Securities and Exchange Commission

17 CFR Parts 229 and 240
Listing Standards for Compensation Committees; Final Rule
SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229 and 240


RIN 3235-AK95

Listing Standards for Compensation Committees

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting a new rule and amendments to our proxy disclosure rules to implement Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10C to the Securities Exchange Act of 1934.

Section 10C requires the Commission to adopt rules directing the national securities 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, new Rule 10C–1 directs the national securities 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 national securities exchanges adopted in accordance with the final rule. In addition, pursuant to Section 10C(c)(2), we are adopting amendments to our proxy disclosure rules concerning issuers’ use of compensation consultants and related conflicts of interest.

DATES: Effective Date: July 27, 2012. Compliance Dates: Each national securities exchange and national securities association must provide to the Commission, no later than September 25, 2012, proposed rule change submissions that comply with the requirements of Exchange Act Rule 10C–1. Further, each national securities exchange and national securities association must have final rules or rule amendments that comply with Rule 10C–1 approved by the Commission no later than June 27, 2012. Issuers must comply with the disclosure changes in Item 407 of Regulation S–K in any proxy or information statement for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting) at which directors will be elected occurring on or after January 1, 2013.

For further information contact: N. Sean Harrison, Special Counsel, Office of Rulemaking, at (202) 551–3430, or Heather Maples, Senior Special Counsel, Office of Chief Counsel, at (202) 551–3520, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–3628.

Supplementary information: We are adopting new Rule 10C–1 under the Securities Exchange Act of 1934 and amendments to Item 407 of Regulation S–K.

Table of Contents

I. Background and Summary

II. Discussion of the Final Rules

A. Exchange Listing Standards

1. Applicability of Listing Standards

a. Proposed Rule

b. Comments on the Proposed Rule

c. Final Rule

2. Independence Requirements

a. Proposed Rule

b. Comments on the Proposed Rule

c. Final Rule

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

a. Proposed Rule

b. Comments on the Proposed Rule

c. Final Rule

4. Compensation Adviser Independence Factors

a. Proposed Rule

b. Comments on the Proposed Rule

c. Final Rule

5. Opportunity To Cure Defects

a. Proposed Rule

b. Comments on the Proposed Rule

c. Final Rule

B. Implementation of Listing Requirements

1. Exchanges and Securities Affected

a. Proposed Rule

b. Comments on the Proposed Rule

c. Final Rule

2. Exemptions

a. Proposed Rule

b. Issuers Not Subject to Compensation Committee Independence Requirements

i. Exemption of Relationships and Other Categories of Issuers

a. Comments on the Proposed Rule

b. Final Rule

C. Compensation Consultant Disclosure and Conflicts of Interest

1. Proposed Rule

2. Comments on the Proposed Rule

3. Final Rule

a. Disclosure Requirements

b. Disclosure Exemptions

c. Disclosure Regarding Director Compensation

D. Transition and Timing

III. Paperwork Reduction Act

A. Background

B. Summary of the Final Rules

C. Summary of Comment Letters and Revisions to Proposals

D. Revisions to PRA Reporting and Cost Burden Estimates

IV. Economic Analysis

A. Background and Summary of the Rule Amendments

B. Benefits and Costs, and Impact on Efficiency, Competition and Capital Formation

1. Section 10C of the Exchange Act, as Added by Section 952 of the Act

2. Discretionary Amendments

V. Final Regulatory Flexibility Act Analysis

A. Need for the Amendments

B. Significant Issues Raised by Public Comments

C. Small Entities Subject to the Final Rules

D. Reporting, Recordkeeping and Other Compliance Requirements

E. Agency Action To Minimize Effect on Small Entities

VI. Statutory Authority and Text of the Amendments

I. Background And Summary

On March 30, 2011, we proposed a new rule and rule amendments to implement Section 10C of the Securities Exchange Act of 1934 (the “Exchange Act”), as added by Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act”). Section 10C requires the Commission to direct the national securities exchanges to prohibit the listing of any equity securities and national securities associations to prohibit the listing of any equity securities.


See Section II.B.1, below, for a discussion of these types of exchanges.

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 of the Exchange Act. FINRA does not list equity securities; therefore, we refer only to national securities 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 15A 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.1, below, for a discussion regarding security futures products.
security of an issuer, with certain exceptions, that does not comply with Section 10C’s compensation committee and compensation adviser requirements.  

Specifically, Section 10C(a)(1) of the Exchange Act requires the Commission to adopt rules directing 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.” 10 The term “independent” is not defined in Section 10C. Instead, Section 10C(a)(3) provides that “independence” is to be defined by the exchanges after taking into consideration “relevant factors,” which are required to include (1) a director’s source of compensation, including any consulting, advisory or other compensatory fee paid by the issuer to such director, and (2) whether a director 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 establish listing standards that provide for the following requirements relating to compensation committees and compensation consultants, independent legal counsel and other advisers (collectively, “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 advisers; 11
- 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; 12
- The compensation committee must be directly responsible for the appointment, compensation and oversight of the work of compensation advisers; 13 and
- Each listed issuer must provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers. 14

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 proposed new Exchange Act Rule 10C–1 to implement the compensation committee listing requirements of Sections 10C(a)–(g) of the Exchange Act. We proposed rule amendments to Item 407 of Regulation S–K to require the disclosures mandated by Section 10C(c)(2), which are to be provided 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). In connection with these amendments, we also proposed to revise the current disclosure requirements with respect to the retention of compensation consultants.

The comment period for the Proposed Release closed on May 19, 2011. We received 58 comment letters from 56 different commentators, including pension funds, corporations, compensation consulting firms, professional associations, trade unions, institutional investors, investment advisory firms, law firms, academics, individual investors and other interested parties. Commentators generally supported the proposed implementation of the new requirements. Some commentors urged us to adopt additional requirements not mandated by the Act. Other commentators opposed some aspects of the proposed rule and rule amendments and suggested modifications to the proposals.

We have reviewed and considered all of the comments that we received on the proposals. The final rules reflect a number of changes made in response to these comments. We discuss our revisions with respect to the proposed rule and rule amendments in more detail throughout this release.

II. Discussion of the Final Rules

A. Exchange Listing Standards

1. Applicability of Listing Standards

We proposed to direct the exchanges to adopt listing standards that would apply Section 10C’s independence requirements to members of a listed issuer’s compensation committee as well as any committee of the board that performs functions typically performed by a compensation committee. We are adopting this aspect of the rule substantially as proposed, but with one change reflecting comments we received.

a. Proposed Rule

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.” 17 In addition, Congress sought to provide “shareholders in a public company” with “additional disclosures involving compensation practices.” 18 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. Moreover, Section 10C does not provide that, in the absence of a compensation committee, the entire board of directors will be considered to be the compensation committee, nor does it include provisions that have the effect of requiring a compensation committee as a practical matter.

Neither the Act nor the Exchange Act defines the term “compensation committee.” 19 Our rules do not

---

9 See Exchange Act Sections 10C(a) and (f).
10 Five categories of issuers are excluded from this requirement: controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act of 1940 (the “Investment Company Act”), and foreign private issuers that disclose in their annual reports the reasons why they do not have an independent compensation committee.
11 Exchange Act Sections 10C(c)(1)(A) and 10C(d)(1).
12 Exchange Act Section 10C(b).
13 Exchange Act Sections 10C(c)(1)(B) and 10C(d)(2).
14 Exchange Act Section 10C(e).
15 Section 10C(g) of the Exchange Act exempts controlled companies from the requirements of Section 10C.
16 We extended the original comment period deadline from April 29, 2011 to May 19, 2011. See Listing Standards for Compensation Committees, Release No. 33–9203 [Apr. 29, 2011] [76 FR 25273],
currently require that a listed issuer establish a compensation committee. Current exchange listing standards, however, generally require listed issuers either to have a compensation committee or to have independent directors determine, recommend or oversee specified executive compensation matters. 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. 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.

Some of the statements of the issuer, and * * * if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

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 unless independent directors. However, these exchanges, which include the BOX Options Exchange, International Securities Exchange, EDGA Exchange, EDGX Exchange, BATS Exchange, and C2 Options Exchange, currently either trade securities only pursuant to an exchange listing standards or trade only standardized options. In addition, the following 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.

See NYSE Listed Company Manual Section 303A.05. Section 303A.05 permits a listed issuer's board of directors to allocate the responsibilities of the compensation committee to another committee, provided that the committee is comprised 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 Company Act. See NYSE Listed Company Manual Section 303A.00.

See Nasdaq Rule 5605(d). Based on data supplied by Nasdaq, we understand that fewer than 2% of its listed issuers utilize the alternative of having independent board members, and not a committee. See also Nasdaq IM 5605–6 (stating that the Nasdaq rule "is intended to provide flexibility for a [c]ompany to choose an appropriate board structure and to reduce resource usage while ensuring [independent] director control of compensation decisions."). Nasdaq exempts certain issuers from this requirement, including asset-backed issuers and other partnerships, limited partnerships, management investment companies registered under the Investment Company Act, and controlled companies. See Nasdaq Rules 5615(a) and 5615(c)(2).

other exchanges have standards comparable to the NYSE's and require their listed issuers to have independent compensation committees. Other exchanges have standards comparable to Nasdaq's and, in the absence of a compensation committee, require executive compensation determinations to be made or recommended by a majority of independent directors on the listed issuer's board.

Proposed Rule 10C–1(b) would direct the exchanges to adopt listing standards that 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. Proposed Rule 10C–1(b), however, would not require the independence listing requirements to apply to members of the board who oversee executive compensation in the absence of a board committee.

b. Comments on the Proposed Rule

Comments on this proposal were generally favorable. Many commentators supported the functional approach of the proposed rule, which would require compensation committee independence listing standards to apply to any board committee charged with oversight of executive compensation, regardless of its formal title. In response to our request for comment on whether we should direct the exchanges to apply the proposed rule's requirements to directors who oversee executive compensation matters in the absence of a formal committee structure, several commentators recommended that we do so, and two of these commentators suggested that such a requirement would help ensure that companies could not rely on technicalities or loopholes to avoid independent director oversight of executive compensation.

Another commentator, however, argued that the final rule should not apply to independent directors who determine, or recommend to the board, executive compensation matters in the absence of a formal committee structure. This commentator believed that broadening the scope of the rule to apply to a group of directors who determine executive compensation in lieu of a formal committee is not clearly mandated by Section 10C and would burden listed issuers that do not have a board committee overseeing executive compensation, without necessarily improving their oversight of executive compensation.

In the Proposing Release, we requested comment on whether the exchanges should be prohibited from listing issuers that do not have compensation committees. Several commentators supported the concept of mandatory compensation committees for listed issuers, on the basis that executive compensation deserves special, ongoing attention by a dedicated working group of the board; a committee structure may promote increased board expertise on compensation; and having a formal committee would help promote accountability to shareholders. Several other commentators opposed such requirements, arguing that the exchanges should be allowed broad discretion on how listed issuers determine compensation matters.

c. Final Rule

After considering the comments, we are adopting Rule 10C–1(b) substantially as proposed. Under the final rule, the exchanges will be directed to adopt listing standards that apply to any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not such committee also

27 See letters from NACD and Railpen.

28 See letter from the American Bar Association, Business Law Section ("ABA").

29 This commentator also noted that, "[a] s a practical matter, we understand that most listed companies that are accelerated filers under the Exchange Act, and many listed companies that are smaller reporting companies, may have one compensation committee or committees performing the functions of compensation committees." Id.

30 See letters from the American Federation of Labor and Congress of Industrial Organizations ("AFL–CIO"), the Council of Institutional Investors ("CII"), Merkl and the Ohio Public Employees’ Retirement System ("OPERS").

31 See letters from ABA, CFA and NACD.
performs other functions or is formally designated as a compensation committee.\footnote{For example, if a listed issuer has a “corporate governance committee” or a “human resources committee,” the responsibilities of which include, among other matters, oversight of executive compensation, such committee will be subject to the compensation committee listing requirements of the applicable exchange.} In addition, the listing standards adopted by the exchanges must also apply the director independence requirements of Rule 10C–1(b)(1), the requirements relating to consideration of a compensation adviser’s independence in Rule 10C– 1(b)(4), and the requirements relating to responsibility for the appointment, compensation and oversight of compensation advisers in Rules 10C–1(b)(2)(i) and (iii) to the members of a listed issuer’s board of directors who, in the absence of a board committee, oversee executive compensation matters on behalf of the board of directors. We believe this approach is an appropriate way to implement Section 10C. The listing standards are intended to benefit investors by requiring that the independent directors of a listed issuer oversee executive compensation matters, consider independence criteria before retaining compensation advisers and have responsibility for the appointment, compensation and oversight of these advisers. We believe it would benefit investors to implement Section 10C in a manner that does not allow listed issuers to avoid these listing standards by simply not having a compensation committee or another board committee oversee executive compensation matters.

We have determined not to require the exchanges to apply the listing standards relating to the compensation committee’s authority to retain compensation advisers, Rule 10C–1(b)(2)(i), or required funding for payment of such advisers to directors who oversee executive compensation matters outside of the structure of a formal board committee, Rule 10C–1(b)(3). As noted above, we understand that action by independent directors acting outside of a formal committee structure would generally be considered action by the full board of directors. As a result, we believe it is unnecessary to apply these requirements to directors acting outside of a formal committee structure, as they retain all the powers of the board in making executive compensation determinations.

We are implementing this change by defining the term “compensation committee” so that it includes, for all purposes other than the requirements relating to the authority to retain compensation advisers in Rule 10C–1(b)(2)(i) and required funding for payment of such advisers in Rule 10C–1(b)(3), the members of the board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a formal committee. For ease of reference throughout this release, in our discussion of the final rules we are adopting, references to an issuer’s “compensation committee” include any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not formally designated as a “compensation committee,” as well as, to the extent applicable, those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of such a committee.

The final rule will not require a listed issuer to have a compensation committee or a committee that performs functions typically assigned to a compensation committee. We believe this aspect of the final rule is consistent with the requirements of Section 10C, which does not direct us to require such a committee. Moreover, in light of our determination to apply the requirements for director independence, consideration of adviser independence, and responsibility for the appointment, compensation and oversight of compensation advisers to those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a formal committee, there will be little difference between the requirements applicable to listed issuers that do not have compensation committees as compared to those applicable to issuers that do have compensation committees.

2. Independence Requirements

Proposed Rule 10C–1(b)(1) would require each member of a listed issuer’s compensation committee to be a member of the board of directors and to be independent. We proposed to require that the exchanges develop a definition of independence applicable to compensation committee members after considering relevant factors, including, but not limited to, the two factors enumerated in Section 10C(a)(3). We are adopting these requirements as proposed, except that, as discussed above, this aspect of the final rule will also apply to those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee.

a. Proposed Rule

Most exchanges that list equity securities already 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 vary somewhat among the different exchanges, listing standards generally prescribe certain bright-line independence tests (including restrictions on compensation, employment and familial or other relationships with the listed issuer or the executive officers of the listed issuer that could interfere with the exercise of independent judgment) that directors must meet in order to be considered independent.\footnote{See NYSE Listed Company Manual Section 303A.02(b); Nasdaq Rule 5605(a)(2).} For example, both NYSE and Nasdaq rules preclude a finding of independence if the director is or recently was employed by the listed issuer, the director’s immediate family member is or recently was employed as an executive officer of the listed issuer, or the director or director’s family member received compensation from the listed issuer in excess of specified limits.\footnote{See id.} 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, affiliation with entities that have material business relationships with the listed issuer, or employment at a company whose compensation committee includes any of the listed issuer’s executive officers.\footnote{See id.}

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.\footnote{See Commentary to NYSE Listed Company Manual Section 303A.02(a); Nasdaq Rule 5605; Nasdaq IM–5605.} 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 issuer\footnote{See NYSE Rule 303A.02(a).} 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.\textsuperscript{39} The other exchanges have similar requirements.\textsuperscript{40}

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).\textsuperscript{41} We understand that many issuers use their independent compensation committees to avail themselves of this exemption.\textsuperscript{42}

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. The definitions of “Non-Employee Director” and “outside director” are similar to the exchanges’ definitions of independent director.

