

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–68642; File No. SR–CBOE–2012–094]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving a Proposed Rule Change To Amend the Listing Rules for Compensation Committees To Comply with Securities Exchange Act Rule 10C–1 and Make Other Related Changes

January 11, 2013.

#### I. Introduction

On September 25, 2012, Chicago Board Options Exchange, Inc. (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) <sup>1</sup> and Rule 19b–4 thereunder, <sup>2</sup> a proposed rule change to modify the Exchange’s rules for compensation committees of listed issuers to comply with Commission 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. <sup>3</sup> 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. <sup>4</sup> The Commission received no comment letters on the proposed rule change. <sup>5</sup> This order approves the CBOE proposed rule change.

#### II. Description of the Proposal

##### 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”), <sup>6</sup> the

Commission proposed Rule 10C–1 under the Act, <sup>7</sup> 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. <sup>8</sup>

Rule 10C–1 requires, among other things, each exchange to adopt rules providing that each member of the compensation committee <sup>9</sup> of a listed issuer must be a member of the board of directors of the issuer, and must otherwise be independent. <sup>10</sup> 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 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”). <sup>11</sup>

In addition, Rule 10C–1 requires the listing rules of exchanges to address the authority of compensation committees to retain or obtain a compensation adviser, and its direct responsibility for the appointment, compensation and oversight of the work of any compensation adviser it retains. <sup>12</sup> 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. <sup>13</sup> 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, <sup>14</sup> as well as any other factors identified by the relevant exchange in its listing standards. <sup>15</sup>

##### B. CBOE Proposal

To comply with Rule 10C–1, CBOE proposes to amend Exchange Rule 31.10 “Corporate Governance.” In particular, to accomplish these changes, the Exchange proposes to amend paragraph (c) of Rule 31.10, entitled “Compensation of Officers.” CBOE also proposes to amend the Interpretations and Policies section of Rule 31.10 by adding a new provision entitled Compensation Consultants, Independent Legal Counsel and Other Compensation Advisers. Current paragraph (c) of Rule 31.10 provides that compensation of the chief executive officers and all other executive officers of a listed company must be determined by a majority of independent directors, <sup>16</sup> or a compensation

<sup>14</sup> See Rule 10C–1(b)(4). The six factors, which CBOE proposes to set forth explicitly in its rules, are specified in the text accompanying note 35, *infra*.

<sup>15</sup> 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.

<sup>16</sup> “Independent Director” is defined in Rule 31.10(h)(2) as: A person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship, which, in the opinion of the company’s board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The following persons shall not be considered independent: (A) A director who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company; (B) a director who accepted or who has a family member who accepted any payments from the company or any parent or subsidiary of the company in excess of \$60,000 during the current or any of the past three fiscal years, other than the following: (i) Compensation for board or board committee service; (ii) payments arising solely from investments in the company’s securities; (iii) compensation paid to a family member who is a non-executive employee of the company or a parent or subsidiary of the company; (iv) benefits under a tax-qualified retirement plan, or non-discretionary compensation; or (v) loans permitted under Exchange Act Section 13(k). Provided, however, that audit committee members are subject to additional, more stringent requirements under Exchange Act Rule 10A–3, which requirements are incorporated by reference in the Exchange rules pursuant to Rule 31.10(b); (C) a director who is a family member of an individual who is, or at any time during the past three years

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

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> See Securities Exchange Act Release No. 68020 (October 09, 2012), 77 FR 625558 (“Notice”).

<sup>4</sup> See Securities Exchange Act Release No. 34–68313 (November 28, 2012), 77 FR 71853 (December 4, 2012).

<sup>5</sup> The Commission notes that comments were received on similar proposals filed by New York Stock Exchange, LLC and Nasdaq Stock Market LLC. For a synopsis of these comments see Securities Exchange Act Release Nos. 68011 (October 9, 2012) (“NYSE Notice”) (File No. SR–NYSE–2012–49); 68013 (October 9, 2012) (“Nasdaq Notice”) (File No. SR–NASDAQ–2012–109); 68639 (January 11, 2013), (“NYSE Approval Order”); 68640 (January 11, 2013), (“Nasdaq Approval Order”).

<sup>6</sup> Public Law 111–203, 124 Stat. 1900 (2010).

<sup>7</sup> 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”).

<sup>8</sup> 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”).

<sup>9</sup> For a definition of the term “compensation committee” for purposes of Rule 10C–1, see Rule 10C–1(c)(2)(i)–(iii).

<sup>10</sup> See Rule 10C–1(a) and (b)(1).

