

The Commission notes that the Shares must comply with the requirements of BZX Rule 14.11(i), other than the 30% Limitation, to be listed and traded on the Exchange on an initial and continuing basis.

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment Nos. 3 and 5, is consistent with Section 6(b)(5) of the Exchange Act<sup>19</sup> and the rules and regulations thereunder applicable to a national securities exchange.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Exchange Act,<sup>20</sup> that the proposed rule change (SR-BatsBZX-2017-14), as modified by Amendment Nos. 3 and 5, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

**Eduardo A. Aleman,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80530; File No. SR-ISE-2017-32]

### Self-Regulatory Organizations; Nasdaq ISE, LLC; Notice of Filing of Proposed Rule Change To Harmonize the Corporate Governance Framework With That of the NASDAQ Stock Market LLC, NASDAQ PHLX LLC, and NASDAQ BX, Inc.

April 26, 2017.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 11, 2017, Nasdaq ISE, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to a rule change (the “Proposed Rule Change”) in connection with the proposed merger (the “Merger”) with a newly-formed Delaware limited liability company under the Exchange’s ultimate parent, Nasdaq, Inc., resulting in the Exchange as the surviving entity. Following the Merger, the Exchange’s board and committee structure, and all related corporate governance processes, will be harmonized with that of the three other registered national securities exchanges and self-regulatory organizations owned by Nasdaq, Inc., namely: The NASDAQ Stock Market LLC (“NSM”), NASDAQ PHLX LLC (“Phlx”), and NASDAQ BX, Inc. (“BX” and together with NSM and Phlx, the “Nasdaq Exchanges”).

The text of the proposed rule change is available on the Exchange’s Web site at [www.ise.com](http://www.ise.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

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

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

###### 1. Purpose

The Exchange was recently acquired by Nasdaq, Inc. (“HoldCo”).<sup>3</sup> Following the acquisition, the Exchange has continued to operate as a separate self-regulatory organization (“SRO”) and continues to have separate rules,

membership rosters, and listings, distinct from the rules, membership rosters, and listings of the Nasdaq Exchanges as well as from ISE Gemini and ISE Mercury. The Exchange now proposes to harmonize the corporate governance framework of the Exchange with that of the Nasdaq Exchanges, and submits this Proposed Rule Change to seek the Commission’s approval of various changes to the Exchange’s organizational documents and Rules that are necessary in connection with the Merger, as described below.

The proposed changes consist of: (1) Deleting the Exchange’s current Third Amended and Restated Limited Liability Company Agreement (the “Current LLC Agreement”) in its entirety and replacing it with a new limited liability company agreement (the “LLC Agreement”) that is based on the limited liability company agreement of NSM, (2) deleting the Exchange’s current Second Amended and Restated Constitution (“Current Constitution”) and together with the Current LLC Agreement, the “Current Governing Documents”) in its entirety and replacing it with a new set of by-laws (the “Bylaws” and together with the LLC Agreement, the “New Governing Documents”) that is based on the by-laws of NSM, and (3) amending certain rules to reflect the changes to its constituent documents through the adoption of the New Governing Documents to replace the Current Governing Documents.<sup>4</sup>

All of the proposed changes are designed to align the Exchange’s corporate governance framework to the existing structure at the Nasdaq Exchanges, particularly as it relates to board and committee structure, nomination and election processes, and related governance practices.<sup>5</sup> The Exchange is not proposing any amendments to its ownership structure and International Securities Exchange Holdings, Inc. (“ISE Holdings”) will remain as the Exchange’s sole limited liability company member (“Sole LLC Member”) and owner of 100% of the Exchange’s limited liability company

<sup>4</sup> The Exchange’s affiliates, ISE Gemini and ISE Mercury, will submit nearly identical proposed rule changes.

<sup>5</sup> The new LLC Agreement and Bylaws are based in form and substance on the NASDAQ Stock Market LLC’s Second Amended Limited Liability Company Agreement (the “NSM LLC Agreement”) and By-Laws (the “NSM Bylaws”). Additionally, the majority of provisions in the organizational documents of Phlx and BX were also based on those of NSM with differences that relate mainly to disciplinary processes (for Phlx) or to corporate structure (for BX). Notwithstanding, the vast majority of the new governance framework and processes proposed herein are materially identical to those of all three Nasdaq Exchanges.

<sup>19</sup> 15 U.S.C. 78f(b)(5).

<sup>20</sup> 15 U.S.C. 78s(b)(2).

<sup>21</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> On June 30, 2016, HoldCo acquired all of the capital stock of U.S. Exchange Holdings, Inc., the Exchange’s indirect parent company (the “Acquisition”). As a result, the Exchange, in addition to its affiliates Nasdaq GEMX, LLC (“ISE Gemini”) and Nasdaq MRX, LLC (“ISE Mercury”), became a wholly-owned subsidiary of HoldCo, and also became an affiliate of NSM, Phlx, and BX through common, ultimate ownership by HoldCo. HoldCo is the ultimate parent of the Exchange. See Securities Exchange Act Release No. 78119 (June 21, 2016), 81 FR 41611 (June 27, 2016) (SR-ISE-2016-11).

interests. Furthermore, the Exchange is not proposing any amendments to its trading rules at this time relating to the Merger other than the minor clarifying changes and technical amendments as noted below.

#### A. The Merger

In order to effectuate the proposed changes above, the Exchange proposes to merge with a Delaware limited liability company (“NewCo”), newly-formed as a wholly-owned subsidiary of ISE Holdings, resulting in the Exchange as the surviving entity. Specifically, pursuant to the Delaware Limited Liability Company Act, as amended from time to time (the “LLC Act”), NewCo would be formed under ISE Holdings upon filing a certificate of formation with the Secretary of State of the State of Delaware (“DE Secretary of State”). Subsequently, the Exchange would enter into an agreement and plan of merger with NewCo (the “Merger Agreement”), under which NewCo would merge into the Exchange, with the Exchange surviving the Merger. The Merger Agreement contemplates that the merged limited liability company (*i.e.*, the Exchange) would have a new LLC Agreement and new Bylaws, which would be attached to the Merger Agreement. Then, a certificate of merger would be filed with the DE Secretary of State, which will effectuate the Merger at the time of filing. The new LLC Agreement and the new Bylaws would also become effective at the time of filing the certificate of merger. Under the LLC Act, the Merger is subject to approval by the Exchange Board and by ISE Holdings as the Sole LLC Member. The Exchange represents that it has obtained or will obtain the necessary approvals prior to filing the certificate of merger with the DE Secretary of State.

Following the Merger, the Exchange proposes to be governed by the New Governing Documents in accordance with the LLC Act. The specific changes effected by the New Governing Documents to the current documents are discussed in the following sections.

#### B. Limited Liability Company Agreement

Following the Merger, the Exchange proposes to adopt the LLC Agreement,<sup>6</sup> which would replace the Current LLC Agreement.<sup>7</sup> The proposed LLC Agreement reflects the expectation that the Exchange will be operated with a governance structure substantially

similar to that of the Nasdaq Exchanges, and substantially mirrors the provisions found in the NSM LLC Agreement other than as specifically noted herein.<sup>8</sup> Schedule B of the LLC Agreement describes the proposed ownership of the Exchange’s limited liability company interests, which ownership structure is identical to that currently in place. ISE Holdings would remain as the Sole LLC Member (and a member of the Exchange within the meaning of the LLC Act) and the sole owner of 100% of the limited liability company interests of the Exchange. Except as specified below, the proposed changes do not affect the manner of the Exchange’s operations or governance structure.

Section 1 of the LLC Agreement, titled “Name,” specifies the name of the surviving entity of the Merger as the name of the Exchange. Section 2 of the LLC Agreement, titled “Principal Business Office,” provides for the principal business office of the Exchange and such other location as may hereafter be determined by the Board.

Sections 3 and 4 of the LLC Agreement, titled “Registered Office” and “Registered Agent,” specifies the place of the Exchange’s registered office and the entity acting as its registered agent, which is the same place and entity used by the Nasdaq Exchanges.<sup>9</sup> The Exchange proposes to replace its current registered office and agent set forth in Section 1.5 of the Current LLC Agreement with the registered office and agent used by the Nasdaq Exchanges for administrative efficiency. This change will not have any material substantive effect on the current operations or the governance of the Exchange.

Section 5 of the LLC Agreement, titled “Member,” provides that the mailing address of the Sole LLC Member is set forth on Schedule B of the LLC Agreement. As noted above, ISE Holdings will remain as the Sole LLC Member of the Exchange.

Section 6 of the LLC Agreement, titled “Certificates,” refers to the filing of the

Certificate of Merger with respect to the Merger. Such provision acknowledges and confirms that such filings, which were necessary for the merger to be effected, were authorized by the Exchange. This Section additionally sets forth those person(s) who have the authority to file any other certificates with the Delaware Secretary of State on behalf of the Exchange pursuant to the LLC Act. This provision is purely administrative in nature and therefore will have no material substantive effect on the current operations or the governance of the Exchange.

Section 7 of the LLC Agreement, titled “Purposes,” discusses the Exchange’s business purpose, which provides that the Exchange may engage in any lawful act or activity for which limited liability companies may be formed under the LLC Act and any and all activities necessary or incidental to the foregoing. Without limiting these general powers, proposed Section 7 also specifically provides that the Exchange’s business would include actions that support its regulatory responsibilities under the Act, including: (i) Supporting the operation, regulation, and surveillance of the national securities exchange operated by the Exchange, (ii) preventing fraudulent and manipulative acts and practices, promoting just and equitable principles of trade, fostering cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, removing impediments to and perfecting the mechanisms of a free and open market and a national market system, and, in general, protecting investors and the public interest, (iii) supporting the various elements of the national market system pursuant to Section 11A of the Act and the rules thereunder, (iv) fulfilling the Exchange’s self-regulatory responsibilities as set forth in the Act, and (v) supporting such other initiatives as the Board may deem appropriate. Section 7 mirrors the Section 7 of the NSM LLC Agreement, and is similar to the language in Section 1.3 of the Current LLC Agreement of the Exchange.

Section 8 of the LLC Agreement, titled “Powers,” discusses the general powers of the Exchange, the Board and the officers of the Exchange. Specifically, the Exchange, the Board and the officers on behalf of the Exchange (i) shall have and exercise all powers necessary, convenient or incidental to accomplish its purposes as set forth in Section 7 of the LLC Agreement and (ii) shall have and exercise all of the powers and rights conferred upon limited liability companies formed pursuant to the LLC

<sup>6</sup> The proposed LLC Agreement is attached hereto as Exhibit 5A [sic].

<sup>7</sup> The Current LLC Agreement is attached hereto as Exhibit 5B [sic].

<sup>8</sup> See the Second Amended Limited Liability Company Agreement of The NASDAQ Stock Market LLC (the “NSM LLC Agreement”). The Second Amended Limited Liability Company Agreement of NASDAQ PHLX LLC (the “Phlx LLC Agreement”) is also based on and is substantially similar to the NSM LLC Agreement. BX is a Delaware corporation and is governed by a Certificate of Incorporation, not an LLC Agreement. However, the board structure is identical across the Nasdaq Exchanges and therefore, BX’s Second Restated Certificate of Incorporation (the “BX COI”) contains substantially similar governance provisions as the NSM LLC Agreement and Phlx LLC Agreement.

<sup>9</sup> See NSM LLC Agreement, Sections 3 and 4; Phlx LLC Agreement, Section 3; and BX COI, Article Second.

Act. Section 8 is based on Section 8 of the NSM LLC Agreement, and is similar to the provisions in the Current LLC Agreement and the Current Bylaws.<sup>10</sup>

Section 9 of the LLC Agreement, titled "Management," sets forth the proposed management structure of the Exchange. Section 9(a) pertains to the Board of the Exchange and provides that the Board will manage the Exchange's business and affairs, similar to the provisions in Section 5.1 of the Current LLC Agreement.<sup>11</sup> By adopting new Section 9(a), the Exchange proposes to mirror the board structure of the Nasdaq Exchanges.<sup>12</sup> The Exchange proposes to add language to indicate that the Sole LLC Member may determine at any time in its sole and absolute discretion the number of Directors<sup>13</sup> to constitute the Board.<sup>14</sup> The authorized number of Directors may be increased or decreased by the Sole LLC Member at any time in its sole and absolute discretion, upon notice to all Directors, but no decrease in the number of Directors shall shorten the term of any incumbent Member Representative Director.<sup>15</sup> This language mirrors Section 9(a) of the NSM LLC Agreement. In addition, the exact composition of the Board is subject to the requirements in the Bylaws relating to independence and fair representation of members, which are described in detail below.

#### Fair Representation of Members

The Exchange proposes in Section 9(a), similar to the Nasdaq Exchanges, that at least 20% of the Directors would be Member Representative Directors.<sup>16</sup>

<sup>10</sup> See Current LLC Agreement, Sections 5.1 and 5.7 and Current Constitution, Sections 3.1 and 4.1.

<sup>11</sup> See also Current Constitution, Section 3.1.

<sup>12</sup> See NSM LLC Agreement, Section 9; Phlx LLC Agreement, Section 8; and BX COI, Article Fifth.

<sup>13</sup> "Director" will be defined as the persons elected or appointed to the board of directors from time to time in accordance with the LLC Agreement and the Bylaws, in their capacity as managers of the Exchange. See proposed Bylaw Article I(j), which is based on NSM Bylaw Article I(i).

