

failure to comply with a collection of information subject to the requirements of the Paperwork Reduction Act unless that collection of information displays a current valid OMB Control Number. The OMB Control Number for this information collection is 2120-0056. Public reporting for this collection of information is estimated to be approximately 5 minutes per response, including the time for reviewing instructions, completing and reviewing the collection of information. All responses to this collection of information are mandatory. Comments concerning the accuracy of this burden and suggestions for reducing the burden should be directed to the FAA at: 800 Independence Ave. SW., Washington, DC 20591, Attn: Information Collection Clearance Officer, AES-200.

Related Information

(h) Refer to MCAI European Aviation Safety Agency (EASA) AD No.: 2011-0042, dated March 11, 2011; and Costruzioni Aeronautiche Tecnam Service Bulletin No. SB 036-CS, 1st Edition, Rev 1, dated December 15, 2010, for related information. For service information related to this AD, contact Costruzioni Aeronautiche TECNAM Airworthiness Office, Via Maiorise—81043 Capua (CE) Italy; telephone: +39 0823 620134; fax: +39 0823 622899; e-mail: m.oliva@tecnam.com, p.violetti@tecnam.com; Internet: <http://www.tecnam.com>. You may review copies of the referenced service information at the FAA, Small Airplane Directorate, 901 Locust, Kansas City, Missouri 64106. For information on the availability of this material at the FAA, call 816-329-4148.

Issued in Kansas City, Missouri, on March 29, 2011.

Earl Lawrence,

Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 2011-8070 Filed 4-5-11; 8:45 am]

BILLING CODE 4910-13-P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229 and 240

[Release Nos. 33-9199; 34-64149; File No. S7-13-11]

RIN 3235-AK95

Listing Standards for Compensation Committees

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing a new rule and rule amendments to implement the provisions of Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which adds Section 10C to the Securities Exchange Act of 1934 (the “Exchange Act”). Section 10C requires the Commission to

adopt rules directing the national securities exchanges (the “exchanges”) and national securities associations to prohibit the listing of any equity security of an issuer that is not in compliance with Section 10C’s compensation committee and compensation adviser requirements. In accordance with the statute, the proposed rule would direct the exchanges to establish listing standards that, among other things, require each member of a listed issuer’s compensation committee to be a member of the board of directors and to be “independent,” as defined in the listing standards of the exchanges adopted in accordance with the proposed rule. In addition, Section 10C(c)(2) of the Exchange Act requires the Commission to adopt new disclosure rules concerning the use of compensation consultants and conflicts of interest.

DATES: Comments should be received on or before April 29, 2011.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to rule-comments@sec.gov; or
- Use the Federal Rulemaking ePortal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments

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

All submissions should refer to File Number S7-13-11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for Web site viewing and printing in the Commission’s Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Nandini A. Acharya, Attorney-Adviser,

or N. Sean Harrison, Special Counsel, at (202) 551-3430, in the Office of Rulemaking, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are proposing to add new Rule 10C-1 under the Securities Exchange Act of 1934.¹ We are also proposing amendments to Item 407² of Regulation S-K.³

Table of Contents

- I. Background and Summary
- II. Discussion of the Proposals
 - A. Proposed Listing Requirements
 1. Applicability of Listing Requirements
 2. Independence Requirements
 3. Authority to Engage Compensation Advisers; Responsibilities; and Funding
 4. Compensation Adviser Independence Factors
 5. Opportunity to Cure Defects
 - B. Implementation of Listing Requirements
 1. Exchanges Affected
 2. Securities Affected
 - a. Listed Equity Securities
 - b. Securities Futures Products and Standardized Options
 3. Exemptions
 - a. General Approach to Exemptions
 - b. Issuers Not Subject to Independence Requirements
 - c. Relationships Exempt from Independence Requirements
 4. Compensation Consultant Disclosure and Conflicts of Interest
 - D. Transition and Timing
- III. Paperwork Reduction Act
 - A. Background
 - B. Summary of Proposed Rule and Rule Amendments
 - C. Burden and Cost Estimates Related to Proposed Amendments
 - D. Request for Comment
- IV. Cost-Benefit Analysis
 - A. Introduction and Objectives of Proposals
 - B. Benefits
 - C. Costs
 - D. Request for Comment
- V. Consideration of Impact on the Economy, Burden on Competition and Promotion of Efficiency, Competition and Capital Formation
- VI. Small Business Regulatory Enforcement Fairness Act
- VII. Initial Regulatory Flexibility Act Analysis
 - A. Reasons for, and Objectives of, the Proposed Action
 - B. Legal Basis
 - C. Small Entities Subject to the Proposed Action
 - D. Reporting, Recordkeeping and Other Compliance Requirements
 - E. Duplicative, Overlapping or Conflicting Federal Rules
 - F. Significant Alternatives
 - G. Solicitation of Comments

¹ 15 U.S.C. 78a *et seq.*

² 17 CFR 229.407.

³ 17 CFR 229.10 *et seq.*

VIII. Statutory Authority and Text of the Proposed Amendments

I. Background and Summary

We are proposing a new rule and rule amendments to implement the provisions of Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act”),⁴ which adds Section 10C to the Securities Exchange Act of 1934 (the “Exchange Act”). Section 10C requires the Commission to direct the national securities exchanges⁵ (the “exchanges”) and national securities associations⁶ to prohibit the listing of any equity⁷ security of an issuer, with certain exemptions, that does not comply with Section 10C’s compensation committee and compensation adviser requirements.⁸

Specifically, Section 10C(a)(1) of the Exchange Act requires the Commission to adopt rules directing the exchanges to prohibit the listing of any equity security of an issuer, with certain exemptions, that is not in compliance

with the independence requirements for members of the compensation committee of the board of directors of an issuer. In accordance with the statute, the rules, once adopted, would require the exchanges to establish listing standards that require each member of a listed issuer’s compensation committee to be a member of the board of directors and to be “independent.” The term “independent” is not defined in Section 10C(a)(1). Instead, the section provides that “independent” is to be defined by the exchanges after taking into consideration “relevant factors.” As provided in Section 10C(a)(1), the “relevant factors” are required to include (1) the source of compensation of a member of the board of directors of an issuer, including any consulting, advisory, or other compensatory fee paid by the issuer to such member of the board of directors, and (2) 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. Section 10C(a)(4) of the Exchange Act requires our rules to permit the exchanges to exempt particular relationships from the independence requirements, as each exchange determines is appropriate, taking into consideration the size of an issuer and any other relevant factors.

In addition to the independence requirements set forth in Section 10C(a), Section 10C(f) of the Exchange Act requires the Commission to adopt rules directing the exchanges to prohibit the listing of any security of an issuer that is not in compliance with the following requirements relating to compensation committees and compensation advisers, as set forth in paragraphs (b)–(e) of Section 10C:

- Each compensation committee must have the authority, in its sole discretion, to retain or obtain the advice of compensation consultants, independent legal counsel and other advisers (collectively, “compensation advisers”);⁹

- Before selecting any compensation adviser, the compensation committee must take into consideration specific factors identified by the Commission that affect the independence of compensation advisers;¹⁰

- The compensation committee must be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser;¹¹ and

- Each listed issuer must provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers.¹²

Finally, Section 10C(c)(2) requires each issuer to disclose in any proxy or consent solicitation material for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting), in accordance with Commission regulations, whether the issuer’s compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed.

We are proposing new Exchange Act Rule 10C–1 to implement the compensation committee listing requirements of Sections 10C(a)–(g)¹³ of the Exchange Act. To implement Section 10C(c)(2) of the Exchange Act, we are proposing rule amendments to Regulation S–K to require disclosure, in any proxy or information statement relating to an annual meeting of shareholders at which directors are to be elected (or special meeting in lieu of the annual meeting), of whether the issuer’s compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed. In connection with these amendments, we also propose to revise the current disclosure requirements with respect to the retention of compensation consultants.¹⁴

II. Discussion of the Proposals

A. Proposed Listing Requirements

1. Applicability of Listing Requirements

In enacting Section 10C of the Exchange Act, Congress intended to require that “board committees that set compensation policy will consist only of directors who are independent.”¹⁵ In addition, Congress sought to provide “shareholders in a public company” with “additional disclosures involving

¹² Exchange Act Section 10C(e).

¹³ Section 10C(g) of the Exchange Act exempts controlled companies from the requirements of Section 10C.

¹⁴ See Item 407(e) of Regulation S–K; Proxy Disclosure Enhancements, Release No. 33–9089 (Dec. 16, 2009) [74 FR 68334].

¹⁵ 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).

⁴ Public Law 111–203, 124 Stat. 1900 (2010).

⁵ A “national securities exchange” is an exchange registered as such under Section 6 of the Exchange Act [15 U.S.C. 78f]. There are currently fifteen national securities exchanges registered under Section 6(a) of the Exchange Act: NYSE Amex (formerly the American Stock Exchange), BATS Exchange, BATS Y-Exchange, NASDAQ OMX BX (formerly the Boston Stock Exchange), C2 Options Exchange, Chicago Board Options Exchange, Chicago Stock Exchange, EDGA Exchange, EDGX Exchange, International Securities Exchange, The NASDAQ Stock Market, National Stock Exchange, New York Stock Exchange, NYSE Arca and NASDAQ OMX PHLX (formerly Philadelphia Stock Exchange). Certain exchanges are registered with the Commission through a notice filing under Section 6(g) of the Exchange Act for the purpose of trading security futures. See Section II.B.1. below, for a discussion of these types of exchanges.

⁶ A “national securities association” is an association of brokers and dealers registered as such under Section 15A of the Exchange Act [15 U.S.C. 78o–3]. The Financial Industry Regulatory Authority (“FINRA”) is the only national securities association registered with the Commission under Section 15A(a) of the Exchange Act. Because FINRA does not list equity securities, we refer only to the exchanges in this release.

In addition, Section 15A(k) of the Exchange Act [15 U.S.C. 78o–3(k)] provides that a futures association registered under Section 17 of the Commodity Exchange Act [7 U.S.C. 21] shall be registered as a national securities association for the limited purpose of regulating the activities of members who are registered as broker-dealers in security futures products pursuant to Section 15(b)(11) of the Exchange Act [15 U.S.C. 78o(b)(11)]. See Section II.B.2. below, for a discussion regarding security futures products.

⁷ See Section II.B.2. below, for a discussion of the scope of Section 10C, including our conclusion that it does not apply to issuers with only listed debt securities. That section also proposes an exemption for securities futures products and standardized options, and clarifies that national securities and futures associations that do not list securities do not have to adopt specific rules in accordance with this rulemaking and Section 10C of the Exchange Act.

⁸ See Exchange Act Sections 10C(a) and (f).

⁹ Exchange Act Sections 10C(c)(1)(A) and 10C(d)(1).

¹⁰ Exchange Act Section 10C(b).

¹¹ Exchange Act Sections 10C(c)(1)(B) and 10C(d)(2).

compensation practices.”¹⁶ Although Section 10C includes numerous provisions applicable to the “compensation committees” of listed issuers, it does not require a listed issuer to have a compensation committee or a committee that performs functions typically assigned to a compensation committee. Nor does Section 10C include provisions that have the effect of requiring a compensation committee as a practical matter. For example, it does not require that the compensation of executives be approved by a compensation committee.

Neither the Act nor the Exchange Act defines the term “compensation committee.”¹⁷ Our rules do not currently require, and our proposed rules would not mandate, that an issuer establish a compensation committee. However, current exchange listing standards generally require listed issuers either to have a compensation committee or to have independent directors determine, recommend or oversee specified executive compensation matters.¹⁸ For example, the New York Stock Exchange (“NYSE”) requires a listed issuer to have a compensation committee composed solely of independent directors and to assign various executive compensation-related tasks to that committee.¹⁹ On the

other hand, the NASDAQ Stock Market (“Nasdaq”) does not mandate that a listed issuer have a compensation committee, but requires that executive compensation be determined or recommended to the board for determination either by a compensation committee composed solely of independent directors or by a majority of the board’s independent directors in a vote in which only independent directors participate.²⁰ Some of the other exchanges have standards comparable to the NYSE’s and require their listed issuers to have independent compensation committees.²¹ Other exchanges have standards comparable to Nasdaq’s and, in the absence of an independent compensation committee, permit executive compensation determinations to be made or recommended by a majority of independent directors on the listed issuer’s board.²²

Proposed Rule 10C–1(b) would direct the exchanges to adopt listing standards that would be applicable to any committee of the board that oversees executive compensation, whether or not the committee performs multiple functions and/or is formally designated as a “compensation committee.” We believe this is appropriate in order to capture board committees that perform these functions and to avoid the possibility that a listed issuer might avoid the proposed requirements merely by assigning a different name to a committee that is functionally equivalent to a compensation committee. For example, if a listed issuer has a designated “corporate governance committee” whose responsibilities include, among other

Company Act of 1940 (“Investment Company Act”). See NYSE Listed Company Manual Section 303A.00.

²⁰ See Nasdaq Rule 5605(d). We understand that less than 2% of Nasdaq listed issuers utilize the alternative of having independent board members, and not a committee, oversee compensation. See also Nasdaq IM 5605–6, stating that the Nasdaq structure is intended to provide flexibility for a company to choose an appropriate board structure and to reduce resource burdens, while ensuring independent director control of compensation decisions. Nasdaq exempts certain issuers from this requirement, including asset-backed issuers and other passive issuers, cooperatives, limited partnerships, and management investment companies registered under the Investment Company Act. See Nasdaq Rule 5615(a).

²¹ NYSE Arca, Inc., National Stock Exchange, Inc., and NASDAQ OMX PHLX, Inc. See NYSE Arca Rule 5.3(k)(4); National Stock Exchange Rule 15.5(d)(5); and NASDAQ OMX PHLX Rule 867.05.

²² NASDAQ OMX BX, Inc., NYSE Amex LLC, Chicago Board Options Exchange, Incorporated, and Chicago Stock Exchange, Inc. See NASDAQ OMX BX Rule 4350(c)(3); NYSE Amex Company Guide Section 805; Chicago Board Options Exchange Rule 31.10; and Chicago Stock Exchange Article 22, Rules 19(d) and 21.

matters, oversight of executive compensation, such committee would be subject to the compensation committee listing standards to be adopted pursuant to our new rules, as would a committee designated as a “human resources committee” whose responsibilities include oversight of executive compensation. However, proposed Rule 10C–1(b) would not require the listing standards to apply to those independent directors who oversee executive compensation in lieu of a board committee, since Section 10C refers only to compensation committees.²³

Request for Comment

- Should the exchanges be required to only list issuers with compensation committees?

- Our proposed rules would apply to a listed issuer’s compensation committee, or in the absence of such a committee, any other board committee that performs functions typically performed by a compensation committee, including oversight of executive compensation. Is this proposed functional approach appropriate and workable? If not, why not?

- As noted above, the listing standards of some exchanges permit a listed issuer to have its executive compensation matters be determined, or recommended to the board for determination, either by a compensation committee composed solely of independent directors or, in the absence of such a committee, by a majority of independent directors in a vote in which only independent directors participate. Should our rules implementing Section 10C require the exchanges to mandate that independent directors performing this function in the absence of a formal committee structure also be subject to our new rules? Would so doing be consistent with the mandate of Section 10C of the Exchange Act?

2. Independence Requirements

Most exchanges that list equity securities require that the board of directors of a listed issuer be composed of a majority of directors that qualify as “independent” under their listing standards.²⁴ As noted above, most

²³ To the extent no board committee is authorized to oversee executive compensation, board determinations with respect to executive compensation matters may be made by the full board with only independent directors participating. In such cases, under state corporate law, we understand that action by the independent directors would generally be considered action by the full board, not action by a committee.

²⁴ See NYSE Listed Company Manual Section 303A.01; Nasdaq Rule 5605(b)(1); NYSE AMEX LLC

¹⁶ *Id.*

¹⁷ By contrast, Section 3(a)(58) of the Exchange Act defines an “audit committee” as a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and if no such committee exists with respect to an issuer, the entire board of directors of the issuer. Our proposed rules would not preclude the exchanges from defining “compensation committee.”

¹⁸ There are some exchanges registered under Section 6(a) of the Exchange Act that have not adopted listing standards that require executive compensation determinations for listed issuers to be made or recommended by an independent compensation committee or independent directors. However, these exchanges, which include the International Securities Exchange, LLC, EDGA Exchange, Inc., EDGX Exchange, Inc., BATS Exchange, Inc., BATS Y–Exchange, Inc. and C2 Options Exchange, Inc., currently either trade securities only pursuant to unlisted trading privileges or trade only standardized options. In addition, the listing standards of certain exchanges that are registered with the Commission for the purpose of trading security futures do not address executive compensation matters. See Section II.B.1, below, for a discussion of these types of exchanges.

