely burdensome and disruptive if prior to each such [compensation committee] meeting, the committee had to conduct a new assessment." The Commission anticipates that compensation committees will conduct such an independence assessment at least annually.

The changes to NYSE Arca's rules on compensation advisers should therefore benefit investors in NYSE Arca-listed companies and are consistent with the requirements in Section 6(b)(5) of the Act that rules of the exchange further investor protection and the public interest.

C. Application to Smaller Reporting Companies

The Commission believes that the requirement for Smaller Reporting Companies, like all other listed companies, to have a compensation committee, composed solely of Independent Directors is reasonable and consistent with the protection of investors.[177] The Commission notes that NYSE Arca's rules for compensation committees have not made a distinction for Smaller Reporting Companies in the past. However, consistent with the exemption of Smaller Reporting Companies from Rule 10C-1, the NYSE Arca proposal would: (i) exempt Smaller Reporting

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175 See Rule 10C-1 Adopting Release, supra note 11.

176 See Corporate Secretaries Letter.

177 As discussed above, the Commission believes that providing an exception to this requirement for Smaller Reporting Companies in limited and exceptional circumstances is appropriate.

Companies from having to consider the additional independence requirements as to compensatory fees and affiliation; and (ii) exempt their compensation committees from having to consider the additional independence factors for compensation advisers. Under this approach, Smaller Reporting Companies will effectively be subject to the same requirements as is currently the case under the existing requirements of Equities Rule 5.3(k)(4) for all companies with respect to providing the compensation committee with the authority and funding for the retention of compensation advisers.

The Commission believes that these provisions are consistent with the Act and do not unfairly discriminate between issuers. The Commission believes that, for similar reasons to those for which Smaller Reporting Companies are exempted from the Rule 10C-1 requirements, it makes sense for NYSE Arca to provide some flexibility to Smaller Reporting Companies. Further, because a Smaller Reporting Company does not need to include the additional provision regarding the independence of compensation advisers that NYSE Arca is requiring all other listed companies to include to comply with Rule 10C-1,[178] and in view of the potential additional costs of such review, it is reasonable not to require a Smaller Reporting Company to conduct such analysis of compensation advisers.

D. Opportunity to Cure Defects

Rule 10C-1 requires the rules of an exchange to provide for appropriate procedures for a listed issuer to have a reasonable opportunity to cure any defects that would be the basis for the exchange, under Rule 10C-1, to prohibit the issuer's listing. Rule 10C-1 also specifies that, with

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178 As discussed supra note 62 and accompanying text, a Smaller Reporting Company will not be required to include, like other listed companies, a requirement that the committee consider independence factors before selecting such advisers, because Smaller Reporting Companies are not subject to that requirement.

respect to the independence standards adopted in accordance with the requirements of the Rule, an exchange may provide a cure period until the earlier of the next annual shareholders meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

The Commission notes that the cure period that NYSE Arca proposes for companies that fail to comply with the enhanced independence requirements designed to comply with Rule 10C-1 is the same as the cure period suggested under Rule 10C-1, but NYSE Arca limits the cure period's use to circumstances where the committee continues to have a majority of independent directors, as NYSE Arca believes this would ensure that the applicable committee could not take an action without the agreement of one or more independent directors. The Commission believes that the accommodation, including the proposed period and limitation, although it gives a company less leeway in certain circumstances than the cure period provided as an option by Rule 10C-1, is fair and reasonable and consistent with investor protection under Rule 6(b)(5) by ensuring that a compensation committee cannot take action without a majority of independent directors even when a member ceases to be independent and the committee is entitled to a period to cure that situation.