<sup>14</sup> See proposed LLC Agreement, Section 9(a). In contrast, the Current Governing Documents have specific limits on the size of the Board in that the Exchange is required to have no less than fifteen and no more than sixteen directors. See Current LLC Agreement, Section 5.2 and Current Constitution, Section 3.2(a).

<sup>15</sup> Currently, the number of directors may only be changed by the approval of the affirmative vote of the holders of two-thirds of the then outstanding Exchange Rights. See Current Constitution, Section 3.2(a).

<sup>16</sup> See NSM LLC Agreement, Section 9; Phlx LLC Agreement, Section 8; BX Bylaws, Section 4.3. "Member Representative Director" will be defined as a Director who has been elected or appointed after having been nominated by the Member Nominating Committee or by an ISE Member. A Member Representative Director may, but is not required to be, an officer, director, employee, or agent of an ISE Member. See proposed Bylaw

Member Representative Directors are elected or appointed after having been nominated by a Member Nominating Committee<sup>17</sup> composed of representatives of the Exchange members or by Exchange members in the manner described in the proposed Bylaws.<sup>18</sup> Currently, there are six directors on the Board who are officers, directors or partners of Exchange members, and are elected by a plurality of the holders of Exchange Rights<sup>19</sup> (the "Exchange Directors"), of which: (i) Two must be elected by a plurality of the holders of Primary Market Maker ("PMM") Exchange Rights, (ii) two must be elected by a plurality of holders of Competitive Market Maker ("CMM") Exchange Rights, and (iii) two must be elected by a plurality of holders of Electronic Access Member ("EAM") Exchange Rights.<sup>20</sup> The Exchange adopted the current board structure as it relates to Exchange Directors to comply with Section 6(b) of the Act, which provides that the Exchange must, among other things, assure fair representation of its members (here, the PMMs, CMMs, and EAMs) in the selection of its directors and administration of its affairs (the "fair representation requirement").<sup>21</sup> Therefore, the Exchange believes that the Exchange Directors serve the same function on the current Board as "Member

Article I(r), which is based on NSM Bylaw Article I(q).

<sup>17</sup> See proposed Section 6(b) of Bylaw Article III. "Member Nominating Committee" will be defined as the Member Nominating Committee appointed pursuant to the Bylaws. See proposed Bylaw Article I(q), which is based on NSM Bylaw Article I(p).

<sup>18</sup> The Commission has previously found that the requirement in the NSM LLC Agreement that 20% of the directors shall be "Member Representative Directors" and the means by which they are elected by the members provides for the fair representation of members in the selection of directors and administration of NSM consistent with the requirement in Section 6(b) of the Act. See Securities Exchange Act Release No. 53128 (Jan. 13, 2006), 71 FR 3550 (January 23, 2006) (Order Granting Registration as a National Securities Exchange).

<sup>19</sup> See Rule 300 Series. "Exchange Rights" means the PMM Rights, CMM Rights and EAM Rights collectively. See Rule 100(a)(17). PMM Rights, CMM Rights and EAM Rights have the meaning set forth in Article VI of the Current LLC Agreement. See Rules 100(a)(11), 100(a)(14) and 100(a)(36). See also Current Constitution, Section 13.1(q). PMMs, CMMs, and EAMs represent the three classes of membership on the Exchange. See Current Constitution, Sections 13.1(g), 13.1(l) and 13.1(bb).

<sup>20</sup> See Current Constitution, Section 3.2(b).

<sup>21</sup> See Section 6(b)(3) of the Act, 15 U.S.C. 78f(b)(3). Upon granting the Exchange's application for registration as a national securities exchange, the Commission found that the board composition requirements related to the Exchange Directors satisfied the principles of fair representation as required by Section 6(b) of the Act. See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11401 (March 2, 2000) (Order Granting Registration as a National Securities Exchange).

Representative Directors" on the boards of the Nasdaq Exchanges in that the Exchange Directors give members a voice in the Exchange's use of self-regulatory authority.<sup>22</sup>

By adopting the new Board structure set forth in the New Governing Documents, the Exchange is proposing to replace the Exchange Director positions and all related concepts thereto,<sup>23</sup> with Member Representative Director positions and all related concepts that will be further discussed below. The Exchange believes that the new Board structure will still provide for the fair representation of its members because the new structure is well-established as meeting the fair representation requirement.<sup>24</sup> It should be noted that there are certain additional protections other than the right to elect Exchange Directors that are afforded to the holders of PMM Rights and CMM Rights (the "Market Maker Rights") set forth in the Current Governing Documents, namely: (i) The right to vote on any change in, amendment or modification of the Core Rights or the definition of "Core Rights"<sup>25</sup> and (ii) the right to transfer or lease PMM or CMM Rights upon approval of the Exchange.<sup>26</sup> These rights reflect ISE's original membership structure, where the original Market Maker Rights provided the holders with an equity ownership interest in ISE as well as trading rights on the Exchange.<sup>27</sup>

<sup>22</sup> Currently, the six Exchange Directors comprise 37.5% of the sixteen-member Board.

<sup>23</sup> Related concepts include: "CMM Directors," "CMM Right," "Competitive Market Maker," "Core Rights," "EAM Directors," "EAM Right," "Electronic Access Member," "Exchange Directors," "Exchange Rights," "PMM Director," "PMM Rights," "Primary Market Maker," and "Voting Rights." See Current LLC Agreement, Section 2.2 and Current Constitution, Section 13 for the definitions.

<sup>24</sup> See note 18 above.

<sup>25</sup> See Current LLC Agreement, Section 6.3(b) and Current Constitution, Section 10.1. "Core Rights" represents the voting rights with respect to any increase in the number of authorized PMM and CMM rights. See Current LLC Agreement, Section 2.2. The number of authorized PMM Rights and CMM Rights are 10 and 160, respectively. See Current LLC Agreement, Section 6.1.

<sup>26</sup> See Current LLC Agreement, Article VI and Current Constitution, Article XII. As stated below, most of the transfer and lease provisions in the Current Governing Documents are also already in the current Rule 300 Series. See note 28 below.

<sup>27</sup> See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11401 (March 2, 2000) (Order Granting Registration as a National Securities Exchange). All of the initial Market Maker Rights provided the rights holders with an equity ownership interest in ISE as well as trading rights on the Exchange. As such, those rights were transferable or leaseable to approved persons or entities (*i.e.*, Exchange members or non-member owners as provided in Rule 300(a)). Additionally, holders of the Market Maker Rights had the right to vote on corporate actions such as increasing the

Today, the Market Maker Rights do not confer any equity ownership in the Exchange and the Market Maker Rights are, for all practical purposes, rights to trade on the Exchange. As such, the Exchange believes that provisions governing the trading privileges of its members are more appropriately located in the Rules than in its organizational documents. Already, all of the provisions governing the transfer and lease of Market Maker Rights located in the Current Governing Documents are also substantially set forth in the Rules,<sup>28</sup> and the Exchange is not proposing any changes to those rules or to any of its trading rules in connection with the Merger. As described in more detail below, the Exchange will amend its Rules only (i) to clarify any Rules that refer back to the Current LLC Agreement or the Current Constitution in the rule text or (ii) to relocate or memorialize in the rulebook certain rights and protections afforded to the Market Maker Rights holders, which are primarily found in the Current Governing Documents as discussed above. As such, the holders of Exchange Rights will continue to have the same trading privileges they currently hold as PMMs, CMMs and EAMs under the Exchange Rules and the proposed Board structure of the Exchange will not change any trading privileges. Virtually all of the proposed changes regarding the removal of Exchange Director positions and related concepts from the Exchange's organizational documents are corporate in nature, and are intended simply to conform the organizational documents with those of the Nasdaq Exchanges in order to

number of memberships in a class (akin to the voting rights related to "Core Rights" today). From the beginning, the holders of EAM Rights had no equity interests in the Exchange and only had rights to trade on the Exchange. Those rights were not transferable by the holders, and could only be held by Exchange members. The Exchange has since demutualized and reorganized into a holding company structure, all of which resulted in the separation of the equity ownership rights in the Exchange (currently all held by ISE Holdings as the Sole LLC Member) from the trading privileges on the Exchange (currently held by PMMs, CMMs, and EAMs). The ability to transfer the PMM Rights and CMM Rights (and the non-transferability of the EAM rights), however, still remains the same today, as reflected in the Exchange's rules as well as the Current Governing Documents. See Rule 307(a); Current LLC Agreement, Section 6.4; and Current Constitution, Sections 12.1(c), 12.2(c), and 12.3(b).

<sup>28</sup> See Rule 300 Series. For example, the holders of PMM Rights and CMM Rights (the "Market Maker Rights") have the right to transfer and lease the Market Maker Rights to an Exchange member. See Rules 307 and 308. Holders of Market Maker Rights that are not Exchange members are required to lease their Market Maker Rights to an Exchange member. See Rule 300(b). Such transfers or leases will be subject to the trading concentration limits associated with PMM Rights and CMM Rights. See Rule 303.

harmonize the Exchange's board structure with its affiliates. The proposed changes will primarily affect current board composition requirements, the current nomination and election processes of the directors and the current committee composition requirements. These provisions are outlined in detail in the proposed Bylaws of the Exchange, which will be discussed below.

New Section 9(a) of the LLC Agreement also proposes that all Directors other than the Member Representative Directors shall be elected by the Sole LLC Member in the manner described in the proposed Bylaws. Mirroring Section 9(a) of the NSM LLC Agreement, each Director elected, designated or appointed by the Sole LLC Member shall hold office until a successor is elected and qualified or until such Director's earlier death, resignation, expulsion or removal. As noted above, Member Representative Directors shall be elected in accordance with the Bylaws. Each Director shall execute and deliver an instrument accepting such appointment and agreeing to be bound by all the terms and conditions of the LLC Agreement and the Bylaws. A Director need not be an Exchange member.

The Exchange is also proposing to adopt the exact verbiage of Section 9 of the NSM LLC Agreement with respect to the Powers of the Board, the By-Laws, the Meeting of the Board of Directors, Quorum; LLC Acts of the Board and Electronic Communications.<sup>29</sup> The section discussing the Powers of the Board is similar to the current provisions in the Current Constitution in that the Board is vested with the power to do any and all acts necessary or for the furtherance of the purposes described in the LLC Agreement, including all powers, statutory or otherwise.<sup>30</sup> The Board also has the power to bind the Exchange and delegate powers.<sup>31</sup> As discussed in the Bylaws section below, the Bylaws proposed to be adopted by the Exchange, the Sole LLC Member and the Board in Section 9(c) of the LLC Agreement will replace the Current Constitution of the Exchange.

The Meeting of the Board contains standard Delaware limited liability company provisions governing regular and special meetings of the board, and

<sup>29</sup> See proposed Sections 9(b) through (f) of the Exchange's LLC Agreement.

<sup>30</sup> See Current Constitution, Section 3.1.

<sup>31</sup> See Current LLC Agreement, Section 2.2 (providing that the Sole LLC Member does not have the power to bind the Exchange, said power being vested solely and exclusively in the Board) and Current Constitution, Sections 3.1, 4.12 and 5.1.

related notice provisions. Similar language is found in Section 3.6 of the Current Constitution, and the Exchange is proposing to streamline these administrative procedures across the Nasdaq Exchanges.

The subsections, Quorum; LLC Acts of the Board and Electronic Communications, contain standard Delaware limited liability company provisions governing quorum rules for Board actions, Board action by unanimous written consent, and how Board and committee members may participate in Board and committee meetings, as applicable. The Exchange notes that these provisions are similar in all material respects to those in the Current Governing Documents<sup>32</sup> and relate primarily to the administrative processes of the Board. Therefore, the Exchange is proposing to streamline these processes across the Nasdaq Exchanges for the sake of efficiency.

Section 9(g) of the LLC Agreement generally discusses the standing committees and provides that the Board may designate one or more committees. By adopting new Section 9(g), the Exchange is proposing to delete the current committees set forth in Article V of the Current Constitution and adopt the standing committees similar to those of the Nasdaq Exchanges. Article V of the Current Constitution provides for the following committees: An Executive Committee, a Corporate Governance Committee, a Finance and Audit Committee, a Compensation Committee, and such other additional committees as may be established by Board resolution. Article V also provides for a nominating committee, which is a committee of the Exchange and not the Board, and nominates the Exchange Directors for election to the Board (the "Exchange Director Nominating Committee"). The Exchange proposes to replace these rules with "Committees Composed Solely of Directors" and "Committees Not Composed Solely of Directors" at newly proposed and named Bylaw Article III. The details of those committees will be discussed below in the Bylaws section.

The Exchange proposes to adopt identical provisions set forth in Section 9(g) of the NSM LLC Agreement with respect to the standing committees.<sup>33</sup> First, the Board may designate one or more Directors as alternate members of any committee who may replace any absent or disqualified member at any meeting of the committee. Second, the Committee members shall hold office

<sup>32</sup> See Current Constitution, Sections 3.6 and 3.7.

<sup>33</sup> See proposed LLC Agreement, Section 9(g)(i)-(v).

for such period as may be fixed by a resolution adopted by the Board. Any member of a committee may be removed from such committee only by the Board. Vacancies shall be filled by the Board. Third, each committee may adopt its own rules of procedure and may meet at stated times or on such notice as such committee may determine. Each committee shall be required to keep regular minutes of its meetings and report the same to the Board when required. Fourth, a majority of the committee shall constitute a quorum and the vote of a majority present shall be an act of the committee. Finally, to the extent provided in the resolution of the Board, any committee that consists solely of one or more Directors shall have and may exercise all the powers and authority of the Board in the management of the business and affairs of the Exchange. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the Board. Further, in the absence or disqualification of a member of a committee composed solely of Directors, the member or members thereof present at any meeting and not disqualified from voting, whether or not such members constitute a quorum, may unanimously appoint another member of the Board to act at the meeting in the place of any such absent or disqualified member. The foregoing provisions are similar to the language found in Section 5.1 of the Current Constitution.