¹⁹ See NYSE Listed Company Manual Section 303A.05. Section 303A.05 permits a listed issuer’s board to allocate the responsibilities of the compensation committee to another committee, provided that the committee is composed entirely of independent directors and has a committee charter. The NYSE exempts certain issuers from this requirement, including controlled companies, limited partnerships, companies in bankruptcy, and closed-end and open-end management investment companies registered under the Investment

exchanges that list equity securities require directors on compensation committees or directors determining or recommending executive compensation matters to be “independent” under their general independence standards. Although independence requirements and standards for determining independence vary somewhat among the different exchanges, listing standards prescribe certain bright-line independence tests (including restrictions on compensation, employment and familial or other relationships with the listed issuer that could interfere with the exercise of independent judgment) that directors must meet in order to be considered independent. For example, both NYSE and Nasdaq rules preclude a finding of independence if the director is or recently was employed by the listed issuer,²⁵ the director’s immediate family member is or recently was employed as an executive officer of the listed issuer,²⁶ or the director or director’s family member received compensation from the listed issuer in excess of specified limits.²⁷ In addition, under both NYSE and Nasdaq rules, directors may be disqualified based on their or their family members’ relationships with a listed issuer’s auditor,²⁸ affiliation with entities that have material business relationships with the listed issuer,²⁹ or employment at a company whose compensation committee includes any of the listed issuer’s executive officers.³⁰ We note, however, that with the exception of audit committee membership requirements, stock ownership alone will not automatically preclude a director from being considered independent under either NYSE or Nasdaq listing standards.³¹

Company Guide Section 802(a); Chicago Board Options Exchange Rule 31.10(a); Chicago Stock Exchange Article 22, Rules 19(a) and 21(a); NASDAQ OMX BX Rule 4350(c)(1); NASDAQ OMX PHLX Rule 867.01; National Stock Exchange Rule 15.5(d)(1). NYSE Amex and the Chicago Stock Exchange permit smaller issuers to have a 50% independent board. See NYSE Amex Company Guide Section 801(h); Chicago Stock Exchange Article 22, Rules 19(a), 19(b)(1)(C)(iii), and 21(a).

²⁵ See NYSE Listed Company Manual Section 303A.02(b)(i); Nasdaq Rule 5605(a)(2)(A).

²⁶ See NYSE Listed Company Manual Section 303A.02(b)(i); Nasdaq Rule 5605(a)(2)(C).

²⁷ See NYSE Listed Company Manual Section 303A.02(b)(ii); Nasdaq Rule 5605(a)(2)(B).

²⁸ See NYSE Listed Company Manual Section 303A.02(b)(iii); Nasdaq Rule 5605(a)(2)(F).

²⁹ See NYSE Listed Company Manual Section 303A.02(b)(v); Nasdaq Rule 5605(a)(2)(D).

³⁰ See NYSE Listed Company Manual Section 303A.02(b)(iv); Nasdaq Rule 5605(a)(2)(E).

³¹ See Commentary to NYSE Listed Company Manual Section 303A.02(a); Nasdaq Rule 5605; Nasdaq IM-5605.

In addition to requiring directors to meet objective criteria of independence, the NYSE and Nasdaq also require their listed issuers’ boards to affirmatively determine that each independent director either, in NYSE’s case, has no material relationship with the company³² or, in Nasdaq’s case, has no relationship which, in the opinion of the issuer’s board of directors, would interfere with the director’s exercise of independent judgment in carrying out his or her responsibilities.³³ The other exchanges have similar requirements.³⁴

Under current Commission rules, listed issuers are required to identify each director who is independent, using the same definition of independence used for determining whether a majority of the board of directors is independent.³⁵ If an exchange has independence requirements for members of the compensation committee, then listed issuers are required to identify each member of the compensation committee who is not independent under those requirements.³⁶ If a listed issuer does not have a separately designated compensation committee or committee performing similar functions, then the issuer must identify all members of the board who do not meet the independence requirements for compensation committee members.³⁷

In addition to meeting exchange listing standards, there are other reasons for members of the compensation committee to be independent. For example, in order for a securities transaction between an issuer and one of its officers or directors to be exempt from short-swing profit liability under Section 16(b) of the Exchange Act, the transaction must be approved by the full board of directors or by a committee of the board that is composed solely of two or more “Non-Employee Directors,” as defined in Exchange Act Rule 16b-3(b)(3).³⁸ We understand that many

³² See NYSE Rule 303A.02.a

³³ See Nasdaq Rule 4200(a)(15).

³⁴ See, e.g., NYSE Arca Rule 5.3(k)(1) or NYSE AMEX LLC Company Guide Section 803.A.02.

³⁵ Item 407(a) of Regulation S-K.

³⁶ *Id.*

³⁷ *Id.*

³⁸ As defined in Exchange Act Rule 16b-3(b)(3)(i) [17 CFR 240.16b-3(b)(3)(i)], a “Non-Employee Director” is a director who is not currently an officer (as defined in Rule 16a-1(f)) of the issuer or a parent or subsidiary of the issuer, or otherwise currently employed by the issuer or a parent or subsidiary of the issuer; does not receive compensation, either directly or indirectly, from the issuer or a parent or subsidiary of the issuer, for services rendered as a consultant or in any capacity other than as a director, except for an amount that does not exceed the dollar amount for which disclosure would be required pursuant to Item 404(a) of Regulation S-K; and does not possess an

interest in any other transaction for which disclosure would be required pursuant to Item 404(a) of Regulation S-K. In addition, Rule 16b-3(b)(3)(ii) provides that a Non-Employee Director of a closed-end investment company is a director who is not an “interested person” of the issuer, as that term is defined in Section 2(a)(19) of the Investment Company Act [15 U.S.C. 80a-2(a)(19)].

issuers use their independent compensation committees to avail themselves of this exemption.³⁹ Similarly, if an issuer wishes to preserve the tax deductibility of the amounts of certain awards paid to executive officers, among other things, the performance goals of such awards must be determined by a compensation committee composed of two or more “outside directors,” as defined in Section 162(m) of the Internal Revenue Code.⁴⁰ The definitions of “Non-Employee Director” and “outside director” are similar to the exchanges’ definitions of director independence.

In order to implement the requirements of Section 10C(a)(1) of the Exchange Act, proposed Rule 10C-1(b)(1)(i) would require each member of a listed issuer’s compensation committee to be a member of the issuer’s board of directors and to be independent. As required by Section 10C(a)(1), proposed Rule 10C-1(b)(1)(ii) would direct the exchanges to develop a definition of independence applicable to compensation committee members after considering relevant factors, including, but not limited to, the source of compensation of a director, including any consulting, advisory or other compensatory fee paid by the issuer to such director, and whether the director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a

interest in any other transaction for which disclosure would be required pursuant to Item 404(a) of Regulation S-K. In addition, Rule 16b-3(b)(3)(ii) provides that a Non-Employee Director of a closed-end investment company is a director who is not an “interested person” of the issuer, as that term is defined in Section 2(a)(19) of the Investment Company Act [15 U.S.C. 80a-2(a)(19)].

³⁹ See letter from Sullivan and Cromwell LLP to Facilitating Shareholder Director Nominations, Release No. 34-60089, available at <http://www.sec.gov/comments/s7-10-09/s71009-430.pdf> (“In our experience, many compensation committee charters require their members to meet the requirements of Rule 16b-3 and Section 162(m).”); Ira G. Bogner & Michael Krasnovsky, *Exchange Rules Impact Compensation Committee Composition*, Metropolitan Corp. Couns., April 2004, at 17 (“Most compensation committees of public companies include at least two directors that are ‘outside directors’ under Section 162(m) of the Internal Revenue Code * * * and ‘non-employee directors’ under Rule 16b-3 of the Securities Exchange Act * * *”).

⁴⁰ A director is an “outside director” if the director (A) is not a current employee of the publicly held corporation; (B) is not a former employee of the publicly held corporation who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year; (C) has not been an officer of the publicly held corporation; and (D) does not receive remuneration from the publicly held corporation, either directly or indirectly, in any capacity other than as a director. For this purpose, remuneration includes any payment in exchange for goods or services. Section 162(m) of the Internal Revenue Code of 1986, as amended. Treas. Reg. Section 1.162-27(e)(3).

subsidiary of the issuer. Other than the factors set out in Section 10C(a)(1), we do not propose to specify any additional factors that the exchanges must consider in determining independence requirements for members of compensation committees, although we request comment regarding whether there are any other such factors that should be included in our rule.

In proposing Rule 10C–1(b)(1), we considered the similarities and differences between Section 952 of the Act and Section 301 of the Sarbanes-Oxley Act of 2002.⁴¹ Section 301 of the Sarbanes-Oxley Act added Section 10A(m)(1) to the Exchange Act,⁴² which required the Commission to direct the exchanges to prescribe independence requirements for audit committee members. Although the independence factors in Section 10C(a)(1) are similar to those in Section 10A(m)(1)—and indeed, Section 952 of the Act essentially provides the compensation committee counterpart to the audit committee requirements of Section 301 of the Sarbanes-Oxley Act—there is one significant difference. Section 10C(a) requires only that the exchanges “consider relevant factors” (emphasis added), which include the source of compensation and any affiliate relationship, in developing independence standards for compensation committee members, whereas Section 10A(m) expressly states that certain relationships preclude independence: an audit committee member “may not, other than in his or her capacity as a member of the audit committee * * * [a]ccept any consulting, advisory, or other compensatory fee from the issuer; or [b]e an affiliated person of the issuer or any subsidiary thereof” (emphasis added).⁴³

As a result, the exchanges have more discretion to determine the standards of independence that audit committee and compensation committee members are required to meet. Section 10A(m) prescribes minimum criteria for the independence of audit committee members and permits the exchanges to

adopt more stringent independence criteria as they deem appropriate, subject to approval pursuant to Section 19(b) of the Exchange Act. In contrast, Section 10C gives the exchanges the flexibility to establish their own minimum independence criteria for compensation committee members after considering the relevant factors enumerated in Section 10C(a)(3)(A)–(B). The exchanges may add other factors, as each such exchange deems appropriate, subject to approval pursuant to Section 19(b) of the Exchange Act.

To comply with proposed Rule 10C–1, the exchanges’ definitions of independence for compensation committee members would be implemented through proposed rule changes that the exchanges would file pursuant to Section 19(b) of the Exchange Act, which are subject to the Commission’s approval.⁴⁴ Proposed Rule 10C–1(a)(4) would require that each proposed rule change submission include, in addition to any information required under Section 19(b) of the Exchange Act and the rules thereunder: a review of whether and how existing or proposed listing standards satisfy the requirements of this rule; a discussion of the exchange’s consideration of factors relevant to compensation committee member independence; and the definition of independence applicable to compensation committee members that the exchange proposes to adopt in light of such review.⁴⁵ The Commission would then consider, prior to final approval, whether the exchanges considered the relevant factors outlined in Section 10C(a) and whether the exchanges’ proposed rule changes are consistent with the requirements of Section 6(b) of the Exchange Act.

Because these relevant factors cover the same matters as the prohibitions in Section 10A(m)’s definition of audit

committee independence, we believe the exchanges would likely consider whether those prohibitions should also be applicable to compensation committee members. The exchanges would not be required to adopt those prohibitions in their definitions and will have flexibility to consider other factors in developing their definitions. For example, we understand that there are concerns, as expressed by several commentators,⁴⁶ about a prohibition against allowing directors affiliated with significant investors (such as private equity funds or venture capital firms) to serve on compensation committees.⁴⁷ Some commentators have noted that such directors are highly motivated to rigorously oversee compensation and are well-positioned to exercise independent judgment regarding compensation.⁴⁸ In addition, some commentators have noted that, although there is a need for audit committee members to be able to exercise objective oversight of an issuer’s financial reporting, with respect to the oversight of executive compensation, the interests of representatives of major shareholders are generally aligned with those of other shareholders.⁴⁹

The exchanges may determine that, even though affiliated directors are not allowed to serve on audit committees,

⁴⁶ To facilitate public input on the Act, the Commission has provided a series of e-mail links, organized by topic, on its Web site at <http://www.sec.gov/spotlight/regreformcomments.shtml>. The public comments we received are available on our Web site at <http://www.sec.gov/comments/df-title-xv/specialized-disclosures/specializeddisclosures-8.pdf>. The public comments we have received on Section 952 of the Act are available on our Web site at <http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml>.

Several commentators have suggested that stock ownership alone should not automatically disqualify a board member from serving as an independent director on the compensation committee. See, e.g., letters from American Bar Association, Brian Foley & Company, Inc., Compensia, Davis Polk & Wardwell, LLP and Frederick W. Cook & Co., Inc.

⁴⁷ One of these commentators noted that one or more venture capital firms sometimes hold significant equity positions and also have one of their partners serving as a director and member of the board’s compensation committee. In this commentator’s experience, these individuals, by virtue of their ongoing history with the listed company as well as their familiarity and experience with executive compensation practices in their industry sector, are valuable members of the compensation committee who can offer perspective and expertise which are largely in line with that of the company’s shareholders. See letter from Compensia.

⁴⁸ See letter from Frederic W. Cook & Co., Inc. (stating that venture capital and private equity firms “will often have a more demanding pay-for-performance orientation than any other category of investor”).

⁴⁹ See, e.g., letters from Davis Polk & Wardwell LLP, American Bar Association, Compensia and Frederic W. Cook & Co., Inc.

⁴⁴ The standard of review for approving proposed exchange listing standards is found in Section 19(b)(2)(C) of the Exchange Act, which provides that “[t]he Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this title and the rules and regulations issued under this title that are applicable to such organization.” Under Section 6(b) of the Exchange Act, the rules of an exchange must be “designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.”

⁴⁵ A filing would be required even if an exchange finds that its existing rules satisfy the requirements of proposed Rule 10C–1.

⁴¹ Public Law 107–204, 116 Stat. 745 (2002).

⁴² 15 U.S.C. 78j–1(m)(1).

⁴³ See Section 10A(m) of the Exchange Act. Exchange Act Rule 10A–3 states that in order to be considered “independent,” an audit committee member cannot accept any consulting, advisory or other compensatory fee (other than receipt of fixed amounts under a retirement plan for prior service with the listed issuer) and, for non-investment company issuers, cannot be an affiliated person of the issuer or its subsidiaries. For investment company issuers, the audit committee member cannot be an “interested person” of the issuer as defined in Section 2(a)(19) of the Investment Company Act.

such a blanket prohibition would be inappropriate for compensation committees, and certain affiliates, such as representatives of significant shareholders, should be permitted to serve. The exchanges might also conclude that other relationships or factors linked more closely to executive compensation matters, such as relationships between the members of the compensation committee and the listed issuer's executive management, should be addressed in the definition of independence.

Because the compensation committee independence requirements of Section 10C, unlike the audit committee independence requirements of Section 10A(m), do not require that the exchanges prohibit all affiliates from serving on a compensation committee, we do not believe it is necessary to separately define the term "affiliate" for purposes of proposed Rule 10C-1. As our proposed rule does not establish required independence standards, we also believe it is unnecessary to create any safe harbors for particular relationships, as we did when we adopted our audit committee independence requirements.⁵⁰ Although each exchange must consider the affiliate relationships specified in the rule in establishing compensation committee independence standards, there is no requirement to adopt listing standards precluding compensation committee membership based on all such relationships. Accordingly, we do not propose a separate definition of "affiliate" for use in connection with proposed Rule 10C-1.

Request for Comment

- Rather than establishing minimum independence standards that the exchanges must apply to compensation committee members, our proposed rule would permit each exchange to establish its own independence criteria, provided the exchange considers the relevant factors specified in Section 10C relating to affiliate relationships and sources of compensation. Is this approach appropriate? Is there a better approach that would be consistent with the requirements of Section 10C?

- The proposed independence factors that must be considered relate to current relationships between the issuer and the compensation committee member,

which is consistent with the approach in Rule 10A-3(b)(1) for audit committee members. Should the required factors also extend to a "look back" period before the appointment of the member to the compensation committee? (We note that the exchanges currently have look-back periods for their definitions of independence for purposes of determining whether a majority of the board of directors is independent.) For members already serving on compensation committees when the new listing standards take effect, should the required factors also extend to a "look back" period before the effective date of the new listing standards? If so, what period (e.g., three years or five years) would be appropriate? Should there be different look-back periods for different relationships or different parties? If so, what should they be, and why?

