

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-68823; File Nos. SR-BSECC-2012-002; SR-BX-2012-075; SR-NASDAQ-2012-142; SR-Phlx-2012-142; SR-SCCP-2012-02)

February 4, 2013

Self-Regulatory Organizations; Boston Stock Exchange Clearing Corporation; NASDAQ OMX BX, Inc.; the NASDAQ Stock Market LLC; NASDAQ OMX PHLX LLC; Stock Clearing Corporation of Philadelphia; Order Approving Proposed Rule Changes With Respect to the Amendment of the By-Laws of The NASDAQ OMX Group, Inc.

I. Introduction

On December 19, 2012, Boston Stock Exchange Clearing Corporation (“BSECC”), NASDAQ OMX BX, Inc. (“BX”), the NASDAQ Stock Market LLC (“NASDAQ”), NASDAQ OMX PHLX LLC (“Phlx”), and the Stock Clearing Corporation of Philadelphia (“SCCP” and, together with BSECC, BX, NASDAQ and Phlx, the “SROs” or “Self-Regulatory Subsidiaries”), filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 (“Act”),<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> proposed rule changes with respect to the amendment of the by-laws (“NASDAQ OMX By-Laws”) of the NASDAQ OMX Group, Inc. (“NASDAQ OMX”), the parent company of the SROs. The proposed rule changes were published for comment in the Federal Register on December 31, 2012 with respect to the BX, NASDAQ and Phlx proposals and on January 2, 2013 with respect to the SCCP and BSECC proposals.<sup>4</sup> The Commission received no comment letters on the proposals.

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

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

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

<sup>4</sup> See Securities Exchange Act Release Nos. 68512 (December 21, 2012), 77 FR 77168 (December 31, 2012) (SR-NASDAQ-2012-142) (“NASDAQ Notice”); 68513 (December 21, 2012), 77 FR 77129 (December 31, 2012) (SR-Phlx-2012-142); 68514

The Commission has reviewed carefully the proposed rule changes and finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange in the case of the proposals by BX, NASDAQ and Phlx and to a clearing agency in the case of the proposals by BSECC and SCCP.<sup>5</sup> In particular, the Commission finds that the proposed rule changes by BX, NASDAQ and Phlx are consistent with Section 6(b)(1) of the Act,<sup>6</sup> which, among other things, requires a national securities exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder and the rules of the exchange. In addition, the Commission finds that the proposed rule changes by BX, NASDAQ and Phlx are consistent with Section 6(b)(5) of the Act,<sup>7</sup> which, among other things, requires that the rules of the exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, 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. The Commission also finds that the proposed rule changes by BSECC and SCCP are consistent with Section 17A of the Act,<sup>8</sup> which, among other things,

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(December 21, 2012), 77 FR 77137 (December 31, 2012) (SR-BX-2012-075); 68536 (December 26, 2012), 78 FR 128 (January 2, 2013) (SR-SCCP-2012-02); 68537 (December 26, 2012), 78 FR 132 (January 2, 2013) (SR-BSECC-2012-002).

<sup>5</sup> In approving the proposed rule changes, the Commission has considered their impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78f(b)(1).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 15 U.S.C. 78q-1(b)(3)(F).

requires that the rules of a clearing agency are designed to facilitate the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds in its custody or control or for which it is responsible, and to protect investors and the public interest.

## II. Discussion and Commission Findings

### Definitions of Directors

The SROs are proposing amendments to provisions of the NASDAQ OMX By-Laws pertaining to the compositional requirements of the Board of Directors of NASDAQ OMX (“NASDAQ OMX Board”). The SROs propose to amend the definition of “Industry Director.” Under the proposed definition, an Industry Director and “Industry committee member”<sup>9</sup> will be defined as a Director who: (1) is, or within the last year was, or has an immediately family member<sup>10</sup> who is, or within the last year was, a member of a Self-Regulatory Subsidiary;<sup>11</sup> (2) is, or within the last year was, employed by a member or a member organization of a Self-

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<sup>9</sup> The term “committee member” in the NASDAQ OMX By-Laws refers to membership in the committees authorized under Section 4.13 of the By-Laws, such as the Executive Committee and the Audit Committee. Under the NASDAQ OMX By-Laws and the Delaware General Corporation Law, all members of committees with the power and authority to act on behalf of the NASDAQ OMX Board in the management of the business and affairs of NASDAQ OMX must themselves be Directors. Accordingly, the definitions of “Industry Director” and “Industry committee member” are coterminous as applied to any member of these committees. The NASDAQ OMX By-Laws do not presently contemplate any committees with non-Director members.