Similar to Section 3.9 of the Current Constitution, proposed Section 9(h) provides that the compensation of Directors shall be fixed by the Board. This language mirrors the provisions in Section 9(h) of the NSM LLC Agreement. The Removal and Resignation of Directors language in proposed Section 9(i) also mirrors Section 9(i) of the NSM LLC Agreement, and is similar to the resignation and removal language in Section 5.4 of the Current LLC Agreement and Sections 3.4 and 3.5 of the Current Constitution. The Directors as Agents language in proposed Section 9(j) provides that the Directors are agents of the Exchange and mirrors Section 9(j) of the NSM LLC Agreement.

Section 10, titled "Officers," the Exchange proposes to adopt identical language regarding officer appointments found in Section 10 of the NSM LLC Agreement, which provisions are similar in nature to the existing provisions in Article IV of the Current Constitution.

Section 11, titled "Limited Liability," contains standard Delaware limited liability company language on the

limitation of liability of the Sole LLC Member and the Directors in the manner permitted under the LLC Act. The proposed language is similar to the limitation of liability language found in the Current LLC Agreement<sup>34</sup> and mirrors Section 11 of the NSM LLC Agreement.

Sections 12 through 14 of the LLC Agreement, which are virtually identical to Sections 12 through 14 of the NSM LLC Agreement, are equity-related provisions that encompass the topics of capital contributions, additional capital contributions, and allocations of profits and losses. These provisions set forth the basic economic arrangement of the Sole LLC Member and remain consistent with the economic arrangement under the Current Governing Documents.<sup>35</sup> Proposed Section 15, which relates to distributions, provides that ISE Holdings, as the Sole LLC Member, is generally entitled to all distributions made by the Exchange. Similar to Section 3.3 of the Current LLC Agreement, however, proposed Section 15 also contains a stipulation that (i) the Exchange shall not be required to make a distribution to the Sole LLC Member on account of its interest in the Exchange if such distribution would violate the LLC Act or any other applicable law or is otherwise required to fulfill the regulatory functions or responsibilities of the Exchange, and (ii) Regulatory Funds shall not be used for non-regulatory purposes, but rather shall be used to fund the legal, regulatory and surveillance operations of the Exchange and the Exchange shall not make a distribution to the Sole LLC Member using Regulatory Funds.

"Regulatory Funds" means fees, fines, or penalties derived from the regulatory operations of the Exchange. "Regulatory Funds" shall not be construed to include revenues derived from listing fees, market data revenues, transaction revenues, or any other aspect of the commercial operations of the Exchange, even if a portion of such revenues are used to pay costs associated with the regulatory operations of the Exchange.<sup>36</sup> This provision is designed to preclude the Exchange from using its authority to raise Regulatory Funds for the purpose of benefitting its Sole LLC Member.

Similar to Section 4.1 of the Current LLC Agreement, Section 16 of the LLC Agreement, titled "Books and Records," sets forth certain information relating to general administrative matters with

respect to the books and records of the Exchange. Specifically, the Board shall keep or cause to be kept complete and accurate books of account and records with respect to the Exchange's business. The books of the Exchange shall at all times be maintained by the Board. The Sole LLC Member and its duly authorized representatives shall have the right to examine the Exchange books, records and documents during normal business hours. The Exchange, and the Board on behalf of the Exchange, shall not have the right to keep confidential from the Sole LLC Member any information that the Board would otherwise be permitted to keep confidential from the Sole LLC Member pursuant to Section 18-305(c) of the LLC Act. The Exchange's books of account shall be kept using the method of accounting determined by the Sole LLC Member. Further, the Exchange's independent auditor shall be an independent public accounting firm selected by the Board.<sup>37</sup> Finally, the Exchange proposes to retain some of the existing concepts on books and records from Section 4.1(b) of the Current LLC Agreement in the new Section 16.<sup>38</sup> First, the books of account and records with respect to the Exchange's business must be kept within the United States. Second, other than as provided in Section 16 with respect to the Sole LLC Member and the Commission, all confidential information pertaining to the self-regulatory function of the Exchange (including but not limited to disciplinary matters, trading data, trading practices and audit information) contained in the books and records of the Exchange shall: (i) Not be made available to any persons other than to those officers, directors, employees and agents of the Exchange that have a reasonable need to know the contents thereof; (ii) be retained in confidence by the Exchange and the officers, directors, employees and agents of the Exchange;

<sup>37</sup> See Section 16 of the NSM LLC Agreement for identical provisions.

<sup>38</sup> These concepts are generally not in the governing documents of the Nasdaq Exchanges, and relate to where the Exchange's books and records must be maintained and who may access such books and records, in particular those that contain confidential information pertaining to the self-regulatory function of the Exchange. While Phlx has a requirement under Section 15 of the Phlx LLC Agreement to keep its books and records in the United States, neither BX nor NSM has this requirement under their respective governing documents. Furthermore, none of the Nasdaq Exchanges have in their governing documents a provision that explicitly sets forth the Commission's right to access their books and records. The Nasdaq Exchanges will each separately file proposed rule changes to harmonize the books and records provisions in their respective governing documents with the language the Exchange proposes for Section 16.

<sup>34</sup> See Current LLC Agreement, Sections 2.3 and 5.8.

<sup>35</sup> See Current LLC Agreement, Sections 3.1 and 3.2.

<sup>36</sup> See proposed LLC Agreement, Schedule A.

and (iii) not be used for any non-regulatory purposes. Nothing in the LLC Agreement shall be interpreted as to limit or impede the rights of the Commission to access and examine such confidential information pursuant to the federal securities laws and the rules and regulations thereunder, or to limit and impede the ability of any officers, directors, employees or agents of the Exchange to disclose such confidential information to the Commission.

Section 17, titled "Reports," is being added to mirror the language of the NSM LLC Agreement, and requires the Board, after the end of each fiscal year, to use reasonable efforts to cause the Exchange's independent accountants, if any, to prepare and transmit to the Sole LLC Member any tax information that the Sole LLC Member may reasonably need to prepare its federal, state and local income tax returns for such fiscal year.<sup>39</sup> Section 18, titled "Other Business," is standard language in the Delaware limited liability company context and merely states that the Sole LLC Member and any Director, officer, employee or agent of the Exchange may engage in other business and that the Exchange has no rights to such other business or the proceeds derived therefrom. The Exchange is proposing to mirror the language found in Section 18 of the NSM LLC Agreement.

Section 19, titled "Exculpation and Indemnification," is based on Section 19 of the NSM LLC Agreement. Similar to the provisions in Article VI of the Current Constitution, the language provides for the exculpation and indemnification of ISE Holdings and any officer, Director, employee or agent of the Exchange or of the affiliate of ISE Holdings. Section 20, titled Assignment, is based on Section 20 of the NSM LLC Agreement, but retains similar transfer restrictions from Section 7.1 of the Current LLC Agreement on any assignments by the Sole LLC Member and prohibits the Sole LLC Member from transferring or assigning its limited liability company interest in the Exchange, unless the Commission approves such transfer or assignment pursuant to a rule filing under Section 19 of the Act.<sup>40</sup> Section 21, titled

<sup>39</sup> See Section 17 of the NSM LLC Agreement for identical provisions.

<sup>40</sup> BX has a similar provision in Section 9.4(c) of the BX Bylaws, which restricts HoldCo, as BX's sole shareholder, from transferring any shares of stock to any entity unless such transfer is filed and approved by the Commission pursuant to a rule filing. In contrast, Section 20 of the NSM LLC Agreement allows HoldCo, as NSM's sole LLC member, to assign NSM's limited liability company interest solely to an affiliate of HoldCo, but does not require approval by the Commission for such assignments. Phlx follows the NSM model. As such,

"Dissolution," sets forth the events which will cause the dissolution of the Exchange, as prescribed by mandatory provisions of the LLC Act or as otherwise agreed among the parties, and is based on Section 21 of the NSM LLC Agreement. The proposed language is similar to the language currently in Section 7.2 of the Current LLC Agreement.

Sections 22 through 28 of the proposed LLC Agreement contain general provisions which are relatively standard in Delaware limited liability company agreements.<sup>41</sup> These provisions include: A benefits of agreement clause, a severability clause, an entire agreement clause, a binding agreement clause, a governing law clause, an amendment provision and a notice provision. The Exchange notes that its members are acknowledged in proposed Section 22 as holding rights under the LLC Agreement and included as third-party beneficiaries to the LLC Agreement as is similarly provided in Section 22 of the NSM LLC Agreement.

Section 27, titled "Amendments," provides that the LLC Agreement may be amended by a resolution adopted by the Board and a written agreement executed and delivered by the Sole LLC Member, and further provides that all such amendments to the LLC Agreement will not become effective until filed with, or filed with and approved by, the Commission, as required under Section 19 of the Exchange Act and the rules promulgated thereunder.<sup>42</sup>

The Exchange proposes to add a new Schedule A to the LLC Agreement, which contains key definitions used in the LLC Agreement. The Exchange also proposes a section on rules of construction further explaining the definitions in proposed Schedule A.

### C. Bylaws

The Exchange proposes to adopt the Bylaws,<sup>43</sup> which would replace the

Phlx and NSM will each separately file a proposed rule change to harmonize their assignment provisions with the Exchange's proposal hereunder.

<sup>41</sup> For example, see Sections 22 through 28 of the NSM LLC Agreement and Sections 22 through 28 of the Phlx LLC Agreement.

<sup>42</sup> This provision is based in concept on Section 6-9 of the Phlx Bylaws, which requires Phlx to file any amendments to the Phlx Bylaws with the Commission. The Phlx LLC Agreement, however, does not have a similar requirement for amendments to the Phlx LLC Agreement. As well, neither BX nor NSM has filing requirements for amendments in their respective governing documents. Therefore, the Nasdaq Exchanges will each separately file proposed rule changes with the Commission to add this requirement in (as applicable): The Phlx LLC Agreement, the BX COI, the BX Bylaws, the NSM LLC Agreement and the NSM Bylaws.

<sup>43</sup> The proposed Bylaws are attached hereto as Exhibit 5C [sic].

Exchange's Current Constitution.<sup>44</sup> The Bylaws reflect the expectation that the Exchange will be operated with governance structures similar to those of the Nasdaq Exchanges. Accordingly, the Exchange proposes to adopt Bylaws that set forth the same corporate governance framework and related processes as those contained in the Bylaws of the Nasdaq Exchanges. Article I of the Bylaws, titled "Definitions," contains key definitions used in the Bylaws, and are based on the defined terms used in NSM Bylaw Article I.

### Nomination and Election Process

Article II of the Bylaws, titled "Annual Election of Member Representative Directors and Other Actions by Exchange Members," mirrors the language in NSM Bylaw Article II,<sup>45</sup> and contains key provisions regarding the processes for the nomination and election of Member Representative Directors. As discussed in the LLC Agreement section above, the Exchange is proposing to replace the Exchange Directors with Member Representative Directors to harmonize its board structure with the Nasdaq Exchanges. The proposed nomination and election process for Member Representative Directors described in new Article II would replace the current processes for the Exchange Directors set forth in the Current Governing Documents.

### Current Nomination and Election Process

Under the current nomination and election process, nominees for election of the Exchange Directors are selected each year by the Exchange Director Nominating Committee (which is not a Board committee but composed of three Exchange member representatives).<sup>46</sup> A petition process will also allow holders of the Exchange Rights to nominate alternate candidates for consideration as

<sup>44</sup> The Current Constitution is attached hereto as Exhibit 5D [sic].

<sup>45</sup> Phlx and BX also have the identical nomination and election processes for their Member Representative Directors. See Phlx Bylaw Article II and Section 4.4 of the BX Bylaws.

<sup>46</sup> See Current Constitution, Section 3.10(a). With respect to the Exchange Director Nominating Committee process, the Secretary of the Exchange, on behalf of the Exchange Director Nominating Committee, will circulate a memorandum to all holders of Exchange Rights soliciting interest in presenting Exchange Director candidates to the Exchange Director Nominating Committee. Shortly after the receipt of candidate submissions, the Exchange Director Nominating Committee will conduct a short interview with each candidate. Following all interviews, the Exchange Director Nominating Committee, by majority vote, will select its Exchange Director candidates and the Secretary of the Exchange will inform the holders of Exchange Rights of the Exchange Director Nominating Committee's selections.