<sup>11</sup> See *id.* See also Rule 10C–1(b)(i)(iii)(A), which sets forth exemptions from the independence requirements for certain categories of issuers. See Rule 10C–1(b)(1)(iii)(A). In addition, an exchange may exempt a particular relationship with respect to 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).

<sup>12</sup> See Rule 10C–1(b)(2).

<sup>13</sup> See Rule 10C–1(b)(3).

committee comprised solely of independent directors.

#### 1. Compensation Committee Composition and Independence Standards

First, the Exchange is proposing to amend text in Rule 31.10 to require that the compensation of all executive officers must be determined by, or recommended for determination by a compensation committee.<sup>17</sup> The Exchange proposes to define the term compensation committee as one of the following: (1) A committee of the board of directors that is designated as the compensation committee; (2) in the absence of a specifically designated committee, a committee of the board of directors that performs functions typically performed by a compensation committee, including oversight of executive compensation, even if it is not designated as the compensation committee or also performs other functions; or (3) in the absence of either of the immediately preceding definitions, the members of the board of directors who oversee executive compensation matters on behalf of the board of directors.<sup>18</sup>

The Exchange also proposes to amend Rule 31.10(c) to state that all members of a Compensation Committee must be

was, employed by the company or by any parent or subsidiary of the company as an executive officer; (D) a director who is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more, other than the following: (i) Payments arising solely from investments in the company's securities; or (ii) payments under non-discretionary charitable contribution matching programs; (E) a director of the listed company who is, or has a family member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the listed company serve on the compensation committee of such other entity; (F) a director who is, or has a family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during any of the past three years; or (G) in the case of an investment company, in lieu of Rules 31.10(h)(2)(A)–(F), 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.

<sup>17</sup> See Rule 31.10(c)(1).

<sup>18</sup> As CBOE does not require a formal compensation committee, the term "Compensation Committee" for purposes of the CBOE proposal and as discussed in this release, in addition to describing a formal compensation committee, also refers to the listed company's independent directors as a group when dealing with executive compensation matters. See proposed Rule 31.10(c)(1).

"Independent Directors" as defined in Rule 31.10(h)(2).<sup>19</sup> In its proposal, the Exchange stated that it believes that its current definition of Independent Director meets the independence requirements of Rule 10C–1.<sup>20</sup> The Exchange notes that, as part of existing Rule 31.10(h)(2) defining independent director, the Exchange has requirements that a director is not considered "independent" if he or a family member has accepted any payments from the company or any parent or subsidiary of the company in excess of \$60,000 during the current or any of the past three fiscal years, other than compensation for board or committee service, payments arising solely from investments in the company's securities, compensation paid to a family member who is a non-executive employee of the company or a parent or subsidiary of the company, benefits under a tax-qualified retirement plan, or non-discretionary compensation, or loans permitted under Exchange Act Section 13(k).<sup>21</sup> The Exchange stated it believes that these requirements demonstrate that the definition of "independent" considers the sources of compensation of a member of the compensation committee.<sup>22</sup>

The Exchange stated that it believes that its current definition of Independent Director meets the requirement in Rule 10C–1 that the Exchange's rules must consider whether the director is affiliated with the issuer or a subsidiary or affiliate of a subsidiary of the issuer.<sup>23</sup> CBOE Rule 31.10(h)(2) states that a director is not "independent" if, in the opinion of the issuer's board of directors, the person has a relationship which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. As the

<sup>19</sup> See Rule 31.10(c)(2). For a definition of independent directors under Rule 31.10(h)(2) see *supra*, note 16.

<sup>20</sup> See Notice, *supra* note 3.

See Rule 10C–1(b)(1)(ii)(A) requiring that in determining the independence requirements for members of compensation committees, exchanges must consider all relevant factors, including, but not limited to, the source of compensation of that director (including any consulting, advisory, or other compensatory fee paid by the issuer to the director), and whether the director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

<sup>21</sup> See Rule 31.10(h)(2), and *supra* note 16.

<sup>22</sup> See Notice, *supra* note 3.

<sup>23</sup> See Notice, *supra* note 3. See also Rule 10C–1(b)(1)(ii)(B) requiring that in determining the independence requirements for members of compensation committees, exchanges must consider all relevant factors, including, but not limited to whether a member of the board of directors of an issuer is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.