<sup>10</sup> A definition of “immediate family member” will be added to the NASDAQ OMX By-Laws as follows: “‘Immediate family member’ means a person’s spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person’s home.” The definition is identical to the definition of “family member” contained in NASDAQ listing standards, as provided in NASDAQ Rule 5605.

<sup>11</sup> This provision will apply to an individual that is or was a member of Phlx, the only Self-Regulatory Subsidiary that allows natural persons to become members.

Regulatory Subsidiary;<sup>12</sup> (3) has an immediate family member who is, or within the last year was, an executive officer of a member or a member organization<sup>13</sup> of a Self-Regulatory Subsidiary; (4) has within the last year received from any member or member organization of a Self-Regulatory Subsidiary more than \$100,000 per year in direct compensation, or received from such members or member organizations in the aggregate an amount of direct compensation that in any one year is more than 10 percent of the Director's annual gross compensation for such year, excluding in each case director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service); or (5) is affiliated, directly or indirectly, with a member or member organization of a Self-Regulatory Subsidiary.

According to the SROs, the current definition of Industry Director focuses on a Director's affiliation with any broker-dealer, regardless of whether the broker-dealer is a member or member organization of a Self-Regulatory Subsidiary, and features a three-year "look-back" period during which a Director formerly associated with a broker-dealer would continue to be deemed an Industry Director.<sup>14</sup> According to the SROs, the proposed definition of Industry Director is less restrictive than the current definition but will continue to serve the purpose of ensuring that members and member organizations of Self-Regulatory Subsidiaries<sup>15</sup> – the self-regulatory organizations owned by NASDAQ OMX – do not have disproportionate influence on

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<sup>12</sup> A broker-dealer that is admitted to membership in Phlx is referred to as a "member organization;" broker-dealers admitted to membership in the other Self-Regulatory Subsidiaries are referred to as "members."

<sup>13</sup> An "Executive Officer" of a member or member organization means those officers covered in Rule 16a-1(f) under the Act, as if the member or member organization were an issuer within the meaning of such Rule. 17 CFR 240.16a-1(f).

<sup>14</sup> See, e.g., NASDAQ Notice, 77 FR at 77168.

<sup>15</sup> The NASDAQ OMX By-Laws define each of NASDAQ, BX, Phlx, BSECC, and SCCP as a "Self-Regulatory Subsidiary."

its governance.<sup>16</sup> Moreover, the SROs state that the change is warranted to ensure that the definition of Industry Director is appropriately focused on the mitigation of potential conflicts of interest associated with Directors who are currently or were very recently employed by members or member organizations of Self-Regulatory Subsidiaries, or that otherwise have material affiliations with such members or member organizations, without unnecessarily restricting highly qualified individuals with extensive knowledge of the financial services industry from serving on the NASDAQ OMX Board.<sup>17</sup> Further, the SROs note that NASDAQ OMX is incorporating concepts from recently-approved changes to the Independence Policy of NYSE Euronext.<sup>18</sup>

In addition, the SROs propose changes to other definitions applicable to categories of Directors. Specifically, the SROs propose to add a definition of “Staff Director” as “an officer of the Corporation that is serving as a Director.”<sup>19</sup> According to the SROs, this change will further restrict the number of possible Staff Directors in instances where the NASDAQ OMX Board is smaller than ten Directors, while retaining the current limit of two Staff Directors for a larger NASDAQ OMX Board.<sup>20</sup>

The SROs also propose to add a definition of “Issuer Director” and “Issuer committee member” as “a Director (excluding any Staff Director) or committee member who is an officer or employee of an issuer of securities listed on a national securities exchange operated by any

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<sup>16</sup> See, e.g., NASDAQ Notice, 77 FR at 77168.

<sup>17</sup> See id., 77 FR at 77171.

<sup>18</sup> See Securities Exchange Act Release No. 67564 (August 1, 2012), 77 FR 47161) (SR-NYSE-2012-17; SR-NYSEArca-2012-59; SR-NYSEMKT-2012-07).