Exchange Directors.<sup>47</sup> At an annual meeting of the holders of Exchange Rights, the Exchange Directors are elected by a plurality of the votes cast at the meeting by the holders of Exchange Rights entitled to vote thereon.<sup>48</sup> Following the full nomination, petition, and voting process, each Exchange Director holds office for a term of two years.<sup>49</sup>

Specifically pursuant to Section 3.2(c) of the Current Constitution, the Exchange Directors are divided into two classes, designated as Class I and Class II directors. Each of Class I and Class II is comprised of half of the PMM Directors, CMM Directors and EAM Directors. The Exchange Directors of each class holds office until their successors are duly elected and qualified. At each annual meeting of the holders of Exchange Rights, the successors of the class of Exchange Directors whose term expires at that meeting will be elected by the Exchange Rights holders to hold office for a term expiring at the annual meeting held in the second year following the year of their election, and until their successors are elected and qualified.<sup>50</sup> No Exchange Director may serve more than three consecutive terms, and after a two-year hiatus, may be eligible to serve as an Exchange Director again.<sup>51</sup>

<sup>47</sup> See Current Constitution, Section 3.10(a). Specifically, in addition to the Exchange Director nominees named by the Nominating Committee, persons eligible to serve as such may be nominated for election to the Board by a petition, signed by the holders of not less than 5% of the outstanding Exchange Rights of the series entitled to elect such person if there are more than eighty (80) Exchange Rights in the series entitled to vote, ten percent (10%) of the outstanding rights of such series entitled to elect such person if there are between eighty (80) and forty (40) Exchange Rights in the series entitled to vote, and twenty-five percent (25%) of the outstanding Exchange Rights of such series entitled to elect such person if there are less than forty (40) Exchange Rights in the series entitled to vote. For purposes of determining whether a person has been nominated for election by petition by the requisite percentage, no Exchange member, alone or together with its affiliates, may account for more than fifty percent (50%) of the signatures of the holders of outstanding Exchange Rights of the series entitled to elect such person, and any such signatures by such Exchange members, alone or together with its affiliates, in excess of such fifty percent (50%) limitation shall be disregarded. *Id.*

<sup>48</sup> See Current Constitution, Sections 2.1 and 2.5. A holder of Exchange Rights, together with any affiliate, may not exercise the voting rights (including with respect to the election of Exchange Directors) associated with more than twenty percent (20%) of the PMM Rights, CMM Rights or EAM Rights. See Current LLC Agreement, Section 6.5(a).

<sup>49</sup> See Current Constitution, Section 3.2(c).

<sup>50</sup> *Id.*

<sup>51</sup> See Current Constitution, Sections 3.2(e). The Exchange does not impose term limits on Non-Industry Directors.

#### Proposed Nomination and Election Process

The Exchange is proposing to adopt identical nomination and election processes as the Nasdaq Exchanges as set forth in proposed Bylaw Article II, Section 1 so that Member Representative Directors would be elected to the Board on an annual basis.<sup>52</sup> For each annual election, the Board would select a Record Date<sup>53</sup> and an Election Date.<sup>54</sup> The Record Date would be at least 10 days but not more than 60 days prior to the Election Date. The Member Nominating Committee, consisting of representatives of the Exchange members, would create a list of one or more candidates for each Member Representative Director position (the "List of Candidates") on the Board to be elected on the Election Date. Promptly after selection of the Election Date, in a notice transmitted to the Exchange members and in a prominent location on a publicly accessible Web site, the Exchange (i) shall announce the Election Date and the List of Candidates, and (ii) shall describe the procedures for Exchange members to nominate candidates for election at the next annual meeting. In the event of a Contested Election, the Exchange shall also send its members the List of Candidates and a formal notice of the Election Date, which notice shall be sent by the Exchange at least 10 days but no more than 60 days prior to the Election Date to the Exchange members that were Exchange members on the Record Date, by any means, including electronic transmission, as determined by the Board or committee thereof.

An additional candidate may be added to the List of Candidates by any Exchange member that submits a timely and duly executed written nomination to the Secretary of the Exchange. To be timely, an Exchange member's notice

<sup>52</sup> See Section 1 of NSM Bylaw Article II, Section 2-1 of the Phlx Bylaws and Section 4.4 of the BX Bylaws. Currently, the Exchange Directors are elected for two-year terms.

<sup>53</sup> "Record Date" will be defined as a date selected by the Board for the purpose of determining the Exchange members entitled to vote for the election of Member Representative Directors on an Election Date in the event of a Contested Election. See proposed Bylaw Article I(bb), which is based on NSM Bylaw Article I(aa). "Contested Election" will be defined as an election for one or more Member Representative Directors for which the number of candidates on the List of Candidates exceeds the number of positions to be elected. See proposed Bylaw Article I(g), which is based on NSM Bylaw Article I(ee).

<sup>54</sup> "Election Date" will be defined as a date selected by the Board on an annual basis, on which the Exchange members may vote with respect to Member Representative Directors in the event of a contested election. See proposed Bylaw Article I(k), which is based on NSM Bylaw Article I(f).

would have to be delivered to the Secretary at the principal executive offices of the Exchange not later than the close of business on the 90th day nor earlier than the close of business on the 120th day prior to the first anniversary of the preceding year's Election Date, provided however that in the event that the Election Date is more than 30 days before or more than 70 days after such anniversary date, notice by the Exchange member must be so delivered not earlier than the close of business on the 120th day prior to such Election Date and not later than the close of business on the later of the 90th day prior to such Voting Election or the tenth day following the day on which public announcement of such Election Date is first made by the Exchange. Such Exchange member's notice shall set forth: (i) As to the person whom the Exchange member proposes to nominate for election as a Member Representative Director, all information relating to that person that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to Regulation 14A under the Act and the rules thereunder (and such person's written consent to be named in the List of Candidates as a nominee and to serving as a Director if elected); (ii) a petition in support of the nomination duly executed by the Executive Representatives<sup>55</sup> of 10% or more of all Exchange members; and (iii) the name and address of the Exchange members making the nomination. The Exchange may require any proposed nominee to furnish such other information as it may reasonably require to determine the eligibility of such proposed nominee to

<sup>55</sup> "Executive Representative" will be defined as an individual appointed by an Exchange member to represent, vote, and act for the Exchange member in all the affairs of the Exchange; provided, however, that other representatives of an Exchange member may also serve on the Board or committees of the Exchange or otherwise take part in the affairs of the Exchange. If an Exchange member is also a member of FINRA, the Exchange executive representative shall be the same person appointed to serve as the FINRA executive representative. An Exchange member may change its executive representative or appoint a substitute for its executive representative upon giving notice thereof to the Exchange Secretary via electronic process or such other process as the Exchange may prescribe. An executive representative of an Exchange member or a substitute shall be a member of senior management and registered principal of the Exchange member. Each executive representative shall maintain an Internet electronic mail account for communication with the Exchange and shall update firm contact information as prescribed by the Exchange. Each member shall review and, if necessary, update its executive representative designation and contact information in the manner prescribed by the Exchange. See proposed Bylaw Article I(l), which is based on NSM Bylaw Article I(k) and NSM Rule 1150.

serve as a Member Representative Director.

If by the date on which an Exchange member may no longer submit a timely nomination, there is only one candidate for each Member Representative Director position to be elected on the Election Date, the Member Representative Directors will be elected by ISE Holdings as the Sole LLC Member from the List of Candidates. In the event of a Contested Election, the Exchange would conduct a vote to determine the candidates on the List of Candidates in accordance with proposed Section 2 of Bylaw Article II, which mirrors the language found in Section 2 of the NSM Bylaw Article II.

If there is a Contested Election, each Exchange member would have the right to cast one vote for each Member Representative Director position to be filled; provided, however, that any such vote must be cast for a person on the List of Candidates. However, an Exchange member, either alone or together with its affiliates, may not cast votes representing more than 20% of the votes cast for a candidate, and any votes cast by the Exchange member, either alone or together with its affiliates, in excess of such 20% limitation would be disregarded.<sup>56</sup> The votes would be cast by written ballot, electronic transmission or any other means as set forth in a notice to the Exchange members sent by the Exchange prior to the Election Date. Only votes received prior to 11:59 p.m. Eastern Time on the Election Date would count for the election of a Member Representative Director. The persons on the List of Candidates who receive the most votes would be elected to the Member Representative Director positions.

New Section 3 of Bylaw Article II proposes that if a Member Representative Director position becomes vacant prior to the expiration of such person's term, or it an increase in the size of the Board results in the creation of a new Member Representative Director position, the Sole LLC Member will elect a person from a list of candidates prepared by the Member Nominating Committee to fill such vacancy, except that if the remaining term of office for the vacant Director position is less than six months, no replacement will be required. The proposal would replace the current process for filling Exchange Director vacancies on the Board,<sup>57</sup> and mirrors Section 3 of NSM Bylaw Article

II. Finally, new Section 4 of Bylaw Article II, copied from Section 4 of NSM Bylaw Article II, proposes that the Exchange will not be required to hold meetings of the Exchange members.<sup>58</sup>

Related to the proposed changes to the Exchange's nomination and election process described above, the Exchange also proposes to create a Member Nominating Committee, which would replace the current Exchange Director Nominating Committee in nominating candidates for director positions that meet the fair representation requirement. New Section 6(b) of Bylaw Article III, which is copied from Section 6(b) of NSM Bylaw Article III, proposes that the Member Nominating Committee would nominate candidates for each Member Representative Director position on the Board, and would also nominate candidates for appointment by the Board for positions on any committees with positions reserved for Member Representative members. The Member Nominating Committee would consist of no fewer than three and no more than six members. All members of the Member Nominating Committee would be a current associated person of a current Exchange member. The Board would appoint such individuals after appropriate consultation with the Exchange members. Member Nominating Committee members would be appointed annually by the Board and may be removed by a majority vote of the Board.

The Exchange believes that the proposed process for selecting Member Representative Directors, together with the requirement in the proposed LLC Agreement that the Board be comprised of at least 20% Member Representative Directors as discussed in the LLC Agreement section above, will continue to provide for a fair representation of its members on the Board. Similar to the nomination and election process currently in place, proposed Bylaw Article II includes a process by which members can directly petition and vote for representation on the Board. In addition, the proposed Member Nominating Committee would be composed solely of persons associated with Exchange members, similar to the current Exchange Director Nominating Committee, and is selected after consultation with representatives of Exchange members. The Commission

<sup>58</sup> In contrast, the Current Constitution requires that an annual meeting of the holders of Exchange Rights be held for the purpose of electing Exchange Directors to fill expiring terms. See Current Constitution, Section 2.1. As noted above for the proposed process, the Exchange members may vote in the event of a Contested Election, through a balloting process without a formal meeting.

has previously approved rule changes for substantially similar board nomination and election processes for the Nasdaq Exchanges.<sup>59</sup>

#### Board Composition

The Exchange is proposing to adopt Article III of the Bylaws, titled "Board of Directors," which is based on NSM Bylaw Article III. Section 1 of Bylaw Article III proposes that if any Director position other than a Member Representative Director position becomes vacant, whether because of death, disability, disqualification, removal, or resignation, the Nominating Committee (discussed below) shall nominate, and the Sole LLC Member shall select, a person satisfying the classification (Industry, Non-Industry, or Public Director), if applicable, for the directorship to fill such vacancy.

Section 2(a) of Bylaw Article III sets forth the proposed Board composition requirements and provides that a Director may not be subject to a statutory disqualification. The Exchange is proposing to replace the current Board qualification requirements with the ones set forth in the new Section 2(a), which mirrors the qualifications language in Section 2(a) of NSM Bylaw Article III. This proposed change to the current Board composition is in addition to the proposal discussed in the LLC Agreement section above to give the Sole LLC Member discretion to determine the size of the Board from time to time.<sup>60</sup>

Currently, the number of directors on the Board must be no less than fifteen and no more than sixteen,<sup>61</sup> and includes: (i) Eight (8) directors who meet the qualifications of "non-industry representatives" set forth in the Current Constitution<sup>62</sup> and elected by ISE

<sup>59</sup> See e.g. Securities Exchange Act Release No. 53128 (Jan. 13, 2006), see note 18 above; Securities Exchange Act Release No. 58324 (August 7, 2008), 73 FR 46936 (August 12, 2008) (SR-BSE-2008-02, -23, -25, SR-BSECC-2001-01) (Order Approving a Proposal by BX to Amend and Restate its COI and its Constitution to Reflect its Acquisition by the NASDAQ OMX Group); and Securities Exchange Act Release No. 59794 (April 20, 2009), 74 FR 18761 (April 24, 2009) (SR-Phlx-2009-17) (Order Approving Proposed Rule Change Relating to the Nomination and Election of Candidates for Governor and Independent Governor).

<sup>60</sup> See proposed Section 9(a) of the LLC Agreement.

<sup>61</sup> See Current Constitution, Section 3.2(a). Currently, the Board is comprised of sixteen directors.

<sup>62</sup> See Current Constitution, Section 3.2(b). The term "non-industry representative" means any person who would not be considered an "industry representative," as well as (i) a person affiliated with a broker or dealer that operates solely to assist the securities-related activities of the business of non-member affiliates, or (ii) an employee of an entity that is affiliated with a broker or dealer that

<sup>56</sup> This is the same as the 20% voting limitation included in Section 6.5(a) of the Exchange's Current LLC Agreement. See note 48 above.

<sup>57</sup> See Current Constitution, Sections 3.3.



Holdings as the Sole LLC Member, at least two (2) of whom must meet the qualifications of “Public Directors,”<sup>63</sup> (ii) one (1) director, who is the Chief Executive Officer of the Exchange (the “CEO Director”),<sup>64</sup> (iii) six (6) Exchange Directors, as described above, and (iv) one (1) Former Employee Director, who may be elected by the Sole LLC Member in its sole and absolute discretion.<sup>65</sup>

The Exchange is proposing to replace the aforementioned Board composition with the board structure in place at the Nasdaq Exchanges. As is the case with the Nasdaq Exchanges, the proposed Board composition would be required to reflect a balance among “Industry Directors,” “Member Representative Directors,” and “Non-Industry Directors,” including “Public Directors.”<sup>66</sup> The new Board structure would be as follows:

- At least twenty percent (20%) of the directors on the Board would be “Member Representative Directors;”<sup>67</sup>

does not account for a material portion of the revenues of the consolidated entity, and who is primarily engaged in the business of the non-member entity. *See* Current Constitution, Section 13.1(w). The term “industry representative” means a person who is an officer, director or employee of a broker or dealer or who has been employed in any such capacity at any time within the prior three (3) years, as well as a person who has a consulting or employment relationship with or has provided professional services to the Exchange and a person who had any such relationship or provided any such services to the Exchange at any time within the prior three (3) years. *See* Current Constitution, Section 13.1(t).