Exchange stated, "any kind of affiliate relationship could be viewed as a conflict of interest that might interfere with the exercise of independent judgment in carrying out the responsibilities of a director."<sup>24</sup> In its proposal, the Exchange stated it believes that its requirement that a board of directors consider whether a director has a relationship which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director in order to determine whether or not the director is "independent" requires consideration of whether the director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.<sup>25</sup>

The Exchange also proposes to add in Rule 31.10(c)(2) language stating that if a member of a compensation committee ceases to be an Independent Director for reasons outside of that member's reasonable control, that person may remain a compensation committee member until the earlier of the next annual shareholders meeting of the issuer or one year from the occurrence of the event that caused the member to no longer be an Independent Director. The Exchange will require that an issuer relying on this provision must provide notice to the Exchange immediately upon learning of the event or circumstance that caused the member to cease to be an Independent Director.<sup>26</sup>

Exchange Rule 31.10(c) currently provides an exception to the independence requirement for compensation committee members. This exception states that, notwithstanding said independence requirements, if the compensation committee is comprised of at least three members, one director, who is not independent as defined in Rule 31.10(h)(2) and is not a current officer or employee or a family member of an officer or employee, may be appointed to the compensation committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the proxy statement for the next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10–K

<sup>24</sup> The Commission notes that CBOE's rules provide a definition of affiliate that states an affiliate of or a person "affiliated with" another person means a person who, directly or indirectly, controls, is controlled by, or is under common control with, such other person. See CBOE Rule 1.1(j).

<sup>25</sup> See Notice, *supra* note 3.

<sup>26</sup> See Rule 31.10(c)(2).

or 20–F), the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years.<sup>27</sup> CBOE notes that Rule 10C–1 is silent with respect to such exception to the independence requirements, and therefore is proposing to delete this exception. As the Exchange stated, it believes that independence of compensation committee members is important to ensure that there exist no undue influences in the compensation of executive officers.<sup>28</sup>

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

Rule 10C–1 also discusses the retention of compensation consultants, independent legal counsel and other compensation advisers to assist the compensation committee of an issuer in determining compensation for executives.<sup>29</sup> CBOE Rule 31.10 currently does not contain provisions regarding the authority to retain compensation advisers. Therefore, the Exchange proposes to adopt the provisions of Rule 10C–1 regarding this issue in a substantively identical manner to that in Rule 10C–1 in new Interpretation and Policy .11 to Rule 31.10.<sup>30</sup>

The new Interpretation and Policy would state that the Compensation Committee of an issuer, in its capacity as a committee of the board of directors, may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser.<sup>31</sup> The Interpretation and Policy states that the Compensation Committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, independent legal counsel and other adviser retained by the Compensation Committee.<sup>32</sup> Further, the Interpretation and Policy states that “nothing in this Interpretation and Policy .11 to Rule 31.10 shall be construed to require the Compensation Committee to implement or act consistently with the advice or recommendations of the compensation consultant, legal counsel or other

adviser to the Compensation Committee, or to affect the ability or obligation of a Compensation Committee to exercise its own judgment in fulfillment of the duties of the Compensation Committee.”<sup>33</sup> Under the new Interpretation and Policy .11 to Rule 31.10, each listed issuer must provide for appropriate funding, as determined by the Compensation Committee, in its capacity as a committee of the board of directors, for payment of reasonable compensation to a compensation consultant, legal counsel or any other adviser retained by the Compensation Committee.<sup>34</sup>

Regarding the independence of compensation advisers, the new Interpretation and Policy .11 to Rule 31.10 states that the compensation committee of a listed issuer may select a compensation consultant, legal counsel or other adviser to the compensation committee only after taking into consideration the following factors: (1) The provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser, (2) the amount of fees received from the issuer 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, (3) 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, (4) any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee, (5) any stock of the issuer owned by the compensation consultant, legal counsel or other adviser, and (6) any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive office of the issuer.<sup>35</sup> Pursuant to the new Interpretation and Policy, a compensation committee must consider these factors with respect to any compensation consultant, legal counsel or other advisor that provides advice to the compensation committee other than in-house legal counsel.<sup>36</sup>

## 3. Exemptions

The Exchange proposes that the requirements of Interpretation and Policy .11 to Rule 31.10, concerning compensation advisers, discussed above at Section II(B)(2), shall not apply to any controlled company or to any smaller reporting company.<sup>37</sup> The Exchange notes that this exemption complies with exemptions stated in Rule 10C–1.<sup>38</sup> Under the new proposal, as the Exchange states, smaller reporting companies will still be subject to other corporate governance rules, as applicable.<sup>39</sup> The Commission notes that this includes the provisions described above concerning independent oversight of executive compensation.