- Should there be additional factors apart from the two proposed factors required to be considered? For example, should the exchanges be required to include business or personal relationships between a compensation committee member and an executive officer of the issuer as mandatory factors for consideration? Should the exchanges be required to include board interlocks or employment of a director at a company included in the listed issuer's compensation peer group as mandatory factors for consideration? Would any such requirements unduly restrain a company in setting the composition of its board of directors?

- Large shareholders may be deemed affiliates by virtue of the percentage of their shareholdings. As noted above, some commentators have expressed the view that directors affiliated with large shareholders should continue to be permitted to serve on compensation committees because their interests are aligned with other shareholders with respect to compensation matters. Would a director affiliated with a shareholder with a significant ownership interest who is otherwise independent be sufficiently independent for the purpose of serving on the compensation committee? Would the interests of all shareholders be aligned with the interests of large shareholders with respect to oversight of executive compensation? Should our rules implementing Section 10C provide additional or different guidance or standards for the consideration of the affiliated person factor?

3. Authority To Engage Compensation Advisers; Responsibilities; and Funding

Section 10C(c)(1) of the Exchange Act provides that the compensation

committee of a listed issuer may, in its sole discretion, retain or obtain the advice of a "compensation consultant,"⁵¹ and Section 10C(d)(1) extends this authority to "independent legal counsel and other advisers"⁵² (collectively, "compensation advisers"). Both sections also provide that the compensation committee shall be directly responsible for the appointment, compensation, and oversight of the work of compensation advisers. Sections 10C(c)(1)(C) and 10C(d)(3) provide that the compensation committee's authority to retain, and responsibility for overseeing the work of, compensation advisers may not be construed to require the compensation committee to implement or act consistently with the advice or recommendations of a compensation adviser or to affect the ability or obligation of the compensation committee to exercise its own judgment in fulfillment of its duties. To ensure that the listed issuer's compensation committee has the necessary funds to pay for such advisers, Section 10C(e) provides that a listed issuer shall provide "appropriate funding," as determined by the compensation committee, for payment of "reasonable compensation" to compensation consultants, independent legal counsel and other advisers to the compensation committee.⁵³

Proposed Rule 10C-1(b)(2) implements Sections 10C(c)(1) and (d)(1) by repeating the provisions set forth in those sections regarding the compensation committee's authority to retain or obtain a compensation adviser, its direct responsibility for the appointment, compensation and oversight of the work of any compensation adviser, and the related rules of construction. In addition, proposed Rule 10C-1(b)(3) implements Section 10C(e) by repeating the provisions set forth in that section regarding the requirement that listed issuers provide for appropriate funding for payment of reasonable compensation to compensation advisers.

We note that while the statute provides that compensation committees of listed issuers shall have the express authority to hire "independent legal counsel," the statute does not require that they do so. Similar to our interpretation⁵⁴ of Section 10A(m) of

⁵⁰ See Exchange Act Rule 10A-3(e)(1)(ii) [17 CFR 240.10A-3(e)(1)(ii)] (providing that a person will be deemed not to be in control of a specified person for purposes of this section if the person "is not the beneficial owner, directly or indirectly, of more than 10% of any class of voting equity securities of the specified person; and is not an executive officer of the specified person").

⁵¹ See Exchange Act Section 10C(c)(1).

⁵² See Exchange Act Section 10C(d)(1).

⁵³ See Exchange Act Section 10C(e).

⁵⁴ See Standards Relating to Listed Company Audit Committees, Release No. 33-8220 (Apr. 9, 2003) [68 FR 18788], at fn. 114 ("As proposed, the requirement does not preclude access to or advice

the Exchange Act, which gave the audit committee authority to engage “independent legal counsel,”⁵⁵ we do not construe the requirements related to independent legal counsel and other advisers as set forth in Section 10C(d)(1) of the Exchange Act as requiring a compensation committee to retain independent legal counsel or as precluding a compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the issuer or management.

Request for Comment

- Is additional specificity in the proposed rule needed to provide clearer guidance to listed issuers? For example, should we define what constitutes an “independent legal counsel”? If so, how?
- Should we clarify more explicitly in the implementing rule that this provision is not intended to preclude the compensation committee from conferring with in-house legal counsel or the company’s outside counsel or from retaining non-independent counsel?
- Our audit committee rules implementing Section 10A(m) provide that each listed issuer must provide funding for ordinary administrative expenses of the audit committee that are necessary or appropriate in carrying out its duties.⁵⁶ Would such a provision be helpful with respect to the compensation committee? Do compensation committees have administrative expenses? If so, are they significant?

4. Compensation Adviser Independence Factors

Section 10C(b) of the Exchange Act provides that the compensation committee may select a compensation adviser only after taking into consideration the factors identified by the Commission. In accordance with Section 10C(b), these factors would apply not only to the selection of compensation consultants, but also to the selection of legal counsel and other advisers to the committee. The statute does not require a compensation adviser to be independent, only that the compensation committee consider the enumerated independence factors before selecting a compensation adviser. Section 10C(b) specifies that the

from the company’s internal counsel or regular outside counsel. It also does not require an audit committee to retain independent counsel.”)

⁵⁵ See Exchange Act Section 10A(m)(5) (“Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.”).

⁵⁶ See Exchange Act Rule 10A-3(b)(5)(iii).

independence factors identified by the Commission must be competitively neutral⁵⁷ and include, at minimum:

- The provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;
- 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;
- 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;
- Any business or personal relationship of the compensation consultant, legal counsel, or other adviser with a member of the compensation committee; and
- Any stock of the issuer owned by the compensation consultant, legal counsel or other adviser.

Because Exchange Act Section 10C does not require compensation advisers to be independent—only that the compensation committee consider factors that may bear upon independence—we do not believe that this provision contemplates that the Commission would necessarily establish materiality or bright-line numerical thresholds that would determine whether or when the factors listed in Section 10C of the Exchange Act, or any other factors added by the Commission or by the exchanges, must be considered germane by a compensation committee. For example, we do not believe that our rules should provide that a committee must consider stock owned by an adviser only if ownership exceeds a specified minimum percentage of the issuer’s stock, or that a committee must consider the amount of revenues that the issuer’s business represents for an adviser only if the percentage exceeds a certain percentage of the adviser’s revenues. Therefore, proposed Rule 10C-1(b)(4) would require the listing

⁵⁷ Although there is no relevant legislative history, we assume this is intended to address the concern expressed by the multi-service compensation consulting firms that the disclosure requirements the Commission adopted last year are not competitively neutral because they do not address potential conflicts of interest presented by boutique consulting firms that are dependent on the revenues of a small number of clients. See letter from Towers Perrin, commenting on Proxy Disclosure and Solicitation Enhancements, Release No. 33-9052 (July 10, 2009), available at <http://www.sec.gov/comments/s7-13-09/s71309-90.pdf>. The list in Section 10C, which covers both multi-service firm “other services” conflicts and boutique firm “revenue concentration” conflicts, is consistent with this assumption.

standards developed by the exchanges to include the independence factors set forth in the statute and incorporated into the rule without any materiality or bright-line thresholds or cut-offs. Under the proposed rules, the exchanges may add other independence factors that must be considered by compensation committees of listed issuers.

We believe the factors set forth in Section 10C(b) are generally comprehensive. We are not proposing any additional compensation adviser independence factors at this time, although we are soliciting comment as to whether there are any additional independence factors that should be taken into consideration by a listed issuer’s compensation committee when selecting a compensation adviser. We are also soliciting comment as to whether the factors set forth in Section 10C(b) and proposed Rule 10C-1(b)(4) are competitively neutral.

We have already received several comment letters with respect to the compensation adviser independence factors.⁵⁸ Commentators are generally supportive of the five factors listed in Section 10C(b), but believe that the factors should be used only in guiding the compensation committee in its selection process, not as an outright bar or prohibition against any one category of compensation adviser.⁵⁹ One commentator stated that in requiring the factors to be “competitively neutral,” Congress sought to ensure that companies “have the flexibility to select the types of adviser[s] that best meet their particular needs.”⁶⁰ Several commentators suggested that the stock ownership independence factor should relate only to shares of the listed issuer owned directly by the consulting firm or by advisers immediately engaged by the compensation committee.⁶¹ Other commentators sought clarification on what constitutes a “business” or “personal” relationship between the compensation adviser and a member of the compensation committee.⁶² In light of our overall approach to implementing the independence factors as provided in Section 10C(b), we are not proposing to address these points, but solicit comment below on whether we should.

⁵⁸ See, e.g., letters from Mercer, Meridian Compensation Partners, LLC, Pay Governance LLC and Frederick W. Cook & Co., Inc.

⁵⁹ See, e.g., letter from Pay Governance LLC.

⁶⁰ See letter from Towers Watson.

⁶¹ See, e.g., letters from Frederick W. Cook & Co., Inc and Mercer.

⁶² See, e.g., letters from Mercer and Pay Governance LLC.

Request for Comment

- Section 10C(b) specifies that the independence factors identified by the Commission must be competitively neutral, but does not state how we should determine whether a factor is competitively neutral. Are there any issues that should be considered to determine or assess whether a factor is competitively neutral?

- Are the five factors identified in Section 10C(b) of the Exchange Act competitively neutral among different types of compensation advisers? If not, what modifications or adjustments should be made in order to make these factors competitively neutral? Are there specific categories of compensation advisers that would be adversely affected by the compensation committee's use of these factors to assess independence?

- Are there any factors affecting independence that we should add to the list of factors identified in proposed Rule 10C-1(b)(4)? If so, what are they and why should they be included?

- Would the existence of a business or personal relationship between a compensation adviser and an executive officer of the issuer be relevant in considering whether to engage the compensation adviser? If so, why? Should we add this to the required list of factors that must be considered?

- Based on the language in Section 10C(b)(2), which distinguishes between the adviser and the person that employs the adviser, a personal or business relationship between the person employing the adviser and a member of the compensation committee would not be covered by the proposed rule (which, like Section 10C(b)(2)(D), only refers to relationships between the adviser and the compensation committee). Should the required list of factors also include a business or personal relationship between the person employing the compensation adviser and a member of the compensation committee? Along those lines, should it also cover a business or personal relationship between the person employing the adviser and an executive officer of the issuer?

- Should we provide materiality, numerical or other thresholds that would apply to whether or when the independence factors must be considered by a compensation committee? If so, what should they be? For example, should we require consideration of stock ownership only if the amount of stock owned constitutes a significant portion of an adviser's net worth, such as 10%?

- Would law firms be affected by the requirement to consider independence factors in a way that would be materially different than how compensation consultants would be affected?

- Should we clarify what is covered by "provision of other services" in proposed Rule 10C-1(b)(4)(i)?

- We interpret "any stock of the issuer owned by the compensation consultant, independent legal counsel or other adviser" in proposed Rule 10C-1(b)(4)(v) to include shares owned by the individuals providing services to the compensation committee and their immediate family members. We do not believe this factor is intended to extend to the person that employs the adviser since Section 10C(b) is specific when factors extend to the employer and that language is not included for stock ownership. Is this an appropriate interpretation of this factor? If not, why and how should this phrase be interpreted? Should it also cover the person that employs the adviser?

- Should we define or clarify the meaning of the phrase "business or personal relationship," as used in proposed Rule 10C-1(b)(4)(iv), and if so, how?

- Would the proposed requirements have any unintended effects on the compensation committee or its process to select a compensation adviser? If so, please explain.

- Should we adopt rule amendments to Regulation S-K to require listed issuers to describe the compensation committee's process for selecting compensation advisers pursuant to the new listing standards? Would information about the compensation committee's selection process—how it works, what it requires, who is involved, when it takes place, whether it is followed—provide transparency to the compensation adviser selection process and provide investors with information that may be useful to them as they consider the effectiveness of the selection process? Or, would such a requirement result in too much detail about this process in the context of disclosure regarding executive compensation?

5. Opportunity To Cure Defects

Section 10C(f)(2) of the Exchange Act specifies that our rules must provide for appropriate procedures for an issuer to have a reasonable opportunity to cure any defects that would be the basis for a prohibition of the listing of an issuer's securities as a result of its failure to meet the requirements set forth in Section 10C, before imposition of such

a prohibition.⁶³ To implement this requirement, proposed Rule 10C-1(a)(3) would require the exchanges to establish such procedures (if their existing procedures are not adequate) before they prohibit the listing of, or delist, any security of an issuer.

As a preliminary matter, we believe that existing continued listing or maintenance standards and delisting procedures of most of the exchanges would satisfy the requirement for there to be reasonable procedures for an issuer to have an opportunity to cure any defects on an ongoing basis. Most exchanges have already adopted procedures to provide issuers with notice and opportunity for a hearing, an opportunity for an appeal and an opportunity to cure defects before their securities are delisted.⁶⁴ Nonetheless, we expect that the rules of each exchange would provide for definite procedures and time periods for compliance with the proposed requirements to the extent they do not already do so.

When we adopted Exchange Act Rule 10A-3(a)(3), which requires that issuers be given an opportunity to cure violations of the audit committee listing requirements, we noted that several commentators to the proposing release for those rules expressed concern regarding rare situations that may occur where an audit committee member ceases to be independent for reasons outside the member's reasonable control.⁶⁵ For example, a listed issuer's audit committee member could be a partner in a law firm that provides no services to the listed issuer, but the listed issuer could acquire another company that is one of the law firm's clients. Without an opportunity to cure such a defect, the audit committee member would cease to be independent. Additional time may be necessary to cure such defects, such as ceasing the issuer's relationship with the audit committee member's firm or replacing

⁶³ See Exchange Act Section 10C(f)(2).

⁶⁴ See, e.g., NYSE Listed Company Manual Section 801-805; Nasdaq Equity Rules 5800 Series; NYSE AMEX LLC Company Guide Section 1009 and Part 12; Chicago Board Options Exchange Rule 31.94; Chicago Stock Exchange Article 22, Rules 4, 17A, and 22; Nasdaq OMX BX Rule 4800 series; Nasdaq OMX PHLX Rule 811. Neither NYSE Arca nor the National Stock Exchange has a rule that specifically requires listed companies to be given an opportunity to submit a plan to regain compliance with corporate governance listing standards other than audit committee requirements; issuers listed on these exchanges, however, are provided notice, an opportunity for a hearing, and an opportunity for an appeal prior to delisting. See NYSE Arca Rule 5.5(m); National Stock Exchange Rule 15.7 and Chapter X.

⁶⁵ See Standards Relating to Listed Company Audit Committees, Release No. 33-8220 (Apr. 9, 2003).

the audit committee member. Accordingly, in our final rule, we provided that the exchanges' rules may provide that if a member of an audit committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable national securities exchange or national securities association, may remain an audit committee member of the listed issuer until the earlier of the next annual meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.⁶⁶

We are proposing that there should be the same opportunity to cure violations of the independence requirements for compensation committee members, for the same reasons we adopted such provisions for curing violations of the independence requirements for audit committee members. Accordingly, consistent with Rule 10A-3(a)(3), proposed Rule 10C-1(a)(3) provides that if a member of a compensation committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable exchange, may remain a compensation committee member of the listed issuer until the earlier of the next annual meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

Request for Comment

- Should the exchanges be required to establish specific procedures for curing defects regarding compliance with compensation committee listing requirements apart from those proposed? If so, what should these procedures be? Should there be a specific course for redress other than the delisting process?

- Should our rule, as proposed, allow exchange rules that would permit the continued service of a compensation committee member who ceases to be independent for reasons outside the member's reasonable control? If so, should our rule impose a maximum time limit for such continued service? Should our rule require that the issuer use reasonable efforts to replace the member who is no longer independent as promptly as practicable?

- Should our rule include specific provisions that set time limits for an opportunity to cure defects other than for instances where a compensation committee member ceases to be

independent for reasons outside the member's reasonable control? If so, what time limits would be appropriate?

- Should companies that have just completed initial public offerings be given additional time to comply with the requirements, as is permitted by Exchange Act Rule 10A-3(b)(1)(iv)(A) with respect to audit committee independence requirements?