The proposed rule would direct the exchanges to develop a definition of independence applicable to compensation committee members after considering relevant factors, including, but not limited to, a director’s source of compensation, including any consulting, advisory, or other compensation fee paid by the issuer to such director, and whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. We did not propose to specify any additional factors that the exchanges must consider in determining independence requirements for members of compensation committees.

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.\textsuperscript{44} Section 301 of the Sarbanes-Oxley Act added Section 10A(m)(1) to the Exchange Act,\textsuperscript{45} 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—one significant difference is that Section 10A requires only that the exchanges “consider relevant factors” (emphasis added), which include the source of compensation and any affiliate relationship, whereas the 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).\textsuperscript{46}

As a result, we interpret Section 10C as providing the exchanges discretion to determine the standards of independence that compensation committee members are required to meet than they are provided under Section 10A with respect to audit committee members. Section 10A(m) prescribes minimum criteria for the independence of audit committee members. In contrast, Section 10C gives the exchanges the flexibility to establish their own minimum independence criteria for compensation committee members after considering relevant factors, including the two enumerated in Section 10C(a)(3). Accordingly, the proposed rule would allow each exchange to establish its own independence definition, subject to Commission review and approval pursuant to Section 19(b) of the Exchange Act, provided the exchange considers relevant factors in establishing its own standards, including those specified in Section 10C(a)(3).

b. Comments on the Proposed Rule

Comments on this proposal were generally favorable. Many commentators supported permitting the exchanges to establish their own independence criteria for compensation committee members, provided they consider the statutorily-required factors.\textsuperscript{47} One commentator claimed that this approach would utilize the relative strengths and experiences of the exchanges by avoiding a “one size fits all” approach and could be more conducive to responding quickly to changes in corporate governance.\textsuperscript{48} Another commentator noted that the proposal permitted each exchange to develop more finely tuned listing rules that

\textsuperscript{39} See Nasdaq Rule 4200(a)(15).
\textsuperscript{40} See, e.g., NYSE Arca Rule 5.3(k)(1) and NYSE AMEX Company Guide Section 803.A.02.
\textsuperscript{41} As defined in Exchange Act Rule 16b–3(b)(3)(ii) [17 CFR 240.16b–3(b)(3)(ii)], 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; does not receive compensation, either directly or indirectly, 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)].
\textsuperscript{43} In our experience, many compensation committee charters require their members to meet the requirements of Rule 16b–3 and Section 162(m)."
\textsuperscript{44} Ira G. Bogner & Michael Krahnovsky, “Exchange Rules Impact Committee Composition,” The Metropolitan Corporate Counsel, Apr. 2004, at 17 (“Most compensation committees 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 * * *.”).\textsuperscript{45} 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
\textsuperscript{46} 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 “may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board 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). For non-investment company issuers, the audit committee member also 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.
\textsuperscript{47} See, e.g., letters from ABA, Barnard, Sanjui Bhagat, et al. (“Bhagat”), the Center on Executive Compensation (“CEC”), CFA, Davis Polk & Wardwell LLP (“Davis Polk”), MarkWest Energy Partners, L.P. (“MarkWest”), NYSE Euronext (“NYSE”), Pfizer Inc. (“Pfizer”) and Sullivan & Cromwell LLP (“S&C”).
\textsuperscript{48} See letter from MarkWest.
reflect the particular characteristics of each exchange’s listed companies.\textsuperscript{49} Allowing the exchanges the latitude to establish their own independence criteria concerned some commentators, however.\textsuperscript{50} These commentators cautioned against permitting the exchanges to establish their own independence criteria and argued in support of a uniform definition of independence across all exchanges.\textsuperscript{51} One of these commentators claimed that uniform requirements would serve as a deterrent to engaging in a “race to the bottom.”\textsuperscript{52} Another commentator recommended that the exchanges’ independence criteria should preclude a finding of independence if a director fails to meet the definitions of an “outside” director under Section 162(m) of the Internal Revenue Code or a “non-employee” director under Exchange Act Rule 16b–3(b)(3); is a party to a related party transaction that must be disclosed pursuant to Item 404 of Regulation S–K; or has an immediate family member who is employed by the company.\textsuperscript{53} Some commentators urged us to require the exchanges to consider additional factors in developing a definition of independence.\textsuperscript{54} Several commentators advocated that we should require the exchanges to include business or personal relationships between a compensation committee member and executive officers of the issuer as factors for consideration,\textsuperscript{55} as well as board interlocks.\textsuperscript{56} Another commentator believed that mandatory factors for consideration should include linkages between a director’s family members and the company or its affiliates and a director’s relationships with other directors.\textsuperscript{57} One commentator believed that, in setting independence standards for compensation committee members, the exchanges should be required to consider all factors relevant to assessing the independence of a board member, including personal, family and business relationships, and all other factors that might compromise a board member’s judgment on matters relating to executive compensation.\textsuperscript{58}

Three commentators, including the NYSE, stated that we should not specify additional mandatory factors that the exchanges must consider in developing a definition of independence applicable to compensation committee members.\textsuperscript{59} In particular, the NYSE expressed concern that if the final rule specifies additional mandatory factors for consideration, such factors would be understood by the exchanges and by many boards of directors as the Commission’s determination that such relationships compromise director independence, which would thereby effectively preempt the review of compensation committee independence standards that would be required to undertake under the rule.\textsuperscript{60} In the Proposing Release, we noted the concern of several commentators\textsuperscript{61} that our rules implementing Section 10C not prohibit directors affiliated with significant investors (such as private equity funds and venture capital firms) from serving on compensation committees. We requested comment on whether a director affiliated with a shareholder with a significant ownership interest who is otherwise independent would be sufficiently independent for the purpose of serving on the compensation committee. Many commentators advocated that a significant shareholder’s stock ownership alone should not preclude directors affiliated with the significant shareholder from serving on an issuer’s compensation committee.\textsuperscript{62} A number of these commentators noted that equity ownership by directors serves to align the directors’ interests with those of the shareholders with respect to compensation matters.\textsuperscript{63} According to one commentator, private equity funds typically have a strong institutional belief in the importance of appropriately structured and reasonable compensation arrangements, and the directors elected by such funds are highly incentivized to rigorously oversee compensation arrangements because the funds’ income, success and reputations are dependent on creating value for shareholders.\textsuperscript{64} This commentator also noted that, while private equity funds may seek to create shareholder value by strengthening or replacing the management team of a portfolio company, such funds rarely appoint partners or employees of their affiliated private equity firms to serve as executives of portfolio companies.\textsuperscript{65}

One commentator did not believe that directors affiliated with large shareholders should be permitted to serve on compensation committees, noting that situations could arise where the director’s obligation to act in the best interest of all shareholders would conflict with the director’s or large shareholder’s own interest.\textsuperscript{66} Two additional commentators noted that private equity and venture capital firms may engage in significant transactions with an issuer, and urged that all ties to the company be considered in evaluating the independence of directors affiliated with significant shareholders.\textsuperscript{67}

Our proposed rule would require the exchanges to consider current relationships between the issuer and the compensation committee member, and we requested comment on whether relationships prior to a director’s appointment to the compensation committee or, for directors already serving as compensation committee members when the new listing standards take effect, prior to the effective date of the new listing standards, should also be considered. Only two commentators expressed support for establishing any such “look-back” period.\textsuperscript{68} One commentator, although not supporting a look-back period, believed that the decision of whether to require one should be determined not by the Commission but...
by the exchanges. Other commentators argued that a look-back period was not necessary because the two largest exchanges (NYSE and Nasdaq) currently impose look-back requirements on listed issuers in their standards regarding director independence.

c. Final Rule

After consideration of the comments, we are adopting the requirements as proposed, except that we are also extending them to apply to those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. Under the final rule, the exchanges will be directed to establish listing standards requiring each member of a listed issuer’s compensation committee to be a member of the board of directors and to be independent. The final rule does not require that exchanges establish a uniform definition of independence. We believe this approach is consistent with the mandates in Section 10C(a)(3). Further, given the wide variety of issuers that are listed on exchanges, we believe that the exchanges should be provided with flexibility to develop independence requirements appropriate for the issuers listed on each exchange and consistent with the requirements of Rule 10C–1(b)(1). Although this provides the exchanges with flexibility to develop the appropriate independence requirements, as discussed below, the independence requirements developed by the exchanges will be subject to review and final Commission approval pursuant to Section 19(b) of the Exchange Act.

In developing their own definitions of independence applicable to compensation committee members, the exchanges will be required to consider relevant factors, including, but not limited to:

- A director’s source of compensation, including any consulting, advisory or compensatory fee paid by the issuer; and
- Whether the director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

The final rule does not specify any additional factors that the exchanges must consider in determining independence requirements for compensation committee members, nor does the final rule prescribe any standards or relationships that will automatically preclude a finding of independence. Because the rule’s relevant factors cover the same matters as the prohibitions in Section 10A(m)’s definition of audit committee independence, we expect the exchanges to consider whether those prohibitions should also apply to compensation committee members. However, consistent with Section 10C, the exchanges are not required to adopt those prohibitions in their requirements and will have flexibility to consider other factors in developing their requirements. As noted above and in the Proposing Release, Section 10C of the Exchange Act does not require that the exchanges prohibit all affiliates from serving on a compensation committee. In establishing their independence requirements, the exchanges may determine that, even though affiliated directors are not allowed to serve on audit committees, such a blanket prohibition would be inappropriate for compensation committees, and certain affiliates, such as representatives of significant shareholders, should be permitted to serve. However, in response to concerns noted by some commentators that significant shareholders may have other relationships with listed companies that would result in such shareholders’ interests not being aligned with those of other shareholders, we emphasize that it is important for exchanges to consider other ties between a listed issuer and a director, in addition to share ownership, that might impair the director’s judgment as a member of the compensation committee. For example, the exchanges might conclude that personal or business relationships between members of the compensation committee and the listed issuer’s executive officers should be addressed in the definition of independence.

Although each exchange must consider affiliate relationships in establishing a definition of compensation committee independence, there is no requirement to adopt listing standards precluding compensation committee membership based on any specific relationships. Accordingly, we do not believe it is necessary to separately define the term “affiliate” for purposes of Rule 10C–1. In addition, the final rule does not require any required look-back periods that must be incorporated in exchange listing standards relating to the independence of compensation committee members. We agree with commentators that the determination of whether to impose a look-back period in evaluating compensation committee member independence should be left to the exchanges and note that the exchanges already incorporate various look-back periods in their general criteria for director independence. In this respect, the final rule is similar to Exchange Act Rule 10A–3, which did not impose a mandatory look-back period for evaluating audit committee member independence in light of look-back periods already required by the exchanges for evaluating director independence generally.

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

3. Authority To Retain 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.” 74 and Section 10C(d) extends this authority to “independent legal counsel and other advisers.” 75 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 advisers. 76

We proposed Rules 10C–1(b)(2) and (3) to implement these statutory requirements. We are adopting these requirements substantially as proposed.

a. Proposed Rule

Proposed Rule 10C–1(b)(2) would implement Sections 10C(c)(1) and (d) by repeating the provisions set forth in those sections regarding the requirement to provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers.

In the Proposing Release, we noted 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 interpretation 77 of Section 10A(m) of the Exchange Act, which gave the audit committee authority to engage “independent legal counsel,” 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.

b. Comments on the Proposed Rule

Many commentators expressed general support for the proposed requirements. 79 While several commentators suggested that compensation committees should use, or be permitted to use, only independent compensation advisers, 80 other commentators agreed with the interpretive position expressed in the Proposing Release that the statute does not require a compensation committee to retain independent legal counsel or preclude the compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or counsel retained by the issuer or management. 81 One commentator noted that the proposed rule should not be interpreted to “apply to or interfere with a compensation committee’s dealings with legal counsel so that listed issuers would have greater assurance that they are in compliance with Exchange Act Section 10C(d)(1).” 82

c. Final Rule

We are adopting the rule substantially as proposed, with modifications to clarify that the scope of the requirements is limited to only those compensation advisers retained by the compensation committee and to apply the requirement that the compensation committee be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser retained by the compensation committee to those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. Under the final rules, the exchanges will be directed to adopt listing standards that provide that:

- The compensation committee may, in its sole discretion, retain or obtain the advice of a compensation adviser;

- The compensation committee may, in its sole discretion, retain or obtain the advice of a compensation adviser;

- The compensation committee may, in its sole discretion, retain or obtain the advice of a compensation adviser;
The compensation committee, which for this purpose includes those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee, shall be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser retained by the compensation committee; and

• Each listed issuer must provide for appropriate funding for payment of reasonable compensation, as determined by the compensation committee, to any compensation adviser retained by the compensation committee.

Consistent with Sections 10C(c)(1)(c) and 10C(d)(3), the final rule may not be construed to require the compensation committee to implement or act consistently with the advice or recommendations of any adviser to the compensation committee or to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

We note that the final rule requires the issuers must provide for appropriate funding applies and the obligation of the issuer to provide for appropriate funding applies only to those advisers that are not retained by the compensation committee, such as compensation consultants or legal counsel retained by management. Rather, the direct responsibility to oversee compensation advisers applies only to those advisers retained by a compensation committee, and the obligation of the issuer to provide for appropriate funding applies only to those advisers so retained.

Finally, in light of the provisions of our final rule and the fact that commentators did not urge us to define “independent legal counsel,” we do not believe such a definition is needed. 88 We note that the final rule requires the payment of reasonable compensation not only to independent legal counsel but also to “any other adviser,” to the compensation committee, which includes any compensation advisers retained by the compensation committee, such as attorneys and consultants, whether or not they are independent.

4. Compensation Adviser Independence Factors

Section 10C(b) of the Exchange Act provides that the compensation committee of a listed issuer may select a compensation adviser only after taking into consideration the five independence factors specified in Section 10C(b) as well as any other factors identified by the Commission. In accordance with Section 10C(b), these factors would apply to the selection of compensation consultants, legal counsel and other advisers to the committee. The statute does not require a compensation adviser to be independent, only that the compensation committee of a listed issuer consider the enumerated independence factors before selecting a compensation adviser. Section 10C(b)(2) specifies that the independence factors identified by the Commission must be competitively neutral 89 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

88 Although there is no relevant legislative history, we assume this requirement is intended to address the concern expressed by the multi-service compensation consulting firms that the disclosure requirements the Commission adopted in 2009 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.

89 The list of independence factors in Section 10C(b)(2), which addresses both multi-service firm “other services” conflicts and boutique firm “revenue concentration” conflicts, is consistent with this assumption.