The Exchange proposes that the requirements of Interpretation and Policy .11 to Rule 31.10, concerning compensation advisers, discussed above at Section II(B)(2), shall not apply to the listing of a security futures product cleared by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q–1) or that is exempt from the registration requirements of section 17A(b)(7)(A) (15 U.S.C. 78q–1(b)(7)(A))<sup>40</sup> or the listing of a standardized option, as defined in § 240.9b–1(a)(4), issued by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q–1).<sup>41</sup> The Exchange stated that these exemptions comply with those stated in Rule 10C–1.<sup>42</sup>

Rule 10C–1 exempts from the independence requirements any limited partnership, company in bankruptcy proceedings, open end management investment company registered pursuant to the Investment Company Act of 1940, and foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee.<sup>43</sup> CBOE thereby proposes to incorporate these exemptions into proposed Rule 31.10(f)(6) by reference by stating that the categories of issuers listed in Rule 10C–1(b)(1)(iii)(A) under the Securities Exchange Act of 1934 are also exempt from the requirements of Rule

<sup>27</sup> See Rule 31.10(c)(3).

<sup>28</sup> See Notice, *supra* note 3. CBOE is also proposing to extend to all executive officers the requirement that an executive officer not be present during the deliberations regarding his or her own compensation.

<sup>29</sup> See Rule 10C–1(b)(2).

<sup>30</sup> See *id.* and Interpretation and Policy .11 to Rule 31.10.

<sup>31</sup> See proposed Interpretation and Policy .11(a)(1) to Rule 31.10.

<sup>32</sup> See proposed Interpretation and Policy .11(a)(2) to Rule 31.10.

<sup>33</sup> See proposed Interpretation and Policy .11(a)(3)(A) and (B) to Rule 31.10.

<sup>34</sup> See proposed Interpretation and Policy .11(b) to Rule 31.10.

<sup>35</sup> See Interpretation and Policy .11(c)(1)–(6) to Rule 31.10.

<sup>36</sup> *Id.*

<sup>37</sup> See Interpretation and Policy .11(d)(1) to Rule 31.10. See also Notice, *supra* note 3.

<sup>38</sup> See Rule 10C–1(b)(5) which exempts such entities from the entire requirements of Rule 10C–1. See also Notice, *supra* note 3.

<sup>39</sup> See Notice, *supra* note 3.

<sup>40</sup> See Interpretation and Policy .11(d)(2) to Rule 31.10.

<sup>41</sup> See Interpretation and Policy .11(d)(3) to Rule 31.10.

<sup>42</sup> See Rule 10C–1(b)(5) which exempts such entities from the requirements of Rule 10C–1.

<sup>43</sup> See Rule 10C–1(b)(1)(iii)(A).

31.10(c)(2) regarding the independence of directors on an issuer's compensation committee. These entities are exempt from the independent director requirements of Rule 31.10(c)(2), discussed *supra* in Section II(B)(1).

Finally, as to exemptions, Rule 31.10(f) currently exempts a number of other categories of issuers from the executive compensation requirements of Rule 31.10(c).<sup>44</sup> These types of issuers are controlled companies, registered management investment companies (which are similar to open-end management investment companies), and asset-backed issuers and other passive issuers, cooperatives. The Exchange determined to exempt these categories of issuers from executive compensation requirements of Rule 31.10(c) due to their various unique attributes.<sup>45</sup> While the Rule 10C-1 changes some of the executive compensation requirements, CBOE believes that these categories of issuers should still be exempt from all executive compensation requirements in Rule 31.10(c) generally.<sup>46</sup> The Exchange has also proposed to add language to its rules to make clear that to the extent the proposed Rule 31.10(f)(6)'s exemption of open-end management investment companies registered under the Investment Company Act of 1940 from the Compensation Committee director independence requirements of Rule 31.10(c)(2) conflicts with the more general already-existing exemption of registered management investment companies from the requirements of Rule 31.10(c), the more general exemption of registered management investment companies from the requirements of Rule 31.10(c) shall be controlling.<sup>47</sup> As such, the exchange proposes to amend Rule 31.10(f)(2) to state that the exemption of management investment companies from the requirements of Rule 31.10(c) shall be controlling over any other potentially-conflicting exemptions that may arise under Rule 31.10(f)(6).<sup>48</sup>

<sup>44</sup> See Rule 31.10(f).

<sup>45</sup> See Notice, *supra* note 3.

<sup>46</sup> See Rule 10C-1(b)(1)(iii)(B) establishing that "in addition to the issuer exemptions set forth in paragraph (b)(1)(iii)(A) of this section, a national securities exchange or a national securities association, pursuant to section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, may exempt from the requirements of paragraph (b)(1) of this section a particular relationship with respect to members of the compensation committee, as each national securities exchange or national securities association determines is appropriate, taking into consideration the size of an issuer and any other relevant factors. *Id.*

<sup>47</sup> See Notice, *supra* note 3.