B. Implementation of Listing Requirements

1. Exchanges Affected

Section 10C of the Exchange Act by its terms applies to all national securities exchanges and national securities associations.⁶⁷ These entities, to the extent that their listing standards do not already comply with the rules we adopt under Section 10C, will be required to issue or modify their rules, subject to Commission review, to conform their listing standards to our new rules. An exchange that lists or trades security futures products (as defined in Exchange Act Section 3(a)(56))⁶⁸ may register as a national securities exchange under Section 6(g) of the Exchange Act solely for the purpose of trading security futures products.⁶⁹ Because the Exchange Act definition of "equity security" includes security futures on equity securities,⁷⁰

⁶⁷ The OTC Bulletin Board (OTCBB) and the OTC Markets Group (previously known as the Pink Sheets and Pink OTC Markets) would not be affected by the proposed requirements, and therefore issuers whose securities are quoted on these interdealer quotation systems similarly would not be affected, unless their securities also are listed on an exchange. The OTCBB is an interdealer quotation system for the over-the-counter securities market operated by FINRA that collects and distributes market maker quotes to subscribers. It does not, however, have a listing agreement or arrangement with the issuers whose securities are quoted on the system. Although market makers may be required to review and maintain specified information about the issuer and to furnish that information to the OTCBB, the issuers whose securities are quoted on it are not required to file any information with the system. The OTC Markets Group is not a registered national securities exchange or association, nor is it operated by a registered national securities exchange or association, and thus is not covered by the terms of the proposed rule.

⁶⁸ Exchange Act Section 3(a)(56) defines the term "security futures product" to mean "a security future or any put, call, straddle, option, or privilege on any security future." 15 U.S.C. 78c(a)(56).

⁶⁹ Exchanges currently registered solely pursuant to Section 6(g) of the Exchange Act include the Board of Trade of the City of Chicago, Inc.; the CBOE Futures Exchange, LLC; the Chicago Mercantile Exchange, Inc.; One Chicago, LLC; the Island Futures Exchange, LLC; and NQLX LLC.

⁷⁰ Under Section 3(a)(11) of the Exchange Act, the term "equity security" is defined as any stock or similar security; or any security future on any such security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or

we believe it is necessary to clarify the application of proposed Rule 10C-1 to those national securities exchanges registered solely pursuant to Section 6(g).

Given that Section 10C(f) of the Act makes no distinction between exchanges registered pursuant to Section 6(a) and those registered pursuant to Section 6(g), we have not proposed a wholesale exemption from the requirements of Rule 10C-1 for those exchanges registered solely pursuant to Section 6(g). However, as discussed below, we are proposing to exempt security futures products from the scope of proposed Rule 10C-1. Accordingly, to the extent our final rule exempts the listing of security futures products from the scope of Rule 10C-1, any national securities exchange registered as such solely pursuant to Section 6(g) of the Exchange Act and that lists and trades only security futures products would not be required to file a rule change in order to comply with Rule 10C-1.

Currently, the only registered national securities association under Section 15A(a) of the Exchange Act is FINRA.⁷¹ However, FINRA does not list securities.⁷² While we recognize that Section 10C of the Act specifically requires national securities associations to prohibit the listing of any equity security of an issuer that does not comply with the requirements of Section 10C, as FINRA does not list any securities and does not have listing standards under its rules, we do not expect FINRA to have to develop listing standards regarding compensation committees in compliance with proposed Rule 10C-1.⁷³ Nevertheless, as Section 10C specifically references national securities associations, proposed Rule 10C-1 would apply to any registered national securities association that lists equity securities in the future.

Request for Comment

- Should we exempt certain exchanges or associations from Section 10C of the Exchange Act? If so, why,

right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security.

⁷¹ Regarding the National Futures Association (NFA), see note 6, above, and note 73, below.

⁷² See note 6, above.

⁷³ Similarly, we do not expect the NFA, which is registered under Section 15A(k) for the limited purpose of regulating the activities of members who are registered as broker-dealers in security futures products, see note 6, above, to develop listing standards regarding compensation committees in compliance with proposed Rule 10C-1.

⁶⁶ See Exchange Act Rule 10A-3(a)(3) [17 CFR 240.10A-3(a)(3)].

and which exchanges or associations should we exempt and why?

- Would we need to exempt an exchange from Section 10C if we also exempt the class of securities listed on such exchange?

2. Securities Affected

a. Listed Equity Securities

Section 10C of the Exchange Act specifies in one subsection that the compensation committee listing requirements are intended to apply to issuers with listed equity securities, but another subsection may suggest that it applies to issuers with any listed securities. Section 10C(a) provides that the Commission shall direct the exchanges to prohibit the listing of any “equity security” of an issuer (other than several types of exempted issuers) that does not comply with the compensation committee member independence requirements. Section 10C(f)(1), which states generally the scope of the compensation committee and compensation adviser listing requirements, provides that, “[n]ot later than 360 days after the date of enactment of this section, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of *any security* of an issuer that is not in compliance with the requirements of this section” (emphasis added).

The Senate-passed version of the bill did not distinguish between equity and non-equity securities, referencing only the prohibition against the listing of “any security” of an issuer not in compliance with the independence requirements. The House-passed version would have required the Commission to adopt rules to direct the exchanges to prohibit the listing of “any class of equity security” of an issuer that is not in compliance with the compensation committee independence standards, as well as with any of the other provisions of that section, including the provisions relating to compensation advisers. According to a press release from the House Financial Services Committee, this language was added during final House deliberations to clarify that the compensation committee independence standards would apply only to “public companies, not to companies that have only an issue of publicly-registered debt.”⁷⁴

Because the Senate-passed version of the bill (which did not specify “equity” securities) was used as the base for the conference draft, it appears that

addition of “equity” securities in Section 10C(a) of the conference draft is deliberate. Unlike the House-passed bill, however, the final bill specifically references equity securities only in connection with compensation committee independence requirements.

Based on this legislative history, we believe that the compensation committee and other requirements in Section 10C are intended to apply only to issuers with listed equity securities.⁷⁵ As noted above, the provision governing compensation committee independence is specifically limited to issuers of equity securities. Against this backdrop, in our view, it is unlikely that Congress intended the remaining compensation committee provisions (compensation adviser independence factors, authority to retain compensation advisers, and responsibility for the appointment, compensation and oversight of the work of the compensation advisers) to apply to issuers with only listed debt securities. We note that the NYSE currently exempts debt-only listed issuers from the compensation committee listing requirements that apply to issuers listing equity securities.⁷⁶ In addition, Exchange Act Rule 3a12–11 exempts listed debt securities from most of the requirements in our proxy and information statement rules.⁷⁷ Finally, most, if not all, issuers with only listed debt securities, other than foreign private issuers, are privately held.⁷⁸ Thus, subjecting

⁷⁵ Although Section 10C is, in many respects, similar to Section 10A(m), there are differences in some of the statutory language. In this regard, we note that the audit committee independence requirements included in Section 10A(m) of the Exchange Act, as set forth in Section 301 of the Sarbanes-Oxley Act, are applicable generally to “listed securities,” and no reference is made to equity securities. Therefore, although Section 10A(m) applies to issuers whether they have listed debt or equity, we do not believe this should necessarily prescribe the scope of Section 10C.

⁷⁶ See NYSE Listed Company Manual Section 303A.00.

⁷⁷ In adopting this rule, the Commission determined that debt holders would receive sufficient protection from the indenture contract, the Trust Indenture Act, the proxy rules’ antifraud proscriptions, and the Exchange Act rules that facilitate the transmission of materials to beneficial owners. See Exemptive Relief and Simplification of Filing Requirements for Debt Securities To Be Listed on a National Securities Exchange, Release No. 34–34922 (Nov. 1, 1994) [59 FR 55342].

⁷⁸ Based on information reported in the most recent annual reports on Forms 10–K, 20–F and 40–F that are available on EDGAR, and current public quotation and trade data on issuers whose debt securities are listed on an exchange, such as the *NYSE Listed and Traded Bonds* and *NYSE Amex Listed Bonds*, we estimate that there are approximately 76 issuers that list only debt securities on an exchange. Of these 76 issuers, approximately 21 are wholly-owned subsidiaries that would be exempt from proposed Exchange Act Rule 10C–1 pursuant to Section 10C(g) of the Act.

issuers of such securities to the requirements of proposed Rule 10C–1 would not serve the general intent of the Act’s executive compensation provisions of protecting “shareholders in a public company.”⁷⁹ In light of the legislative history and our and the exchanges’ historical approach to issuers with only listed debt securities, we believe the new listing standards required by Section 10C are intended to apply only to issuers with listed equity securities.

Request for Comment

- We read Section 10C as applying only to issuers with listed equity securities, and our proposed rules are consistent with that view. Should we instead mandate that the requirements of Sections 10C(b) through (e) be applied to a broader range of issuers, including issuers with only listed debt securities or issuers with other types of listed securities? Why or why not?

b. Securities Futures Products and Standardized Options

The Exchange Act’s definition of “equity security” includes any security future on any stock or similar security.⁸⁰ The Commodity Futures Modernization Act of 2000 (the “CFMA”)⁸¹ permits national securities exchanges registered under Section 6 of the Exchange Act⁸² and national securities associations registered under Section 15A(a) of the Exchange Act⁸³ to trade futures on individual securities and on narrow-based security indices (“security futures”)⁸⁴ without such securities being subject to the registration requirements of the Securities Act of 1933 (the “Securities Act”) and Exchange Act so long as they are cleared by a clearing agency that is registered under Section 17A of the Exchange Act⁸⁵ or that is exempt from registration under Section 17A(b)(7)(A) of the Exchange Act. In December 2002, we

None of these 76 issuers has a class of equity securities registered under Section 12 of the Exchange Act.

⁷⁹ 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 (Conf. Rep.) (June 29, 2010) (“In this subtitle, Congress provides shareholders in a public company with a vote on executive compensation and additional disclosures regarding compensation practices.”).

⁸⁰ Exchange Act Section 3(a)(11).

⁸¹ Public Law 106–554, 114 Stat. 2763 (2000).

⁸² 15 U.S.C. 78f.

⁸³ 15 U.S.C. 78o–3(a).

⁸⁴ Exchange Act Section 3(a)(56) [15 U.S.C. 78c(a)(56)], and Commodities Exchange Act Section 1a(32) [7 U.S.C. 1a(32)] define “security futures product” as a security future or any put, call, straddle, option, or privilege on any security future.

⁸⁵ 15 U.S.C. 78q–1.

⁷⁴ See http://www.house.gov/apps/list/press/financialsvcs_dem/press_072809.shtml.

adopted rules to provide comparable regulatory treatment for standardized options.⁸⁶

The clearing agency for security futures products and standardized options is the issuer of these securities,⁸⁷ but its role as issuer is fundamentally different from an issuer of common stock of an operating company. The purchaser of these securities does not, except in the most formal sense, make an investment decision regarding the clearing agency. As a result, information about the clearing agency's business, its officers and directors and its financial statements is less relevant to investors in these securities than information about the issuer of the underlying security. Similarly, the investment risk in these securities is determined by the market performance of the underlying security rather than the performance of the clearing agency, which is a self-regulatory organization subject to regulatory oversight. Furthermore, unlike a conventional issuer, the clearing agency does not receive the proceeds from sales of security futures products or standardized options.⁸⁸

In recognition of these fundamental differences, the Commission provided exemptions for security futures products and standardized options when it adopted the audit committee listing requirements in Exchange Act Rule 10A-3.⁸⁹ Specifically, Rule 10A-3(c) exempts the listing of a security futures

⁸⁶ See Release No. 33-8171 (Dec. 23, 2002) [68 FR 188]. In that release, we exempted standardized options issued by registered clearing agencies and traded on a registered national securities exchange or on a registered national securities association from all provisions of the Securities Act, other than the antifraud provision of Section 17, as well as the Exchange Act registration requirements. Standardized options are defined in Exchange Act Rule 9b-1(a)(4) [17 CFR 240.9b-1(a)(4)] as option contracts trading on a national securities exchange, an automated quotation system of a registered securities association, or a foreign securities exchange which relate to option classes the terms of which are limited to specific expiration dates and exercise prices, or such other securities as the Commission may, by order, designate.

⁸⁷ See Fair Administration and Governance of Self-Regulatory Organizations; Disclosure and Regulatory Reporting by Self-Regulatory Organizations; Recordkeeping Requirements for Self-Regulatory Organizations; Ownership and Voting Limitations for Members of Self-Regulatory Organizations; Ownership Reporting Requirements for Members of Self-Regulatory Organizations; Listing and Trading of Affiliated Securities by a Self-Regulatory Organization, Release No. 34-50699 (Nov. 18, 2004) [69 FR 71126], at n. 260 ("Standardized options and security futures products are issued and guaranteed by a clearing agency. Currently, all standardized options and security futures products are issued by the Options Clearing Corporation ('OCC').").

⁸⁸ However, the clearing agency may receive a clearing fee from its members.

⁸⁹ See Exchange Act Rules 10A-3(c)(4) and (5).

product cleared by a clearing agency that is registered pursuant to Section 17A of the Exchange Act or that is exempt from registration pursuant to Section 17A(b)(7)(A) and the listing of a standardized option issued by a clearing agency that is registered pursuant to Section 17A of the Exchange Act. For the same reasons that we exempted these securities from Rule 10A-3, we propose to exempt these securities from Rule 10C-1, as we believe that there would be no benefit to investors or to the public interest in subjecting the issuers of these securities to the requirements of proposed Rule 10C-1.

Request for Comment

- Is our proposed exemption for securities futures products and standardized options necessary or appropriate in the public interest and consistent with the protection of investors?
- Alternatively, would it further the goal of investor protection to adopt Rule 10C-1 without the proposed exemption for securities futures products and standardized options?

3. Exemptions

a. General Approach to Exemptions

Section 10C of the Exchange Act has four different provisions relating to exemptions from some or all of the requirements of Section 10C:

- Section 10C(a)(1) provides that our rules shall direct the exchanges to prohibit the listing of any equity security of an issuer, other than an issuer that is in one of five specified categories, that is not in compliance with the compensation committee member independence requirements of Section 10C(a)(2);
- Section 10C(a)(4) provides that our rules shall authorize the exchanges to exempt a particular relationship from the independence requirements applicable to compensation committee members, as each exchange determines is appropriate, taking into consideration the size of the issuer and other relevant factors;
- Section 10C(f)(3) provides that our rules shall authorize the exchanges to exempt any category of issuer from the requirements of Section 10C, taking into account the potential impact of the requirements on smaller reporting companies;⁹⁰ and

⁹⁰ Exchange Act Rule 12b-2 defines "smaller reporting company" as "an issuer that is not an investment company, an asset-backed issuer * * *, or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) Had a public float of less than \$75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the

- Section 10C(g) specifically exempts controlled companies, as defined in Section 10C(g), from all of the requirements of Section 10C.

We can exempt any person, security or transaction, or any class or classes of person, securities or transactions, from any of the requirements of the Exchange Act, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.⁹¹ In addition, as noted above, Section 10C(f)(3) provides that our rules shall authorize the exchanges to exempt any category of issuers from the requirements of Section 10C.⁹² As with any listing standards, listing standards implementing this provision would be subject to Commission review pursuant to Section 19(b) of the Exchange Act. In view of this statutory approach, we are preliminarily of the view that it should be up to the exchanges to propose the categories of issuers to be exempted from Section 10C's requirements, subject to our review in the rule filing process. Because issuers frequently consult the exchanges regarding independence determinations and committee responsibilities, the exchanges may be in the best position to identify the types of common relationships that are likely to compromise the ability of an issuer's

aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or (2) In the case of an initial registration statement under the Securities Act or Exchange Act for shares of its common equity, had a public float of less than \$75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus, in the case of a Securities Act registration statement, the number of such shares included in the registration statement by the estimated public offering price of the shares; or (3) In the case of an issuer whose public float as calculated under paragraph (1) or (2) of this definition was zero, had annual revenues of less than \$50 million during the most recently completed fiscal year for which audited financial statements are available." Whether or not an issuer is a smaller reporting company is determined on an annual basis.

⁹¹ See Exchange Act Section 36.

⁹² We are proposing to implement Section 10C(c)(2)'s compensation consultant disclosure requirements by amending Item 407(e)(3) of Regulation S-K. See Section II.C., below, for a discussion of these proposed amendments. Because Item 407 of Regulation S-K is not part of Section 10C, Section 10C(f)(3) would not permit exchanges to exempt any category of issuers from our proposed revisions to Item 407, if adopted. We request comment below on whether smaller reporting companies should be exempt from our proposed disclosure requirements in the event the exchanges exempt such companies from the listing standards required by Section 10C.

compensation committee to make impartial determinations on executive compensation and the types of issuers that should be exempted from the other compensation committee listing requirements. Accordingly, relying on the exchanges to exercise their exemptive authority under our rules may result in more efficient and effective determinations as to the types of relationships and the types of issuers that merit an exemption, whether in whole or in part, from the requirements of Section 10C.