90 See Proposing Release, 76 FR at 18972.
the independence factors set forth in the statute and incorporated into the rule without any materiality or bright-line thresholds or cutoffs.91

b. Comments on the Proposed Rule

Comments on this proposal were mixed. A number of commentators supported directing the exchanges to adopt listing standards that require the compensation committee to take into account the five factors enumerated in Section 10C, in addition to any other factors identified by the exchanges.92

One multi-service compensation consulting firm believed that the five factors listed in Section 10C(b)(2) were, in total, competitively neutral, but that, on an individual basis, some of the factors were not competitively neutral.93

This commentator suggested that we should provide an instruction to the final rules to emphasize that the factors should be considered in their totality and that no one factor should be viewed as a determinative factor of independence.94

Several commentators argued that some or all of the five factors identified in Section 10C(b)(2) and included in the proposed rule were not competitively neutral.95

Multi-service consulting firms argued that the consideration of other services provided to the issuer by the person that employs the compensation consultant was not competitively neutral as this factor would affect only multi-service firms. For their part, smaller consulting firms argued that the consideration of the amount of fees received from the issuer as a percentage of a firm’s total revenues was not competitively neutral because the likelihood of revenue concentration would be greater in smaller firms.96

Three commentators argued that our existing compensation consultant fee disclosure requirements disproportionately affect multi-service consulting firms, and suggested that we could improve the competitive neutrality of our rules by requiring competitively neutral disclosure of fees paid to all compensation consultants or advisers.97

Many commentators urged us to add more independence factors to the list of factors that could affect the independence of a compensation adviser.98

Several commentators argued that we should include a comparison of the amount of fees received for providing executive compensation consulting services to the amount of fees received for providing non-executive compensation consulting services.99

Other commentators expressed support for requiring compensation committees to consider any business or personal relationship between an executive officer of the issuer and an adviser or the person employing the compensation adviser.100

Some commentators, however, opposed adding new factors to the list of factors identified in the proposed rule,101 although one of these commentators acknowledged that it would advise any compensation committee evaluating the independence of a potential adviser to consider the business and personal relationships between the issuer’s executive officers and the adviser or adviser’s firm.102

In the Proposing Release, we requested comment on the application of the independence factors to different categories of advisers. Several commentators requested that we stipulate that a compensation committee conferring with or soliciting advice from the issuer’s in-house or outside legal counsel would not be required to consider the independence factors with respect to such counsels.103

These commentators believed that a compensation committee should be required to consider the independence factors only when the committee itself selects a compensation adviser, but not when it receives advice from, but does not select, an adviser.104

Moreover, two of these commentators questioned the usefulness of the independence assessment as it relates to in-house legal counsel, outside legal counsel to an issuer or a compensation adviser retained by management, as they are not held out, or considered by the compensation committee, to be independent.105

On the other hand, a number of commentators argued that the compensation adviser independence requirements should apply to any legal counsel that provides advice to the compensation committee.106 One of these commentators argued that the language of Section 10C(b)(1) is unambiguous and that the final rules should clarify that exchange listing standards must require compensation committees to consider the independence factors whenever a committee receives advice from legal counsel, regardless of whether or not the committee selected counsel.107

We also requested comment on whether we should include materiality, numerical or other thresholds that would limit the circumstances in which a compensation committee is required to consider the independence factors. Several commentators opposed including such materiality, numerical or other bright-line thresholds in the rule.108 These commentators expressed concern that such thresholds may not be competitively neutral and could reduce the flexibility compensation committees have to select advisers best-suited to the issuer. A number of commentators supported a materiality threshold with respect to the stock ownership factor. One commentator suggested that consideration of this factor should be required only if an individual beneficially owns in excess of 5% of an outstanding class of an issuer’s equity.109
securities. Another commentator suggested a threshold of $50,000 in fair market value or 5,000 shares of a listed issuer’s stock, below which an adviser’s stock ownership would not be deemed to affect his or her independence. Other commentators suggested that compensation committees should be required to consider only stock owned by the lead adviser and not stock owned by other employees on the adviser’s team.

Comments were mixed as to whether the final rule should clarify the phrases “provision of other services” or “business or personal relationships,” as used in proposed Rule 10C–1(b)(4). Some commentators thought no further clarification of the phrase “provision of other services” was necessary, and another commented that it “is better to have a general principle than to have exhaustive detailed rules that may leave loopholes for services that may impair the independence of an advisory firm.” Two commentators suggested defining the phrase to expressly exclude certain relationships that might impair adviser independence. Another commentator thought it unnecessary for us to further define the phrase because the “myriad possible definitions and considerations are unlikely to be fully encompassed by such a definition.”

A few commentators also urged that we clarify the scope of individuals whose relationships would need to be considered in the context of evaluating adviser independence. One commentator recommended limiting the required consideration to the individual adviser who renders services to the compensation committee, and another commentator similarly recommended limiting the required consideration to the lead consultant, counsel or adviser to the committee, but not to other members of the adviser’s team serving the compensation committee.

We requested comment on whether we should require disclosure of a compensation committee’s process for selecting advisers. Many commentators criticized this idea, citing concerns about extending already lengthy proxy statement discussions of executive compensation and expressing doubt that additional disclosure of the process for selecting advisers would provide any useful information to investors. However, some commentators thought such disclosure could be useful in providing transparency as to whether compensation committees were following the required process for selecting advisers.

c. Final Rule

After considering the comments, we are adopting the requirements substantially as proposed, but with some revisions. As discussed above, this aspect of the final rule will also apply to those members of a listed issuer’s board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. We have also decided to include one additional independence factor that compensation committees must consider before selecting a compensation adviser. Under the final rule, the exchanges will be directed to adopt listing standards that require a compensation committee to take into account the five factors enumerated in Section 10C(b)(2), as well as any business or personal relationships between the executive officers of the issuer and the compensation adviser or the person employing the adviser. This would include, for example, situations where the chief executive officer of an issuer and the compensation adviser have a familial relationship or where the chief executive officer and the compensation adviser (or the adviser’s employer) are business partners. We agree with commentators who stated that business and personal relationships between an executive officer and a compensation adviser or a person employing the compensation adviser may potentially pose a significant conflict of interest that should be considered by the compensation committee before selecting a compensation adviser.

As was proposed, the final rule does not expand the stock ownership factor to require consideration of stock owned by the person employing a compensation adviser. As we noted in the Proposed Release, we interpret “any stock of the issuer owned by the compensation consultant, legal counsel, or other adviser” to include shares owned by the individuals providing services to the compensation committee and their immediate family members.

Other than the additional factor described above, the final rules will not require the listing standards to mandate consideration of independence factors beyond those set forth in Section 10C(b)(2). We believe that these six factors, when taken together, are competitively neutral, as they will require compensation committees to consider a variety of factors that may bear upon the likelihood that a compensation adviser can provide independent advice to the compensation committee, but will not prohibit committees from choosing any particular adviser or type of adviser. We agree with the commentator who suggested that the factors should be considered in their totality and that no one factor should be viewed as a determinative factor of independence. We do not believe it is necessary, however, to provide an instruction to this effect, as the final rule directs the exchanges to require consideration of all of the specified factors. In response to concerns echoed by a number of commentators, we emphasize that neither the Act nor our final rule requires a compensation adviser to be independent, only that the
compensation committee consider the enumerated independence factors before selecting a compensation adviser. Compensation committees may select any compensation adviser they prefer, including ones that are not independent, after considering the six independence factors outlined in the final rule.\textsuperscript{127}

In response to comments,\textsuperscript{128} we are including an instruction to the final rule to provide that a compensation committee need not consider the six independence factors before consulting with or obtaining advice from in-house counsel. Commentators noted that it is routine for in-house counsel to consult with, and provide advice to, the compensation committee on a variety of issues, such as, for example, the terms of an existing benefit plan or how a proposed employment contract would affect an existing benefit plan or how a routine for in-house counsel to consult with or obtaining advice from in-house counsel. Commentators noted that it is routine for in-house counsel to consult with, and provide advice to, the compensation committee.

This instruction will not affect the obligation of a compensation committee to consider the independence of outside legal counsel or compensation consultants or other advisers retained by management or by the issuer. We believe that information gathered from an independence assessment of these categories of advisers will be useful to the compensation committee as it considers any advice that may be provided by these advisers. In addition, excluding outside legal counsel or compensation consultants retained by management or by the issuer from the required independence assessment may not be competitively neutral, since, as some commentators pointed out, they often perform the same types of services as the law firms and compensation consultants selected by the compensation committee.\textsuperscript{130}

Accordingly, we are including an instruction to the final rule that provides that a listed issuer’s compensation committee is required to conduct the independence assessment outlined in Rule 10C–1(b)(4) with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house legal counsel.

The final rule, like our proposal, does not include any materiality, numerical or other thresholds that would narrow the circumstances in which a compensation committee is required to consider the independence factors specified in the rule. We are concerned that adding materiality or other brightline thresholds may not be competitively neutral. The absence of any such thresholds means that all facts and circumstances relevant to the six factors will be presented to the compensation committee for its consideration of the independence of a compensation adviser, and not just those factors that meet a prescribed threshold. For similar reasons, the final rule does not further define the phrases “provision of other services” or “business or personal relationship.” Consistent with the proposed rule, the final rule does not require listed issuers to describe the compensation committee’s process for selecting compensation advisers pursuant to the new listing standards. We are sensitive to the concerns of commentators that adding such disclosure would increase the length of proxy statement disclosures on executive compensation without necessarily providing additional material information to investors.

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 prohibition.\textsuperscript{131} To implement this requirement, we proposed Rule 10C–1(a)(3), which would require the exchanges to establish such procedures if their existing procedures are not adequate. We are adopting the rule as proposed.

a. Proposed Rule

Proposed Rule 10C–1(a)(3) would provide that the exchange listing standards required by Rule 10C–1 must allow issuers a reasonable opportunity to cure violations of the compensation committee listing requirements. The proposed rule did not set forth specific procedures for curing violations of compensation committee listing requirements, but specified that the listing standards may provide 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 shareholders’ meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent. Proposed Rule 10C–1(a)(3) was patterned after similar provisions contained in Exchange Act Rule 10A–3(a)(3).\textsuperscript{132}

b. Comments on the Proposed Rule

Commentators generally supported proposed Rule 10C–1(a)(3). Two commentators favored requiring the exchanges to provide issuers the same opportunity to cure non-compliance with the compensation committee listing requirements as they have with respect to audit committee requirements. Commentators favored requiring the exchanges to establish more limited procedures for curing defects.\textsuperscript{133} We also requested comment as to whether listed issuers that have just completed initial public offerings should be given additional time to comply with the compensation committee independence requirements, as is permitted by Exchange Act Rule 10A–3(b)(1)(iv)(A) with respect to audit committee independence requirements. Several commentators supported providing newly listed issuers with additional time to comply with the compensation committee listing requirements.\textsuperscript{134} The NYSE argued that the exchanges should have the flexibility to permit an issuer applying for listing in connection with an initial public offering to have additional time to comply with compensation committee requirements.\textsuperscript{135} The NYSE also requested that we clarify the authority the exchanges would have under Rule 10C–1(a)(3) to provide issuers an opportunity to cure defects is

\textsuperscript{127} See letters from ABA, Davis Polk and S&C.
\textsuperscript{128} See letters from Davis Polk and S&C.
\textsuperscript{129} See letters from Jackson and Towers.
\textsuperscript{130} See letters from Better Markets.
\textsuperscript{131} See letters from Debevoise and CadPERS.
\textsuperscript{132} See, e.g., letters from Davis Polk and Merkl.
\textsuperscript{133} See letter from Better Markets.
\textsuperscript{134} See, e.g., letters from ABA, Davis Polk, Merkl and NYSE.
\textsuperscript{135} See letter from NYSE.
not limited to situations where a previously independent compensation committee member loses his or her independent status for reasons outside his or her control. 138

c. Final Rule

After consideration of the comments, we are adopting Rule 10C–1(a)(3) as proposed. Similar to Exchange Act Rule 10A–3(a)(3), the final rule requires the exchanges to provide appropriate procedures for listed issuers to have a reasonable opportunity to cure any noncompliance with the compensation committee listing requirements that could result in the delisting of an issuer’s securities. The exchanges’ rules may also provide that if a member of a listed issuer’s 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 shareholders’ meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent. The exchanges’ authority to provide issuers an opportunity to cure defects is not limited to situations where a previously independent compensation committee member loses his or her independent status for reasons outside his or her control.

As we noted in the Proposing Release, we believe that existing listing standards and delisting procedures of most of the exchanges 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. 139 Nonetheless, we expect that the rules of each exchange would provide for definite procedures and time periods for compliance with the final rule requirements to the extent they do not already do so.

We have not made any modifications to Rule 10C–1(a)(3) with respect to newly listed issuers. As discussed in more detail in Section II.B.2 of this release, in accordance with Exchange Act Section 10C(f)(3), our final rule will authorize the exchanges to exempt categories of issuers from the requirements of Section 10C. We believe this authority will allow the exchanges to craft appropriate limited exceptions from the required compensation committee listing standards for newly listed and other categories of listed issuers, subject to Commission review and approval pursuant to Section 19(b) of the Exchange Act.

B. Implementation of Listing Requirements

1. Exchanges and Securities Affected

We proposed to apply the requirements of Section 10C only to exchanges that list equity securities. In addition, the proposed rule would require that the exchanges adopt listing standards in compliance with the rule only with respect to issuers with listed equity securities. Along with the exemptions contained in Section 10C, the proposed rule would also exempt security futures products and standardized options. We are adopting the rule as proposed.

a. Proposed Rule

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. In contrast, Section 10C(f)(1), which states generally the scope of the compensation committee and compensation adviser listing requirements, provides that the Commission shall direct the national securities exchanges and national securities associations “to prohibit the listing of any security of an issuer that is 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. 140 The initial 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. 141 According to a press release issued by the House Financial Services Committee, this language was added during deliberations by that committee to clarify that the compensation committee independence standards apply only to “public companies, not to companies that have only an issue of publicly-registered debt.” 142 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 was deliberate. Unlike the House-passed bill, however, the final bill specifically references equity securities only in connection with compensation committee member independence requirements.

As we noted in the Proposing Release, the NYSE currently exempts issuers whose only listed securities are debt securities from the compensation committee listing requirements that apply to issuers listing equity securities. 143 In addition, Exchange Act Rule 3a12–11 exempts listed debt securities from most of the requirements in our proxy and information statements rules. 144 Finally, most, if not all, issuers with only listed debt securities, other than foreign private issuers, are privately held. 145 In light of the

---

138 See id.

139 See, e.g., NYSE Listed Company Manual Section 801–805; Nasdaq Equity Rules Series: NYSE AMEX 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 OMQ BX Rule 4800 series; Nasdaq OMX PHDLX 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 5.33(m); National Stock Exchange Rule 15.7 and Chapter X.

140 See H.R. 4173, 111th Cong. § 952 (as passed, with amendments, by the Senate on May 20, 2010).

141 See H.R. 4173, 111th Cong. § 2003 (as passed by the House of Representatives on Dec. 11, 2009).


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

144 In adopting this rule, the Commission determined that debt holders would receive sufficient protection from the indenture, the Trust Indenture Act, the proxy rules’ anti-fraud 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].

145 Based on a review of information reported on Forms 10-K, 20-F and 40-F 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 83 issuers that list only debt securities on an exchange. Of these 83 issuers, approximately 45 are wholly-owned subsidiaries that would be exempt from proposed Exchange Act
legislative history and our and the exchanges’ historical approach to issuers with only listed debt securities, we noted in the Proposing Release that we view the requirements of Section 10C as intended to apply only to issuers with listed equity securities.146 Accordingly, we proposed to apply Rule 10C–1 only to exchanges that list equity securities, and to direct these exchanges to adopt listing standards implementing our rule only as to issuers that are seeking to list or have listed equity securities. We noted in the Proposing Release that proposed Rule 10C–1 would not currently apply to FINRA, the only existing national securities association registered under Section 15A(a) of the Exchange Act, as FINRA does not list any securities and does not have listing standards under its rules.147 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.148

Rule 10C–1 pursuant to Section 10C(g) of the Act. None of these 83 issuers has a class of equity securities registered under Section 12 of the Exchange Act.149 Although Section 10C is, in many respects, similar to the audit committee independence requirements contained in Section 10A(m), there are differences in some of the statutory language. In this regard, we note the 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.

Similarly, we stated that we did not expect the National Futures Association, which is a national securities association registered under Section 15A(k) for the limited purpose of regulating the activities of members that are registered as broker-dealers in security futures products, see note 8, above, to develop listing standards regarding compensation committees in compliance with proposed Rule 10C–1. See Proposing Release, 76 FR at 18974, n. 73.

The OTC Bulletin Board (OTCBB) and the OTC Markets Group (previously known as the Pink Sheets and Pink OTC Markets) will not be affected by Rule 10C–1, and therefore issuers whose securities are quoted on these interdealer quotation systems similarly will not be affected, unless their securities are also listed on a national securities exchange. The OTCBB is an “interdealer quotation system” for over-the-counter securities that is operated by FINRA. (Exchange Act Rule 15c2–11 defines the term “interdealer quotation system.” 17 CFR 240.15c2–11.) It does not, however, have a listing agreement or arrangement with the issuers whose securities are quoted on the OTCBB that are not required to submit any information to the system. The OTC Markets Group is not a registered national securities exchange or association, nor is operated by a registered national securities exchange or association, and thus is not covered by the terms of the final rule.