<sup>63</sup> “Public Director” means is a non-industry representative who has no material relationship with a broker or dealer or any affiliate of a broker or dealer or the Exchange or any affiliate of the Exchange. *See* Current Constitution, Section 3.2(b) and Sections 13.1(aa) and (bb).

<sup>64</sup> *See* Current Constitution, Section 3.2(b). The Chief Executive Officer of the Exchange is elected by the Board and will be nominated by the Board for a directorship by virtue of his or her office. *See* Current Constitution, Section 4.6(a). The Chief Executive Officer will only serve on the Board for so long as such person remains the Chief Executive Officer. *See* Current Constitution, Section 3.2(e).

<sup>65</sup> The Former Employee Director is a director who meets the requirements of a “non-industry representative,” except that such person was employed by the Exchange at any time during the three (3) year period prior to his or her initial election. The Exchange is not required under its Current Constitution to fill this director position. *See* Current Constitution, Section 3.2(b).

<sup>66</sup> *See* Section 2(a) of NSM Bylaw Article III, Section 3–2(a) of Phlx Bylaws and Section 4.3 of BX Bylaws.

<sup>67</sup> *See* proposed LLC Agreement, Section 9(a). “Member Representative Director” will be defined as a Director who has been elected or appointed after having been nominated by the Member Nominating Committee or by an ISE Member. A Member Representative Director may, but is not required to be, an officer, director, employee, or agent of an Exchange member. *See* proposed Bylaws, Article I(r), which is based on NSM Bylaw Article I(q).

- The number of “Non-Industry Directors”<sup>68</sup> would equal or exceed the sum of the number of “Industry Directors”<sup>69</sup> and “Member Representative Directors”<sup>70</sup>

- The Board would include at least one “Public Director”<sup>71</sup> and at least one issuer representative (or if the Board consists of ten or more Directors, at least two issuer representatives);

- Up to two officers of the Exchange (“Staff Directors”) may be elected to the Board.<sup>72</sup>

Under proposed Section 2(b), which mirrors Section 2(b) of NSM Bylaw Article III, a Director would be disqualified and removed immediately upon a determination by the Board, by a majority vote of the remaining

<sup>68</sup> “Non-Industry Director” will be defined as a Director (excluding Staff Directors) who is (i) a Public Director; (ii) an officer, director, or employee of an issuer of securities listed on the Exchange; or (iii) any other individual who would not be an Industry Director. *See* proposed Bylaws, Article I(w), which is based on NSM Bylaw Article I(v).

<sup>69</sup> An “Industry Director” will be a person with direct ties to the securities industry as a result of connections to a broker-dealer, the Exchange or its affiliates, FINRA, or certain service providers to such entities. Specifically, an “Industry Director” will be defined as a Director (excluding Staff Directors), who (i) is or has served in the prior three years as an officer, director, or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (ii) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (iii) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (iv) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the Director or 20 percent or more of the gross revenues received by the Director’s firm or partnership; (v) provides professional services to a director, officer, or employee of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director’s, officer’s, or employee’s professional capacity and constitute 20 percent or more of the professional revenues received by the Director or member or 20 percent or more of the gross revenues received by the Director’s or member’s firm or partnership; or (vi) has a consulting or employment relationship with or provides professional services to the Exchange or any affiliate thereof or to FINRA (or any predecessor) or has had any such relationship or provided any such services at any time within the prior three years. *See* proposed Bylaws Article I(m), which is based on NSM Bylaw Article I(l).

<sup>70</sup> *See* proposed Section 2(a) of Bylaw Article III.

<sup>71</sup> Id. “Public Director” will be defined as a Director who has no material business relationship with a broker or dealer, the Exchange or its affiliates, or FINRA. *See* proposed Bylaw Article I(z), which is based on NSM Bylaw Article I(y).

<sup>72</sup> *See* proposed Bylaw Article I(m). Staff Directors will not be considered as either Industry or Non-Industry Directors.

Directors, (a) that the Director no longer satisfies the classification for which the Director was elected; and (b) that the Director’s continued service as such would violate the compositional requirements of the Board set forth in proposed Section 2(a). Thus, for example, if a Public Director became employed by a broker-dealer and the Board thereby had an inadequate number of Public Directors, the Director would be disqualified and removed. If a Director is disqualified and removed, and the remaining term of office of such Director at the time of termination is not more than 6 months, a replacement for the Director is not required until the next annual meeting. Analogous disqualification provisions exist for committee members.<sup>73</sup>

Upon the Acquisition, there were a number of harmonizing changes to the Board so that the directors on the boards of the Nasdaq Exchanges also currently serve as directors on the Exchange Board.<sup>74</sup> As a result, there is a complete overlap of directors on the boards of the Exchange, NSM, Phlx and BX. Specifically, there are eight (8) directors meeting the qualifications of “non-industry representatives” under the Current Constitution and “Non-Industry Directors” under each of the Nasdaq Exchanges’ Bylaws.<sup>75</sup> Furthermore, two of these directors also meet the compositional requirements of “Public Directors” under the Current Constitution and under the Bylaws of each Nasdaq Exchange.<sup>76</sup> The Chief Executive Officer appointed upon the Acquisition by the Sole LLC Member became a Board member by virtue of his office under the current Constitution, and also meets the qualifications of “Staff Director” under each of the Nasdaq Exchange Bylaws. Five of the six Exchange Directors serving on the

<sup>73</sup> *See* proposed Section 4(b) of Bylaw Article III, which mirrors the language in Section 4(b) of NSM Bylaw Article III.

<sup>74</sup> These changes consisted of the resignations of all directors, other than the Exchange Directors, sitting on the Board immediately prior to the consummation of the Acquisition, and the appointments of Nasdaq designees to fill these vacancies on the Board. The changes were effected through a series of unanimous written consents by the Board, as well as unanimous written consents by the Exchange Director Nominating Committee and the Corporate Governance Committee. The Exchange represents that these changes were effected in accordance with the Current Governing Documents.

<sup>75</sup> These eight directors also sat on the three Nasdaq Exchange boards immediately prior to the Acquisition.

<sup>76</sup> In addition, the current Board also satisfies the requirement under the Nasdaq Exchange Bylaws that the board be composed of at least one Public Director and at least one (or two, if the board consists of ten or more directors) issuer representatives.

Board immediately prior to the Acquisition remained on the Board post-Acquisition. One Exchange Director was appointed by the Exchange Director Nominating Committee and elected to the Board upon the Acquisition due to his predecessor being term limited out under the Current Constitution. The six Exchange Directors also serve as "Member Representative Directors" on the Nasdaq Exchange boards, therefore satisfying the 20% Member Representative Director requirement under their Bylaws. Finally, one additional director was appointed to the "Former Employee Director" seat of the Board by the Sole LLC Member, meeting the qualifications for such directorship and also meeting the qualifications of "Staff Director" under each of the Nasdaq Exchange Bylaws. As such, the Exchange believes that the current Board also satisfies the composition requirements contained in the proposed Bylaws.

The terms of the current directors will end at the 2017 annual election of the Board, to be held on same date as the 2017 annual elections of the Nasdaq Exchange boards (currently expected to be held on June 19, 2017). As described in the following, the Exchange will hold its 2017 annual meeting to elect the Board (the "2017 Board") in accordance with the nomination, petition and voting processes set forth in the Current Governing Documents. Once the New Governing Documents become operative, no additional actions will be required under the LLC Act with respect to the 2017 Board. It is currently contemplated that the 2017 Board will consist of the existing directors serving on the current Board to the greatest extent possible and, similar to the current Board as described above, the Exchange fully expects that the 2017 Board will satisfy both board composition requirements in the Current Governing Documents as well as in the New Governing Documents.<sup>77</sup> Even though the 2017 Board will not have been nominated or voted upon in accordance with New Governing Documents, the Exchange believes that the 2017 Board will be consistent with the Act in that it will continue to provide for the fair representation of members and have one or more directors that would be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer. First, six Exchange Directors, who will be officers, directors or partners of

Exchange members as required by Section 3.2(b) of the Current Constitution, will be nominated by the Exchange Director Nominating Committee and elected to the 2017 Board by a plurality of the holders of the Exchange Rights. These Exchange Directors will be subject to the full petition and voting process by membership in accordance with Articles II and III of the Current Constitution, which process the Commission has already found as satisfying the principles of fair representation as required by Section 6(b) of the Act.<sup>78</sup> Furthermore as noted above, the Exchange believes that the Exchange Directors serve the same function as the Member Representative Directors under the proposed board structure in that both directorships give Exchange members a voice in the Exchange's use of self-regulatory authority. The Exchange notes that only the corporate governance structure is changing under the Proposed Rule Change, and the Exchange currently expects that its membership will remain substantially the same both before and after the 2017 annual election.

Second, eight directors who meet the requirements of non-industry representatives under the Current Constitution as well as Non-Industry Directors under the proposed Bylaws will be nominated by the existing Corporate Governance Committee and elected by the Sole LLC Member to the 2017 Board. The Exchange will also ensure that at least three of these directors will be Public Directors or issuer representatives, consistent with the composition requirements under the Current Constitution and proposed Bylaws. As such, the 2017 Board will reflect a balance among the six Exchange Directors (*i.e.*, Member Representative Directors) and the eight non-industry representative directors (*i.e.*, Non-Industry Directors, including Public Directors or issuer representatives). The Exchange's Chief Executive Officer will also be elected to the 2017 Board by the Sole LLC Member, thereby satisfying the composition requirements of CEO Director and Staff Director under the Current Constitution and proposed Bylaws.

For the annual elections starting in 2018 and subject to approval by the Commission, the Exchange will hold its annual elections in accordance with the processes contemplated in the New

Governing Documents and as such, the 2017 Board will serve until the 2018 annual election. Specifically upon the Merger, the 2017 Board will appoint a Nominating Committee (as discussed in detail below) and a Member Nominating Committee, and such committees would nominate candidates for the 2018 annual election pursuant to the procedures set forth in proposed Bylaw Article I (for Member Representative Directors) and in proposed Section 9(a) of the LLC Agreement and proposed Bylaw Article III (for all other Directors).

Section 3 of Bylaw Article III, which is copied from Section 3 of NSM Bylaw Article III, contains standard provisions for a Delaware limited liability company governing the appropriateness of reliance by Directors upon the records of the Exchange. Section 3 also recognizes the Exchange's status as an SRO by providing that the Board, when evaluating any proposal, shall, to the fullest extent permitted by applicable law, take into account all factors that the Board deems relevant, including, without limitation, to the extent deemed relevant, (i) the potential impact thereof on the integrity, continuity and stability of the national securities exchange operated by the Exchange and the other operations of the Exchange, on the ability to prevent fraudulent and manipulative acts and practices and on investors and the public, and (ii) whether such would promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities or assist in the removal of impediments to or perfection of the mechanisms for a free and open market and a national market system. Taken together, these provisions are designed to reinforce the notion that the Exchange is not solely a commercial enterprise but rather an SRO registered pursuant to the Act and subject to the obligations imposed by the Act.

#### Standing Committees

The proposed new Sections 4, 5 and 6 of Bylaw Article III, which is based on Sections 4, 5 and 6 of the NSM Bylaw Article III, would include provisions governing the composition and authority of various standing committees established by the Board. Proposed new Section 4 of Bylaw Article III would require prospective committee members, who are not Directors, to provide the Secretary of the Exchange with certain information to classify a committee member as an

<sup>77</sup> See Current Constitution, Section 3.2; proposed LLC Agreement, Section 9(a); and proposed Bylaw Article III, Section 2(a).

<sup>78</sup> See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11401 (March 2, 2000) (Order Granting Registration as a National Securities Exchange).

Industry member,<sup>79</sup> a Member Representative member,<sup>80</sup> a Non-Industry member,<sup>81</sup> or a Public member.<sup>82</sup> Analogous new provisions are also proposed for prospective Directors.<sup>83</sup>

Sections 5 and 6 of proposed Bylaw Article III, titled “Committees Composed Solely of Directors” and “Committees Not Composed Solely of Directors,” establishes several standing committees and delineates their general duties and responsibilities. The proposed committee structure is modeled substantially on the committee

<sup>79</sup> “Industry member” will be defined as a member of any committee appointed by the Board who (i) is or has served in the prior three years as an officer, director, or employee of a broker or dealer, excluding an outside director or a director not engaged in the day-to-day management of a broker or dealer; (ii) is an officer, director (excluding an outside director), or employee of an entity that owns more than ten percent of the equity of a broker or dealer, and the broker or dealer accounts for more than five percent of the gross revenues received by the consolidated entity; (iii) owns more than five percent of the equity securities of any broker or dealer, whose investments in brokers or dealers exceed ten percent of his or her net worth, or whose ownership interest otherwise permits him or her to be engaged in the day-to-day management of a broker or dealer; (iv) provides professional services to brokers or dealers, and such services constitute 20 percent or more of the professional revenues received by the committee member or 20 percent or more of the gross revenues received by the committee member’s firm or partnership; (v) provides professional services to a director, officer, or employee of a broker, dealer, or corporation that owns 50 percent or more of the voting stock of a broker or dealer, and such services relate to the director’s, officer’s, or employee’s professional capacity and constitute 20 percent or more of the professional revenues received by the committee member or 20 percent or more of the gross revenues received by the committee member’s firm or partnership; or (vi) has a consulting or employment relationship with or provides professional services to the Exchange or any affiliate thereof or to FINRA (or any predecessor) or has had any such relationship or provided any such services at any time within the prior three years. See proposed Bylaw Article I(n), which is based on NSM Bylaw Article I(m).