We note that Section 10C of the Exchange Act makes no distinction between domestic and foreign issuers, other than to exempt from the independence requirements foreign private issuers that disclose in their annual reports the reasons why they do not have independent compensation committees. Many listed foreign private issuers maintain compensation committees, and other than the committee member independence requirements in proposed Rule 10C-1(b)(1), the proposed rule and rule amendments, therefore, would apply to foreign private issuers as well as domestic issuers.

Because the exchanges will be permitted to propose exemptions to the listing standards required by Section 10C and our rules, we do not propose to exempt any category of issuer or any relationship from rules implementing Section 10C, other than the five categories of issuers not subject to the compensation committee independence requirements, as directed by Section 10C(a)(1), securities futures products and standardized options, as discussed above in Section II.B.2.b, and the equity securities of controlled companies, as directed by Section 10C(g).

Instead of providing exemptions in our rules, consistent with Section 10C(f)(3), proposed Rule 10C-1(b)(5)(i) permits the exchanges to exempt a category of issuers from the requirements of Section 10C, as each exchange determines is appropriate. In determining appropriate exemptions, the exchanges are required by the statute to take into account the potential impact of the requirements of Section 10C on smaller reporting issuers.⁹³

⁹³ See Exchange Act Section 10C(f)(3)(B). Section 10C of the Exchange Act includes no express exemptions for smaller reporting companies. We note that neither NYSE nor Nasdaq currently exempts smaller reporting companies from their corporate governance requirements. Other than limited exemptions from requirements to have a majority independent board or three-member audit committee—for example, NYSE Amex and the Chicago Stock Exchange permit smaller issuers to have a 50% independent board and a minimum of two members on the issuer's audit committee—we

Request for Comment

- Should the Commission exempt any types of issuers, such as registered management investment companies, foreign private issuers or smaller reporting companies, from some or all of the requirements of Section 10C? If so, why? Instead, should the Commission, as proposed, defer to the exchanges for exemptions from Section 10C's requirements, rather than propose and adopt exemptions in our rules?

- Should the Commission issue additional guidance to the exchanges as to the factors that should weigh in favor of granting exemptions? What concerns, if any, should the Commission be aware of in reviewing exemptions proposed by the exchanges?

- Rather than exempt any category of issuers, should the Commission require the exchanges to give additional time to certain types of issuers to comply with the requirements of Section 10C, such as companies that have just completed initial public offerings? Or, should we defer to the exchanges to provide temporary exemptions, as proposed?

b. Issuers Not Subject to Independence Requirements

As noted above, Exchange Act Section 10C(a)(1) provides that our rules shall direct the exchanges to prohibit the listing of any equity security of an issuer, other than an issuer that is in one of five specified categories, that is not in compliance with the compensation committee member independence requirements of Section 10C(a)(2). These five categories include controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act⁹⁴ and foreign private issuers that provide annual disclosures to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee. Accordingly, proposed Rule 10C-1(b)(1)(iii) provides that these five categories of issuers are not subject to an exchange's compensation committee independence

are unaware of any corporate governance listing standards or related exemptions that are tailored to smaller reporting companies. See NYSE Amex Company Guide Section 801(h); Chicago Stock Exchange Article 22, Rules 19(a), 19(b)(1)(C)(iii), and 21(a). Section 10C(f)(3) requires the exchanges to take into account the potential impact of the listing requirements on smaller reporting issuers when exercising the exemptive authority permitted by our rules. Any such exemptions, rule changes and any other new listing requirements would be subject to Commission approval through the rule submission process under Section 19(b) of the Exchange Act.

⁹⁴ 15 U.S.C. 80a-1 *et seq.*

requirements and, therefore, an issuer that is in one of these categories cannot be delisted for not complying with such requirements.

Controlled Companies

Section 10C(g)(2) of the Exchange Act defines "controlled company" as an issuer that is listed on an exchange and holds an election for the board of directors of the issuer in which more than 50 percent of the voting power is held by an individual, a group or another issuer. Proposed Rule 10C-1(c)(2) would incorporate this definition of "controlled company."

Limited Partnerships

Section 10C does not define the term "limited partnerships." In general, a limited partnership is a form of business ownership and association consisting of one or more general partners who are fully liable for the debts and obligations of the partnership and one or more limited partners whose liability is limited to the amount invested.⁹⁵ We do not propose to define this term in proposed Rule 10C-1(c), although we solicit comment on whether we should do so.

Companies in Bankruptcy Proceedings

Section 10C does not define the scope of "companies in bankruptcy proceedings." This term is used in Commission rules without definition.⁹⁶ We do not propose to define the scope of "companies in bankruptcy proceedings," although we solicit comment on whether we should do so.

Open-End Management Investment Companies

Section 10C does not define the term "open-end management investment company." Under the Investment Company Act, an open-end management investment company is an investment company, other than a unit investment trust or face-amount certificate company, that offers for sale or has outstanding any redeemable security of which it is the issuer.⁹⁷ We propose to

⁹⁵ See Unif. Ltd. P'ship Act §§ 102, 303 and 404 (2001).

⁹⁶ See, e.g., Section 55(a)(3)(A) of the Investment Company Act [15 U.S.C. 80a-54(a)(3)(A)]; Item 1107(k) of Regulation AB [17 CFR 229.1107(k)]; and Rule 457 under the Securities Act [17 CFR 230.457].

⁹⁷ See Sections 4 and 5(a)(1) of the Investment Company Act [15 U.S.C. 80a-4 and 80a-5(a)(1)]. Open-end and closed-end management investment companies registered under the Investment Company Act are generally exempt from current exchange listing standards that require listed issuers to either have a compensation committee or to have independent directors determine, recommend, or oversee specified executive compensation matters. See, e.g., NYSE Listed

define this term by referencing Section 5(a)(1) of the Investment Company Act.

Foreign Private Issuers

Under Section 10C(a), a foreign private issuer that provides annual disclosure to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee would be exempt from the compensation committee independence requirements. Exchange Act Rule 3b-4 defines "foreign private issuer" as "any foreign issuer other than a foreign government, except for an issuer that has more than 50% of its outstanding voting securities held of record by U.S. residents and any of the following: a majority of its officers and directors are citizens or residents of the United States, more than 50% of its assets are located in the United States, or its business is principally administered in the United States."⁹⁸ Since this definition applies to all Exchange Act rules, we do not believe it is necessary to provide a cross-reference to Rule 3b-4 in our proposed rules.

We note that certain foreign private issuers have a two-tier board, with one tier designated as the management board and the other tier designated as the supervisory or non-management board. In this circumstance, we believe that the supervisory or non-management board would be the body within the company best equipped to comply with the proposed requirements. Consistent with our approach to Rule 10A-3, we propose to clarify that in the case of foreign private issuers with two-tier boards of directors, the term "board of directors" means the supervisory or non-management board. As such, to the extent the supervisory or non-management board forms a separate compensation committee, proposed Rule 10C-1 would apply to that committee, with the exception of the committee member independence requirements, assuming the foreign private issuer discloses why it does not have an independent compensation committee in its annual report.

Request for Comment

- Should we provide a definition of "limited partnership" in our proposed rules? If so, what should it be?
- Should we define the scope of "companies in bankruptcy proceedings"? If so, what should that scope be?
- Do we need to clarify, as proposed, that in the case of foreign private issuers

with two-tier boards of directors, the term "board of directors" means the supervisory or non-management board?

c. Relationships Exempt From Independence Requirements

As noted above, Section 10C(a)(4) of the Exchange Act provides that the Commission's rules shall permit an exchange to exempt a particular relationship from the compensation committee independence requirements, as such exchange deems appropriate, taking into consideration the size of the issuer and any other relevant factors.⁹⁹ To implement this provision, proposed Rule 10C-1(b)(1)(iii)(B) would authorize the exchanges to establish listing standards under the Section 19(b) process that exempt particular relationships between members of the compensation committee and listed issuers that might otherwise impair the member's independence, taking into consideration the size of an issuer and any other relevant factors.

We do not propose to exempt any particular relationships from the independence requirements at this time. As with the authority to exempt particular categories of issuers, we are preliminarily of the view that it should be up to the exchanges to identify and propose the types of particular relationships that should be exempted from the independence requirements.

Request for Comment

- Should the Commission, as proposed, defer to the exchanges to identify and propose the types of particular relationships to be exempted from the independence requirements? If not, why not?
- Should we give guidance to the exchanges on how they should analyze relationships to determine whether an exemption is warranted or not?
- Some of the exchanges, in their existing compensation committee listing standards, permit a listed issuer with a compensation committee comprised of at least three members to include one director who is not independent and is not a current officer or employee, or immediate family member of a current officer or employee, on the compensation committee for no more than two years if the issuer's board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required in the best interests of the company and its shareholders.¹⁰⁰ Should our proposed

rule expressly permit the exchanges to continue this practice by exempting certain relationships from the independence requirements, based on the conditions outlined above? Should our proposed rule expressly prohibit the exchanges from continuing this practice?

- What issues should an exchange consider in proposing an exemption?
- Exchange Act Rule 10A-3 requires listed issuers that avail themselves of an exemption from the audit committee independence requirements to disclose such reliance on an exemption in the listed issuer's proxy statement and Form 10-K or, in the case of a registered management investment company, Form N-CSR. Should we similarly require any issuer availing itself of any of the exemptions set forth directly in Section 10C(a)(1) of the Exchange Act or any exemption granted by the relevant exchange to disclose that fact in its proxy statement and Form 10-K or, in the case of a registered management investment company, Form N-CSR or another form? Under current rules, an issuer is required to identify any compensation committee members who are not independent. In light of this requirement, is a specific requirement to note reliance on an exemption unnecessary?

- If a listed issuer's board of directors determines, in accordance with applicable listing standards, to appoint a director to the compensation committee who is not independent, including as a result of exceptional or limited or similar circumstances, should we require the issuer to disclose the nature of the relationship that makes that individual not independent and the reasons for the board of directors' determination, as we do with respect to audit committee members in Item 407(d)(2) of Regulation S-K?

C. Compensation Consultant Disclosure and Conflicts of Interest

Section 10C(c)(2) of the Exchange Act requires that, in any proxy or consent solicitation material for an annual meeting (or a special meeting in lieu of the annual meeting), each issuer must disclose, in accordance with regulations of the Commission, whether:

- The compensation committee has retained or obtained the advice of a compensation consultant; and
- The work of the compensation consultant has raised any conflict of interest and, if so, the nature of the

Company Manual Section 303A.00; Nasdaq Rule 5615(a)(5); NYSE Arca Rule 5.3; NYSE AMEX LLC Company Guide Section 801.

⁹⁸ 17 CFR 240.3b-4(c).

⁹⁹ See Exchange Act Section 10C(a)(4).

¹⁰⁰ See NYSE Amex LLC Company Guide, Section 805(b); NYSE Arca Rule 5.3(k)(4); Nasdaq Rule

5605(d)(3); NASDAQ OMX BX Rule 4350(c)(3)(C); Chicago Board Options Exchange Rule 31.10(c)(3); and Chicago Stock Exchange Article 22, Rule 19(d)(3).

conflict and how the conflict is being addressed.

Item 407 of Regulation S–K currently requires Exchange Act registrants that are subject to the proxy rules to provide certain disclosures concerning their compensation committees and the use of compensation consultants.¹⁰¹ Item 407(e)(3)(iii) generally requires registrants to disclose “any role of compensation consultants in determining or recommending the amount or form of executive and director compensation,” including:

- Identifying the consultants;
- Stating whether such consultants were engaged directly by the compensation committee or any other person;
- Describing the nature and scope of the consultants’ assignment, and the material elements of any instructions given to the consultants under the engagement; and
- Disclosing the aggregate fees paid to a consultant for advice or recommendations on the amount or form of executive and director compensation and the aggregate fees for additional services if the consultant provided both and the fees for the additional services exceeded \$120,000 during the fiscal year.¹⁰²

The current item excludes from the disclosure requirement any role of compensation consultants limited to consulting on any broad-based plan that does not discriminate in scope, terms or operation in favor of executive officers or directors of the registrant and that is available generally to all salaried employees, or limited to providing information that either is not customized for a particular registrant or is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice.¹⁰³

¹⁰¹ Registered investment companies are subject to separate proxy disclosure requirements set forth in Item 22 of Schedule 14A, which do not include the compensation committee disclosure described in Item 407(e) of Regulation S–K. See Item 7(g) of Schedule 14A. Consistent with our current regulations, registered investment companies would continue to provide disclosure under Item 22 and would not be subject to the amendments to Item 407(e) proposed in this release.

¹⁰² See current Items 407(e)(3)(iii)(A) and (B) [17 CFR 229.407(e)(3)(iii)(A) and 229.407(e)(3)(iii)(B)]. Fee disclosure, however, is not required for compensation consultants that work with management if the compensation committee has retained a separate consultant. In promulgating these requirements, we recognized that in this situation the compensation committee may not be relying on the compensation consultant used by management, and, therefore, potential conflicts of interest are less of a concern.

¹⁰³ See Proxy Disclosure Enhancements, Release No. 33–9089 (Dec. 16, 2009) [74 FR 68334]. The

Given the similarities between the disclosure required by Section 10C(c)(2) and the disclosure required by Item 407 of Regulation S–K for registrants subject to our proxy rules, we propose to integrate Section 10C(c)(2)’s disclosure requirements with the existing disclosure rule, rather than simply “tacking on” the new requirements to the existing ones. Section 10C(c)(2) specifies that these disclosures are to be required “in any proxy or consent solicitation material for an annual meeting of the shareholders (or a special meeting in lieu of the annual meeting).” By contrast, our proxy rules currently require issuers to provide disclosure relating to the retention of a compensation consultant and fees paid to consultants only in proxy or information statements for annual meetings at which directors are to be elected, and not for all annual meetings. However, Section 10C(c)(2) also provides that the compensation consultant disclosures be made “in accordance with regulations of the Commission.” Because we view this disclosure as being most relevant in the context of a meeting at which directors will be elected, consistent with our current rules, we propose to require Section 10C(c)(2)’s compensation consultant and conflict of interest disclosure only for proxy and information statements for annual meetings (or a special meeting in lieu of an annual meeting) at which directors are to be elected.

Section 10C(f) of the Exchange Act requires us to adopt rules directing the exchanges to prohibit the listing of any security of an issuer that is not in compliance with the requirements of Section 10C, which include Section 10C(c)(2)’s disclosure requirements. Consequently, we are required to extend these disclosure requirements to listed issuers other than controlled companies,¹⁰⁴ but we are not required to extend them to all Exchange Act registrants subject to our proxy rules. However, given the similar nature of the disclosure required by current Item 407(e) and Section 10C(c)(2) and the apparent common purpose of these disclosure requirements, and to avoid any potential confusion that could arise from having different disclosure

Commission determined (based on comments it received on the rule proposal) that the provision of such work by a compensation consultant does not raise conflict of interest concerns that warrant disclosure of the consultant’s selection, terms of engagement or fees.

¹⁰⁴ Section 10C(g) specifically exempts controlled companies, as defined in Section 10C(g), from all of the requirements of Section 10C. Controlled companies are subject to our existing Item 407(e)(3) disclosure requirements.

requirements on the same topic for listed issuers on one hand and for unlisted issuers and controlled companies on the other, we propose to combine the current Item 407(e) and Section 10C(c)(2) into one disclosure requirement that would apply to Exchange Act registrants subject to our proxy rules, whether listed or not, whether they are controlled companies or not.

We note that the trigger for disclosure about compensation consultants under Section 10C(c)(2) of the Exchange Act is worded differently from the trigger for disclosure under the amendments to Item 407 that we adopted in 2009.¹⁰⁵ Specifically, Section 10C(c)(2) states that the issuer must disclose whether the “compensation committee retained or obtained the advice of a compensation consultant.” By contrast, as noted above, our current rule refers to whether compensation consultants played “any role” in the registrant’s process for determining or recommending the amount or form of executive or director compensation. Once disclosure is required, the specifics of what must be disclosed are also different. With regard to conflicts of interest, our current rule requires detailed disclosure about fees in certain circumstances in which there may be a conflict of interest, whereas Section 10C(c)(2) is more open-ended and requires disclosure of any conflict of interest, the nature of the conflict and how the conflict is being addressed, which our existing rules do not require.

As proposed, revised Item 407(e)(3)(iii) would have a disclosure trigger that is consistent with the statutory language and would, therefore, require the registrant to disclose whether the compensation committee has “retained or obtained” the advice of a compensation consultant during the registrant’s last completed fiscal year. We anticipate that the practical effect of the proposed change would be minimal, as we believe it would be unusual for a consultant to play a role in determining or recommending the amount of executive compensation without the compensation committee also retaining or obtaining the consultant’s advice. And, we believe having a consistent trigger for disclosure would benefit issuers and investors by reducing potential confusion about the disclosure requirements.