Under proposed Rule 10C–1(a), exchanges would be required, to the extent that their listing standards did not conform with Rule 10C–1, to issue or amend their listing rules, subject to Commission review, to comply with the new rule. As noted in the Proposing Release, an exchange that lists or trades security futures products (as defined in Exchange Act Section 3(a)(56))145 may register as an exchange under Section 6(g) of the Exchange Act solely for the purpose of trading those products. As the Exchange Act definition of “equity security” includes security futures on equity securities,150 exchanges whose only listed equity securities are security futures products151 would be required to comply with Rule 10C–1 absent an applicable exemption. Given that Section 10C(f) of the Exchange Act makes no distinction between exchanges registered pursuant to Section 6(a)—such as the NYSE and Nasdaq—and those registered pursuant to Section 6(g), we did not propose 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 proposed to exempt security futures products from the scope of proposed Rule 10C–1. Accordingly, we noted in the Proposing Release that, to the extent the final rule exempted the listing of security futures products from the scope of Rule 10C–1, any exchange registered 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.

We proposed to exempt security futures products and standardized options from the requirements of Rule 10C–1. Although the Exchange Act defines “equity security” to include any security future on any stock or similar security, the Commodity Futures Modernization Act of 2000 (the “CFMA”)152 permits the exchanges to trade futures on individual securities and on narrow-based security indices (“security futures”)153 without such securities being subject to the registration requirements of the Securities Act of 1933 (the “Securities Act”) and the Exchange Act so long as they are cleared by a clearing agency that is registered under Section 17A of the Exchange Act154 or that is exempt from registration under Section 17A(b)(7)(A) of the Exchange Act. In December 2002, we adopted rules that provide comparable regulatory treatment for standardized options.155

The clearing agency for security futures products and standardized options is the issuer of these securities,156 but its role as issuer is fundamentally different from an issuer of equity securities of an operating company. The purchasers of security futures products and standardized options do not, except in the most formal sense, make an investment decision based on the issuer. As a result, information about the clearing agency’s business, its officers and directors and its financial statements is much less

146 Although Section 10C is, in many respects, similar to the audit committee independence requirements contained in Section 10A(m), there are differences in some of the statutory language. In this regard, we note the 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.

148 The OTC Bulletin Board (OTCBB) and the OTC Markets Group (previously known as the Pink Sheets and Pink OTC Markets) will not be affected by Rule 10C–1, and therefore issuers whose securities are quoted on these interdealer quotation systems similarly will not be affected, unless their securities are also listed on a national securities exchange. The OTCBB is an “interdealer quotation system” for over-the-counter securities that is operated by FINRA. (Exchange Act Rule 15c2–11 defines the term “interdealer quotation system.” 17 CFR 240.15c2–11.) It does not, however, have a listing agreement or arrangement with the issuers whose securities are quoted on the OTCBB that are not required to submit any information to the system. The OTC Markets Group is not a registered national securities exchange or association, nor is operated by a registered national securities exchange or association, and thus is not covered by the terms of the final rule.


150 Section 3(a)(11) of the Exchange Act defines the term “equity security” 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 right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate in the public interest or for the protection of investors, to treat as an equity security.

151 Exchanges currently registered solely pursuant to Section 6(b) 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 Intercontinental Exchange, LLC; and NQX LLC.


155 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 on a registered national securities exchange from all provisions of the Securities Act, other than the antifraud provision of Section 17, as well as the Exchange Act registration requirements.

156 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 (“The standardized or options and standardized 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").”.)
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 results of operations or 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 the sales of security futures products or standardized options.

In recognition of these fundamental differences, we provided exemptions for security futures products and standardized options from the audit committee listing requirements in Exchange Act Rule 10A–3.158

Specifically, Rule 10A–3–3(c) exempts the listing of a security futures 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(f)(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 proposed to exempt these securities from Rule 10C–1.

b. Comments on the Proposed Rule

Commentators generally agreed that Section 10C should apply only to issuers with listed equity securities.159 Some commentators argued that the proposed rule should apply to all domestic exchanges and public companies without exception.160 These commentators did not specifically comment on whether the statute is intended to apply only to issuers with listed equity securities. One commentator recommended that we exempt only exchanges that do not list equity securities and agreed that our proposed exemption for security futures products and standardized options is necessary or appropriate in the public interest and consistent with the protection of investors.161

c. Final Rule

After consideration of the comments, we are adopting the proposals without change. As adopted, the final rule will:

• Require all exchanges that list equity securities, to the extent that their listing standards do not already comply with the final rule, to issue or amend their listing rules to comply with the new rule;
  • Provide that exchange listing standards required by the new rule need apply only to issuers with listed equity securities; and
  • Exempt security futures products 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(f)(7)(A) and standardized options that are issued by a clearing agency that is registered pursuant to Section 17A of the Exchange Act.

2. 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 that is not in compliance with the compensation committee member independence requirements of Section 10C(a)(2), other than an issuer that is in one of five specified categories—controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act162 and foreign private issuers that disclose in their annual reports the reasons why they do not have an independent compensation committee;

  • 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 any 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 as the exchanges determines is appropriate, and that, in making such determinations, the exchanges must take into account the potential impact of the requirements on smaller reporting issuers; and

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

We proposed Rule 10C–1(b)(1)(iii)(A) to exempt the five categories of issuers enumerated in Section 10C(a)(1); Rule 10C–1(b)(1)(iii)(B) to 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; Rule 10C–1(b)(5)(ii) to permit the exchanges to exempt any category of issuer from the requirements of Section 10C, as each exchange determines is appropriate, taking into consideration the potential impact of such requirements on smaller reporting issuers; and Rule 10C–1(b)(5)(ii) to exempt controlled companies from the requirements of Rule 10C–1. We are adopting the proposals with changes made in response to comments.

a. Proposed Rule

i. Issuers Not Subject to Compensation Committee 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). Accordingly, we proposed to exempt controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act 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 from these requirements.

Under Section 10C(g)(2) of the Exchange Act, a “controlled company” is defined as an issuer that is listed on an exchange and that holds an election for the board of directors of the issuer in which more than 50% of the voting power is held by an individual, a group or another issuer. We proposed to incorporate this definition into Rule 10C–1(c)(2). Section 10C did not define the terms “limited partnerships” or “companies in bankruptcy proceedings.” As noted in the Proposing Release, we believe that a limited partnership is generally understood to mean 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.163 We also noted in

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

158 See Exchange Act Rules 10A–3–4(6) and (5).

159 See, e.g., letters from Debevoise and PLGGCC.

160 See letters from CII and FLSBA.

161 See letter from Merk.

162 15 U.S.C. 80a–1 et seq.

the Proposing Release that the phrase “companies in bankruptcy proceedings” is used in several Commission rules without definition. Accordingly, we did not further define either term in proposed Rule 10C–1(c).

Section 10C does not define the term “open-end management investment company.” As discussed in the Proposing Release, 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. We proposed to define this term in proposed Rule 10C–1(c) by referencing Section 5(a)(1) of the Investment Company Act.

Under Section 10C(a)(1), 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 and the reasons it is exempt from the compensation committee member 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.” Since this definition applies to all Exchange Act rules, we did not believe it was necessary to include a cross-reference to Rule 3b–4 in our proposed rules.

In the Proposing Release, we noted 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. Similar to our approach to Rule 10A–3, proposed Rule 10C–1(b)(1)(iii) would 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. Accordingly, 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.

ii. Exemption of Relationships and Other Categories of Issuers

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 account the size of the issuer and any other relevant factors. In addition, as noted above, Section 10C(f)(3) provides that our rules shall authorize an exchange to exempt a category of issuers from the requirements of Section 10C, as the exchange determines is appropriate, taking into account the potential impact of the Section 10C requirements on smaller reporting issuers. To implement these provisions, we proposed Rule 10C–1(b)(1)(iii)(B), which would authorize the exchanges to establish listing standards 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, and Rule 10C–1(b)(1)(iii)(I), which would allow the exchanges to exempt categories of listed issuers from the requirements of Section 10C, as each exchange determines is appropriate. In determining the appropriateness of categorical issuer exemptions, the exchanges would be required, in accordance with the statute, to consider the potential impact of the requirements of Section 10C on smaller reporting issuers.

b. Comments on the Proposed Rule

Comments on the proposals were generally favorable. Commentators generally supported the proposed approach of deferring to the exchanges any decisions to exempt any categories of issuers or particular relationships that might compromise committee member independence. One commentator expressed concern that the proposed definition of “controlled companies” would not exempt some listed issuers that are controlled companies under applicable listing standards, but do not actually hold director elections, such as some limited liability companies. This commentator recommended that we revise the definition of “controlled companies” in proposed Rule 10C–1(c)(2) so that it would encompass companies that do not actually hold director elections but have more than 50% of the voting power for the election of directors held by an individual, a group or another company.

In the Proposing Release, we requested comment on whether we should 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. The NYSE stated its view that the express exclusion of certain types of issuers in Other than the five categories of issuers in Section 10C(a)(1), we did not propose to exempt any relationship or any category of issuer from the compensation committee member independence requirements under Section 10C(a)(1). Instead of including specific exemptions, the proposed rule generally would leave the determination of whether to exempt particular relationships or categories of issuers to the discretion of the exchanges, subject to our review in the rule filing process. Because listed issuers frequently consult the exchanges regarding independence determinations and committee responsibilities, in the proposal we explained that we believed that the exchanges are in the best position to identify any relationships or categories of issuers that may merit exemption from the compensation committee listing requirements.
Section 10C(a)(1) should not prevent an exchange from exempting other types of issuers, and urged us to clarify that the general exemptive authority exchanges would have under Rule 10C–1 is not limited to smaller reporting companies.\textsuperscript{171}

Several commentators urged us to exempt all foreign private issuers from the requirements of Section 10C.\textsuperscript{172} Another commentator urged us to exempt smaller reporting companies from the requirements of Section 10C because smaller reporting companies may experience more difficulty than other issuers in finding independent directors who are willing to serve on their boards.\textsuperscript{173} Other commentators, however, believed that we should not exempt foreign private issuers or smaller reporting companies from the requirements of Section 10C.\textsuperscript{174} Several of these commentators supported a uniform application of compensation committee independence requirements to all public companies.\textsuperscript{175} One commentator believed that domestic companies should not face a stricter regime than foreign companies and that foreign companies could be given a time frame within which they would be required to meet the listing standards that apply to domestic companies.\textsuperscript{176}

One commentator urged us to exempt all registered investment companies from the requirements of Section 10C.\textsuperscript{177} This commentator noted that registered investment companies are subject to the requirements of the Investment Company Act, including, in particular, requirements concerning potential conflicts of interest related to investment adviser compensation. The commentator also noted that most registered investment companies are externally managed, do not have compensated executives and, therefore, do not need compensation committees to oversee executive compensation.

c. Final Rule

After consideration of the comments, we are adopting the rule with revisions in response to comments. Rule 10C–1(b)(1)(iii) will exempt from the compensation committee member independence listing standards required under Rule 10C–1(a) limited partnerships, companies in bankruptcy proceedings, registered open-end management investment companies 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.

As we proposed, we are also exempting controlled companies from the requirements of Rule 10C–1. In light of Section 10C(g)’s general exemption for controlled companies, we have eliminated the specific exemption for controlled companies from the compensation committee member independence listing standards in final Rule 10C–1(b)(1)(iii). We believe this specific exemption from the compensation committee member independence listing standards for controlled companies is unnecessary in light of the broader exemption for controlled companies provided by final Rule 10C–1(b)(5)(ii).

In response to comments that our proposed definition of controlled company would not exempt listed issuers that would otherwise be controlled companies but for the fact that they do not hold director elections, we are modifying the definition of controlled company in the final rule. Under the final rule, a controlled company will be defined as a listed company in which more than 50% of the voting power for the election of directors is held by an individual, a group or another company. We have removed from the definition the phrase “holds an election for the board of directors.” The revised definition of “controlled company” will more closely follow the definition of the term currently used by the NYSE and Nasdaq.\textsuperscript{178} Although the definition in the final rule is slightly broader than the definition of “controlled company” in Section 10C(g)(2), we believe this modification is consistent with the statutory intent to exempt from the requirements of Section 10C those companies that are in fact controlled by a shareholder or group of shareholders, regardless of whether director elections are actually held.

In addition to controlled companies, we are exempting smaller reporting companies, as defined in Exchange Act Rule 12b–2, from the requirements of Rule 10C–1.\textsuperscript{179} As noted above, one commentator urged us to exempt smaller reporting companies from the requirements of Section 10C because smaller reporting companies may experience more difficulty than other issuers in finding independent directors who are willing to serve on their boards.\textsuperscript{180} This commentator also noted that the compensation committees of smaller reporting companies often do not hire outside compensation consultants, both because their compensation programs tend to be “relatively simple” and also because smaller reporting companies “often cannot afford to hire outside experts.”\textsuperscript{181}

We recognize that some commentators opposed such an exemption,\textsuperscript{182} but we believe, on balance, that an exemption is appropriate. In 2006, when we substantially revised our executive compensation disclosure rules, we adopted new scaled executive compensation disclosure requirements for smaller companies in recognition of the fact that the “executive compensation arrangements of small business issuers generally are so much less complex than those of other public companies that they do not warrant the more extensive disclosure requirements imposed on companies that are not small business issuers and related regulatory burdens that could be disproportionate for small business issuers.”\textsuperscript{183} In light of those findings with respect to smaller reporting companies’ less complex executive compensation arrangements, we are not persuaded that the additional burdens of complying with Rule 10C–1 are warranted for smaller reporting companies.

We appreciate that these burdens for listed smaller reporting companies may not be significant given that such issuers are already subject to listing standards requiring directors on compensation committees or directors determining or recommending executive compensation.