<sup>48</sup> See Rule 31.10(f)(2).

### III. Discussion and Commission Findings

After careful review, the Commission finds that the CBOE proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>49</sup> In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b) of the Act,<sup>50</sup> as well as with Section 10C of the Act<sup>51</sup> and Rule 10C-1 thereunder.<sup>52</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>53</sup> 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 CBOE 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,<sup>54</sup> Congress resolved to require that "board committees that set

<sup>49</sup> In approving the CBOE proposed rule change the Commission has considered its impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

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

<sup>51</sup> 15 U.S.C. 78j-3.

<sup>52</sup> 17 CFR 240.10C-1.

<sup>53</sup> 15 U.S.C. 78f(b)(5).

<sup>54</sup> See *supra* note 6.

compensation policy will consist only of directors who are independent."<sup>55</sup> 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, CBOE 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 believes that the proposed rule change appropriately revises CBOE'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 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

<sup>55</sup> 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).

Rule 10C-1(b)(1).<sup>56</sup> 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 considering the Fees Factor and Affiliation Factor of Rule 10C-1 CBOE decided its existing independence standards that currently apply to board and compensation committee members, which include certain bright line tests, in Rule 31.10(h)(2), are sufficient.<sup>57</sup> The CBOE's proposal also adopts: (1) A requirement that listed issuers have a compensation committee composed entirely of Independent Directors as required by Rule 10C-1 and (2) the cure procedures set forth in Rule 10C-1(a)(3) for compensation committee members who cease to be independent for reasons outside their reasonable control.

The Commission notes that CBOE's proposal to require executive officer compensation to be determined only by Independent Directors, as defined in CBOE rules, is consistent with the requirements of Rule 10C-1 and Section 6(b)(5) of the Act. The Commission notes, compensation of executive officers must be determined only by Independent Directors even where the board oversees executive compensation without a formal committee. The Commission also believes that CBOE has met the requirements of Rule 10C-1 to consider relevant factors including the Fee Factor and Affiliation Factor. As noted above, after such consideration, CBOE has determined that its existing independence standards, including its bright line independence factors, adequately take into account the additional independence factors for compensation committee members contained in Rule 10C-1.<sup>58</sup>

With respect to the Fees Factors of Rule 10C-1,<sup>59</sup> the Exchange commentary states that as part of Rule 31.10(h)(2) defining independent director, the Exchange has requirements that a director is not considered "independent" if he or a family member has accepted any payments from the company or any parent or subsidiary of

the company in excess of \$60,000 during the current or any of the past three fiscal years, other than compensation for board or committee service, payments arising solely from investments in the company's securities, compensation paid to a family member who is a non-executive employee of the company or a parent or subsidiary of the company, benefits under a tax-qualified retirement plan, or non-discretionary compensation, or loans permitted under Exchange Act Section 13(k).<sup>60</sup> The Exchange stated it believes that this existing requirement demonstrates that the definition of "independent" considers the sources of compensation of a member of the compensation committee.<sup>61</sup>

The Commission believes that the provisions noted above to address the Fees Factor give clear guidance when considering 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, by providing an aggregate fee cap in their bright line tests, the approach is consistent with Rule 10C-1. The Exchange's general independence standards will also provide a basis for a board to prohibit a director from being a member of the compensation committee, should the director receive compensation to a degree 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. The Commission, therefore, believes that the proposed existing 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, which could potentially influence their decisions on compensation matters.

With respect to the Affiliation Factor of Rule 10C-1,<sup>62</sup> the Exchange concluded that it believes that the current definition of Independent Director meets the requirement in Rule 10C-1 that the Exchange's rules must consider whether the director is affiliated with the issuer, a subsidiary of

the issuer, or an affiliate of a subsidiary of the issuer.<sup>63</sup> CBOE Rule 31.10(h)(2) states that a director is not "independent" if, in the opinion of the issuer's board of directors, the person has a relationship which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.<sup>64</sup> As the Exchange noted, "any kind of affiliate relationship, under the Exchange's own definition of affiliate \* \* \* could be viewed as a conflict of interest that might interfere with the exercise of independent judgment in carrying out the responsibilities of a director."<sup>65</sup>

In considering whether a has a relationship, which, in the opinion of the company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director, the board would necessarily have to consider whether the director is an affiliate of the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer, as those relationships necessarily could be relationships that interfere with the exercise of independent judgment in carrying out the responsibilities of a director, including the responsibilities as a member of the Compensation Committee.