<sup>80</sup> “Member Representative member” will be defined as a member of any committee appointed by the Board who has been elected or appointed after having been nominated by the Member Nominating Committee pursuant to the Bylaws. See proposed Bylaw Article I(s), which is based on NSM Bylaw Article I(r).

<sup>81</sup> “Non-Industry member” will be defined as a member of any committee appointed by the Board who is (i) a Public member; (ii) an officer or employee of an issuer of securities listed on the national securities exchange operated by the Exchange; or (iii) any other individual who would not be an industry member. See proposed Bylaw Article I(x), which is based on NSM Bylaw Article I(w).

<sup>82</sup> “Public member” will be defined as a member of any committee appointed by the Board who has no material business relationship with a broker or dealer, the Exchange or its affiliates, or FINRA. See proposed Bylaw Article I(aa), which is based on NSM Bylaw Article I(z).

<sup>83</sup> See proposed Section 6(b)(v) of Bylaw Article III, which is based on Section 6(b)(v) of NSM Bylaw Article III.

structures of the Nasdaq Exchanges, and are copied to the extent such committees are relevant to the Exchange.<sup>84</sup>

Currently, the standing Board committees of the Exchange are: An Executive Committee, a Corporate Governance Committee, a Finance and Audit Committee, a Compensation Committee, and such other additional committees as may be established by Board resolution.<sup>85</sup> As discussed above, the Exchange also has an Exchange Director Nominating Committee, which is a committee of the Exchange and not the Board. All committee appointments are made by the Board, and each appointee serves for one year or until his or her successor is duly appointed.

#### Proposed Committees Composed Solely of Directors

New Section 5 of Bylaw Article III, which copies the language in Section 5 of NSM Bylaw Article III, provides for an Executive Committee, a Finance Committee, and a Regulatory Oversight Committee.

#### Creation of an Executive Committee

The Exchange proposes to adopt new Section 5(a), which provides that the Board may appoint an Executive Committee and delineates its composition and functions. In particular, the proposed Executive Committee may exercise all the powers and authority of the Board in the management of the business and affairs of the Exchange between meetings of the Board. The number of Non-Industry Directors on the Executive Committee must equal or exceed the number of Industry Directors on the Executive Committee. The percentage of Public Directors on the Executive Committee must be at least as great as the percentage of Public Directors on the whole Board, and the percentage of Member Representative Directors on the Executive Committee must be at least as great as the percentage of Member Representative Directors on the whole Board. Currently, the Executive Committee is a permanent standing

<sup>84</sup> For example, the Exchange does not propose to establish an Exchange Listing and Hearing Review Council because the Exchange does not offer any original listings. Similarly, the Exchange does not propose to establish an Arbitration and Mediation Committee as the Exchange’s arbitration and mediation program is operated by the Financial Industry Regulatory Authority (“FINRA”) in accordance with the FINRA rules pursuant to a regulatory services agreement dated June 10, 2013, as amended (“RSA”). Under the RSA, FINRA provides a comprehensive dispute resolution program for Exchange members.

<sup>85</sup> See Current Constitution, Article V.

committee of the Board.<sup>86</sup> Under the new Section 5(a), the Executive Committee would be an optional committee, to be appointed only if deemed necessary by the Board. The Exchange’s proposal is similar to all three Nasdaq Exchanges where the Exchange Committee is optional, at the discretion of the Board.<sup>87</sup>

#### Elimination of the Current Finance and Audit Committee

The Exchange also proposes to adopt new Section 5(b), which provides that the Board may appoint a Finance Committee and delineates its composition and functions. In particular, the Finance Committee will advise the Board with respect to the oversight of the financial operations and conditions of the Exchange, including recommendations for the Exchange’s annual operating and capital budgets and proposed changes to the rates and fees charged by the Exchange. By adopting new Section 5, the Exchange is proposing to eliminate the current Finance and Audit Committee, and have all of its duties and functions performed at the Board level, assigned to other proposed Board committees or to the HoldCo audit committee (the “HoldCo Audit Committee”).<sup>88</sup>

Pursuant to its current charter, the Finance and Audit Committee<sup>89</sup> is primarily charged with: (i) Oversight of financial operations of the Exchange; (ii) oversight of the Exchange’s financial reporting process; (iii) oversight of the systems of internal controls established by management and the Board, and for monitoring compliance with laws and regulations; (iv) evaluation of independent external auditors; and (v) direction and oversight of the internal audit function. Under the new Section 5(b), the Board would retain oversight of the financial operations of the Exchange instead of delegating these functions to

<sup>86</sup> The Executive Committee (consisting of six directors, and with the number of non-industry representatives equaling or exceeding the number of Exchange Directors) on behalf of the Board and subject to its control, has all of the powers of the Board except the power to approve any merger, consolidation, sale or dissolution of the Exchange. See Current Constitution, Section 5.2.

<sup>87</sup> See Section 5(a) of NSM Bylaw Article III, Section 4.13(a) of the BX Bylaws and Section 5–2(a) of the Phlx Bylaws.

<sup>88</sup> See Article IV, Section 4.13(g) of the HoldCo By-Laws. See also the HoldCo Audit Committee Charter (available at <http://ir.nasdaq.com/corporate-governance-document.cfm?DocumentID=195>).

<sup>89</sup> The current Finance and Audit Committee must be composed of at least three (3) and not more than five (5) directors, all of whom must be non-industry representatives. See Current Constitution, Section 5.5. In addition, committee members must be “financially literate” as determined by the Board.

standing committee, and would have to option to appoint a Finance Committee at the Board's discretion. The Exchange's proposal is similar to all three Nasdaq Exchanges where the Finance Committee is optional, at the discretion of the Board.<sup>90</sup>

Furthermore, the HoldCo Audit Committee also covers the functions of the current Finance and Audit Committee. The HoldCo Audit Committee is composed of at least three directors, all of whom must satisfy the standards for independence set forth in Section 10A(m) of the Act<sup>91</sup> and Rule 5605 of NSM's listing rules. All committee members must be able to read and understand financial statements, and at least one member must have past employment experience in finance or accounting, requisite professional certification in accounting or any other comparable experience or background that results in the individual's financial sophistication.

The HoldCo Audit Committee has broad authority to review the financial information that will be provided to shareholders of HoldCo and others, systems of internal controls, and audit, financial reporting and legal and compliance processes. Because HoldCo's financial statements are prepared on a consolidated basis that includes the financial results of HoldCo's subsidiaries, including the Exchange and the other Nasdaq Exchange subsidiaries, HoldCo's audit committee purview necessarily includes these subsidiaries. The Exchange notes that unconsolidated financial statements of the Exchange will still be prepared for each fiscal year in accordance with the requirements set forth in its application for registration as a national securities exchange.<sup>92</sup> To the extent the current Finance and Audit Committee oversees the Exchange's financial reporting process, its activities are duplicative of the activities of the HoldCo Audit Committee, which is also charged with providing oversight over financial reporting and independent auditor selection for HoldCo and all of its subsidiaries, including the Exchange and the other Nasdaq Exchange subsidiaries. Similarly, the HoldCo Audit Committee has general responsibility for oversight over internal controls, and direction and oversight over the internal audit function for HoldCo and all of its subsidiaries. Thus, the responsibilities of the Exchange's

Finance and Audit Committee as it relates to the functions set forth in clauses (ii)–(v) above are fully duplicated by the responsibilities of the HoldCo Audit Committee. Accordingly, the Exchange is proposing to allow the elimination of its Finance and Audit Committee. The Commission has previously approved similar proposals by the Nasdaq Exchanges to eliminate their respective audit committees.<sup>93</sup>

#### Creation of a Regulatory Oversight Committee

The Exchange believes, however, that even in light of the HoldCo Audit Committee's overall responsibilities for internal controls and the internal audit function, it is nevertheless important for the Board to maintain its own independent oversight over the Exchange's controls and internal audit matters relating to the Exchange's operations. Therefore, the Exchange is proposing to create a Regulatory Oversight Committee ("ROC") so that regulatory oversight functions formerly performed by the Finance and Audit Committee may be assumed by the new committee.<sup>94</sup> Like the ROCs of the Nasdaq Exchanges, the new committee will have broad authority to oversee the adequacy and effectiveness of the Exchange's regulatory and self-regulatory organization responsibilities, and will therefore be able to maintain oversight over controls in tandem with the HoldCo Audit Committee's overall oversight responsibilities.

Similarly, it is already a formal practice of HoldCo's Internal Audit Department, which performs internal audit functions for all HoldCo subsidiaries, to report to the Nasdaq Exchange boards on all Nasdaq Exchange-related internal audit matters and to direct such reports to the ROCs of the Nasdaq Exchanges.<sup>95</sup> The Exchange proposes that the HoldCo Internal Audit Department would also similarly report to the Exchange Board and direct such reports to the new ROC.

<sup>93</sup> See Securities Exchange Act Release No. 60276 (July 9, 2009), 74 FR 34840 (July 17, 2009) (SR-NASDAQ-2009-042); Securities Exchange Act Release No. 60247 (July 6, 2009), 74 FR 33495 (July 13, 2009) (SR-BX-2009-021); and Securities Exchange Act Release No. 60687 (September 18, 2009), 74 FR 49060 (September 25, 2009) (SR-Phlx-2009-59).

<sup>94</sup> See proposed Section 5(c) of Bylaw Article III. The Nasdaq Exchanges also have Regulatory Oversight Committees, which have the same authority in all material respects to the proposed ROC. See Section 5(c) of NSM Bylaw Article III, Section 4.13(c) of the BX Bylaws and Section 5-2(c) of the Phlx Bylaws.

<sup>95</sup> See the Regulatory Oversight Committee Charter of NSM, Phlx and BX (available at <http://ir.nasdaq.com/corporate-governance-document.cfm?DocumentID=1097>).

In addition, to ensure that the Exchange Board retains authority to direct the Department's activities with respect to the Exchange, the Department's written procedures will stipulate that the Exchange's ROC may, at any time, direct the Department to conduct an audit of a matter of concern to it and report the results of the audit both to the Exchange ROC and the HoldCo Audit Committee. The Internal Audit Department is currently required to conduct such audits upon the request of the Nasdaq Exchange ROCs.

To effectuate this change, the Exchange proposes to adopt the new Section 5(c) providing for a ROC and delineating its composition and functions. In particular, the proposed ROC's responsibilities will be to: (i) Oversee the adequacy and effectiveness of the Exchange's regulatory and self-regulatory organization responsibilities; (ii) assess the Exchange's regulatory performance; and (iii) assist the Board and other committees of the Board in reviewing the regulatory plan and the overall effectiveness of the Exchange's regulatory functions. In furtherance of its functions, the ROC shall: (A) Review the Exchange's regulatory budget and specifically inquire into the adequacy of resources available in the budget for regulatory activities; (B) meet regularly with the Exchange's Chief Regulatory Officer in executive session; and (C) be informed about the compensation and promotion or termination of the Chief Regulatory Officer and the reasons therefor. The Exchange proposes that the ROC shall consist of three members, each of whom shall be a Public Director and an "independent director" as defined in Rule 5605 of the Rules of The NASDAQ Stock Market, LLC.

Given the expansive regulatory and internal oversight of the proposed ROC and HoldCo Audit Committee, coupled with the oversight and responsibilities of the full Board and HoldCo's Internal Audit Department, the Exchange believes that all of the duties and functions of the eliminated Finance and Audit Committee would continue to be performed in the new governance structure as proposed herein.

#### Elimination of the Current Compensation Committee

By adopting the new Board committees in Section 5, the Exchange also proposes to eliminate its current Compensation Committee, and to prescribe that its duties be performed by the HoldCo management compensation committee or the full Board when required. The Compensation

<sup>90</sup> See Section 5(b) of NSM Bylaw Article III, Section 4.13(b) of the BX Bylaws and Section 5-2(b) of the Phlx Bylaws.

<sup>91</sup> See U.S.C. 78j-1(m).

<sup>92</sup> See note 27 above.

Committee<sup>96</sup> is primarily charged with reviewing and approving compensation policies and plans for the Chief Executive Officer and other senior executive officers of the Exchange. Under the Nasdaq governance structure, this function is performed by the HoldCo management compensation committee or the full boards of the Nasdaq Exchanges. The HoldCo By-Laws provide that its management compensation committee (a committee consisting of at least two HoldCo board members meeting the independence and other eligibility standards in the listing rules of NSM) considers and recommends compensation policies, programs, and practices for employees of HoldCo. Because many employees performing work for the Exchange are also employees of HoldCo, its compensation committee already performs these functions for such employees. Moreover, certain of its senior officers are also officers of HoldCo and other HoldCo subsidiaries because their responsibilities relate to multiple entities within the HoldCo corporate structure. Accordingly, HoldCo pays these individuals and establishes compensation policy for them. Most notably, the current Chief Executive Officer of the Exchange is also an “executive officer” of HoldCo within the meaning of NSM Rule 5605. Under that rule, the compensation of executive officers of an issuer of securities, such as the common stock of HoldCo, that is listed on NSM, must be determined by, or recommended to the board of directors for determination by, a majority of independent directors or a compensation committee comprised solely of independent directors. Accordingly, the HoldCo board of directors and/or its compensation committee is legally required to establish the compensation for this individual.