The Commission agrees with the understanding of the commenter who believed that Rule 10C-1 requires that an exchange provide a company an opportunity to cure any defects in compliance with any of the new requirements. The Commission believes that NYSE Arca's general due process procedures for the delisting of companies that are out of compliance with the Exchange's rules satisfy this requirement. For example, NYSE Arca's rules provide that, unless continued listing of the company raises a public interest concern,[179] when a company is deficient

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179 See Equities Rule 7.13 (Trading Suspensions).

in compliance with listing standards, the Exchange will request the issuer to take action to remedy any identified deficiency. If the issuer fails to remedy the deficiency, NYSE Arca will hold a meeting to hear any reasons why the issuer believes its security should not be delisted, including reviewing any written response. If, after such meeting, NYSE Arca determines that the security should be delisted, the issuer may appeal the decision to the Board of Directors and request a hearing.[180]

The Commission believes that these general procedures for companies out of compliance with listing requirements, in addition to the particular cure provisions for failing to meet the new independence standards, adequately meet the mandate of Rule 10C-1 and also are consistent with investor protection and the public interest, since they give a company a reasonable time period to cure non-compliance with these important requirements before they will be delisted.[181]

E. Exemptions

The Commission believes that it is appropriate for NYSE Arca to exempt from the new requirements established by the proposed rule change the same categories of issuers that are exempt from its existing standards for oversight of executive compensation for listed companies. Although Rule 10C-1 does not explicitly exempt some of these categories of issuers from its requirements, it does grant discretion to exchanges to provide additional exemptions. NYSE Arca states that the reasons it adopted the existing exemptions apply equally to the new requirements, and the Commission believes that this assertion is reasonable.

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180 See supra text accompanying notes 140-141. See also NYSE Response Letter, supra note 6.

181 The Commission notes that the general procedures to cure non-compliance adequately address the comments made in the Corporate Secretaries Letter.

NYSE Arca proposed to exempt limited partnerships, companies in bankruptcy proceedings and open-end management investment companies that are registered under the Investment Company Act from all of the requirements of Rule 10C-1. The Commission believes such exemptions are reasonable, and notes that such entities, which were already generally exempt from NYSE Arca's existing compensation committee requirements, also are exempt from the compensation committee independence requirements specifically under Rule 10C-1. NYSE Arca also proposes to exempt closed-end management investment companies registered under the Investment Company Act from the requirements of Rule 10C-1. The Commission believes that this exemption is reasonable because the Investment Company Act already assigns important duties of investment company governance, such as approval of the investment advisory contract, to independent directors, and because such entities were already generally exempt from NYSE Arca's existing compensation committee requirements. The Commission notes that, as one commenter stated, typically registered investment companies do not employ executives or employees or have compensation committees. The Commission notes that the existing language of these exemptive provisions is not changed, but that the provisions, which go beyond Rule 10C-1's exemptions, are consistent with Rule 10C-1.

The Commission further believes that other proposed exemption provisions relating to controlled companies,[182] asset-backed issuers and other passive issuers, and issuers whose only listed equity stock is a preferred stock are reasonable, given the specific characteristics of these entities. As noted by the Exchange, many of these issuers are externally managed and do not

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182 The Commission notes that controlled companies are provided an automatic exemption from the application of the entirety of Rule 10C-1 by Rule 10C-1(b)(5).

directly employ executives; do not, by their nature, have employees, or have executive compensation policy set by a body other than their board.

The NYSE Arca proposal would continue to permit foreign private issuers to follow home country practice in lieu of the provisions of the new rules, but would now require further disclosure from such entities regarding the reason why they do not have a compensation committee. The Commission believes that granting exemptions to foreign private issuers in deference to their home country practices with respect to compensation committee practices is appropriate, and believes that the existing and proposed disclosure requirements will help investors determine whether they are satisfied with the alternative standard. The Commission also notes that NYSE Arca's proposal conforms its rules to Rule 10C-1, which exempts foreign private issuers from the compensation committee independence requirements of Rule 10C-1 to the extent such entities disclose in their annual reports the reasons they do not have independent compensation committees.

F. Transition to the New Rules for Companies Listed as of the Effective Date

The Commission believes that the NYSE Arca's deadline for compliance with the proposal's provisions, July 1, 2013, is reasonable and should afford listed companies adequate time to make the changes, if any, necessary to meet the new standards. The Commission believes that the deadline proposed is clear-cut.