<sup>19</sup> The SROs note that the definition of “Industry Director” will continue to exclude Staff Directors, who might otherwise be considered Industry Directors by virtue of affiliation with NASDAQ Exchange Services LLC and NASDAQ Options Services, LLC, registered broker-dealers that are members of NASDAQ and BX and member organizations of Phlx. See, e.g., NASDAQ Notice, 77 FR at 77169 n.12.

<sup>20</sup> See, e.g., NASDAQ Notice, 77 FR at 77169.

Self-Regulatory Subsidiary, excluding any Director or committee member who is a director of such an issuer but is not also an officer or employee of such an issuer.” According to the SROs, the exclusion of Staff Directors from the definition is necessary because NASDAQ OMX is listed on NASDAQ, but the purpose of the NASDAQ OMX By-Laws in requiring issuer representation to promote a diversity of viewpoints among Directors would not be well served by deeming Staff Directors also to be Issuer Directors.<sup>21</sup> The SROs also state that the proposed definition of Issuer Director and Issuer committee member would exclude persons who are directors of issuers but who are not also officers or employees of such issuers, which is intended to make clear that a Director is not barred from being considered a Public Director merely because the Director serves as an independent director of another listed company.<sup>22</sup>

The SROs also propose to amend the definition of “Public Director” and “Public committee member” to state: “a Director or committee member who (1) is not an Industry Director or Industry committee member, (2) is not an Issuer Director or Issuer committee member, and (3) has no material business relationship with a member or member organization of a Self-Regulatory Subsidiary, the Corporation or its affiliates, or FINRA.”<sup>23</sup> The current definition covers a person who “has no material business relationship with a broker or dealer, the Corporation or its affiliates, or FINRA.”<sup>24</sup> According to the SROs, the proposed definition makes clear that any Industry Director or Issuer Director would not be considered a Public Director, but an independent director of an issuer of securities listed on NASDAQ could be

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<sup>21</sup> See, e.g., NASDAQ Notice, 77 FR at 77169.

<sup>22</sup> See, e.g., id.

<sup>23</sup> See, e.g., id.

<sup>24</sup> See, e.g., id.

considered a Public Director.<sup>25</sup> The SROs also state that in keeping with the change to the definition of Industry Director discussed above, the final clause of the definition of Public Director would be revised to focus on the existence of a material business relationship with a member or member organization of a Self-Regulatory Subsidiary, rather than any broker or dealer.

In addition, the SROs propose changing the definition of “Non-Industry Director” or “Non-Industry committee member” to cover any “Director (excluding any Staff Director) or committee member who is (1) a Public Director or Public committee member; (2) an Issuer Director or Issuer committee member; or (3) any other individual who would not be an Industry Director or Industry committee member.”<sup>26</sup> According to the SROs, this revised definition is generally consistent with the current definition, but reflects the new definition of “Issuer Director” and “Issuer committee member.”<sup>27</sup>

The SROs believe that the foregoing definitional changes will enhance the clarity of these provisions and will promote a diversity of backgrounds and viewpoints on the NASDAQ OMX Board, and will collectively promote the capacity of the NASDAQ OMX Board to fulfill its responsibilities.<sup>28</sup>

The Commission finds that the BX, NASDAQ and Phlx proposals are consistent with the Act, particularly Sections 6(b)(1) and (b)(5) of the Act. The Commission also finds that the BSECC and SCCP proposals are consistent with Section 17A of the Act. The Commission

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<sup>25</sup> See, e.g., id.

<sup>26</sup> See, e.g., NASDAQ Notice, 77 FR at 77170.

<sup>27</sup> Due to the above described changes and the addition of a term “Issuer Director,” the SROs proposed making conforming changes to the letter designations of paragraphs in the NASDAQ OMX By-Laws.

<sup>28</sup> See, e.g., NASDAQ Notice, 77 FR at 77169.

believes that these proposed definitional changes to the NASDAQ OMX By-Laws will help to ensure that potential conflicts of interest with respect to the composition of the NASDAQ OMX Board will continue to be mitigated and at the same time will help promote the capacity of NASDAQ OMX, which is the parent company of the Self-Regulatory Subsidiaries, to fulfill its responsibilities.