\textsuperscript{171} See letter from NYSE.
\textsuperscript{172} See letters from ABA, Davis Polk and SAP AG.
\textsuperscript{173} See letter from ABA.
\textsuperscript{174} See letters from CalPERS, CII, FLsBA, the Local Authority Pension Fund Forum (“LAPFF”), Merkl, Railpen and USS.
\textsuperscript{175} See letters from CII, FLsBA and USS.
\textsuperscript{176} See letter from LAPFF.
\textsuperscript{177} See letter from the Investment Company Institute (“ICI”).
\textsuperscript{178} See NYSE Listed Company Manual Section 303A.00 and Nasdaq Rule 5615(c).
\textsuperscript{179} Approximately 1%, 25% and 53% of the operating companies listed on the NYSE, the Nasdaq Stock Market, and NYSE Amex, respectively, are smaller reporting companies. See Memorandum to File No. 57–13–11, dated May 8, 2012, concerning information on listed smaller reporting companies, which is available at http://www.sec.gov/comments/s7–13–11/571311–60.pdf.
\textsuperscript{180} See letter from ABA.
\textsuperscript{181} See id.
\textsuperscript{182} See letters from CalPERS, CII, FLsBA, Merkl and Railpen. These commentators did not provide specific reasons for their opposition, other than two commentators noting that the matters addressed in Section 10C are relevant to all public companies. See letters from CII and FLsBA.
matters to be “independent” under the exchanges’ general independence standards. We do believe, however, that exempting smaller reporting companies from the listing standards mandated by Rule 10C–1 can offer cost savings to these listed issuers to the extent that an exchange, in connection with the listing standards review required by Rule 10C–1, chooses to create a new independence standard for compensation committee members that is more rigorous than its existing standards—for example, a new standard could address personal or business relationships between members of the compensation committee and the listed issuer’s executive officers. Issuers subject to the exchange’s new standard may need to replace existing compensation committee members, and incur the associated costs, if the existing members do not qualify as independent under the new standard. In addition, although listed smaller reporting companies do not often engage outside compensation consultants, there would be cost savings to these listed issuers from not having to comply with the listing standards involving the compensation committee’s engagement and oversight of compensation advisers. For example, the exchanges are required to adopt listing standards that require the compensation committee to consider the six independence factors listed in Rule 10C–1(b)(4) before selecting a compensation adviser. To comply with these listing standards, compensation committees will likely need to create procedures for collecting and analyzing information about potential compensation advisers before they can receive advice from such advisers, which would require the listed issuers to incur costs. We expect, however, that a portion of these cost savings would likely be offset by the costs that smaller reporting companies may incur to comply with the new requirement to disclose compensation consultants’ conflicts of interest, which is described in Section II.C below. In light of these considerations, we do not believe it is necessary to require the exchanges to go through the process of proposing to exempt smaller reporting companies in the Section 19(b) rule filing process, since we have concluded that it is appropriate to provide this exemption in any event. Accordingly, we are exempting smaller reporting companies from the requirements of Rule 10C–1. \(^{184}\)

We are adopting Rules 10C–1(b)(1)(iii)(B) and 10C–1(b)(5)(i) substantially as proposed. Rule 10C–1(b)(1)(iii)(B) authorizes the exchanges to exempt a particular relationship from the compensation committee member independence requirements, as the exchanges deem appropriate, taking into consideration the size of the issuer and any other relevant factors. Rule 10C–1(b)(5)(i) authorizes the exchanges to exempt any category of issuers from the requirements of Section 10C. \(^{185}\) As each exchange determines is appropriate, taking into consideration the potential impact of the requirements on smaller reporting issuers. In response to comments, we are clarifying that the final rule does not prohibit the exchanges from considering other relevant factors as well. The final rule will allow the exchanges flexibility to propose transactions or categories of issuers to exempt, subject to our review and approval under the Exchange Act Section 19(b) rule filing process. As we noted in the Proposing Release, we believe that relying on the exchanges in this manner to exercise the expansive authority expressly granted to them under the final rules is consistent with the requirements of Section 10C and will result in more effective determinations as to the types of relationships and the types of issuers that merit an exemption. \(^{186}\)

As noted by one commentator, most registered investment companies do not have compensated employees or compensation committees. \(^{187}\) Therefore, the requirements of Rule 10C–1, which does not itself require any issuer to have a compensation committee, will not affect most registered investment companies or impose any compliance obligations on them. \(^{188}\) This commentator did not explain why, in the infrequent case where a registered investment company has compensated executives and a compensation committee (which are not addressed by Investment Company Act requirements related to investment adviser compensation), the registered investment company should be exempt from the requirements that apply to all other listed issuers with compensation committees. We believe that the exchanges are in a better position to determine the appropriate treatment of registered investment companies that have compensated executives and compensation committees, if any.

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 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 conflict and how the conflict is being addressed.

We proposed amendments to Item 407 of Regulation S–K to require issuers to include the disclosures required by Section 10C(c)(2) in any proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected. After consideration of the comments, we are adopting a modified version of the proposal.

1. Proposed Rule

Item 407 of Regulation S–K currently requires Exchange Act registrants that are subject to the proxy rules, other than registered investment companies, to provide certain disclosures concerning their compensation committees and the use of compensation consultants. Item 407(e)(3)(ii) generally requires

\(^{184}\) We believe that an issuer loses its smaller reporting company status, it will be required to comply with the listing standards applicable to non-smaller reporting companies. We anticipate that the exchanges will provide for a transition period for issuers that lose smaller reporting company status, similar to what they currently have for issuers that lose controlled company status. See, e.g., NYSE Listed Company Manual Section 303A.00: Nasdaq Rule 5615(c)(3).

\(^{185}\) As noted in the Proposing Release, Rule 10C–1(b)(5)(i) does not provide the authority for the exchanges to exempt listed issuers from the disclosure requirements under Item 407 of Regulation S–K, which include Section 10C(c)(2)’s compensation compensation committee requirements.


\(^{187}\) Proposed rule makes no accommodation for this category of issuer, and the JOBS Act does not require that exchanges do so. The rules we are adopting will permit the exchanges to consider, subject to the Commission’s review and approval, whether any exemptions from the listing standards required by Rule 10C–1 are appropriate for emerging growth companies or any other category of issuer.

\(^{188}\) We do not believe that any board committee or members of the board of a registered investment company or business development company would be a “compensation committee” under Rule 10C–1 solely as a result of carrying out the board’s responsibilities under Rule 38a–1 under the Investment Company Act to approve the designation and compensation of the fund’s chief compliance officer. Under Rule 38a–1, the approval of a majority of the board’s independent directors is required. See 17 CFR 270.38a–1(a)(4).
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.

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.

As we noted in the Proposing Release, the trigger for disclosure about compensation consultants under Section 10C(c)(2) is worded differently from the existing disclosure trigger under Item 407(e)(3)(iii). Under Section 10C(c)(2), an issuer must disclose whether the “compensation committee retained or obtained the advice of a compensation consultant.” By contrast, existing Item 407 requires disclosure, with limited exceptions, whenever a compensation consultant plays “any role” in determining or recommending the amount or form of executive or director compensation. Given the similarities between the disclosure required by Section 10C(c)(2) and the disclosure required by Item 407(e)(3)(iii), we proposed amendments to integrate Section 10C(c)(2)’s disclosure requirements with the existing disclosure rule. Specifically, as proposed, revised Item 407(e)(3)(iii) would include a disclosure trigger consistent with the statutory language and would, therefore, require issuers to disclose whether the compensation committee had “retained or obtained” the advice of a compensation consultant during the issuer’s last completed fiscal year.

If so, the issuer would also be required to provide related disclosures describing the consultant’s assignment, any conflicts of interest raised by the consultant’s work, and how such conflicts were being addressed. In addition, our proposed rule would alter the existing consultant fee disclosure requirements to include the same disclosure trigger. We noted in the Proposing Release that we believed the practical effect of this change would be minimal, as 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.

Our proposed integrated disclosure requirement would no longer provide an exception from the requirement to disclose the role of a compensation consultant where that role is 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 issuer or is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice.

Finally, under the proposed amendments, these disclosures would be required only in a proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected and would apply to issuers subject to our proxy rules, whether listed or not, and whether they are controlled companies or not.

2. Comments on the Proposed Rule

Comments on the proposed amendments were mixed, with the exception of our proposal to require the disclosures called for by Section 10C(c)(2) only in proxy or information statements for meetings at which directors are to be elected, which commentators generally supported. Several commentators expressed general support for our proposal to require disclosure about compensation consultants’ conflicts of interest. Some of these commentators noted that timely disclosure of conflicts is needed to allow investors to adequately monitor...
compensation committee performance.194 For this reason, another commentator noted that disclosure concerning compensation consultant conflicts of interest “is most appropriately required in the context of other corporate governance disclosures that are most relevant in the context of making voting decisions with respect to the election of directors.” 195

Several commentators expressed general support for integrating the Section 10C(c)(2) disclosure requirements into the existing compensation consultant disclosure requirements contained in Item 407(e)(3)(iii) of Regulation S–K.196 One of these commentators believed that a combined rule with a single trigger for disclosure would benefit issuers and investors by simplifying the disclosure requirement and enhancing the clarity of the disclosure.197 One commentator opposed integrating the disclosure requirements of Section 10C(c)(2) into Item 407(e)(3)(iii), and believed that a better approach would be to retain the existing disclosure trigger in Item 407(e)(3)(iii) and include a separate disclosure item within Item 407 to address conflict of interest disclosure requirements.198 This commentator also criticized our proposed amendments because they would narrow the disclosure currently required by Item 407(e)(3)(iii) by excluding those compensation consultants that may have participated in executive compensation determinations but were not actually retained by the compensation committee.199 Another commentator supported our proposal to integrate the disclosure requirements, but believed it was unnecessary to modify the wording of Item 407(e)(3)(iii) to include the “retain or obtain the advice” disclosure trigger included in the Act.200 This commentator noted that issuers and consulting firms had already made significant adjustments to their business practices in light of the existing Item 407(e)(3) requirements and that it would be costly and unnecessary to make additional adjustments if the wording of the existing rules is changed simply to mirror the language included in the Act.201

A significant number of commentators expressed concern over the proposed instruction to clarify the phrase “obtained the advice.”202 These commentators believed that the proposed instruction was too broad and could potentially cover director education programs, unsolicited survey results and publications that contain executive compensation data, which they believed were not intended to be covered by Section 10C(c)(2).203 A number of these commentators recommended modifications to the instruction, including:

- Excluding insubstantial or unsolicited interaction with a compensation committee; 204
- Clarifying that the phrase “obtained the advice” excludes materials prepared for management by a compensation consultant engaged by management, even if such materials are made available to the compensation committee;205 and
- Clarifying that “advice” has not been obtained unless the compensation consultant provides a recommendation to the committee regarding the amount or form of executive compensation.206

A few commentators supported our proposal to require disclosure about the role of compensation consultants even where that role is limited to consulting on broad-based plans or providing non-customized benchmark information.207 Many more commentators, however, opposed eliminating the current disclosure exclusions under Item 407(e)(3) and recommended that we extend those disclosure exclusions to the new disclosure requirements.208 Some of these commentators noted that, when the disclosure exemptions in Item 407(e)(3)(iii) were adopted in December 2009, the Commission stated that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that would warrant disclosure of the consultant’s selection, terms of engagement or fees.209 Another commentator believed that retaining the existing disclosure exclusions in Item 407(e)(3)(iii) would be consistent with the purposes of Section 10C(c)(2) because a consulting firm that provided only non-customized benchmark data to a compensation committee would not be providing “advice” to the compensation committee.210

Commentators generally supported our proposal to identify the five factors in proposed Rule 10C–1(b)(4)(i) through (v) as among the factors that should be considered in determining whether a conflict of interest exists,211 though some commentators suggested additional factors that they believed should be considered.212 In the Proposing Release, we requested comment on whether we should include the appearance of a conflict of interest in our interpretation of what constitutes a “conflict of interest” that must be disclosed under the proposed amendments. A few commentators believed that we should require disclosure of the appearance of a conflict of interest or potential conflicts of interest.213 One of these commentators argued that including potential conflicts is necessary because actual conflicts of interest can be difficult to identify with precision.214 Other commentators believed that we should not require disclosure of either an appearance of a conflict of interest or a potential conflict of interest, for various reasons, such as: potential conflicts were not covered by the text of Section 10C(c)(2);215 potential conflicts would be difficult to define and would not provide investors with additional material information regarding the compensation consultant relationship;216 and compensation committees are not reluctant or unable to conclude that a conflict of interest exists.217

Many commentators requested that we clarify that the amendments to Item 407(e)(3)(iii) apply only to board committees that are charged with determining executive compensation, and not to any committee of the board, if separate, that oversees the compensation of non-employee

---

194 See letters from CII and FLIBA.
195 See, e.g., letter from ABA.
196 See, e.g., letters from Davis Polk, Debevoise, Meridian, Pfizer and UAW.
197 See letter from Meridian.
198 See letter from ABA.
199 See id.
200 See letter from AON.
201 See id.
202 See, e.g., letters from AON, CEC, Davis Polk, Mercer, Meridian, Pearl Meyer & Partners (“Pearl Meyer”), McGuireWoods, NACD, Pfizer, SCGP and Towers.
203 See, e.g., letters from Davis Polk, Meridian, NACD and Towers.
204 See, e.g., letters from Davis Polk and Meridian.
205 See letters from Davis Polk and Towers.
206 See letters from Pfizer and SCGP.
207 See, e.g., letters from AFSCEME and UAW.
208 See, e.g., letters from ABA, AON, CEC, Davis Polk, Debevoise, Meridian, SCGP, Towers and U.S. Chamber of Commerce (Apr. 28, 2011) (“Chamber”).
209 See, e.g., letter from ABA and Davis Polk.
210 See letter from SCGP.
211 See letters from AON and Towers.
212 See, e.g., letters from AFSCEME (urging consideration of the ratio between fees paid for executive compensation and non-executive compensation consulting work, as well as equity ownership and incentive compensation arrangements of consultants) and Merki (urging consideration of private and business relationships between the person employing the adviser and executive officers or members of the compensation committee, as well as stock ownership by the person that employs the adviser, if it is material).
213 See letters from Better Markets, OPERS, and Towers.
214 See letter from Better Markets.
215 See letters from ABA, AON, and Mercer.
216 See letter from ABA.
217 See letter from AON.
Several of these commentators noted that in many instances, a committee other than the company’s compensation committee, such as a governance committee, determines the compensation of the company’s non-executive directors.

We requested comment on whether we should extend the Section 10C(c)(2) disclosure requirements to compensation advisers other than compensation consultants. Comments were mixed. A number of commentators believed we should require conflicts of interest disclosures for all types of advisers, including legal counsel.

One commentator stated that extending the disclosure requirements to legal counsel would benefit the investing public in its consideration of compensation issues. Another commentator noted that requiring such disclosure would allow investors to determine whether the compensation committee had the benefit of independent legal advice in making compensation determinations. Other commentators wrote that conflicted compensation advisers of any kind could not be relied upon to serve the best interests of the issuer and its shareholders. Two commentators opposed extending the proposed disclosure requirements to legal counsel. One of these commentators believed that the specific statutory reference in Section 10C(c)(2) to “compensation consultants” reflects a deliberate policy choice by Congress to limit the additional required disclosures to compensation consultants alone.

The proposed rule would apply to issuers that are required to comply with the proxy rules. One commentator supported our proposal to require controlled companies to provide disclosures relating to compensation consultants and conflicts of interest raised by the consultants’ work. Three commentators were opposed to this proposed requirement, and one of them questioned the value of requiring disclosure of a compensation consultant’s conflicts of interest in cases where the composition of the board of directors and compensation committee is subject to the direction of a control person or group. One commentator supported our proposal to require smaller reporting companies to provide disclosures relating to compensation consultant conflicts of interest, noting that “[w]e are not aware of any particular problems smaller reporting companies have had with the existing rules, and we do not believe the additional rules mandated by Dodd-Frank will be any more burdensome on smaller reporting companies.”

We received few comments on our proposal to extend the disclosure requirements to Exchange Act registrants that are not listed issuers. Two commentators supported our proposal. One commentator who opposed the proposal believed that extending the disclosure requirements of Section 10C(c)(2) to non-listed issuers is not required by Section 10C or for the protection of investors.

Several commentators agreed that we should not amend Forms 20-F or 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). Two of these commentators noted that imposing such requirements would be inconsistent with the current disclosure paradigm for compensation matters, which generally defers to a foreign private issuer’s home country rules. One commentator, however, expressed the view that foreign private issuers should have to comply with the same compensation consultant disclosure requirements as domestic issuers.

3. Final Rule

After consideration of the comments, we are adopting a modified version of the proposed amendments. The amendments we are adopting implement the disclosure requirements of Section 10C(c)(2) while preserving the existing disclosure requirements under Item 407(e)(3).

a. Disclosure Requirements

Rather than integrating the new disclosure requirements with the existing compensation consultant disclosure provisions, as proposed, we are retaining the existing disclosure trigger and requirements of Item 407(e)(3)(iii) and adding a new subparagraph to Item 407(e)(3) to require the disclosures mandated by Section 10C(c)(2)(B). With respect to Section 10C(c)(2)(A), which requires an issuer to disclose whether its compensation committee retained or obtained the advice of a compensation consultant, we believe existing Item 407(e)(3)(iii) implements this disclosure requirement, as it requires disclosure, with certain exceptions discussed more fully below, of any role compensation consultants played in determining or recommending the amount or form of executive and director compensation.

As we noted in the Proposing Release, we believe it would be unusual for a compensation consultant to play “any role” in determining or recommending the amount of executive compensation without the compensation committee also retaining or obtaining the compensation consultant’s advice.