G. Compliance Schedule: Companies that Cease to be a Smaller Reporting Company

The Commission believes that the compliance schedule for companies that cease to be Smaller Reporting Companies, as revised in Amendment No. 2, affords such companies ample time to come into compliance with the full panoply of rules that apply to other companies. In the

Commission's view, the revised schedule also offers such companies more clarity in determining when they will be subject to the heightened requirements.

V. Accelerated Approval of Amendment No. 2 to the Proposed Rule Change

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,[183] for approving the proposed rule change, as modified by Amendment No. 2, prior to the 30th day after the date of publication of notice in the Federal Register.

The change made to the proposal by Amendment No. 2 to change a reference from Item 10(f)(1) of Regulation S-K to a reference to Exchange Act Rule 12b-2 is not a substantive one and merely references an otherwise identical definition.

The revision made by Amendment No. 2 to the compliance rules for companies that cease to be Smaller Reporting Companies[184] establishes a schedule that is easier to understand, while still affording such companies adequate time to come into compliance with the applicable requirements. The Commission notes that the Start Date of the compliance period for such a company is six months after the Smaller Reporting Company Determination Date, and the company is given no less than another six months from the Start Date to gain compliance with the rules from which it had been previously exempt. As originally proposed a Smaller Reporting Company had to comply within six months of the Smaller Reporting Company Determination Date, and for the adviser assessment at the Smaller Reporting Company Determination Date. The Commission believes the amendments to the transitions for issuers that lose their status as a Smaller Reporting Company will afford such companies additional time to comply and avoid issues involving inadvertent non-compliance because of the provision that originally applied

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183 15 U.S.C. 78s(b)(2).

184 See supra notes 73-76 and accompanying text.

immediately on the Smaller Reporting Company Determination Date. The amendments also provide additional clarity on when the time frames commence, and as such the Commission believes good cause exists to accelerate approval.

The change to commentary made by Amendment No. 2 to exclude advisers that provide only certain types of services from the independence assessment is also appropriate. As discussed above, the Commission has already determined to exclude such advisers from the disclosure requirement regarding compensation advisers in Regulation S-K because these types of services do not raise conflict of interest concerns. Finally, the addition of further guidance by Amendment No. 2 merely clarifies that nothing in the Exchange's rules requires a compensation adviser to be independent, only that the compensation committee consider the independence factors before selecting or receiving advice from a compensation adviser, and is not a substantive change, as it was the intent of the rule as originally proposed.

For all the reasons discussed above, the Commission finds good cause to accelerate approval of the proposed changes made by Amendment No. 2.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing and whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSEArca-2012-105 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSEArca-2012-105. This file number should be included on the subject line if e-mail is used.

To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSEArca-2012-105, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VII. Conclusion

In summary, and for the reasons discussed in more detail above, the Commission believes that the rules being adopted by NYSE Arca, taken as whole, should benefit investors by helping listed companies make informed decisions regarding the amount and form of executive compensation. NYSE Arca's new rules will help to meet Congress's intent that compensation

committees that are responsible for setting compensation policy for executives of listed companies consist only of independent directors.

NYSE Arca's rules also, consistent with Rule 10C-1, require compensation committees of listed companies to assess the independence of compensation advisers, taking into consideration six specified factors. This should help to assure that compensation committees of NYSE Arca-listed companies are better informed about potential conflicts when selecting and receiving advice from advisers. Similarly, the provisions of NYSE Arca's standards that require compensation committees to be given the authority to engage and oversee compensation advisers, and require the listed company to provide for appropriate funding to compensate such advisers, should help to support the compensation committee's role to oversee executive compensation and help provide compensation committees with the resources necessary to make better informed compensation decisions.

For the foregoing reasons, the Commission finds that the proposed rule change, SR-NYSEArca-2012-105, as modified by Amendment No. 2, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(5) of the Act.[185]

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[186] that the

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185 15 U.S.C. 78f(b)(5).

186 15 U.S.C. 78s(b)(2).

proposed rule change, SR-NYSEArca-2012-105, as modified by Amendment No. 2, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[187]

Kevin M. O'Neill
Deputy Secretary

[187] 17 CFR 200.30-3(a)(12).