Consistent with Section 10C(c)(2), disclosure of whether the compensation committee obtained or retained the advice of a compensation consultant during the registrant’s last completed

¹⁰⁵ *Id.*

fiscal year and whether the consultant's work raised any conflict of interest and, if so, the nature of the conflict and how it is being addressed, would be required without regard to the existing exceptions in Item 407(e)(3). For example, disclosure about the compensation consultant would be required even if the consultant provides only advice on broad-based plans or provides only non-customized benchmark data. In this regard, we would be broadening the scope of disclosure currently required by Item 407(e)(3)(iii). We believe this is consistent with the purposes of Section 10C(c)(2), which is to require disclosure about compensation consultants and any conflicts of interest they have in a competitively neutral fashion. We solicit comment, however, on whether any of the current exclusions should extend to this new disclosure requirement or, conversely, whether we should eliminate the exclusions with respect to the existing disclosure requirements. We also solicit comment on whether it would be preferable to retain the existing requirements without modification and add the new requirements without integrating them into the existing ones.

The other existing disclosure requirements of Item 407(e)(3) would remain the same, aside from amending the fee disclosure requirements to link the disclosure of fees to the compensation committee "retaining or obtaining the advice of a compensation consultant" and to management "retaining or obtaining the advice of a compensation consultant."¹⁰⁶ The disclosure of the aggregate fees paid to a compensation consultant is intended to enable security holders to assess the potential for conflicts of interest resulting from the compensation consultant's financial incentive to provide services to the issuer in addition to executive compensation consulting services. We believe that this disclosure benefits investors and complements the required Section 10C(c)(2) disclosures, and therefore propose to retain this existing disclosure requirement, modified as noted above.

To provide guidance to issuers as to whether the compensation committee or management has "obtained the advice" of a compensation consultant,¹⁰⁷ we are proposing an instruction to clarify this statutory language. This instruction would provide that the phrase "obtained

the advice" relates to whether a compensation committee or management has requested or received advice from a compensation consultant, regardless of whether there is a formal engagement of the consultant or a client relationship between the compensation consultant and the compensation committee or management or any payment of fees to the consultant for its advice.

Currently, Item 407(e)(3) focuses on the conflicts of interest that may arise from a compensation consultant also providing other non-executive compensation consulting services to an issuer, which may lead the consultant to provide executive compensation advice favored by management in order to obtain or retain such other assignments. Section 10C(c)(2) is more open-ended about conflicts of interest in that it requires issuers to disclose whether the work of a compensation consultant raised "any conflict of interest" and, if so, the nature of the conflict and how the conflict is being addressed. The term "conflict of interest" is not defined in Section 10C(c)(2), and our proposed rule would not supply a definition.

As discussed above, Sections 10C(f) and 10C(b) of the Exchange Act require the Commission to adopt rules directing the exchanges to prohibit the listing of the securities of an issuer whose compensation committee does not consider the independence factors identified by the Commission when retaining compensation advisers. Section 10C(b)(2) identifies specific factors that must be included in these listing standards, and, as described above, we are proposing to include them in proposed Rule 10C-1(b)(4)(i) through (v).¹⁰⁸

In light of the link between the requirement that the compensation committees of listed issuers consider independence factors before retaining compensation advisers and the disclosure requirements about compensation consultants and their conflicts of interest, we believe it would be appropriate to provide some guidance to issuers as to the factors that should be considered in determining whether there is a conflict of interest that would trigger disclosure under the proposed amendments. Therefore, we propose to include an instruction that identifies the factors set forth in proposed Rule 10C-1(b)(4)(i) through (v) as among the factors that issuers should consider in determining whether there is a conflict of interest that may need to be disclosed in response to our

proposed amendments to Item 407(e)(3)(iii). Although only listed issuers will be required to consider the five independence factors before selecting a compensation consultant, we believe that these five factors will be helpful to all Exchange Act registrants subject to the proxy rules in assessing potential conflicts of interest.

We have not concluded that the presence or absence of any of these individual factors indicates that a compensation consultant has a conflict of interest that would require disclosure under the proposed amendments, nor have we concluded that there are no other circumstances or factors that might present a conflict of interest for a compensation consultant retained by a compensation committee. Moreover, if, under our rules, disclosure of fees paid to a compensation consultant is required, this does not reflect a conclusion that a conflict of interest is present.¹⁰⁹ In addition to considering the factors enumerated above and any other factors that the exchanges may highlight in applicable listing standards, the issuer would need to consider the specific facts and circumstances relating to a consultant's engagement to determine whether there may be a conflict of interest that would be required to be disclosed under our new rules.

If a compensation committee determines that there is a conflict of interest with the compensation consultant based on the relevant facts and circumstances, the issuer would be required to provide a clear, concise and understandable description of the specific conflict and how the issuer has addressed it. A general description of an issuer's policies and procedures to address conflicts of interest or the appearance of conflicts of interest would not suffice.

Request for Comment

- We request comment on our proposed implementation of the requirements of Section 10C(c)(2). Is it appropriate to limit Section 10C(c)(2)'s disclosure requirement to proxy and information statements for meetings at

¹⁰⁹ See Proxy Disclosure Enhancements, Release No. 33-9089 (Dec. 16, 2009) [74 FR 68334] ("Our amendments as adopted are intended to facilitate investors' consideration of whether, in providing advice, a compensation consultant may have been influenced by a desire to retain other engagements from the company. This does not reflect a conclusion that we believe that a conflict of interest is present when disclosure is required under our new rule, or that a compensation committee or a company could not reasonably conclude that it is appropriate to engage a consultant that provides other services to the company requiring disclosure under our new rule.")

¹⁰⁶ See proposed Items 407(e)(3)(iii)(A) and (B). The fee disclosure requirements would continue to include the existing exclusions for consulting on any non-discriminatory, broad-based plan or providing non-customized information.

¹⁰⁷ See letter from Compensia.

¹⁰⁸ See Section II.A.4, above, for a description of proposed Rule 10C-1(b)(4)(i) through (v).

which directors are to be elected? If not, why not? Is it appropriate to extend Section 10C(c)(2)'s disclosure requirement to controlled companies and those Exchange Act registrants that are not listed issuers, as proposed? If not, why not?

- Should we amend Forms 20-F and 40-F to require foreign private issuers that are not subject to our proxy rules to provide annual disclosure of the type required by Section 10C(c)(2)? Why or why not?

- Is it preferable to integrate the Section 10C(c)(2) disclosure requirements with the existing requirements of Item 407(e)(3), as proposed, or, instead, should we add the new requirements without modifying the existing requirements of the item?

- Should we extend any of the current exclusions under Item 407(e)(3) to the new Section 10C(c)(2) disclosures? Conversely, should we eliminate altogether the exclusions under Item 407(e)(3)?

- Are there any additional disclosures concerning conflicts of interest involving the activities of compensation consultants that would be beneficial to investors?

- Is additional clarification necessary regarding the phrase "obtained the advice"? Does our proposed instruction provide adequate guidance to issuers on how to interpret that phrase?

- Do the five factors in proposed Rule 10C-1(b)(4)(i) through (v) help issuers determine whether there is a "conflict of interest"? Should we define the term "conflict of interest"? If so, how? Are there other factors that should be considered in determining whether there is a conflict of interest? If so, should these factors also be identified in the proposed instruction?

- Because a compensation committee may be reluctant or unable to definitively conclude whether a conflict of interest exists, should we also include the appearance of a conflict of interest in our interpretation of what constitutes a "conflict of interest" that must be disclosed under our proposed rules? Why or why not? Should we include potential conflicts of interest in our interpretation? Why or why not? We note that our 2009 amendments to Item 407(e) did not conclude that there was a conflict of interest posed by a consultant providing additional services to the issuer, only that there was a potential conflict of interest.

- Should we should require fee disclosure for other types of potential conflicts of interest, such as revenue concentration, in light of Section 10C(c)(2)'s requirement that the factors

considered by the compensation committee before engaging compensation advisers be "competitively neutral"? For example, to address revenue concentration, we could require disclosure of an adviser's fees received from the issuer (in percentage terms) if such fees comprise more than 10% of the adviser's annual revenues. Would this be appropriate?

- Although a listed issuer's compensation committee is required to consider independence factors before selecting any compensation adviser, Section 10C(c)(2) requires conflict of interest disclosure only as to compensation *consultants*. Should we also extend this disclosure requirement to other types of advisers to the compensation committee, such as legal counsel? Why or why not?

- As proposed, and consistent with current rules, Item 407(e)(3) would apply to smaller reporting companies. Should we exempt such companies from these disclosure requirements? Do many smaller reporting companies' compensation committees retain or obtain the advice of compensation consultants? Should an exemption be provided if the exchanges exempt such companies from the listing standards required by Section 10C?

D. Transition and Timing

The Act requires us to issue rules directing the exchanges to prohibit the listing of issuers not in compliance with Section 10C "not later than 360 days after" the enactment of Section 10C, or by July 16, 2011.¹¹⁰ The Act did not establish a specific deadline by which the listing standards promulgated by the exchanges must be in effect. To facilitate timely implementation of the proposals, we propose that each exchange must provide to the Commission, no later than 90 days after publication of our final rule in the **Federal Register**, proposed rules or rule amendments that comply with our final rule. Further, each exchange would need to have final rule or rule amendments that comply with our final rule approved by the Commission no later than one year after publication of our final rule in the **Federal Register**. We request comment below on the appropriateness of these periods.

Section 10C(c)(2) requires that each issuer disclose in any proxy or consent solicitation material for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting)

¹¹⁰ See Section 10C(f)(1) of the Exchange Act [15 U.S.C. 78j-3(f)(1)]. The Act was enacted on July 21, 2010. The 360th day following enactment would be July 16, 2011.

whether the issuer's compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed. Although the statute specifies that this disclosure would be required with respect to meetings occurring on or after the date that is one year after the enactment of Section 10C, which would be July 21, 2011, the statute also requires these disclosures to be "in accordance with regulations of the Commission," and our regulations do not currently require such disclosures to be made. Consequently, Section 10C(c)(2)'s compensation consultant and conflict of interest disclosures would not be required for proxy or information statements filed in definitive form before the effective date of our rules implementing Section 10C(c)(2).

Request for Comment

- Do the proposed implementation dates provide sufficient time for exchanges to propose and obtain Commission approval for new or amended rules to meet the requirements of our proposed rules? If not, what other dates would be appropriate, and why?

- What factors should the Commission consider in determining these dates?

- Should our rules also specify the dates by which listed issuers must comply with an exchange's new or amended rules meeting the requirements of our proposed rules? If so, what dates would be appropriate? Should there be uniformity among the exchanges with respect to the dates by which their listed issuers must comply with the exchanges' new or amended rules?

- Would a period beyond the proposed date be necessary or appropriate for compliance by smaller reporting companies? Are there special considerations that we should take into account for foreign private issuers?

General Request for Comment

We request and encourage any interested person to submit comments on any aspect of our proposals, other matters that might have an impact on the amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

III. Paperwork Reduction Act

A. Background

Certain provisions of the proposed rule and rule amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (PRA).¹¹¹ We are submitting the proposed rule and rule amendments to the Office of Management and Budget (OMB) for review in accordance with the PRA.¹¹² The titles for the collection of information are:

- (1) "Regulation 14A and Schedule 14A" (OMB Control No. 3235-0059);
- (2) "Regulation 14C and Schedule 14C" (OMB Control No. 3235-0057); and
- (3) "Regulation S-K" (OMB Control No. 3235-0071).¹¹³

Regulation S-K was adopted under the Securities Act and Exchange Act; Regulations 14A and 14C and the related schedules were adopted under the Exchange Act. The regulations and schedules set forth the disclosure requirements for proxy and information statements filed by companies to help investors make informed investment and voting decisions. The hours and costs associated with preparing, filing and sending the schedules constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. Compliance with the proposed rule and rule amendments would be mandatory. Responses to the information collections would not be kept confidential and there would be no mandatory retention period for the information disclosed.

B. Summary of Proposed Rule and Rule Amendments

As discussed in more detail above, we are proposing new Rule 10C-1 under the Exchange Act and amendments to Item 407(e) of Regulation S-K. Proposed Rule 10C-1 would implement the requirements of Section 10C of the Exchange Act, as added by Section 952

of the Act. Specifically, proposed Rule 10C-1 would direct the exchanges to prohibit the listing of any equity security of an issuer, with certain exemptions, that is not in compliance with Section 10C's compensation committee and compensation adviser requirements. We are proposing to adopt several limited exemptions from the requirements of proposed Rule 10C-1 and to authorize the exchanges to include other exemptions in their listing standards, pursuant to the rule filing process under Section 19(b) of the Exchange Act, as each exchange determines is appropriate, taking into consideration the size of the issuer and any other relevant factors.

To implement Section 10C(c)(2), we are proposing to amend Item 407(e)(3) of Regulation S-K to require disclosure, in any proxy or information statement relating to an annual meeting of shareholders (or a special meeting in lieu of an annual meeting) at which directors are to be elected, of whether the issuer's compensation committee (or another board committee performing similar functions) retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed.¹¹⁴ We also propose to combine and streamline these disclosure requirements with the existing disclosure requirements of Item 407(e)(3).

C. Burden and Cost Estimates Related to the Proposed Amendments

The proposed amendments to Item 407(e)(3) of Regulation S-K would require, if adopted, additional disclosure in proxy or information statements filed on Schedule 14A or Schedule 14C relating to an annual meeting of shareholders (or a special meeting in lieu of an annual meeting) at which directors are to be elected and would increase the burden hour and cost estimates for each of those forms. For purposes of the PRA, we estimate the total annual increase in the paperwork burden for all affected issuers to comply with our proposed

collection of information requirements to be approximately 23,940 hours of in-house personnel time and approximately \$3,192,000 for the services of outside professionals.¹¹⁵ These estimates include the time and the cost of collecting the information, preparing and reviewing disclosure, filing documents, and retaining records. In deriving our estimates, we assumed that the burden hours of the proposed disclosure requirements would be comparable to the burden hours related to similar disclosure requirements under our current rules regarding compensation consultants.¹¹⁶ Based on our assumptions, we estimated that the proposed amendments to Item 407(e)(3)(iii) of Regulation S-K would impose on average four incremental burden hours.¹¹⁷

The table below shows the total annual compliance burden, in hours and in costs, of the collection of information pursuant to the proposed amendments to proxy and information statements and to Regulation S-K.¹¹⁸ The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take an issuer to prepare and review the proposed disclosure requirements. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours. For purposes of the PRA, we estimate that 75% of the burden of preparation of Schedules 14A and 14C is carried by the issuer internally and that 25% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of \$400 per hour. There is no change to the estimated burden of the collections of information under Regulation S-K because the burdens that this regulation imposes are reflected in our burden estimates for Schedules 14A and 14C.

¹¹⁵ Our estimates represent the average burden for all issuers, both large and small.

¹¹⁶ See Proxy Disclosure Enhancements, Release No. 33-9089 (Dec. 16, 2009) [74 FR 68334] (in which the Commission estimated the average incremental disclosure burden for the rule amendments to Item 407(e)(3) relating to compensation consultants to be three hours).

¹¹⁷ These four incremental burden hours would be in addition to the three incremental burden hours relating to our current compensation consultant disclosure rules. *Id.*

¹¹⁸ For convenience, the estimated hour and cost burdens in the table have been rounded to the nearest whole number.

¹¹¹ 44 U.S.C. 3501 *et seq.*

¹¹² 44 U.S.C. 3507(d) and 5 CFR 1320.11.

¹¹³ The paperwork burden from Regulation S-K is imposed through the forms that are subject to the disclosure requirements in Regulation S-K and is reflected in the analysis of these forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience we estimate the burden imposed by Regulation S-K to be a total of one hour.

¹¹⁴ Section 10C(c)(2) requires listed issuers to provide this disclosure; we propose to extend this disclosure requirement to non-listed issuers as well. We have not, however, proposed to require comparable disclosure from foreign private issuers, as foreign private issuers are not subject to Exchange Act Sections 14(a) and 14(c). See Exchange Act Rule 3a12-3.

TABLE 1—INCREMENTAL PAPERWORK BURDEN UNDER THE PROPOSED AMENDMENTS FOR SCHEDULES 14A AND 14C.