With respect to the disclosures mandated by Section 10C(c)(2)(B), we are persuaded by comments noting that our proposal to use the “retain or obtain the advice” disclosure trigger included in Section 10C could result in unnecessary, and potentially costly, adjustments by issuers and consulting firms that have adapted their business practices in light of the existing Item 407(e)(3)(iii) disclosure requirements. In addition, we note the comment pointing out that our proposal would eliminate the existing requirement to disclose the role of compensation consultants retained by management rather than the compensation committee. Consequently, we have concluded that this change to the existing requirement is not appropriate. In lieu of our proposal to integrate the Section 10C(c)(2) disclosure requirements with the existing disclosure rule, we have determined to adopt a new disclosure provision, new Item 407(e)(3)(iv), to implement Section 10C(c)(2).

Under Item 407(e)(3)(iii), registrants will continue to be required to disclose “any role of compensation consultants in determining or recommending the amount or form of executive and director compensation.” Specifically, registrants will continue to be required to:

• Identify the consultants;
• State whether such consultants were engaged directly by the compensation committee or any other person;
• Describe the nature and scope of the consultant’s assignment and the material elements of any instructions given to the consultants under the engagement; and
• Disclose 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.\textsuperscript{235}

With respect to the new requirement in Item 407(e)(3)(iv) to disclose compensation consultant conflicts of interest, we have decided to use the “any role” disclosure trigger rather than the “obtained or retained the advice” trigger included in Section 10C. Hence, the new requirement will apply to any compensation consultant whose work must be disclosed pursuant to Item 407(e)(3)(iii), regardless of whether the compensation consultant was retained by management or the compensation committee or any other board committee. We believe that this approach is consistent with the meaning of the words “retained or obtained” (emphasis added) in Section 10C, as there will be little practical difference in the application of the two disclosure triggers as they relate to consultants advising on executive compensation matters. Based on the comments on this aspect of the proposal, we also believe that the existing disclosure trigger is well-understood by issuers. Because we are not changing the disclosure trigger, we no longer find it necessary to include an instruction to clarify when a compensation committee has “obtained” advice. We are persuaded by commentators who expressed the view that the instruction, as proposed, was overly broad.

As is the case with our existing requirement to disclose the role of compensation consultants in determining or recommending the amount or form of executive and director compensation, issuers will be required to comply with the new disclosure requirement relating to compensation consultant conflicts of interest in a proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected. Although Section 10C(2) is not explicitly limited to proxy statements for meetings at which directors will be elected, we believe this approach is appropriate in light of the approach in our rules to disclosure of compensation consultant matters generally.

This new subparagraph will apply to issuers subject to our proxy rules, including controlled companies, non-listed issuers and smaller reporting companies.\textsuperscript{236} Although Section 10C(c)(2) does not mandate this disclosure for issuers that will not be subject to the listing standards required by Rule 10C–1, we believe that investors are better served by requiring all issuers subject to our proxy rules to provide timely disclosure of compensation consultants’ conflicts of interests, which will enable investors to adequately monitor compensation committee performance and will help investors make better informed voting decisions with respect to the election of directors, including members of the compensation committee. Under the final amendments, issuers subject to our proxy rules will be required to disclose, with respect to any compensation consultant that is identified pursuant to Item 407(e)(3)(iii) as having played a role in determining or recommending the amount or form of executive and director compensation, 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. As commentators generally supported our proposal to identify the independence factors that a compensation committee must consider before selecting a compensation adviser as among the factors that should be considered in determining whether a consultant conflict of interest exists, the final amendments will include an instruction to Item 407(e)(3)(iii) that, in deciding whether there is a conflict of interest that may need to be disclosed, issuers should, at a minimum, consider the six factors set forth in Rule 10C–1(b)(4)(i) through (vi).

We are sensitive to the additional burdens placed on issuers from the expansion of disclosure obligations under our rules. In light of those concerns, the final rule will not require disclosure of potential conflicts of interest or an appearance of a conflict of interest, nor require disclosure with respect to compensation advisers other than compensation consultants. These additional disclosures are not mandated by Section 10C, and we are not persuaded that the additional burdens of requiring this disclosure are justified by the potential benefit to investors.

b. Disclosure Exemptions

We proposed to eliminate the disclosure exemption in Item 407(e)(3) for compensation consulting services involving only broad-based, non-discriminatory plans and the provision of non-customized survey data. Several commentators opposed to the proposed elimination noted that, when the disclosure exemptions in Item 407(e)(3)(iii) were adopted in December 2009, we stated that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that would warrant disclosure of the consultant’s selection, terms of engagement, or fees.\textsuperscript{237} We continue to believe that compensation consulting work limited to these activities does not raise conflict of interest concerns. Accordingly, consulting on broad-based plans and providing non-customized benchmark data will continue to be exempted from the compensation consultant disclosure requirements under Item 407(e)(3), including the new conflicts of interest disclosure required in our rules implementing Section 10C(c)(2).

c. Disclosure Regarding Director Compensation

Several commentators requested that we clarify that the proposed amendments to Item 407(e)(3)(iii) apply only to board committees that are charged with determining executive compensation and not to other committees that oversee the compensation of non-employee directors.\textsuperscript{238} We believe these comments were prompted by our proposal, described above, to replace the existing disclosure trigger in Item 407(e)(3)(iii) with our proposed trigger, which referenced compensation consultants retained by the compensation committee. As discussed above, we have determined to retain the existing disclosure trigger in Item 407(e)(3), which requires disclosure of the role played by compensation consultants in determining or recommending “executive and director compensation” (emphasis added).

Issuers are currently required to discuss in proxy and information statements the role played by

\textsuperscript{235} The rule will continue not to require fee disclosure for compensation consultants that work with management if the compensation committee has retained a separate compensation consultant. As we noted in the Proxy Disclosure Enhancements Release, in this situation, the compensation committee may not be relying on the compensation consultant retained by management and potential conflicts of interest are therefore less of a concern.

\textsuperscript{236} Foreign private issuers that are not subject to our proxy rules will not be required to provide this disclosure. Registered investment companies are subject to separate proxy disclosure requirements set forth in Item 22 of Schedule 14A, which do not include the compensation consultant disclosure requirement in Item 407(e)(3) of Regulation S–K. See Item 7(g) of Schedule 14A. As we proposed, registered investment companies will continue to provide disclosure under Item 22 and will not be subject to the amendments to Item 407(e) adopted in this release.

\textsuperscript{237} See letters from ABA, Davis Polk and SCGPS.

\textsuperscript{238} See, e.g., letters from CEC, Chamber, Davis Polk, Pfizer, and SCGPS.
compensation consultants in determining or recommending the amount or form of director compensation, including the nature and scope of their assignment and any material instructions or directions governing their performance under the engagement and to provide fee disclosure, all to the same extent that the disclosure is required regarding executive compensation. In light of the approach we are taking to the new disclosure requirement generally, which is to add the new requirement to the existing disclosure requirements using the existing triggers, we believe it is appropriate to apply the compensation consultant conflict of interest disclosure requirement to director compensation in the same manner as executive compensation. We believe this will benefit investors by providing for more complete and consistent disclosures on how the board manages compensation-related conflicts of interest. Accordingly, to the extent consulting on director compensation raises a conflict of interest on the part of the compensation consultant, disclosure would be required in response to new Item 407(e)(3)(iv).

D. Transition and Timing

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 proposed that each exchange must provide to the Commission, no later than 90 days after publication of our final rule in the Federal Register, proposed listing rules or rule amendments that comply with our final rule. Further, we proposed that each exchange would need to have final rules 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, proposed listing rules or rule amendments that comply with our final rule.

Comments were mixed on these proposals. One commentator did not believe that the 90-day period would afford the exchanges enough time to draft the proposed rules or rule amendments or to work through related concerns or issues. The only comment letter we received from an exchange, however, indicated that the 90-day period would be adequate. The exchange recommended, however, that instead of obligating exchanges to have rules approved by the Commission within any set timeframe, we should instead require exchanges to respond to any written comments issued by the Commission or its staff within 90 days.

Two commentators requested that we clarify that the exchanges may provide their listed issuers a transition period to come into compliance with the listing standards required by Rule 10C–1.

Two other commentators requested that the Commission include a transition period for newly listed issuers directly in Rule 10C–1.

One of these commentators also recommended a two-year delayed phase-in period for smaller reporting companies, if they are not exempted entirely from the compensation committee and independence requirements and consultant disclosures.

Another commentator requested that we establish a specific time period by which all listed issuers must comply with an exchange’s new or amended rules meeting the requirements of our final rules. This commentator believed that a longer time frame, such as a year, would give listed issuers sufficient time to comply with the new standards.

After consideration of the comments, we are adopting the implementation period as proposed. We believe that retaining the requirement for each exchange to have final rules 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 will ensure that the exchanges work expeditiously and in good faith to meet the requirements of the new rule. We also note that Rule 10A–3 included a similar requirement with a significantly shorter compliance period. Although the final rule does not provide an extended transition period for newly listed issuers, we note that the exemptive authority provided to the exchanges under the final rule permits them to propose appropriate transition periods. As noted above, we are exempting smaller reporting companies from the requirements of Rule 10C–1. Section 10C(c)(2) provides that the compensation consultant conflict of interest 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 was July 21, 2011; however, the statute also requires these disclosures to be “in accordance with regulations of the Commission.” and, prior to the adoption of these new rules, our regulations have not required such disclosures to be made. We recognize that issuers will need to implement disclosure controls and procedures to collect and analyze information relevant to whether their compensation consultants have a conflict of interest. As a result, we have decided to require compliance with new Item 407(e)(3)(iv) in any proxy or information statement for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting) at which directors will be elected occurring on or after January 1, 2013.

III. Paperwork Reduction Act

A. Background

Certain provisions of the final rule and rule amendments contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”). We published a notice requesting comment on the collection of information requirements in the Proposing Release for the rule amendments, and we submitted these requirements to the Office of Management and Budget (“OMB”) for review in accordance with the PRA. 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).

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 new rule and rule amendments will be mandatory. Responses to the information collections will not be kept confidential, and there is no mandatory retention period for the information disclosed.

B. Summary of the Final Rules

As discussed in more detail above, we are adopting new Rule 10C–1 under the Exchange Act and amendments to Item 407(e)(3) of Regulation S–K. Rule 10C–1 will direct the exchanges to prohibit the listing of any equity security of an issuer, subject to certain exceptions, that is not in compliance with several enumerated standards relating to the issuer’s compensation committee and the process for selecting a compensation adviser to the compensation committee. Rule 10C–1 will not impose any collection of information requirements on the exchanges or on listed issuers. The amendments to Item 407(e)(3) will require issuers, other than registered investment companies, to disclose, 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, whether the work of any compensation consultant that has played any role in determining or recommending the amount or form of executive and director compensation (other than any role limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers 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) has raised a conflict of interest. If so, the issuer must also disclose the nature of the conflict and how the conflict is being addressed.

C. Summary of Comment Letters and Revisions to Proposals

In the Proposing Release, we requested comment on our PRA burden hour and cost estimates and the analysis used to derive such estimates. Only one commentator specifically addressed our PRA analysis and burden estimates of the proposed amendments.250 This commentator asserted that some of the estimates we used to calculate the burden hours of the proposed amendments may be inaccurate, which could result in our underestimating the actual burden of the amendments. This commentator, however, did not provide any alternative burden hour or cost estimates for us to consider and did not identify any particular estimates included in the Proposing Release that it believed to be inaccurate.

In response to comments on the proposals, we have made modifications to the rule proposals that will reduce the compliance burden on issuers. First, the final rule amendments leave intact the existing exemption from the requirement to disclose the role of a compensation consultant where that role is limited to providing advice on broad-based plans and information that either is not customized for a particular issuer or is customized based on parameters that are not developed by the consultant and about which the consultant does not provide advice. Accordingly, issuers will be required to provide less disclosure than would have been required under the proposed amendments. Second, we have retained the existing disclosure trigger in Item 407(e)(3) and eliminated the proposed instruction regarding whether a compensation committee has “obtained the advice” of a compensation consultant. Based on comments received that issuers are already familiar with and have adopted business practices to comply with the existing disclosure trigger, we believe retaining the existing disclosure trigger will make it easier for issuers to determine whether conflict of interest disclosure is required for a particular compensation consultant.

D. Revisions to PRA Reporting and Cost Burden Estimates

As a result of the changes described above, we have reduced our reporting and cost burden estimates for the collection of information under the final amendments. The final rule amendments to Item 407(e)(3) of Regulation S–K will require additional disclosure in proxy or information statements filed on Schedule 14A or Schedule 14C of whether the work of a compensation consultant that has played any role in determining or recommending the amount or form of executive and director compensation, with certain exceptions, has raised a conflict of interest, and, if so, the nature of the conflict and how the conflict is being addressed. The instruction to Item 407(e)(3)(iv) provides that an issuer, in determining whether there is any such conflict, should consider the same six independence factors that the compensation committee of a listed issuer is required to consider before selecting a compensation adviser. For purposes of the PRA, we now estimate that the total annual increase in the paperwork burden for all companies to prepare the disclosure that would be required under the proposed amendments will be approximately $1,970 hours of in-house personnel time and approximately $1,596,000 for the services of outside professionals.251 We estimate that the amendments to Item 407(e)(3) of Regulation S–K would impose on average a total of two incremental burden hours per issuer. These estimates include the time and the cost of collecting the required information, preparing and reviewing responsive disclosure, and retaining records. We continue to believe it is appropriate to assume that the burden hours associated with the amendments will be comparable to the burden hours related to similar disclosure requirements under our current rules regarding compensation consultants. Our estimates, as well as their reasonableness, were presented to the public for consideration, and we received no alternative burden hour or cost estimates in response.252

The table below shows the total annual compliance burden, in hours and in costs, of the collection of information pursuant to the final amendments to Item 407(e)(3) of Regulation S–K.253 These 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 adopted 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

249 Registered investment companies are subject to separate proxy disclosure requirements set forth in Item 22 of Schedule 14A, which do not include the compensation consultant disclosure requirement in Item 407(e)(3) of Regulation S–K. See Item 22g) of Schedule 14A. As we proposed, registered investment companies will continue to provide disclosure under Item 22 and will not be subject to the amendments to Item 407(e) adopted in this release.

250 See letter from Chamber.

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

252 See Proxy Disclosure Enhancements Release (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).

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

### TABLE 1—ESTIMATED INCREMENTAL PAPERWORK BURDEN UNDER THE FINAL RULES FOR SCHEDULES 14A AND 14C

<table>
<thead>
<tr>
<th>Schedule</th>
<th>Number of responses (A)</th>
<th>Incremental burden hours/ (B)</th>
<th>Total incremental burden hours (C)=(A)*(B)</th>
<th>Internal company time (D)</th>
<th>External professional time (E)</th>
<th>Professional costs (F)=(E)*$400</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sch. 14A</td>
<td>7,300</td>
<td>2</td>
<td>14,600</td>
<td>10,950</td>
<td>3,650</td>
<td>$1,460,000</td>
</tr>
<tr>
<td>Sch. 14C</td>
<td>680</td>
<td>2</td>
<td>1,360</td>
<td>1,020</td>
<td>340</td>
<td>136,000</td>
</tr>
<tr>
<td>Total</td>
<td>7,980</td>
<td></td>
<td>15,960</td>
<td>11,970</td>
<td>3,990</td>
<td>$1,596,000</td>
</tr>
</tbody>
</table>

### IV. Economic Analysis

#### A. Background and Summary of the Rule Amendments

As discussed above, we are adopting a new rule and rule amendments to implement Section 10C of the Exchange Act, as added by Section 952 of the Act. Section 10C of the Exchange Act requires us to adopt rules directing the exchanges to prohibit the listing of any equity security of an issuer, with certain exceptions, that is not in compliance with several enumerated standards regarding compensation committees. In addition, 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. The rule and rule amendments we are adopting implement these mandates, and also include the following provisions:

- New Rule 10C–1 will direct the exchanges to adopt listing standards that apply to any board committee that oversees executive compensation, whether or not such committee performs other functions or is formally designated as a “compensation committee.”