#### Qualifications of Directors

The SROs propose to amend Section 4.3 of the NASDAQ OMX By-Laws, which governs the qualifications and compositional requirements of the NASDAQ OMX Board. Specifically, the changes to the composition of the NASDAQ OMX Board will (i) increase from one to two the required number of Public Directors, (ii) replace the requirement to include at least one issuer representative (or at least two issuer representatives if the NASDAQ OMX Board consists of ten or more Directors) with a requirement to include at least one, but no more than two, Issuer Directors and (iii) limit the number of Staff Directors to one, unless the Board consists of ten or more Directors, in which case the number of Staff Directors cannot exceed two. The NASDAQ OMX By-Laws will continue to require that the number of Non-Industry Directors must equal or exceed the number of Industry Directors. As previously mentioned, because the term “Issuer Director” is a new definition, the SROs also propose to make a conforming change by adding that term to Sections 4.8 and 4.13(h) of NASDAQ OMX’s By-Laws, which govern the filling of vacancies on the NASDAQ OMX Board and the determination of Directors’ qualifications by NASDAQ OMX’s Secretary.

The Commission finds that the proposed changes by BX, NASDAQ and Phlx regarding the qualifications and compositional requirements of the NASDAQ OMX Board are consistent with the Act, particularly Sections 6(b)(1) and (b)(5) of the Act. The Commission also finds that

the proposed rule changes by BSECC and SCCP regarding the qualifications and compositional requirements of the NASDAQ OMX Board are consistent with Section 17A of the Act. The Commission concurs with the SROs that the proposals will continue to ensure a diversity of representation among Industry, Staff, Issuer, and Public Directors, will place more stringent caps on the number of Issuer and Staff Directors, and will increase the requirement regarding the number of Public Directors.<sup>29</sup> Further, as noted by the SROs, the proposed rule changes do not alter in any respect the compositional requirements imposed by NASDAQ listing standards on NASDAQ OMX as a NASDAQ listed issuer, particularly the requirement that the NASDAQ OMX Board be composed of a majority of independent directors.<sup>30</sup>

#### Executive Committee

The SROs propose to amend the compositional requirement of NASDAQ OMX's Executive Committee, which is authorized by Section 4.13(d) of the NASDAQ OMX By-Laws. Under the proposed rule changes, NASDAQ OMX's By-Laws will be amended to require that there be at least two Public Directors on the Executive Committee (as opposed to the current

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<sup>29</sup> See, e.g., NASDAQ Notice, 77 FR at 77170.

<sup>30</sup> NASDAQ Rule 5605 requires that the board of directors of a company listed on NASDAQ must have a majority of directors that are "independent" within the meaning of that rule. As provided in NASDAQ Rule 5605(a)(2) with respect to a company listed on NASDAQ ("Company"), "'Independent Director' means a person other than an Executive Officer or employee of the Company or any other individual having a relationship which, in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director." NASDAQ Rule 5605 further provides that directors having certain defined relationships with a Company may not be considered independent. The SROs note that, while Staff Directors are clearly not independent within the meaning of NASDAQ Rule 5605, other Directors may or may not be considered independent, depending on the specific facts of their relationship to NASDAQ OMX.

requirement that the percentage of Public Directors on the Executive Committee must be at least as great as the percentage of Public Directors on the NASDAQ OMX Board).<sup>31</sup>

The Commission finds that this proposal is consistent with the Act, particularly Sections 6(b)(1) and (b)(5) of the Act. The Commission also finds that the proposed rule changes are consistent with Section 17A of the Act. The Commission believes that the proposal to amend the compositional requirement of NASDAQ OMX's Executive Committee will continue to ensure a diversity of representation among Directors serving on the Executive Committee and will help to ensure that potential conflicts of interest with respect to the composition of the NASDAQ OMX Board will continue to be mitigated.

#### Audit Committee

The SROs also proposed changes to the composition requirements of the NASDAQ OMX Audit Committee. Under the proposed rule changes to the compositional requirements of the Audit Committee, Section 4.13(g) of NASDAQ OMX's By-Laws will be amended to reflect that the number of Non-Industry Directors on the Audit Committee must be equal to or exceed the number of Industry Directors (as opposed to the current requirement that the Audit Committee be composed of a majority of Non-Industry Directors). The SROs state that the proposed compositional requirements for the Audit Committee with regard to the balance between Industry Directors and Non-Industry Directors will be consistent with the compositional requirements currently provided for in the NASDAQ OMX By-Laws with respect to NASDAQ OMX's Executive Committee, Nominating & Governance Committee, Management Compensation Committee<sup>32</sup>, and the NASDAQ OMX Board. According to the SROs, this

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<sup>31</sup> See, e.g., NASDAQ Notice, 77 FR at 77170.