	Number of responses (A) ¹¹⁹	Incremental burden hours/form (B)	Total incremental burden hours (C)=(A)*(B)	Internal company time (D)	External professional time (E)	Professional costs (F)=(E)*\$400
Sch. 14A	7,300	4	29,200	21,900	7,300	\$2,920,000
Sch. 14C	680	4	2,720	2,040	680	\$272,000
Total	7,980	31,920	23,940	7,980	\$3,192,000

D. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;

- Evaluate the accuracy of our assumptions and estimates of the burden of the proposed collections of information;

- Determine whether there are ways to enhance the quality, utility and clarity of the information to be collected;

- Evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and

- Evaluate whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct their comments to the Office of Management and Budget, Attention: Desk Officer for the U.S. Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090, with reference to File No. S7–13–11. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–13–11 and be submitted to the U.S. Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington DC 20549–0213. Because the OMB is

required to make a decision concerning the collections of information between 30 and 60 days after publication of this release, your comments are best assured of having their full effect if the OMB receives them within 30 days of publication.

IV. Cost-Benefit Analysis

A. Introduction and Objectives of Proposals

We are proposing rulemaking to implement and supplement the provisions of the Act relating to compensation committees and compensation advisers. Section 952 of the Act amends the Exchange Act by adding new Section 10C. Section 10C(a)(1) requires the Commission to adopt rules directing the exchanges to prohibit the listing of any equity security of an issuer, with certain exemptions, that is not in compliance with the independence requirements for members of the compensation committee. In accordance with the statute, the rules, once adopted, would require the exchanges to establish listing standards that require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent." The term "independent" is not defined in Section 10C(a)(1). Instead, the section provides that "independent" is to be defined by the exchanges after taking into consideration relevant factors, including, but not limited to, the source of compensation of a 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.

In addition to the independence requirements set forth in Section 10C(a), Section 10C(f) requires the Commission to adopt rules directing the exchanges to prohibit the listing of any security of an issuer that is not in compliance with the following requirements relating to compensation committees and compensation advisers, as set forth in paragraphs (b) through (e) of Section 10C:

- Each compensation committee must have the authority, in its sole discretion, to retain or obtain the advice of compensation consultants, independent legal counsel and other advisers (collectively, "compensation advisers");¹²⁰

- Before selecting any compensation adviser, the compensation committee must take into consideration specific factors identified by the Commission that affect the independence of compensation advisers;¹²¹

- The compensation committee must be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser;¹²² and

- Each listed issuer must provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers.¹²³

Finally, Section 10C(c)(2) requires each listed issuer to disclose in any proxy or consent solicitation material for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting), in accordance with Commission regulations, whether the issuer's compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed.

Under Section 10C, our rules must permit the exchanges to exempt particular categories of issuers from the requirements of Section 10C and particular relationships from the compensation committee independence requirements of Section 10C(a). Our rules must also provide for appropriate procedures for an issuer to have a reasonable opportunity to cure any defects that might otherwise result in the delisting of the issuer's securities.

¹²⁰ Exchange Act Sections 10C(c)(1)(A) and 10C(d)(1) [15 U.S.C. 78j–3(c)(1)(A) and (d)(1)].

¹²¹ Exchange Act Section 10C(b) [15 U.S.C. 78j–3(b)].

¹²² Exchange Act Sections 10C(c)(1)(B) and 10C(d)(2) [15 U.S.C. 78j–3(c)(1)(B) and (d)(2)].

¹²³ Exchange Act Section 10C(e) [15 U.S.C. 78j–3(e)].

¹¹⁹ The number of responses reflected in the table equals the actual number of schedules filed with the Commission during the 2010 fiscal year.

We are proposing new Exchange Act Rule 10C-1 to implement the compensation committee listing requirements of Sections 10C(a)-(g) of the Exchange Act. Proposed Rule 10C-1 closely tracks the statutory requirements of Section 10C. To implement Section 10C(c)(2) of the Exchange Act, we are proposing rule amendments to Regulation S-K to require disclosure, in any proxy or information statement relating to an annual meeting of shareholders at which directors are to be elected (or special meeting in lieu of the annual meeting), of whether the issuer's compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed. In connection with these amendments, we also propose to revise the current disclosure requirements relating to the retention of compensation consultants by providing a uniform trigger for when compensation consultant disclosures will be required. In addition, our proposed amendments would eliminate the existing exception from the requirement to identify compensation consultants and describe their engagements for those cases in which a consultant's role is limited to consulting on a broad-based plan or providing information that either is not customized for a particular registrant 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.

The Commission is sensitive to the costs and benefits imposed by the proposed rule and rule amendments. The discussion below focuses on the costs and benefits of the proposals made by the Commission to implement the Act within its permitted discretion, rather than the costs and benefits of the Act itself.

B. Benefits

The proposed rulemaking is intended to implement and supplement the requirements of Section 10C of the Exchange Act as set forth in Section 952 of the Act.

Required Listing Standards

Under proposed Rule 10C-1, the exchanges would be directed to adopt listing standards that would apply to any committee of the board that oversees executive compensation, whether or not such committee performs other functions or is formally

designated as a "compensation committee." We believe this aspect of the rule proposal may help achieve the objectives of the Act by providing clarity and reducing any uncertainty about the application of Section 10C. Moreover, this may benefit investors because it would limit the ability of listed issuers to circumvent the compensation committee independence requirements under Section 10C by delegating oversight of executive compensation to a board committee that is not formally designated as the "compensation committee," but performs that function.

As directed by Section 10C, proposed Rule 10C-1 directs the exchanges to develop a definition of independence applicable to compensation committee members after considering the relevant factors set forth in Exchange Act Section 10C(a)(3). We do not propose to specify any additional factors that the exchanges must consider in determining independence requirements for compensation committee members. We believe that permitting exchanges greater latitude in crafting the required independence standards, subject to Commission review pursuant to Section 19(b) of the Exchange Act, may result in more efficient and effective determinations as to what types of relationships should preclude a finding of independence with respect to membership on a board committee that oversees executive compensation. Because issuers frequently consult the exchanges regarding independence determinations, the exchanges may be in the best position to identify the types of common relationships that are likely to compromise the ability of an issuer's compensation committee to make impartial determinations on executive compensation.

Disclosure Amendments

Our proposed amendments to Item 407(e)(3) of Regulation S-K would require the specific disclosures mandated by Section 10C(c)(2). While no other disclosures are proposed to be required, our proposed amendments would extend the disclosure requirement of Section 10C(c)(2) to issuers, whether listed or not, that file proxy or information statements relating to an election of directors. Although controlled companies are exempt from the requirements of Section 10C, we propose to extend the disclosure requirements of Section 10C(c)(2) to controlled companies in order to have uniform compensation consultant disclosure requirements for all issuers subject to our proxy rules. Under the proposed amendments, in addition to

the disclosure currently required by Item 407(e)(3), issuers would be required to disclose whether the compensation committee has retained or obtained the advice of a compensation consultant, whether the work of the compensation consultant has raised any conflict of interest, and, if so, the nature of the conflict and how the conflict is being addressed.

We believe that requiring these disclosures of issuers subject to the proxy rules will benefit investors by providing them with easily understandable and uniform disclosure regarding compensation consultant conflicts of interest. Under our existing disclosure rules, these issuers must already discuss the selection of compensation consultants and disclose the nature and scope of their assignment, including any material instructions or directions governing their performance under the engagement. We believe the proposed amendment would complement these existing disclosure requirements by increasing the transparency of issuers' policies regarding compensation consultant conflicts of interest. To the extent that the relationships between an issuer and a compensation consultant are more transparent under the proposed amendments, investors should benefit through their ability to better monitor the process of recommending and determining executive and director pay. The increased disclosure should improve the ability of investors to monitor performance of directors responsible for overseeing compensation consultants, thus enabling them to make more informed voting and investment decisions.

We also propose to harmonize current Item 407(e)(3)(iii)'s disclosure triggers with the requirements of Section 10C(c)(2). Our goal in proposing uniform disclosure triggers is to prevent the adoption of potentially duplicative or overlapping disclosure requirements; we also believe that providing a uniform standard for when these disclosures will be required will benefit issuers by allowing them to streamline their procedures for ensuring proper disclosure compliance.

The proposed amendments also include an instruction that provides guidance to issuers as to whether the compensation committee has "obtained the advice" of a compensation consultant. This instruction should benefit issuers by providing clarity and reducing any uncertainty about whether disclosure under the new rules is required. In addition, we propose to include an instruction that identifies the factors set forth in proposed Rule 10C-

1(b)(4)(i) through (v) as among the factors to be considered in determining whether there is a conflict of interest that may need to be disclosed in response to our proposed amendments to Item 407(e)(3)(iii). Although only listed issuers will be required to consider the five independence factors before selecting a compensation consultant, we believe that identifying these five factors as factors that should be considered in determining whether conflict of interest disclosure is required will aid all Exchange Act registrants subject to the proxy rules in complying with their proxy disclosure obligations.

C. Costs

Required Listing Standards

Under our proposed rules, exchanges would be required to adopt independence requirements that apply to members of listed issuer compensation committees or committees performing equivalent functions, but not to directors who oversee executive compensation matters in the absence of such committees. Some exchange listing standards currently require issuers to form compensation or equivalent committees; others require independent directors to oversee specified compensation matters but do not require the formation of a compensation or equivalent committee. Exchanges that do not require the formation of a compensation or equivalent committee could, on their own initiative, determine to apply the same independence standards to directors who oversee compensation matters in the absence of a compensation committee as they do to formally organized compensation committees. In the event they do not, however, issuers could seek to list on such exchanges in order to avoid having to comply with the compensation committee independence standards that would apply at the exchanges that require the formation of a compensation or equivalent committee. Further, to the extent exchanges compete for listings, they may have an incentive to propose standards that issuers may find less onerous. This could result in costs to exchanges to the extent they lose issuer listings, as well as costs to issuers to the extent they choose to alter their existing committee structure to avoid having to comply with the new standards.

Our decision not to exempt additional categories of issuers, beyond those specified in Section 10C(a)(1), from the independence requirements of our proposed rule and instead to rely on the various exchanges to propose additional exemptions for appropriate categories of

issuers, may also result in certain direct or indirect costs. For example, the exchanges will bear the direct cost of evaluating whether additional exemptions would be appropriate and including such exemptions in the rule filings that they are required to make in order to comply with our proposed rule.

Disclosure Amendments

As noted above, our proposal implements the requirements of Section 10C(c)(2). In addition, although not required by Section 10C(c)(2), we propose to require all issuers subject to our proxy rules, rather than only listed issuers, to provide the disclosures called for by Section 10C(c)(2). We also propose to combine and streamline the new disclosure requirements with the existing compensation consultant disclosure requirements. Specifically, we propose to provide a uniform trigger for when compensation consultant disclosures will be required and eliminate the existing exception from the requirement to identify compensation consultants and describe their engagements for those cases in which a consultant's role is limited to consulting on a broad-based plan or providing non-customized benchmark compensation information.

As a result, controlled companies and non-listed issuers will incur costs in disclosing all compensation consultant engagements and in determining and disclosing whether the work of any compensation consultant has raised any conflict of interest, the nature of the conflict, and how the conflict is being addressed. These costs, which would not be required to be incurred by Section 10C(c)(2), may be mitigated to an extent because our existing rules already require issuers subject to our proxy rules to disclose, with limited exceptions, any role of compensation consultants in determining or recommending the amount or form of executive and director compensation. As a result, these issuers will already have developed procedures for collecting and analyzing information about the use of compensation consultants.

For purposes of the PRA, we estimate the aggregate annual cost of the proposed compensation consultant and related conflicts of interest disclosure to be approximately 23,940 hours of company personnel time and approximately \$3,192,000 for the services of outside professionals. However, this amount includes the costs associated with the disclosure requirements of Section 10C(c)(2) of the Exchange Act, as well as our proposed extension of the disclosure requirement

to controlled companies and non-listed issuers and the revisions proposed for the purpose of integrating the new disclosure requirements with existing Item 407(e)(3). As a result, a portion of the reporting costs are attributable to the requirements of the Act rather than to our proposed amendments to Item 407.

We have not proposed that compensation committees of non-listed issuers be required to consider the independence of compensation consultants or other compensation advisers before they are selected; nonetheless, in light of our proposal that issuers subject to our proxy rules will be required to identify and disclose how they manage any conflicts of interest raised by the work of compensation consultants that serve as advisers to the compensation committee, non-listed issuers may incur additional costs to develop more formalized selection processes than they otherwise would have absent such a disclosure requirement. For example, to prepare for the disclosure requirement, at the time any compensation consultant is selected, compensation committees of non-listed issuers may devote additional time and resources to analyzing and assessing the independence of the compensation consultant and addressing and resolving potential conflicts of interest. Although our proposed disclosure requirement will not preclude compensation committees from selecting the compensation consultant of their choosing, such committees may elect to engage new, alternative or additional compensation advisers after considering what disclosure might be required under our proposed rules. Such decisions could result in additional costs to issuers, including costs related to termination of existing services and search and engagement costs to retain new advisers. In addition, costs may increase if an issuer decides to engage multiple compensation consultants for services that had previously been provided by a single consultant.

As a mitigating factor, our proposed rules would require issuers to provide narrative disclosure regarding the management of conflicts of interest. To the extent a non-listed issuer's compensation committee determines to retain a compensation consultant, despite potential conflicts of interest, this provision provides the issuer a means to communicate to investors both the reasons why the committee believes that retaining the consultant and managing the potential conflict of interest is the best approach and the methods employed by the issuer to manage or address the potential conflict.

D. Request for Comment

We request data to quantify the costs and the value of the benefits described above. We seek estimates of these costs and benefits, as well as any costs and benefits not already defined, that may result from the adoption of these proposed amendments. We also request qualitative feedback on the nature of the benefits and costs described above and any benefits and costs we may have overlooked.

V. Consideration of Impact on the Economy, Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition.¹²⁴ In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Section 2(b) of the Securities Act¹²⁵ and Section 3(f) of the Exchange Act¹²⁶ require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

Our proposed rule and rule amendments would implement the requirements of Section 952 of the Act, which added Section 10C to the Exchange Act. Among other provisions, Section 10C requires us to direct the exchanges to prohibit the listing of any equity security of an issuer that is not in compliance with Section 10C's compensation committee and compensation adviser requirements. It is possible that some listed issuers might find the proposed requirements too onerous and seek to list on foreign exchanges or other markets to avoid compliance. This could cause U.S. exchanges to lose trading volume. We do not believe our proposed rules are likely to have this effect, as issuers listed on U.S. exchanges must, for the most part, already provide for executive compensation oversight by independent directors.¹²⁷ It is also possible that, in competing for listings, the exchanges could adopt different definitions of independence for compensation

committee members, which could affect an issuer's decision about where to list its securities.

Section 10C also requires disclosure from listed issuers, other than controlled companies, as to their use and oversight of compensation consultants. We propose to require companies subject to our proxy rules, including controlled companies, to provide this disclosure, whether listed or not. We believe this expansion of the statutory disclosure requirement will promote uniform disclosure on these topics among reporting companies and may allow investors to better understand the process by which compensation committees select compensation consultants and manage conflicts of interest.

Our proposals may promote efficiency and competitiveness of the U.S. capital markets by increasing the transparency of executive compensation decision-making processes and by improving the ability of investors to make informed voting and investment decisions, which may encourage more efficient capital formation. The proposals also may affect competition among compensation consultants. By requiring disclosure of the existence and management of potential compensation consultant conflicts of interest, our proposed rules may lead compensation committees to engage in more thorough and deliberative analyses of adviser independence. If this results in the selection of compensation advisers that are more independent or impartial than might otherwise be chosen, this could in turn promote more efficient executive compensation determinations. The proposed disclosure also could incent consultants to compete on the basis of their policies that serve to minimize any potential conflicts of interest or, to the extent other consultants are available, lead compensation committees to avoid hiring consultants perceived as having a conflict of interest.

We request comment on whether the proposed amendments, if adopted, would promote efficiency, competition and capital formation or have an impact or burden on competition. Commentators are requested to provide empirical data and other factual support for their views, to the extent possible.

VI. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA),¹²⁸ we solicit data to determine whether the proposed rule amendments constitute a "major" rule.

Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

Commentators should provide empirical data on (1) The potential annual effect on the economy; (2) any increase in costs or prices for consumers or individual industries; and (3) any potential effect on competition, investment or innovation.