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."<sup>66</sup> In determining that CBOE's

<sup>63</sup> See Notice, *supra* note 3. See also Rule 10C-1(b)(1)(ii)(B) requiring that in determining the independence requirements for members of compensation committees, exchanges must consider all relevant factors, including, but not limited to whether a member of the board of directors of an issuer is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.

<sup>64</sup> See Rule 31.10(h)(2).

<sup>65</sup> See Notice, *supra* note 3.

<sup>66</sup> See Rule 10C-1 Adopting Release, *supra* note 8. 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

<sup>56</sup> 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.

<sup>57</sup> See Rule 31.10(h)(2) and *supra* footnotes 16-26 and accompanying text.

<sup>58</sup> See Rule 10C-1(b)(1)(ii).

<sup>59</sup> See Rule 10C-1(b)(1)(ii)(A).

<sup>60</sup> See Rule 31.10(h)(2).

<sup>61</sup> See Notice, *supra* note 3.

<sup>62</sup> See Rule 10C-1(b)(1)(ii)(B).

affiliation standard is consistent with Sections 6(b)(5) and 10C under the Act, the Commission notes that CBOE's proposal requires a company's board, in selecting compensation committee members, to consider "whether the person has a relationship which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director."<sup>67</sup> The Commission believes the Exchange has adequately considered the affiliation standard. As such, the Exchange's decision to retain its current definition of Independent Director is consistent with Sections 6(b)(5) and 10C under the Act.<sup>68</sup>

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

As discussed above, CBOE 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<sup>69</sup> and are consistent with the Act.<sup>70</sup>

#### *C. Compensation Adviser Independence Factors*

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

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 make independent judgment" as a member of the compensation committee. See also *supra* notes 23-25 and accompanying text.

<sup>67</sup> See Interpretation and Policy .01 to Rule 31.10(h)(2) stating that "[i]t is important for investors to have confidence that individuals serving as independent directors do not have a relationship with the listed company that would impair their independence. The board has a responsibility to make an affirmative determination that no such relationships exist through the application of Rule 31.10(h)(2)."

<sup>68</sup> The Commission also believes it is consistent with Section 6(b)(5) for CBOE to prohibit all executive officers, not just the chief executive officer as currently required, to be barred from all compensation committee deliberations regarding their own compensation. We agree this will help prohibit undue influence in the determination of executive officer compensation.

<sup>69</sup> 17 CFR 240.10C-1.

<sup>70</sup> 15 U.S.C. 78j-3.

or other adviser to the compensation committee.<sup>71</sup> Of these factors, five of the six were dictated by Congress itself in the Dodd-Frank Act. As previously stated by the Commission in adopting Rule 10C-1, the 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.<sup>72</sup> The Commission believes that this provision is consistent with Rule 10C-1 and Section 6(b)(5) of the Act.

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 concerning executive compensation. Finally, one commenter on the New York Stock Exchange LLC's proposal requested guidance "on how often the required independence assessment should occur."<sup>73</sup> This commenter observed that it "will be extremely burdensome and disruptive if prior to each compensation committee meeting, the committee had to conduct a new assessment." The Commission anticipates that Compensation Committees will conduct such an independent assessment at least annually.<sup>74</sup>

The changes to CBOE's rules on compensation advisers should therefore benefit investors of 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.

#### *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 respect to the independence standards adopted in

<sup>71</sup> See note 35, *supra* and accompanying text.

<sup>72</sup> See Rule 10C-1 Adopting Release, *supra* note 8.

<sup>73</sup> See Comment to NYSE Notice by Robert B. Lamm, Chair, Securities Law Committee, The Society of Corporate Secretaries & Governance Professionals, dated December 7, 2012 ("Corporate Secretaries Letter").

<sup>74</sup> See NYSE Approval Order and Nasdaq Approval Order, *supra* note 5 for a discussion of comments.

accordance with the requirements of the Rule, an exchange may provide a cure period of 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 CBOE 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. The Commission believes that the accommodation is fair and reasonable and consistent with investor protection under Rule 6(b)(5) by ensuring that when a member ceases to be independent, the committee is entitled to a period to cure that situation. CBOE has delisting procedures that provide issuers with notice, opportunity for a hearing, opportunity for appeals, and delisting.<sup>75</sup>

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.

As noted above, CBOE is removing its exception that allows members of a Compensation Committee to not be independent in certain circumstances. The Commission agrees with CBOE's rationale for eliminating the exception. As the Exchange noted, independence of compensation committee members is important to ensure that no undue influences affect the compensation of executive officers. Given the heightened importance of executive compensation decisions, we think that this is consistent with the investor protection provisions of Section 6(b)(5) of the Act.