- The exchanges will be directed to apply the required listing standards, other than those relating to the authority to retain compensation advisers in Rule 10C–1(b)(2)(i) and required funding for payment of such advisers in Rule 10C–1(b)(3), also to those members of a listed issuer’s board of directors who, in the absence of a board committee performing such functions, oversee executive compensation matters on behalf of the board of directors.

- With respect to the factors required by Section 10C(b) of the Exchange Act, we are adopting one additional independence factor that compensation committees must consider before engaging a compensation adviser.

- An instruction to final Rule 10C–1(b)(4) will provide that the compensation committee of a listed issuer is not required to consider the independence factors before consulting with or receiving advice from in-house counsel.

- We are exempting security futures products, standardized options, and smaller reporting companies from the scope of Rule 10C–1.

- For purposes of Rule 10C–1, we are modifying the definition of a controlled company, which is exempt from Rule 10C–1, to be a listed company in which more than 50% of the voting power for the election of directors is held by an individual, a group or another company, which is consistent with the definition used by the NYSE and Nasdaq.

- The final rules will require the disclosures relating to compensation consultant conflicts of interest called for by Section 10C(c)(2) only in proxy or information statements for meetings at which directors are to be elected.

- The compensation consultant conflicts of interest disclosure requirement will apply when a compensation consultant plays “any role” in “determining or recommending the amount or form of executive and director compensation,” other than any role limited to consulting on broad-based plans or providing non-customized benchmark data, which is consistent with the existing Item 407(e)(3)(iii) of Regulation S–K standard.

- The compensation consultant conflicts of interest disclosure requirement will apply to all issuers subject to our proxy rules, including controlled companies, smaller reporting companies and non-listed issuers.

- The compensation consultant conflicts of interest disclosure requirement will require disclosure of compensation consultant conflicts of interest that relate to director compensation, in addition to executive compensation.

- The instruction to the compensation consultant conflicts of interest disclosure requirement provides that an issuer, in determining whether there is a conflict of interest, should consider the same six independence factors that the compensation committee of a listed issuer is required to consider before selecting a compensation adviser.

- We are sensitive to the costs and benefits imposed by our rules. The discussion below attempts to address both the costs and benefits of Section 10C, as well as the incremental costs and benefits of the rule and rule amendments we are adopting within our discretion to implement Section 10C.

These two types of costs and benefits may not be entirely separable to the extent our discretion is exercised to realize the benefits that we believe were intended by Section 952 of the Act. 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. 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 Act and Section 3(f) of the Exchange Act 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. We have integrated our consideration of those issues into this economic analysis.

In the Proposing Release, we solicited comment on the costs and benefits of the proposed rules, whether the proposed rule and rule amendments would place a burden on competition, and the effect of the proposal on efficiency, competition, and capital formation. Only one commentator specifically addressed the cost-benefit analysis we included in the Proposing Release or our analysis of whether the proposals would burden competition or impact efficiency, competition, and capital formation. This commentator argued that the proposals would impose additional compensation disclosure and director independence requirements that could be burdensome and result in additional disclosure of an issuer’s use of compensation consultants, without in every case providing meaningful benefit to issuers or investors, and that could also confuse investors or deter investors from “reading proxy materials by increasing their length and density without pruning other, less pertinent, or dated disclosures.” As discussed throughout this release, we have made numerous revisions to the proposed rules in order to address these concerns and reduce compliance burdens where consistent with investor protection. Other commentators addressed specific aspects of the proposed rule amendments that identified possible costs, benefits, or effects on efficiency, competition or capital formation, which we discuss in more detail below.

B. Benefits and Costs, and Impact on Efficiency, Competition and Capital Formation

1. Section 10C of the Exchange Act, as Added by Section 952 of the Act

New Rule 10C–1 implements the listing standard requirements of Section 10C by directing the exchanges to prohibit the listing of any equity security of an issuer that is not in compliance with the following standards:

- Each member of the compensation committee of the issuer must be a member of the issuer’s board of directors and independent according to independence criteria determined by each exchange following consideration of specified factors;
- The compensation committee of each issuer must be directly responsible for the appointment, compensation, retention and oversight of the work of any compensation adviser retained by the committee, and each such compensation adviser must report directly to the compensation committee;
- Each compensation committee must have the authority to retain independent legal counsel and other compensation advisers;
- The compensation committee of each issuer may select a compensation adviser only after assessing the adviser’s independence using specified factors; and
- Each issuer must provide appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to compensation advisers retained by the compensation committee.

Under the final rule, subject to our review in accordance with Section 19(b) of the Exchange Act, an exchange may exempt any category of issuers from the compensation committee listing requirements and any particular relationships from the compensation committee member independence requirements, as the exchange determines is appropriate, after consideration of the impact of the requirements on smaller reporting issuers and other relevant factors.

The rules we are adopting are intended to benefit both issuers and investors. The final rules are expected to help achieve Congress’s intent that listed issuers’ board committees that set compensation policy consist only of directors who are independent. By requiring compensation committees to consider the independence of potential compensation advisers before they are selected, the final rules should also help assure that compensation committees of affected listed issuers are better informed about potential conflicts, which could reduce the likelihood that they are unknowingly influenced by conflicted compensation advisers. The provisions of the listing standards that will require compensation committees to be given the authority to engage, oversee and compensate independent compensation advisers should bolster the access of board committees of affected listed issuers that are charged with oversight of executive compensation to the resources they need to make better informed compensation decisions. Taken as a whole, these requirements could benefit issuers and investors to the extent they enable compensation committees to make better informed decisions regarding the amount or form of executive compensation.

The listing standard provisions of the rule and rule amendments will also result in certain costs to exchanges and affected listed issuers. Final Rule 10C–1 directs 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. Exchanges will incur direct costs to comply with the rule, as they will need to review their existing rules and propose appropriate rule changes to implement the requirements of Rule 10C–1. Once the exchanges have adopted listing standards required by Rule 10C–1, listed issuers will incur costs in assessing and demonstrating their compliance with the new listing standards. We note that these costs are primarily imposed by statute.

The adoption of new listing standards may have some distributional effects as some listed issuers may seek to list on foreign exchanges or other markets to avoid compliance with listing requirements that an exchange develops. To the extent they do so, listed issuers would incur costs in seeking to transfer their listings, and exchanges that lose issuer listings would, as a result, lose related fees and trading volume. We believe that any such effect would be minimal as the exchanges already require directors on compensation committees or directors determining or recommending executive compensation matters for domestic issuers to be “independent” under their general independence standards.

As required by Section 10C, 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). These factors include:

- A director’s source of compensation, including any consulting, advisory or compensatory fee paid by the issuer; and
- whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

We are not adopting any additional factors that the exchanges must consider in determining independence requirements for compensation committee members. Instead, Rule 10C–1 affords the exchanges latitude in

---

256 See letter from Chamber.
259 Id.
determining the required independence standards. Several commentators indicated that the proposed rule would permit the exchanges to determine listing standards that take into account the characteristics of each exchange’s listed issuers.261 We believe that affording the exchanges flexibility in determining the required independence standards, subject to our review pursuant to Section 19(b) of the Exchange Act, will result in more efficient and effective determinations as to the types of relationships that should preclude a finding of independence with respect to membership on a board committee that oversees executive compensation. We believe that because listed issuers frequently consult the exchanges regarding independence determinations, the exchanges will be in the best position to identify the types of relationships that are likely to compromise the ability of an issuer’s compensation committee to make impartial determinations on executive compensation.

We acknowledge, however, that because exchanges compete for listings, they may have an incentive to propose standards that issuers will find less onerous. This could affect investor confidence in the degree of independent oversight of executive compensation at issuers listed on exchanges with less onerous standards and could also result in costs to exchanges that adopt relatively more rigorous standards, to the extent they lose issuer listings as a result.

In accordance with Section 10C(a)(1), Rule 10C–1(b)(1)(i)(iii) exempts limited partnerships, companies in bankruptcy proceedings, registered open-end management investment companies and foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders of foreign private issuers that provide annual disclosures to shareholders.

Accordingly, we do not believe that the exchanges’ existing requirements already impose independence requirements on directors who oversee executive compensation matters. Finally, we note that, in overseeing executive compensation matters, these independent directors are acting as the board of directors, and the same board processes that attend to other types of board decisions—e.g., scheduling meetings, preparing review materials, attending meetings, preparing and reviewing meeting minutes—also presumably attend to board decisions about executive compensation. Accordingly, we do not believe that the application of the requirements relating
to director independence, consideration of the independence of compensation advisers and responsibility for the appointment, compensation and oversight of compensation advisers to directors who oversee executive compensation matters in the absence of a board committee will result in any disproportionate incremental burdens for issuers that do not have a compensation committee or any other board committee that oversees executive compensation.

As required by Section 10C(g), controlled companies are exempt from all requirements of Rule 10C–1 pursuant to final Rule 10C–1(b)(5)(ii). Rule 10C–1 as adopted includes a slightly broader definition of “controlled company” than the definition provided in Section 10C. Under Section 10C(g)(2) of the Exchange Act, a “controlled company” is defined as an issuer that is listed on an exchange and that holds an election for the board of directors of the issuer in which more than 50% of the voting power is held by an individual, a group or another issuer. We proposed to incorporate this definition into Rule 10C–1(c)(2). In response to comments that our proposed definition would not exempt listed issuers that would otherwise be controlled companies but for the fact that they do not hold director elections, we have removed from the definition the phrase “holds an election for the board of directors” in order to align the definition in Rule 10C–1 more closely to the definition of controlled company currently used by the NYSE and Nasdaq. This change will eliminate any unnecessary compliance burdens for listed issuers that do not hold director elections but satisfy the definition of “controlled company” pursuant to listing standards of the NYSE, Nasdaq and other exchanges with a similar definition.

Under Rule 10C–1(b)(4), the exchanges are directed to adopt listing standards that require a compensation committee to take into account the five independence factors enumerated in Section 10C(b)(2) before selecting a compensation adviser. In addition to these five factors, we are including in the final rule one additional independence factor that must be considered before a compensation adviser is selected: any business or personal relationships between the executive officers of the issuer and the compensation adviser or the person employing the adviser. Several commentators supported requiring compensation committees to consider any business or personal relationship between an executive officer of the issuer and an advisor or the person employing the compensation adviser. This would include, for example, situations where the chief executive officer of a listed issuer and the compensation adviser have a familial relationship or where the chief executive officer and the compensation adviser (or the adviser’s employer) are business partners. We agree with commentators that such relationships would be relevant to an assessment of the independence of the compensation adviser and believe that adding this factor complements the five independence factors enumerated in Section 10C(b)(2). Adding this factor should help compensation committees reach better informed decisions in selecting compensation advisers since any business or personal relationship that a compensation adviser, or the person employing the adviser, may have with an executive officer may be relevant to assessing whether there is a conflict of interest. Section 10C(b) mandates that the independence factors to be considered must be competitively neutral among categories of compensation advisers and that compensation committees must be able to retain the services of members of any such category. We believe that the six factors included in the final rule, when considered as a whole, are competitively neutral and that this requirement will therefore not inhibit competition among categories of compensation advisers.

We have included an instruction to Rule 10C–1(b)(4) that provides that the compensation committee of a listed issuer is not required to consider the independence factors with respect to in-house counsel with whom the compensation committee consults or obtains advice. Several commentators noted that, as in-house legal counsel are employees of the issuer, they are not held out to be independent. As such, the benefits of requiring the compensation committee to consider the independence factors with respect to in-house counsel would seem to be minimal. We do not believe that our determination to exclude in-house counsel from this required consideration will negatively impact competition among compensation advisers, as we do not believe compensation committees consider that in-house counsel serve in the same role as a compensation consultant or outside legal counsel.

As adopted, the final rule exempts security futures products and standardized options from the scope of Rule 10C–1. We believe that exempting security futures products and standardized options is appropriate because these securities are fundamentally different than the equity securities of an operating company. This exemption will benefit the issuers of these securities and the exchanges on which such securities trade by providing clarity and eliminating any regulatory uncertainty about the application of Section 10C to these products.

In addition, we are exempting smaller reporting companies from the requirements of Rule 10C–1. We appreciate that the burdens of complying with the listing standards mandated by Rule 10C–1 for listed smaller reporting companies may not be significant given that such issuers are already subject to listing standards requiring directors on compensation committees or directors determining or recommending executive compensation matters to be “independent” under the exchanges’ general independence standards. We do believe, however, that exempting smaller reporting companies from the listing standards mandated by Rule 10C–1 can offer cost savings to these issuers to the extent that an exchange, in connection with the listing standards review required by Rule 10C–1, chooses to create a new independence standard for compensation committee members that is more rigorous than its existing standards—for example, a new standard could address personal or business relationships between members of the compensation committee and the listed issuer’s executive officers. Issuers subject to the exchange’s new standard may need to replace existing compensation committee members, and incur the associated costs, if they do not qualify as independent under the new standard. In addition, although listed smaller reporting companies do not often engage outside compensation consultants, there would be cost savings to these listed issuers from not having to comply with the listing standards involving the compensation committee’s engagement and oversight of compensation advisers. For example, the exchanges are required to adopt listing standards that require the compensation committee to consider the six independence factors listed in Rule 10C–1(b)(4) before selecting a compensation adviser. To comply with these listing standards, compensation committees are likely need to create

\[266\] See letters from Davis Polk and S&C.
procedures for collecting and analyzing information about potential compensation advisers before they can receive advice from such advisers, which would require the listed issuers to incur costs. We expect, however, that a portion of these cost savings would likely be offset by the costs that smaller reporting companies may incur in order to comply with the new disclosure requirements in Item 407(e)(3)(iv) of Regulation S–K relating to compensation consultants’ conflicts of interest.

We are adopting amendments to Item 407(e)(3) of Regulation S–K to implement the disclosure requirements of Section 10C(c)(2). Under these amendments, issuers subject to our proxy rules will be required to disclose whether the work of any compensation consultant that has played any role in determining or recommending the form or amount of executive and director compensation has raised a conflict of interest, and, if so, the nature of the conflict and how the conflict is being addressed. Issuers subject to our existing proxy disclosure rules must already discuss the role played by compensation consultants in determining or recommending the amount or form of executive and director compensation, including the nature and scope of their assignment and any material instructions or directions governing their performance under the engagement. 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. We believe the amendment to our existing disclosure requirements by increasing the transparency of issuers’ policies regarding compensation consultant conflicts of interest for all issuers subject to the existing disclosure requirement.

The final amendments preserve the existing disclosure requirements under Item 407(e)(3), including the disclosure trigger in Item 407(e)(3)(iii) of “any role” played by the consultant and the disclosure exception for compensation consulting services involving only broad-based, non-discriminatory plans and the provision of non-customized survey data. Some commentators suggested that retaining the existing disclosure trigger in Item 407(e)(3)(iii) and including a separate disclosure item within Item 407 to address the conflict of interest disclosure requirements of Section 10C(c)(2)(B) would be the better approach to implement Section 10C(c)(2) requirements. Additionally, commentators contended that eliminating the disclosure exemptions in Item 407(e)(3)(iii) would be inconsistent with our past determination that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that warrant disclosure of the consultant’s selection, terms of engagement or fees. We agree with these commentators and believe that the amendment to Item 407(e)(3) that we are adopting, which retains the existing disclosure exemptions, is the better approach to implementing Section 10C(c)(2)’s requirements. By retaining the existing disclosure trigger and disclosure exemptions under Item 407(e)(3)(iii), the final amendments will require disclosure of conflicts of interest only when a compensation consultant’s role is otherwise required to be disclosed. We believe this will promote efficiency by mitigating an issuer’s compliance burden in situations where a compensation consultant does not provide “analytical input, discretionary judgment or advice.”