VII. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Analysis (IRFA) has been prepared in accordance with the Regulatory Flexibility Act.¹²⁹ This IRFA involves proposals to direct the national securities exchanges and national securities associations to prohibit the listing of an equity security of an issuer that is not in compliance with several requirements relating to the issuer's compensation committee, and to revise the disclosure requirements of Regulation S-K Item 407 related to compensation consultants.

A. Reasons for, and Objectives of, the Proposed Action

We are proposing amendments to implement Section 10C of the Exchange Act as added by Section 952 of the Act. The proposals would direct the exchanges to prohibit the listing of equity securities of any issuer that does not comply with Section 10C's compensation committee and compensation adviser requirements. Our proposed amendments would also require issuers to provide certain disclosures regarding their use of compensation consultants and management of compensation consultant conflicts of interest.

B. Legal Basis

We are proposing the amendments pursuant to Sections 6, 7, 10, and 19(a) of the Securities Act; and Sections 10C, 12, 13, 14, 15(d), 23(a) and 36 of the Exchange Act.

C. Small Entities Subject to the Proposed Action

The proposals would affect exchanges that list equity securities and issuers subject to our proxy rules. The Regulatory Flexibility Act defines "small

¹²⁴ 15 U.S.C. 78w(a)(2).

¹²⁵ 15 U.S.C. 77b(b).

¹²⁶ 15 U.S.C. 78c(f).

¹²⁷ See, e.g., NYSE Listed Company Manual Section 303A.05(a) and Nasdaq Rule 5605(d).

¹²⁸ 5 U.S.C. 801 *et seq.*

¹²⁹ 5 U.S.C. 603.

entity” to mean “small business,” “small organization,” or “small governmental jurisdiction.”¹³⁰ The Commission’s rules define “small business” and “small organization” for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission. Exchange Act Rule 0–10(e) provides that the term “small business” or “small organization,” when referring to an exchange, means any exchange that: (1) Has been exempted from the reporting requirements of Exchange Act Rule 601;¹³¹ and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined under Exchange Act Rule 0–10. No exchanges are small entities because none meet these criteria. Securities Act Rule 157¹³² and Exchange Act Rule 0–10(a)¹³³ define a company, other than an investment company, to be a “small business” or “small organization” if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,207 registrants, other than registered investment companies, that may be considered small entities. The proposed amendments would affect small entities that have a class of securities that are registered under Section 12 of the Exchange Act. An investment company, including a business development company, is considered to be a “small business” if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.¹³⁴ We believe that the amendments to Item 407(e) of Regulation S–K would affect small entities that are business development companies that have a class of securities registered under Section 12 of the Exchange Act. We estimate that there are approximately 31 business development companies that may be considered small entities.

D. Reporting, Recordkeeping and Other Compliance Requirements

Under the proposals, the exchanges will be directed to prohibit the listing of an equity security of an issuer that does not comply with Section 10C’s compensation committee and compensation adviser requirements. These requirements relate to: the independence of compensation committee members; the authority of the

compensation committee to engage compensation advisers; the compensation committee’s responsibility for considering factors that affect the independence of compensation advisers prior to their selection; the compensation committee’s responsibility for the appointment, compensation, and oversight of the work of compensation advisers; funding for advisers engaged by the compensation committee; and the opportunity to cure defects.

The proposals would also require additional disclosure about the use of compensation consultants and conflicts of interest. Large and small entities would be subject to the same disclosure requirements. The proposals would require small entities subject to the proxy rules to provide disclosure of whether:

- The compensation committee has retained or obtained the advice of a compensation consultant; and
- The work of a compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed.

The proposals will impose additional costs on small entities in order to comply with the new listing standards and to collect, record and report the disclosures that we propose to require. Our existing disclosure rules require small entities to disclose information regarding any compensation consultant that plays a role in determining or recommending the amount and form of executive and director compensation in proxy and information statements. The additional information concerning compensation consultants that would be required under the proposals should be readily available to these small entities. Also, we believe that many small entities do not use the services of a compensation consultant, which would significantly minimize the impact of the reporting and recordkeeping requirements under the proposals on small entities. In addition, we believe that the impact of the proposals on small entities will be lessened because most aspects of the proposals apply only to listed issuers, and the quantitative listing standards applicable to issuers listing securities on an exchange, such as market capitalization, minimum revenue, and shareholder equity requirements, will serve to limit the number of small entities that would be affected.

E. Duplicative, Overlapping or Conflicting Federal Rules

We believe the proposed amendments would not duplicate, overlap, or conflict with other Federal rules.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed disclosure amendments, we considered the following alternatives:

- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards;
- Exempting small entities from all or part of the requirements; and
- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities.

We believe that our proposed amendments would require clear and straightforward disclosure of the use of compensation consultants and the management of compensation consultant conflicts of interest. We believe that our proposed rules will promote consistent disclosure among all companies without creating a significant new burden for small entities.

The proposals attempt to clarify, consolidate and simplify the compliance and reporting requirements for all entities, including small entities, by including instructions to the amendments to clarify the circumstances under which disclosure is required. We have used a mix of design and performance standards in developing the proposed disclosure requirements. Based on our past experience, we believe the amendments will be more useful to investors if there are specific disclosure requirements; however, we have not proposed specific procedures or arrangements that an issuer must develop to comply with the proposed amendments. The additional disclosure requirements are intended to result in more comprehensive and clear disclosure.

Although we preliminarily believe that an exemption for small entities from coverage of the proposals would not be appropriate at this time, we seek comment on whether we should exempt small entities from any of the proposed disclosure requirements or scale the proposed amendments to reflect the characteristics of small entities and the needs of their investors. Further, as

¹³⁰ 5 U.S.C. 601(6).

¹³¹ 17 CFR 242.601.

¹³² 17 CFR 230.157.

¹³³ 17 CFR 240.0–10(a).

¹³⁴ 17 CFR 270.0–10(a).

directed by Exchange Act Section 10C, our proposed rules would permit the exchanges to exempt particular categories of issuers from the requirements of Section 10C and particular relationships from the compensation committee membership requirements of Section 10C(a), taking into account the potential impact of the requirements on smaller reporting companies. To the extent exchanges adopt such exemptions for small entities, the compliance burden would be reduced.

At this time, we do not believe that different compliance methods or timetables for small entities would be appropriate. The proposals are intended to improve the accountability for and transparency of executive compensation determinations. The specific disclosure requirements in the proposals will promote consistent disclosure among all issuers, including small entities. Separate compliance requirements or timetables for small entities could interfere with achieving the goals of the statute and our proposals. Nevertheless, we solicit comment on whether different compliance requirements or timetables for small entities would be appropriate, and consistent with the purposes of Section 952 of the Dodd-Frank Act.

G. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- How the proposed amendments can achieve their objective while lowering the burden on small entities;
- The number of small entities that may be affected by the proposed amendments;
- Whether small entities should be exempt from the rules;
- The existence or nature of the potential impact of the proposed amendments on small entities discussed in the analysis; and
- How to quantify the impact of the proposed amendments.

Respondents are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VIII. Statutory Authority and Text of the Proposed Amendments

The amendments contained in this release are being proposed under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act and Sections 10C, 12, 13, 14, 15(d), 23(a), and 36 of the Exchange Act.

List of Subjects in 17 CFR Parts 229 and 240

Reporting and recordkeeping requirements, Securities.

Text of the Proposed Amendments

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II, of the Code of Federal Regulations as follows:

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K

1. The authority citation for part 229 is revised to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78l, 78m, 78n, 78n-1, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

2. In § 229.407, revise paragraph (e)(3)(iii) and add instructions 1 and 2 to item 407(e)(3) to read as follows:

§ 229.407 (Item 407) Corporate governance.

- * * * * *
- (e) * * *
- (3) * * *

(iii) Whether the compensation committee (or another board committee performing equivalent functions) retained or obtained the advice of a compensation consultant during the registrant's last completed fiscal year, identifying such consultants, stating whether such consultants were engaged directly by the compensation committee (or another board committee performing equivalent functions), describing the nature and scope of the consultant's assignment and the material elements of the instructions or directions given to the consultant with respect to the performance of the consultant's duties under the engagement, and discussing whether the work of the consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed:

(A) If the compensation committee (or another board committee performing equivalent functions) retained or obtained the advice of a compensation consultant and the consultant's services were not limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees, or providing information that either is not customized for a particular registrant 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, and the compensation consultant or its affiliates also provided additional services to the registrant or its affiliates in an amount in excess of \$120,000 during the registrant's last completed fiscal year, then disclose the aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for such additional services. Disclose whether the decision to engage the compensation consultant or its affiliates for these other services was made, or recommended, by management, and whether the compensation committee (or another board committee performing equivalent functions) or the board approved such other services of the compensation consultant or its affiliates.

(B) If the compensation committee (or another board committee performing equivalent functions) has not retained or obtained the advice of a compensation consultant, but management has retained or obtained the advice of a compensation consultant and the consultant's services were not limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees, or providing information that either is not customized for a particular registrant 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, and such compensation consultant or its affiliates has provided additional services to the registrant in an amount in excess of \$120,000 during the registrant's last completed fiscal year, then disclose the aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for any additional services provided

by the compensation consultant or its affiliates.

Instruction 1 to Item 407(e)(3). For purposes of this paragraph, a compensation committee (or another board committee performing equivalent functions) or management has “obtained the advice” of a compensation consultant if such committee or management has requested or received advice from a compensation consultant, regardless of whether there is a formal engagement of the consultant or a client relationship between the compensation consultant and the compensation committee or management or any payment of fees to the consultant for its advice.

Instruction 2 to Item 407(e)(3). For purposes of this paragraph, the factors outlined in § 240.10C–1(b)(4)(i) through (v) of this chapter are among the factors that should be considered in determining whether a conflict of interest exists.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The general authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78j-3, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

4. Add an undesignated center heading following § 240.10A–3 to read as follows:

Requirements Under Section 10C

5. Add § 240.10C–1 to read as follows:

§ 240.10C–1 Listing standards relating to compensation committees.

(a) Pursuant to section 10C(a) of the Act (15 U.S.C. 78j-3(a)) and section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. 111–203, 124 Stat. 1900):

(1) *National securities exchanges.* The rules of each national securities exchange registered pursuant to section 6 of the Act (15 U.S.C. 78f), to the extent such national securities exchange lists equity securities, must, in accordance with the provisions of this section, prohibit the initial or continued listing of any equity security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(2) *National securities associations.* The rules of each national securities association registered pursuant to section 15A of the Act (15 U.S.C. 78o-3), to the extent such national securities association lists equity securities in an automated inter-dealer quotation system, must, in accordance with the provisions of this section, prohibit the initial or continued listing in an automated inter-dealer quotation system of any equity security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(3) *Opportunity to cure defects.* The rules required by paragraphs (a)(1) and (a)(2) of this section must provide for appropriate procedures for a listed issuer to have a reasonable opportunity to cure any defects that would be the basis for a prohibition under paragraph (a) of this section, before the imposition of such prohibition. Such rules may provide that if a member of a compensation committee ceases to be independent in accordance with the requirements of this section for reasons outside the member’s reasonable control, that person, with notice by the issuer to the applicable national securities exchange or national securities association, may remain a compensation committee member of the listed issuer 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.

(4) *Implementation.* (i) Each national securities exchange and national securities association that lists equity securities must provide to the Commission, no later than 90 days after publication of this section in the **Federal Register**, proposed rules or rule amendments that comply with this section. Each submission must include, in addition to any other information required under section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, a review of whether and how existing listing standards satisfy the requirements of this rule, a discussion of the consideration of factors relevant to compensation committee independence conducted by the national securities exchange or national securities association, and the definition of independence applicable to compensation committee members that the national securities exchange or national securities association proposes to adopt in light of such review.

(ii) Each national securities exchange and national securities association that lists equity securities must have rules or rule amendments that comply with this section approved by the Commission no

later than one year after publication of this section in the **Federal Register**.

(b) *Required standards.* The requirements of this section apply to the compensation committees of listed issuers. If a listed issuer has a committee of the board performing functions typically performed by a compensation committee, including oversight of executive compensation, then such committee, even if it is not designated as a compensation committee or performs other functions, shall be fully subject to the requirements of this section.

(1) *Independence.* (i) Each member of the compensation committee must be a member of the board of directors of the listed issuer, and must otherwise be independent.

(ii) *Independence requirements.* In determining independence requirements for members of compensation committees, the national securities exchanges and national securities associations shall consider relevant factors, including, but not limited to:

(A) The source of compensation of a member of the board of directors of an issuer, including any consulting, advisory or other compensatory fee paid by the issuer to such member of the board of directors; and

(B) 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.

(iii) *Exemptions from the independence requirements.* (A) The listing of equity securities of the following categories of listed issuers are not subject to the requirements of paragraph (b)(1) of this section:

- (1) Controlled companies;
- (2) Limited partnerships;
- (3) Companies in bankruptcy proceedings;

(4) Open-end management investment companies registered under the Investment Company Act of 1940; and

(5) Any foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee.

(B) 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.

(2) *Authority to engage compensation consultants, independent legal counsel and other compensation advisers.* The compensation committee of a listed 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. 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 to the compensation committee. Nothing in this paragraph (b) shall be construed:

(i) 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

(ii) To affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

(3) *Funding.* 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, independent legal counsel or any other adviser to the compensation committee.

(4) *Independence of compensation consultants and other advisers.* 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, as well as any other factors identified by the relevant national securities exchange or national securities association in its listing standards:

(i) The provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;

(ii) 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;

(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; and

(v) Any stock of the issuer owned by the compensation consultant, legal counsel or other adviser.

(5) *General exemptions.* (i) The national securities exchanges and national securities associations, pursuant to section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, may exempt from the requirements of this section certain categories of issuers, as the national securities exchange or national securities association determines is appropriate, taking into consideration the potential impact of such requirements on smaller reporting issuers.

(ii) The requirements of this section shall not apply to any controlled company.

(iii) 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)) is not subject to the requirements of this section.

(iv) 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) is not subject to the requirements of this section.

(c) *Definitions.* Unless the context otherwise requires, all terms used in this section have the same meaning as in the Act. In addition, unless the context otherwise requires, the following definitions apply for purposes of this section:

(1) In the case of foreign private issuers with a two-tier board system, the term *board of directors* means the supervisory or non-management board.

(2) The term *controlled company* means an issuer:

(i) That is listed on a national securities exchange or by a national securities association; and

(ii) That holds an election for the board of directors of the issuer in which more than 50 percent of the voting power is held by an individual, a group or another issuer.

(3) The terms *listed* and *listing* refer to equity securities listed on a national securities exchange or listed in an automated inter-dealer quotation system of a national securities association or to issuers of such securities.

(4) The term *open-end management investment company* means an open-end company, as defined by Section 5(a)(1) of the Investment Company Act

of 1940 (15 U.S.C. 80a-5(a)(1)), that is registered under that Act.

Dated: March 30, 2011.

Elizabeth M. Murphy,
Secretary.

[FR Doc. 2011-7948 Filed 4-5-11; 8:45 am]

BILLING CODE 8011-01-P

DEPARTMENT OF COMMERCE

Patent and Trademark Office

37 CFR Part 1

[Docket No.: PTO-P-2011-0014]

RIN 0651-AC56

Revision of Patent Term Extension and Adjustment Provisions Relating to Appellate Review and Information Disclosure Statements

AGENCY: United States Patent and Trademark Office, Commerce.

ACTION: Notice of proposed rulemaking.

SUMMARY: The United States Patent and Trademark Office (Office) is proposing to revise the patent term adjustment and extension provisions of the rules of practice in patent cases. The patent term adjustment provisions of the American Inventors Protection Act of 1999 (AIPA) and the patent term extension provisions of the Uruguay Round Agreements Act (URAA) each provide for patent term extension or adjustment if the issuance of the patent was delayed due to appellate review by the Board of Patent Appeals and Interferences (BPAI) or by a Federal court and the patent was issued pursuant to or under a decision in the review reversing an adverse determination of patentability. The Office is proposing to change the rules of practice to indicate that in most circumstances an examiner reopening prosecution of the application after a notice of appeal has been filed will be considered a decision in the review reversing an adverse determination of patentability for purposes of patent term adjustment or extension purposes. Therefore, in such situations, patentees would be entitled to patent term extension or adjustment. In addition, the AIPA provides for a reduction of any patent term adjustment if the applicant failed to engage in reasonable efforts to conclude prosecution of the application. The Office is also proposing to change the rules of practice pertaining to the reduction of patent term adjustment for applicant delays to exclude information disclosure statements resulting from the citation of information by a foreign patent office in a counterpart