#### *E. 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. However, consistent with the exemption of Smaller Reporting Companies from Rule 10C-1, the CBOE proposal would exempt smaller reporting companies from the

<sup>75</sup> See Rule 31.94(G).

requirements of Interpretation and Policy .11 to Rule 31.10 concerning compensation advisers, discussed *supra* at Section II(B)(2).<sup>76</sup> Under the new proposal, as the Exchange states, smaller reporting companies will still be subject to other corporate governance rules, as applicable, and are only exempted out of the compensation advisor provisions.<sup>77</sup>

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 CBOE to provide some flexibility to Smaller Reporting Companies. Further, regarding the exemption from having to consider additional factors regarding compensation advisers, 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.

#### F. Additional Exemptions

The Commission believes that it is appropriate for CBOE 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. CBOE states that the reasons it adopted the existing exemptions apply equally to the new requirements, and the Commission believes that this assertion is reasonable.

The requirements of Interpretation and Policy .11 to Rule 31.10, concerning compensation advisers, discussed *supra* at Section II(B)(2), exempt security futures products cleared by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1) or that is exempt from the registration requirements of section 17A(b)(7)(A) (15 U.S.C. 78q-1(b)(7)(A))<sup>78</sup> and the listing of a standardized option, as defined in § 240.9b-1(a)(4), issued by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1).<sup>79</sup> The Commission notes that these

exemptions comply with those stated in the Rule 10C-1.<sup>80</sup>

Additionally, Rule 10C-1 exempts from the independence requirements Limited partnerships, companies in bankruptcy proceedings, and open-end management investment companies registered under the Investment Company Act of 1940.<sup>81</sup> The CBOE proposal incorporates these exemptions into proposed Rule 31.10(f)(6).<sup>82</sup> The Commission believes such exemptions are reasonable, and notes that such entities also are exempt from the compensation committee independence requirements specifically under Rule 10C-1.

The CBOE proposal would exempt any foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee.<sup>83</sup> 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 disclosure requirements will help investors determine whether they are satisfied with the alternative standard. The Commission notes that such entities are exempt from the compensation committee independence requirements of Rule 10C-1 to the extent such entities disclose in annual reports the reasons it does not have an independent compensation committee.

The CBOE proposal would retain Rule 31.10(f), which currently exempts a number of other categories of issuers from all of the executive compensation requirements of Rule 31.10(c).<sup>84</sup> These types of issuers are controlled companies, registered management investment companies (which are similar to open-end management investment companies and include closed-end management investment companies), asset-backed issuers and other passive issuers, and cooperatives. The Exchange determined to exempt these categories of issuers from executive compensation requirements of Rule 31.10(c) due to their various unique attributes. 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 of closed end management investment companies. The Commission further believes that other proposed exemption provisions relating to controlled companies,<sup>85</sup> asset-backed issuers and other passive issuers, and cooperatives are reasonable given the specific characteristics of these entities, and as noted by the Exchange, their various unique attributes. The Commission believes that exemption of these entities from the requirements of Rule 10C-1 is consistent with the exemptive authority granted in Rule 10C-1.<sup>86</sup>

#### IV. Conclusion

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

CBOE'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 potential CBOE-listed companies are better informed about potential conflicts when selecting and receiving advice from advisers. Similarly, the provisions of CBOE'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

<sup>85</sup> 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).

<sup>86</sup> See Rule 10C-1(b)(1)(iii)(B) establishing that "in addition to the issuer exemptions set forth in paragraph (b)(1)(iii)(A) of this section, a national securities exchange or a national securities association, pursuant to section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, may exempt from the requirements of paragraph (b)(1) of this section a particular relationship with respect to members of the compensation committee, as each national securities exchange or national securities association determines is appropriate, taking into consideration the size of an issuer and any other relevant factors." *Id.*

<sup>76</sup> See Interpretation and Policy .11(d)(1) to Rule 31.10. See also Rule 10C-1(b)(5).

<sup>77</sup> See Notice, *supra* note 3.

<sup>78</sup> See Interpretation and Policy .11(d)(2) to Rule 31.10.

<sup>79</sup> See Interpretation and Policy .11(d)(3) to Rule 31.10.

<sup>80</sup> See Rule 10C-1(b)(5) which exempts such entities from all of the requirements of Rule 10C-1.

<sup>81</sup> See Rule 10C-1(b)(1)(iii)(A) and Rule 31.10(f)(6).