To the extent that policies, programs, and practices must also be established for any Exchange officers or employees who are not also HoldCo officers or employees, the Board would perform such actions without the use of a compensation committee (but subject to the recusal of the Staff Directors).<sup>97</sup>

<sup>96</sup> The committee must be composed of at least three and not more than five directors who must all meet the “Non-Industry Director” qualifications under the Current Constitution. See Current Constitution, Section 5.4.

<sup>97</sup> As discussed in the proposed Board composition section above, “Staff Directors” would be Exchange directors that are also serving as officers. Since the Board would not be responsible for setting the compensation of any Staff Directors who are also officers of HoldCo, they would be permitted to participate in discussions concerning compensation of Exchange employees, but would

Finally, it should be noted that under the new Section 5(c) of Bylaw Article III, the ROC of the Board would be informed about the compensation and promotion or termination of the Exchange’s Chief Regulatory Officer and the reasons therefor, to allow the ROC to provide oversight over decisions affecting this key officer. Therefore, the Exchange believes that the duties and functions of the eliminated Compensation Committee would continue to be performed and covered in the new corporate governance structure proposed by the New Governing Documents. The Commission has previously approved proposals by the Nasdaq Exchanges to eliminate their respective compensation committees.<sup>98</sup>

#### Elimination of the Current Corporate Governance Committee

Finally, the Exchange also proposes to eliminate the current Corporate Governance Committee, and to prescribe that its duties be performed by the new Nominating Committee (as discussed below), the new ROC or by the full Board when required. The Corporate Governance Committee<sup>99</sup> is primarily charged with: (i) Nominating candidates for all vacant or new non-industry representative positions on the Board, (ii) overseeing the Exchange’s regulatory activities and program, and (iii) overseeing and evaluating the governance of the Exchange. As discussed below, the Exchange is proposing to establish a new Nominating Committee that would nominate candidates for all vacant or new non-Member Representative Director positions on the Board, and therefore would perform the Non-Industry Director nominating functions of the current Corporate Governance Committee.<sup>100</sup> Furthermore, the new ROC would have carry out the regulatory oversight tasks currently within purview of the Corporate Governance Committee. In particular, the new ROC would (i) oversee the adequacy and effectiveness of the Exchange’s regulatory and self-regulatory organization responsibilities; (ii) assess the Exchange’s regulatory

recuse themselves from a vote on the subject to allow the determination to be made by directors that are not officers or employees of the Exchange. If a Staff Director was an officer or employee of the Exchange but not of HoldCo, that Staff Director would also absent himself or herself from any deliberations regarding his or her compensation.

<sup>98</sup> See note 93 above.

<sup>99</sup> The committee must consist of at least three directors, all of whom are required to meet the “Non-Industry Director” standards under the Current Constitution. See Current Constitution, Section 5.4.

<sup>100</sup> See proposed Section 6(b) of Bylaw Article III.

performance; and (iii) assist the Board and other committees of the Board in reviewing the regulatory plan and the overall effectiveness of the Exchange’s regulatory functions. Its duties would include reviewing the Exchange’s regulatory budget and inquiring into the adequacy of resources available in the budget for regulatory activities; meeting regularly with the Exchange’s Chief Regulatory Officer in executive session; and having oversight over compensation, hiring and termination decisions affecting this key officer as discussed above.

As it relates to the general supervision over the corporate governance of the Exchange, the full Board would perform such functions without the use of a corporate governance committee, similar to the boards of the Nasdaq Exchanges.<sup>101</sup> In particular, the full Board, led by the Chair of the Board,<sup>102</sup> would perform annual self-assessments, oversee annual formal director and Chair evaluations, and periodically review the allocations of powers between management and the Board. Therefore, the Exchange believes that the duties and functions of the eliminated Corporate Governance Committee would continue to be performed and covered in the new corporate governance structure proposed by the New Governing Documents.

#### Proposed Committees Not Composed Solely of Directors

In addition to the proposed Board committees discussed above, new Section 6 of Bylaw Article III provides for the appointment by the Board of certain standing committees, not composed solely of Directors, to administer various provisions of the rules that the Exchange expects to propose with respect to governance, options trading and member discipline. By adopting Section 6, the Exchange proposes to eliminate certain standing committees and have their relevant functions performed by the new committees, each as described below.

#### Creation of a Member Nominating Committee

The new Member Nominating Committee, responsible for the nomination of Member Representative

<sup>101</sup> See the Corporate Governance Guidelines of NSM, Phlx and BX (available at <http://ir.nasdaq.com/corporate-governance-document.cfm?DocumentID=6027>).

<sup>102</sup> The Board Chair will be an “independent director” (i.e., person other than an officer or employee of HoldCo or its subsidiaries, including the Exchange) as provided under the listing rules of NSM and SEC requirements.

Directors or Member Representative members, would replace the Exchange Director Nominating Committee. The composition requirements of the Member Nominating Committee are discussed in the Nomination and Election Process section above.

#### Creation of a Nominating Committee

The new Nominating Committee will nominate candidates for all other vacant or new Director positions on the Board, and therefore, would perform the non-industry representative nomination function currently assigned to the Corporate Governance Committee. The Nominating Committee will consist of no fewer than six and no more than nine members, and the number of Non-Industry members (*i.e.*, committee members not associated with broker-dealers) shall equal or exceed the number of Industry members on the Nominating Committee. If the Nominating Committee consists of six members, at least two shall be Public members. If the Nominating Committee consists of seven or more members, at least three shall be Public members. No officer or employee of the Exchange shall serve as a member of the Nominating Committee in any voting or non-voting capacity. No more than three of the Nominating Committee members and no more than two of the Industry members shall be current Directors. A Nominating Committee member may not simultaneously serve on the Nominating Committee and the Board, unless such member is in his or her final year of service on the Board, and following that year, that member may not stand for election to the Board until such time as he or she is no longer a member of the Nominating Committee. Nominating Committee members will be appointed annually by the Board and may be removed by a majority vote of the Board.<sup>103</sup>

#### Creation of a Quality of Markets Committee

The new Quality of Markets Committee (the "QMC"), which is modeled off of the QMCs of the Nasdaq Exchanges,<sup>104</sup> will have the following functions: (i) To provide advice and guidance to the Board on issues relating to the fairness, integrity, efficiency, and competitiveness of the information, order handling, and execution mechanisms of the Exchange from the

<sup>103</sup> See Section 6(b) of NSM Bylaw Article III, Section 4.14(b) of the BX Bylaws and Section 5-3(a) of the Phlx Bylaws for similar provisions related to the Nominating Committee.

<sup>104</sup> See Section 6(c) of NSM Bylaw Article III, Section 4.14(c) of the BX Bylaws and Section 5-3(c) of the Phlx Bylaws.

perspective of investors, both individual and institutional, retail firms, market making firms and other market participants; and (ii) to advise the Board with respect to national market system plans and linkages between the facilities of the Exchange and other markets. The QMC shall include broad representation of participants in the Exchange, including investors, market makers, retail firms, and order entry firms. The QMC shall include a number of Member Representative members that is equal to at least 20% of the total number of members of the QMC. The number of Non-Industry members on the proposed QMC shall equal or exceed the sum of the number of Industry members and Member Representative members. A quorum of the QMC will consist of a majority of its members, including not less than 50% of its Non-Industry members, unless this requirement is waived pursuant to proposed Section 6(c)(iii) of Bylaw Article III.

#### Other Proposed Bylaw Provisions

Proposed Section 7 of Bylaw Article III contains standard provisions for a Delaware limited liability company requiring recusal by Directors or committee members subject to a conflict of interest, and providing for the enforceability of contracts in which a Director has an interest if appropriately approved or ratified by disinterested Directors. This language is based on Section 7 of NSM Bylaw Article III. Proposed Section 8 of Bylaw Article III allows for reasonable compensation of the Board and committee members, and mirrors Section 8 of NSM Bylaw Article III.

Bylaw Article IV, titled "Officers, Agents, and Employees," contains provisions governing the Exchange's officers, agents and employees, and is based on Article IV of the NSM Bylaws. Proposed Section 1 of Bylaw Article IV provides that the Board may delegate the duties and powers of any officer of the Exchange to any other officer or to any Director for a specified period of time and for any reason that the Board may deem sufficient. Proposed Section 2 discusses how an officer of the Exchange may resign or may be removed. Proposed Sections 3 through 11 each specifically provides for the appointment of a Chair of the Board,<sup>105</sup> a Chief Executive Officer, a President, Vice Presidents, a Chief Regulatory Officer, a Secretary, an Assistant Secretary, a Treasurer, and an Assistant

<sup>105</sup> The Chair of the Board would be an independent Director as defined in Rule 5605 of the listing rules of The NASDAQ Stock Market, LLC.

Treasurer.<sup>106</sup> The Exchange notes that proposed Section 7 of Bylaw Article IV specifically provides for a Chief Regulatory Officer, a position that is not expressly provided for in the Current Governing Documents, who would have general supervision of the regulatory operations of the Exchange, including responsibility for overseeing the Exchange's surveillance, examination, and enforcement functions and for administering any regulatory services agreements with another SRO to which the Exchange is a party. The Chief Regulatory Officer shall meet with the Regulatory Oversight Committee of the Exchange in executive session at regularly scheduled meetings of such committee, and at any time upon request of the Chief Regulatory Officer or any member of the Regulatory Oversight Committee. The Chief Regulatory Officer may also serve as the General Counsel of the Exchange. The Exchange notes that while the position of chief regulatory officer has long existed at the Exchange, this position is not expressly in the Current Governing Documents and now proposes to codify this position in the new Bylaws.

Bylaw Article VII, titled "Miscellaneous Provisions," contains standard limited liability company provisions relating to waiver of notice of meetings and the Exchange's contracting ability. Article VIII, titled "Amendments; Emergency By-Laws," authorizes amendments to the By-Laws by either the Sole LLC Member or the vote of a majority of the whole Board,<sup>107</sup> as well as the adoption of emergency by-laws by the Board. Other than as noted above, Articles VII and VIII mirror the language in Articles VII and VIII of the NSM Bylaws.

Article IX, titled "Exchange Authorities," which mirrors NSM Bylaw Article IX, contains specific authorization for the Board to adopt rules needed to effect the Exchange's obligations as an SRO, to establish disciplinary procedures and impose sanctions on its members, to establish standards for membership, to impose dues, fees, assessments, and other charges and to take action under

<sup>106</sup> See NSM Bylaw Article IV for substantially similar provisions.

<sup>107</sup> As proposed, all such changes must be filed with the Commission under Section 19(b) of the Act, 15 U.S.C. 78s(b), and become effective thereunder before being implemented. See proposed Bylaw Article VIII, Section 1. The BX Bylaws and the NSM Bylaws do not have a similar requirement, but Phlx has a similar requirement in Section 6-9 of the Phlx Bylaws. BX and NSM will each separately file proposed rule changes with the Commission to add this requirement in their respective governing documents. See note 42 above.

emergency or extraordinary market conditions.

#### D. Rules

The Exchange proposes to amend its current Rules to reflect the changes to its constituent documents through the adoption of the New Governing Documents to replace the Current Governing Documents.<sup>108</sup> Most proposed changes are non-substantive, and primarily reflect the changing terminology from “Constitution” to “By-Laws.” Furthermore, a number of defined terms used in the Rules refer back to the Current LLC Agreement or the Current Constitution for their meanings. As discussed below, the Exchange proposes to add these defined terms originally contained in the Current Governing Documents as new Rules. In addition, the Exchange proposes to amend the Rules to add certain provisions relating to the Market Maker Rights, primarily to import language originally found in the Current Governing Documents as further described below. Finally, the Exchange proposes to make a number of technical amendments to renumber the Rules, which is a result of adding the new definitions as further discussed below.

In Rule 100, titled “Definitions,” the Exchange proposes to make the following changes:

- Rule 100(a) currently refers to Article XIV of the Current Constitution as containing certain defined terms that are also used in the Exchange’s rulebook.<sup>109</sup> The proposed change would replace the reference to Article XIV of the Current Constitution with references to the proposed LLC Agreement and By-Laws.
- Rule 100(a)(11) “CMM Rights” currently refers to Article VI of the Current LLC Agreement. The proposed change would relocate the concept of CMM Rights from the Current LLC Agreement to this Rule, and would state that the term CMM Rights means the transferable rights held by a Competitive Market Maker or a “non-member owner” (as that term is defined in Rule 300(a)).<sup>110</sup> The

<sup>108</sup> The amended Rules are attached hereto as Exhibit 5E [sic].

<sup>109</sup> The reference to Article XIV of the Current Constitution in Rule 100(a) should instead refer to Article XIII because there is no Article XIV in the Current Constitution. The Exchange previously filed a proposed rule change with the Commission (SR-ISE-2006-26) that inadvertently changed the reference in Rule 100(a) from Article XIII to Article XIV in the rule filing’s Exhibit 5.

<sup>110</sup> CMM Rights are transferable rights in that the holders of CMM Rights may lease or sell these rights in accordance with the Exchange’s rules and Current Governing Documents. As discussed in the LLC Agreement section above, all Exchange Rights (*i.e.*, PMM, CMM and EAM Rights) convey voting rights and trading privileges on the Exchange. From ISE’s inception, however, only the holders of the PMM Rights and CMM Rights could transfer the voting rights and trading privileges associated with such Market Maker Rights, while the voting rights

number of authorized CMM Rights as set forth in Section 6.1(a) of the Current LLC Agreement would also be relocated to Rule 100(a)(11) as amended, so that the Rule would further provide that the number of authorized CMM Rights will be 160 CMM Rights.