To promote comprehensive disclosure about compensation consultants, the amendments to Item 407(e)(3) extend the disclosure requirements of Section 10C(c)(2) to proxy and information statements where action is to be taken with respect to an election of directors, as well as to conflicts of interests for compensation consultants who play any role in determining or recommending the amount or form of director compensation. Existing Item 407(e)(3) already requires these proxy and information statements to include disclosure about any role of compensation consultants in determining or recommending the amount or form of executive compensation and director compensation, including the nature and scope of their assignment, any material instructions or directions governing their performance under the engagement, and specified information with respect to fees paid to the compensation consultants.

Several commentators supported applying the new disclosure requirements to all Exchange Act issuers subject to our proxy rules. However, other commentators believed that this is not required by Section 10C and opposed extending the disclosure requirements to non-listed issuers. We are expanding the statutory disclosure requirement to those categories of issuers that will not be subject to the listing standards adopted by the exchanges pursuant to Rule 10C–1, including non-listed issuers, smaller reporting companies and controlled companies, because we believe that timely disclosure of compensation consultants’ conflicts of interests will enable investors in these categories of issuers to better monitor compensation committee performance and will help investors make better informed voting decisions with respect to the election of directors, including members of the compensation committee. In addition, this would promote consistent disclosure on these topics among reporting companies and should benefit investors by fostering comparability of disclosure of compensation practices across companies.

Non-listed issuers, smaller reporting companies and controlled companies may incur additional costs to develop more formalized selection processes than they otherwise would have absent such a disclosure requirement. For example, even though they will not be subject to the listing standards requiring compensation committees to consider independence factors before selecting a compensation adviser, in light of this disclosure requirement, issuers may invest the time and resources to analyzing and assessing the independence of the compensation consultant and addressing and resolving any conflicts of interest. Although the disclosure

267 See, e.g., letters from AON and Merkl.
268 See letter from DeBecker.
269 For purposes of the PRA, we estimated that the total annual increase in the paperwork burden for all companies to prepare the disclosure that would be required under the proposed amendments will be approximately 11,976 hours of in-house personnel time and approximately $1,596,000 for the services of outside professionals. One commentator asserted that some of the estimates we used to calculate the burden hours of the proposed amendments may be inaccurate, which could result in our underestimating the PRA burden of the final amendments. See letter from Chamber. As described in the discussion of the PRA, we received no alternative paperwork burden hour or cost estimates in response to our estimate of the paperwork burden in the Proposing Release. We believe our reduced paperwork burden estimate is
requirement does not prohibit a compensation committee from selecting a compensation consultant of its choosing, some committees may elect to engage new, alternative or additional compensation consultants after considering what disclosure might be required under our final 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 consultants. 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. We believe these potential costs are likely to be limited because our existing disclosure rules already require disclosure of any role played by compensation consultants in determining or recommending the amount or form of executive and director compensation, including the nature and scope of their assignment, any material instructions or directions governing their performance under the engagement, and specified information with respect to fees paid to the compensation consultants. To the extent the new requirement to disclose compensation consultant conflicts of interest results in an issuer significantly modifying its consultant selection processes, we believe it would also likely result in such issuer making better-informed choices regarding compensation consultant selection.

To the extent that providing advice on director compensation raises a conflict of interest on the part of a compensation consultant, disclosure would be required in response to new Item 407(e)(3)(iv). Issuers are currently required to discuss in proxy and information statements the role played by compensation consultants in determining or recommending the amount or form of director compensation to the same extent that the disclosure is required regarding executive compensation. In light of the approach we are taking to the new disclosure requirement generally, which is to add the new requirement to the existing disclosure requirements using the existing triggers, we determined that the compensation consultant conflict of interest disclosure requirement should apply to director compensation in the same manner as executive compensation. We believe this will benefit investors by providing for more complete and consistent disclosures on how the board manages compensation-related conflicts of interest.

The amendments to Regulation S–K may promote efficiency and competitiveness of the U.S. capital markets by increasing the transparency of executive compensation decision-making processes. Increased transparency may improve the ability of investors to make better informed voting and investment decisions, which may encourage more efficient capital allocation and formation. Some commentators asserted that 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. 273

The amendments also may affect competition among compensation consultants. By requiring disclosure of the existence of compensation consultant conflicts of interest and how those conflicts of interest are addressed, the new disclosure requirement may lead compensation committees to engage in more thorough and deliberative analyses of adviser independence. This could result in the selection of compensation advisers that are more independent or impartial than might otherwise be chosen, which, in turn, could promote more effective executive compensation practices. The amendments may also incentivize compensation consultants to adopt policies that serve to minimize any conflicts of interest and for compensation committees to avoid hiring consultants perceived as having a conflict of interest.

V. Final Regulatory Flexibility Act Analysis

This Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with the Regulatory Flexibility Act. 274 This FRFA relates to new Exchange Act Rule 10C–1, which will require the exchanges to prohibit the listing of an equity security of an issuer that is not in compliance with several enumerated requirements relating to the issuer’s compensation committee, and to amendments to Item 407(e)(3) of Regulation S–K, which will require new disclosure from issuers regarding any conflict of interest raised by the work of a compensation consultant that has played a role in determining or recommending the form or amount of executive and director compensation.

A. Need for the Amendments

We are adopting the new rule and rule amendments to implement Section 10C of the Exchange Act. Exchange Act Rule 10C–1 directs the exchanges to prohibit the listing of the equity securities of any issuer that does not comply with Section 10C’s compensation committee and compensation adviser requirements. The amendments to Regulation S–K will require issuers to provide certain disclosures regarding their use of compensation consultants and how they address compensation consultant conflicts of interest.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposed rules, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed rule and amendments. We did not receive comments specifically addressing the IRFA. However, some commentators addressed aspects of the proposed rules that could potentially affect small entities. In particular, one commentator expressed concern that smaller issuers may experience difficulty in locating qualified candidates to serve on compensation committees who could meet the independence standards that will be developed by the exchanges. 275 This commentator advocated that smaller companies should be exempted from all or parts of the amendments.

C. Small Entities Subject to the Final Rules

The final rules will affect some companies that are small entities. The Regulatory Flexibility Act defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction." 276 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) 277 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

---

273 See, e.g., letters from CalSTRS and FLSBA.
275 See letter from ABA.
277 17 CFR 240.0–10(e).
601; 278 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 157 279 and Exchange Act Rule 0–10(a) 280 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. The final rules will affect small entities that have a class of equity securities that are registered under Section 12 of the Exchange Act. We estimate that there are approximately 457 such registrants, other than registered investment companies, that may be considered small entities. 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.281 We believe that the amendments to Regulation S–K will affect some 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 28 business development companies that may be considered small entities.

D. Reporting, Recordkeeping and Other Compliance Requirements

Under new Exchange Act Rule 10C–1, the exchanges will be directed to prohibit the listing of an equity security of an issuer that is not in compliance 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 retain compensation advisers;
- The compensation committee’s responsibility to assess factors that affect the independence of compensation advisers before their selection by the compensation committee; and
- The compensation committee’s responsibility for the appointment, compensation, and oversight of the work of compensation advisers retained by the compensation committee; and funding for consultants and other advisers retained by the compensation committee.

Rule 10C–1 will not impose any reporting or recordkeeping obligations on the exchanges, or any issuers with equity securities listed on an exchange. Furthermore, the rule does not require a listed issuer to establish or maintain a compensation committee. As discussed in more detail below, we have exempted smaller reporting companies from the requirements of Rule 10C–1. We do not believe the new rule will have a significant impact on small entities because the listing requirements will apply only to issuers that have equity securities listed on an exchange and that are not smaller reporting companies.282 All of the exchanges generally impose a combination of quantitative requirements such as market capitalization, minimum revenue, and shareholder equity thresholds that an issuer must satisfy in order to be listed on the exchange. Consequently, the substantial majority of small entities are not listed on an exchange but are quoted on the OTC Bulletin Board or the OTC Markets Group.283 Rule 10C–1 will not apply to the OTC Bulletin Board or the OTC Markets Group, and therefore small entities whose securities are quoted on these interdealer quotation systems would not need to comply with any listing standards developed under the rule by the exchanges. Small entities that are listed on an exchange and that are not smaller reporting companies would generally need to comply with the standards adopted by the exchange pursuant to Rule 10C–1 if they wish to have their equity securities listed on the exchange. Small entities subject to these listing standards may need to spend additional time and incur additional costs to comply with these standards. Consistent with Section 10C(f)(3), the final rule will allow the exchanges flexibility to propose exemptions for small entities, subject to our review and approval under the Exchange Act Section 19(b) rule filing process.

The amendments to Item 407(e)(3) of Regulation S–K will impose some reporting and recordkeeping obligations on small entities. Under the amendments, an issuer will be required to disclose whether the work of any compensation consultant that has played a role in determining or recommending the amount or form of executive and director compensation has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. This disclosure requirement will apply equally to both large and small issuers. One commentator has noted that many small entities do not use the services of a compensation consultant,284 which should significantly minimize the impact of the reporting and recordkeeping requirements under the amendments on small entities.

E. Agency Action to Minimize Effect on Small Entities

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 proposals, we considered the following alternatives:

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

In connection with Exchange Act Rule 10C–1, we considered, but did not establish, different compliance requirements, or an exemption, for small entities. As noted above, very few small entities list their securities on an exchange. The substantial majority of small entities with publicly held equity

278 17 CFR 242.601.
280 17 CFR 240.0–10(a).
281 17 CFR 270.0–10(a).
282 Based on data obtained from the Thomson Financial’s Worldscope database, we estimate that as of December 31, 2010, there were two exchange-listed small entities that would not qualify as a smaller reporting company.
283 Based on information retrieved from the Thomson Financial’s Worldscope database, we estimate that as of December 31, 2010, there were less than four issuers that had total assets of $5 million or less listed on an exchange.
284 See letter from ABA.
In addition, we are providing an exemption from the requirements in Rule 10C–1 for smaller reporting companies. We estimate that as of December 31, 2010, there were two exchange-listed smaller reporting companies.285 Smaller reporting companies that are listed on an exchange are already subject to listing standards requiring directors on compensation committees or directors determining or recommending executive compensation matters to be “independent” under the exchanges’ general independence standards. Accordingly, we do not believe that the additional burdens of complying with Rule 10C–1 are warranted for smaller reporting companies.

In addition, under Rule 10C–1, the exchanges will be expressly authorized 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 issuers. Because of the close relationship and frequent interaction between the exchanges and their listed issuers, we believe that exchanges will be in the best position to determine additional types of issuers, including any small entities that are not smaller reporting companies, that should be exempted from the listing requirements under the rule.

In connection with the amendments to Regulation S–K, we considered alternatives, including establishing different compliance or reporting requirements that take into account the resources available to small entities, clarifying or simplifying compliance and reporting requirements under the amendments for small entities, using performance rather than design standards, and exempting small entities from all or part of the amendments. We considered, but did not establish, different compliance requirements, or an exemption, for small entities. Although we believe it is appropriate to exempt smaller reporting companies from Rule 10C–1 because we do not believe that the additional burdens of complying with Rule 10C–1 are warranted for smaller reporting companies, we are unable to reach the same conclusion with respect to the disclosure requirements of amended Item 407(e)(3).

In our view, mandating uniform and comparable disclosures for all issuers subject to our proxy rules is consistent with the statute and will promote investor protection. We believe that investors have an interest in, and would benefit from disclosure regarding, conflicts of interest involving compensation consultants, to the extent that they are used by small entities. Several commentators opposed providing an exemption to small issuers and noted that the required disclosure would provide investors with additional information that would allow them to make better informed investment and voting decisions.286 Different compliance requirements or an exemption from the amendments to Regulation S–K for small entities would interfere with achieving the goal of enhancing the information provided to all investors.

The amendments to Regulation S–K clarify, consolidate and simplify the compliance and reporting requirements for all entities, including small entities. Under the amendments, disclosure will only be required if a compensation consultant plays a role in determining or recommending the form or amount of executive and director compensation and the compensation consultant’s work raises a conflict of interest. Although we believe the disclosure requirements are clear and straightforward, we have attempted to further clarify, consolidate and simplify the compliance and reporting requirements, by including an instruction to the amendments to provide guidance to issuers as to when a conflict of interest may be present that would require disclosure.

Final Rule 10C–1 uses a mix of performance and design standards. We are not specifying the procedures or arrangements an issuer or compensation committee must develop to comply with the listing standards required by Rule 10C–1, but compensation committees will be required to consider the factors specified in Rule 10C–1(b)(4) when conducting the required independence assessments. The amendments to Regulation S–K employ design standards rather than performance standards, as Section 10C(c)(2) mandates the specific disclosures that must be provided. Moreover, based on our past experience, we believe specific disclosure requirements will promote consistent and comparable disclosure among all companies, and the amendments are intended to result in more comprehensive and clear disclosure.

VI. Statutory Authority and Text of the Amendments

The amendments contained in this release are being adopted under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act and Sections 3(b), 10C, 12, 14, 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 Amendments

For the reasons set out in the preamble, the Commission amends 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 general authority citation for part 229 is revised and the sectional authorities are removed to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77u–2, 77z–3, 77aa(25), 77aa(26), 77dd, 77eee, 77gff, 77hhh, 77ii, 77jj, 77nnnn, 77sss, 78c, 78i, 78j, 78–3, 7sl, 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. Section 229.407 is amended by adding paragraph (e)(3)(iv) and an instruction to paragraph (e)(3)(iv) to read as follows:

§ 229.407 (Item 407) Corporate governance.

* * * * *

(e) * * *

(3) * * *

(iv) With regard to any compensation consultant identified in response to Item 407(e)(3)(iii) whose work has raised any conflict of interest, disclose the nature of the conflict and how the conflict is being addressed.

Instruction to Item 407(e)(3)(iv).

For purposes of this paragraph (e)(3)(iv), the factors listed in § 240.10C–1(b)(4)(i) through (vi) 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, 77mm, 77sss, 77ttt, 78b, 78f, 78i, 78g, 78i, 78j, 78l–1, 78l–3, 78k, 78k–1, 78l, 78m, 78n–1, 1, 78o–4, 78p, 78q, 78s, 78u–5, 78w, 78x, 78l, 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 immediately following the new undesignated center heading to read as follows:

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


(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 or proposed 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 or retain 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.

(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 is not subject to the requirements of paragraph (b)(1) of this section:

(1) Limited partnerships;

(2) Companies in bankruptcy proceedings;

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

(4) 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 retain compensation consultants, independent legal counsel and other compensation advisers. (i) 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.

(ii) The compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, independent legal counsel and other adviser retained by the compensation committee.

(iii) Nothing in this paragraph (b)(2) shall be construed:

(A) To require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant, independent legal counsel
or other adviser to the compensation committee; or
(8) 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 retained by 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;

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

(vi) Any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the issuer.

Instruction to paragraph (b)(4) of this section: A listed issuer’s compensation committee is required to conduct the independence assessment outlined in paragraph (b)(4) of this section with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house legal counsel.

(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 appropriate, taking into consideration, among other relevant factors, the potential impact of such requirements on smaller reporting issuers.

(ii) The requirements of this section shall not apply to any controlled company or to any smaller reporting 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 and the rules and regulations thereunder. 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 compensation committee means:

(i) A committee of the board of directors that is designated as the compensation committee;

(ii) In the absence of a committee of the board of directors that is designated as the compensation committee, a committee of the board of directors performing functions typically performed by a compensation committee, including oversight of executive compensation, even if it is not designated as the compensation committee or also performs other functions;

(iii) For purposes of this section other than paragraphs (b)(2)(i) and (b)(3), in the absence of a committee as described in paragraphs (c)(2)(i) or (ii) of this section, the members of the board of directors who oversee executive compensation matters on behalf of the board of directors.

(3) The term controlled company means an issuer:

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

(ii) Of which more than 50 percent of the voting power for the election of directors is held by an individual, a group or another company.

(4) 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.

(5) 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.