<sup>32</sup> As a listed company on NASDAQ, NASDAQ OMX must also comply with NASDAQ's

change will provide greater flexibility to NASDAQ OMX with regard to populating the Audit Committee with Directors having relevant expertise and will ensure that the Audit Committee is not too large in relation to the size of the NASDAQ OMX Board, while continuing to ensure that Directors associated with members and member organizations of the Self-Regulatory Subsidiaries do not exert disproportionate influence on the governance of NASDAQ OMX.<sup>33</sup>

The Commission finds that this proposal is consistent with the Act, particularly Sections 6(b)(1) and (b)(5) of the Act. The Commission also finds that the proposed rule changes are consistent with Section 17A of the Act. The Commission believes that the proposal will help to ensure that potential conflicts of interest with respect to the composition of the NASDAQ OMX Board will continue to be mitigated and at the same time will help promote the capacity of NASDAQ OMX to fulfill its responsibilities.

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listing rules, which contain certain provisions that require Independent Directors to serve on such company's board of directors and on various board committees. See supra note 30 for a summary of the definition of Independent Director as set forth in NASDAQ Rule 5605(a)(2). Among other requirements in NASDAQ's listing rules, a listed company's compensation committee must be comprised solely of such Independent Directors. The Commission recently approved amendments that NASDAQ proposed in order for NASDAQ to comply with Rule 10C-1 under the Act. The new rules require, among other things, that members of a listed company's compensation committee must meet enhanced independence requirements, in addition to having to be Independent Directors as defined in NASDAQ's existing listing rules. NASDAQ's listed companies must comply with these enhanced independence requirements at the earlier of the company's first annual meeting after January 15, 2014 or October 31, 2014. See NASDAQ Rule 5605(d) and Securities Exchange Act Release No. 68640 (January 11, 2013), 78 FR 4554 (January 22, 2013).

The Commission notes that the SROs' proposed rule changes are not intended to address whether a particular Industry or Non-Industry Director would qualify under the NASDAQ's definition as an Independent Director or could qualify as a compensation committee member under the newly-adopted enhanced standards of independence for compensation committee service. As for any listed company, NASDAQ OMX will have to do its own assessment of whether a particular director qualifies as an Independent Director for service on the listed company's board or board committees, particularly the audit, compensation, or nomination committees, under NASDAQ's listing standards.

<sup>33</sup> See, e.g., NASDAQ Notice 77 FR 77170.

The Commission notes that the proposed rule changes will not alter NASDAQ OMX's obligations under Section 10A of the Act<sup>34</sup> and SEC Rule 10A-3 thereunder,<sup>35</sup> which relate to audit committee requirements of listed issuers. According to the SROs, the NASDAQ OMX Audit Committee will continue to be composed solely of Directors who are independent within the meaning of Section 10A and Rule 10A-3 thereunder. Under NASDAQ Rule 5605(c), the NASDAQ OMX Audit Committee is required to be comprised of Independent Directors (as defined in NASDAQ's Rule 5605(a)(2)). The Commission notes that the NASDAQ OMX Audit Committee's members also must meet the independence requirements of Section 10A of the Act and Rule 10A-3 thereunder.

### III. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule changes are consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange in the case of BX, NASDAQ and Phlx and with the Act and rules and regulations thereunder applicable to a registered clearing agency in the case of BSECC and SCCP.

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<sup>34</sup> 15 U.S.C. 78j-1.

<sup>35</sup> 17 CFR 240.10A-3.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act<sup>36</sup> that the proposed rule changes (SR-BSECC-2012-02; SR-BX-2012-075; SR-NASDAQ-2012-142; SR-Phlx-2012-142; SR-SCCP-2012-02) are approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>37</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>36</sup> 15 U.S.C. 78f(b)(2).

<sup>37</sup> 17 CFR 200.30-3(a)(12).