<sup>82</sup> The Commission notes that proposed Rule 31.10(f), open end management investment companies would also be exempt from all the requirements of Rule 31.10(c), not just the independence standards.

<sup>83</sup> Rule 10C-1(b)(1)(iii).

<sup>84</sup> See Rule 31.10(f).



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-CBOE-2012-094 is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(5) of the Exchange Act.<sup>87</sup>

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>88</sup> that the proposed rule change, SR-CBOE-2012-094 be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>89</sup>

**Kevin M. O'Neill,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68654; File No. SR-NASDAQ-2013-007]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Extend the Operative Date of Recent Changes Made to Rules 4613(a)(2)(F) and (G), and Rule 4751(f)(15)

January 15, 2013.

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (the "Act")<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that, on January 14, 2013, The NASDAQ Stock Market LLC (the "NASDAQ" or the "Exchange") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to extend the operative date of recent changes made to

Rules 4613(a)(2)(F) and (G), and Rule 4751(f)(15) to February 25, 2013, thereby extending the retirement of the automated quotation refresh functionality from January 15, 2013 to February 25, 2013.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

On December 17, 2012, the Exchange filed an immediately effective rule change to retire the automated quotation refresh functionality ("AQR") provided to Exchange market makers under Rules 4613(a)(2)(F) and (G), and to make conforming changes to Rule 4751(f)(15).<sup>4</sup> The proposed changes are operative on January 15, 2013. The Exchange received one comment letter to the rule change, seeking an extension of the AQR retirement date to February 25, 2013.<sup>5</sup> The commenter, an industry association which represents a substantial number of NASDAQ members, noted it was concerned that the January 15, 2013 retirement date does not allow sufficient time for implementation of all functionality associated with the AQR system. The commenter explained that new functionality to automate quote movement after quote execution must be developed and incorporated into order management and trading systems. In support of its argument for an extension, the commenter noted that some firms require architectural reprogramming to mission critical systems that control trading operations, and that thorough testing of such changes must be done. The commenter further noted that year-end code freezes, which typically

extend into the first week of January, will make it difficult for firms to adequately implement and test these significant changes to their systems by January 15, 2013. The Exchange has received similar telephonic comments from some of its member firms that are Exchange market makers.

In light of member firm and industry feedback received on the current retirement date, the Exchange believes that a brief extension is warranted to allow member firms adequate time to program and test their systems to use the Market Maker Peg Order<sup>6</sup> or develop alternative means of complying with their market maker obligations. Given that member firms may not be prepared to comply with their market making obligations on January 15, 2013 in the absence of AQR and the potential market disruption that may be caused by eliminating AQR on that date, the Exchange has determined to extend the retirement date of AQR to February 25, 2013, and likewise extend the related changes to Rules 4613(a)(2)(F) and (G), and Rule 4751(f)(15) filed with the Commission on December 21, 2012<sup>7</sup> to February 25, 2013.

The Exchange reminds member firms that AQR presents difficulties to market makers in meeting their obligations under Rule 15c3-5 under the Act (the "Market Access Rule")<sup>8</sup> and Regulation SHO under the Act.<sup>9</sup> The Exchange emphasizes that market makers using AQR remain obligated to monitor their quotes and are responsible for complying with all Exchange rules, the Market Access Rule, as well as Rule 610, Rule 611 of Regulation NMS and Rule 200(g) of Regulation SHO, even in the event that AQR is not functioning properly. Market makers must have policies and procedures to address such contingencies and systems in place to ensure that they can continuously meet their two-sided obligation.

###### 2. Statutory Basis

The statutory basis for the proposed rule change is Section 6(b)(5) of the Act,<sup>10</sup> which requires the rules of an exchange 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

<sup>6</sup> On August 2, 2012, the Commission approved the Exchange's new Market Maker Peg Order, which is designed to replace AQR. See Securities Exchange Act Release No. 67584 (August 2, 2012), 77 FR 47472 (August 8, 2012) (SR-NASDAQ-2012-066).

<sup>7</sup> *Supra* note 3.

<sup>8</sup> 17 CFR 240.15c3-5.

<sup>9</sup> 17 CFR 242.200 through 204.

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>87</sup> 15 U.S.C. 78f(b)(5).

<sup>88</sup> 15 U.S.C. 78s(b)(2).

<sup>89</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> Securities Exchange Act Release No. 68528 (December 21, 2012), 77 FR 77165 (December 31, 2012) (SR-NASDAQ-2012-140).

<sup>5</sup> See Letter from Manisha Kimmel, Executive Director, Financial Information Forum, to Elizabeth M. Murphy, Secretary, Commission, dated December 21, 2012.