- New Rule 100(a)(12) “Competitive Market Maker” would be relocated from Section 13.1(g) of the Current Constitution. Currently, this term is used throughout the Exchange’s rulebook, but the definition is only found in the Current Constitution.
- Rules 100(a)(12)–(13) “covered short position” and “discretion,” respectively, would be renumbered as Rules 100(a)(13)–(14).
- Rule 100(a)(14) “EAM Rights” currently refers to Article VI of the Current LLC Agreement. The proposed change would relocate the concept of EAM Rights from the Current LLC Agreement to this Rule, and would state that EAM Rights means the non-transferable rights held by an Electronic Access Member.<sup>111</sup> The Rule would also be renumbered as Rule 100(a)(15).
- New Rule 100(a)(16) “Electronic Access Member” would be relocated from Section 13.1(l) of the Current Constitution. Currently, this term is used throughout the Exchange’s rulebook, but the definition is only found in the Current Constitution.
- Rules 100(a)(15)–(17) “European-style option,” “Exchange Act” and “Exchange Rights,” respectively, would be renumbered as Rules 100(a)(17)–(19).
- New Rule 100(a)(20) “Exchange Transaction” would be relocated from Section 13.1(r) of the Current Constitution. Currently, this term is used throughout the Exchange’s rulebook, but the definition is only found in the Current Constitution.
- Rules 100(a)(18), (18A) and (19) “exercise price,” “expiration date” and “Federal Reserve Board,” respectively, would be renumbered as Rules 100(a)(21), (21A) and (22).
- New Rule 100(a)(23) “good standing” would be relocated from Section 13.1(s) of the Current Constitution. Currently, this term is used throughout the Exchange’s rulebook, but the definition is only found in the Current Constitution.
- Rules 100(a)(20) and (21) “he,” “him” or “his” and “long position,” respectively, would be renumbered as Rules 100(a)(24) and (25).
- Rule 100(a)(22) “LLC Agreement” would be deleted as that term would no longer be used in the Rules, as amended by this rule change.
- Rules 100(a)(23)–(35) “Member,” “Membership,” “market makers,” “Market Maker Rights,” “Non-Customer,” “Non-Customer Order,” “offer,” “opening purchase transaction,” “opening writing transaction,” “Voluntary Professional,” “options contract,” “OPRA,” “order” and “outstanding,”

and trading privileges associated with the EAM Rights have never been transferable. *See* note 27 above.

<sup>111</sup> EAM Rights are non-transferable in that the holders of EAM Rights may not lease or sell these rights (unlike PMM and CMM Rights, which are transferable). *See* note 110 above.

respectively, would be renumbered as Rules 100(a)(26)–(38).

- Rule 100(a)(36) “PMM Rights” currently refers to Article VI of the Current LLC Agreement. The proposed change would relocate the concept of PMM Rights from the Current LLC Agreement to this Rule, and would state that PMM Rights means the transferable rights held by a Primary Market Maker or a “non-member owner” (as that term is defined in Rule 300(a)).<sup>112</sup> The number of authorized PMM Rights as set forth in Section 6.1(a) of the Current LLC Agreement would also be relocated to this Rule, so that the amended Rule would further provide that the number of authorized PMM Rights will be 10 PMM Rights. Finally, the Rule would also be renumbered as Rule 100(a)(39).

• New Rule 100(a)(40) “Primary Market Maker” would be relocated from Section 13.1(bb) of the Current Constitution. Currently, this term is used throughout the Exchange’s rulebook, but the definition is only found in the Current Constitution.

- Rules 100(a)(37), (37A), (37B), (37C), (38)–(48) “primary market,” “Priority Customer,” “Priority Customer Order,” “Professional Order,” “Public Customer,” “Public Customer Order,” “put,” “Quarterly Options Series,” “quote” or “quotation,” “Rules of the Clearing Corporation,” “SEC,” “series of options,” “short position,” “Short Term Option Series” and “SRO,” respectively, would be renumbered as Rules 100(a)(41), (41A), (41B), (41C), (42)–(52).
- New Rule 100(a)(53) “System” would be relocated from Section 13.1(gg) of the Current Constitution. Currently, this term is used throughout the Exchange’s rulebook, but the definition is only found in the Current Constitution.
- Rules 100(a)(49)–(51) “type of option,” “uncovered” and “underlying security,” respectively, would be renumbered as Rules 100(a)(54)–(56).

The Exchange proposes to add as new paragraphs (d) and (e) in Rule 300 certain protections in the Current Governing Documents that relate to the Market Maker Rights. First, new paragraph (d) preserves the concept of Core Rights from the Current Governing Documents, and would state that any increase in the number of authorized PMM Rights or authorized CMM Rights must be approved by the affirmative vote of the holders of at least a majority of the then outstanding PMM Rights, voting as a class, and the affirmative vote of the holders of at least a majority of the then outstanding CMM Rights, voting as a class.<sup>113</sup> Second, new paragraph (e) would state that any amendments to the LLC Agreement or the Bylaws that would alter or change the powers, preferences or special rights of one or more series of PMM Rights or CMM Rights must also be approved by the holders of a majority of such PMM

<sup>112</sup> *See* note 110 above.

<sup>113</sup> *See* note 25 above.

Rights or CMM Rights, as applicable. As such, paragraph (e) would preserve the existing amendment rights from the Current Governing Documents to the extent they relate to the Market Maker Rights holders.<sup>114</sup>

The Exchange is proposing in .02 of Supplementary Material to Rule 303, which sets forth concentration limits for owning multiple PMM Rights, to clarify that a Primary Market Maker, together with any affiliate, is prohibited from gaining ownership rights or voting rights in excess of 20% of the outstanding PMM Rights. The current Rule contains the same limitation, but refers back to the Exchange's Current LLC Agreement and Current Constitution instead of explicitly providing for the 20% ownership and voting limitation on the Primary Market Maker and its affiliates.<sup>115</sup> The proposed change would delete the references to the Current Governing Documents and replace it with the explicit 20% limitation. The Exchange also proposes to relocate the same explicit 20% limitation on CMM Rights from Section 6.5(a) of the Current LLC Agreement into .02 of Supplementary Material to Rule 303 to clarify that this restriction applies to both Primary Market Makers and Competitive Market Makers. The proposed language as it relates to CMM Rights would therefore provide that, for the avoidance of doubt, no Competitive Market Maker, together with any affiliate, may gain ownership or voting rights in excess of 20% of the then outstanding CMM Rights.

The Exchange is proposing to delete references to "LLC Agreement" in Rule 307(b)(4) "Sale and Transfer of Market Maker Rights" and .01 of Supplementary Material to Rule 307. These provisions refer to the concentration limits. As noted in the LLC Agreement section above, all provisions related to the trading privileges associated with the Exchange Rights located in the Current Governing Documents, including the concentration limits, would be set forth solely in the Rules as the Current LLC Agreement would be replaced by the proposed LLC Agreement.

In the introductory paragraph of Rule 308, the Exchange proposes to add a

<sup>114</sup> See Current LLC Agreement, Section 8.1 and Current Constitution, Section 10.1. The Exchange notes that the proposed amendment rights for the Market Maker Rights holders in Rule 300(e) are broader than the ones contained in the Current Governing Documents because they will apply for all amendments that affect the powers, preferences or special rights of one or more series of PMM Rights or CMM Rights, rather than solely to the amendments that adversely affect these Market Maker Rights.

<sup>115</sup> See Current LLC Agreement, Section 6.5(a).

requirement that, in the context of a lease of Market Maker Rights, the holder of Market Maker Rights must retain the Core Rights associated with such Market Maker Rights and not transfer such voting rights to the lessee. This requirement is imported from Section 12.4(b) of the Current Constitution, which requires that the Core Rights remain with the lessor in the context of a lease. Section 12.4(b) further provides that under a lease agreement, the lessor may retain the voting rights with respect to the PMM Rights and CMM Rights or may transfer such voting rights to the lessee. Today, the voting rights associated with the PMM Rights and CMM Rights are with respect to the election of Exchange Directors and the Core Rights.<sup>116</sup> As discussed in the LLC Agreement section above, the voting rights with respect to the election of Exchange Directors will be eliminated under the Proposed Rule Change, so the only voting rights that will remain are with respect to the Core Rights, which voting rights are not transferable under a lease agreement. As such, the Exchange also proposes to amend Rule 308(b)(4), which currently requires Market Maker Right lease agreements to include provisions covering, as between the parties, which party shall exercise the voting rights of the Exchange membership. In particular, the Exchange proposes to delete in Rule 308(b)(4) the clause "which party shall exercise the voting rights of the Membership and" to reflect that there will no longer be any transferable voting rights associated with the Exchange membership given that the only voting rights that will remain are with respect to the Core Rights.

In Rule 312 "Limitation on Affiliation between the Exchange and Members," the Exchange proposes to replace references to "Exchange Director" and "Constitution" with "Member Representative Director" and "By-Laws," respectively, for the reasons discussed above. The proposed changes in Rule 713(a), Rule 720(a)(1), and .01 and .02 of Supplementary Material to Rule 1901 reflect the renumbering of the defined terms "offer," "quotations," "Priority Customer Orders," "Professional Orders," "Priority Customer" and "Non-Customer Orders."

Finally, the Exchange proposes to amend Rule 802(b) to add a new subparagraph (2), which would provide that if a Primary Market Maker fulfills its obligations as a Primary Market Maker under the Rules, the Exchange will not reallocate the options classes to which such Primary Market Maker is

appointed, unless otherwise requested by the Primary Market Maker. The foregoing, however, would not limit or affect the Exchange's responsibility under Rule 802(d) to reallocate any options classes in the interests of a fair and orderly market. This proposal is consistent with the manner in which products are allocated to PMMs on the Exchange today. Currently, when ISE lists new options classes, it allocates them to one of its PMMs under Rule 802. Pursuant to delegated authority by the Board, an Allocation Committee, which consists of employees of the Exchange, makes allocation decisions according to the guidelines contained in Rule 802. The Allocation Committee has not reallocated the products appointed to a PMM since the Exchange's inception for reasons other than as provided in the proposed rule. As such, the proposed changes are simply to memorialize a longstanding practice on the Exchange.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>117</sup> in general, and furthers the objectives of Section 6(b)(1) of the Act<sup>118</sup> in particular, in that it enables the Exchange to be so organized as to have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its exchange members and persons associated with its exchange members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange. The Exchange also believes that this proposal furthers the objectives of Section 6(b)(3) and (b)(5) of the Act<sup>119</sup> in particular, in that it is designed to assure a fair representation of Exchange members in the selection of its directors and administration of its affairs and provide that one or more directors would be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer; and is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest.

The Exchange believes that its proposal to adopt the Board and committee structure and related nomination and election processes set forth in New Governing Documents are consistent with the Act, including

<sup>117</sup> 15 U.S.C. 78f(b).

<sup>118</sup> 15 U.S.C. 78f(b)(1).

<sup>119</sup> 15 U.S.C. 78f(b)(3) and (b)(5).

<sup>116</sup> See Current LLC Agreement, Section 6.3.



Section 6(b)(1) of the Act, which requires, among other things, that a national securities exchange be organized to carry out the purposes of the Act and comply with the requirements of the Act. In general, the proposed changes would make the Exchange's Board and committee composition requirements, and related nomination and election processes, more consistent with those of its affiliates, BX, NSM and Phlx. The Exchange therefore believes that the proposed changes would contribute to the orderly operation of the Exchange and would enable the Exchange to be so organized as to have the capacity to carry out the purposes of the Act and comply with the provisions of the Act by its members and persons associated with members.

Additionally, the Exchange believes that the New Governing Documents support a corporate governance framework that is designed to insulate the Exchange's regulatory functions from its market and other commercial interests so that the Exchange can carry out its regulatory obligations in furtherance of Section 6(b)(1) of the Act. Specifically, the Exchange believes that creation of a ROC, modeled on the approved ROCs of other Nasdaq Exchanges, and the inclusion of the Chief Regulatory Officer in the proposed Bylaws, would underscore the importance of the Exchange's regulatory function and specifically empower an independent committee of the Board to oversee regulation and meet regularly with the Chief Regulatory Officer. Furthermore, proposed language in the New Governing Documents specifically providing that the Exchange's business and the Board's evaluations would include actions and evaluations that support and take into account its regulatory responsibilities under the Act, reinforce the notion that the Exchange is not solely a commercial enterprise, but an SRO subject to the obligations imposed by the Act. The restriction on using Regulatory Funds to pay dividends to the Sole LLC Member further underscores the independence of the Exchange's regulatory function. Finally, the Exchange believes that the proposed requirements to include Public Directors on the Board (at least two Directors) and that on the ROC (all three Directors) would help to ensure that no single group of market participants will have the ability to systematically disadvantage other market participants through the exchange governance process, and would foster the integrity of the Exchange by providing unique,

unbiased perspectives. Accordingly, the Exchange believes that the new board and committee structure contemplated by the proposed New Governing Documents is designed to insulate the Exchange's regulatory functions from its market and other commercial interests so that the Exchange can carry out its regulatory obligations in furtherance of Section 6(b)(1) of the Act.

The Exchange also believes that the proposed 20% requirement for Member Representative Directors and the proposed method for selecting Member Representative Directors would ensure fair representation of Exchange members on the Board and allow members to have a voice in the Exchange's use of its self-regulatory authority. In particular, the Exchange notes that the Member Nominating Committee would be composed solely of persons associated with Exchange members and is selected after consultation with representatives of Exchange members. In addition, the new Bylaws include a process by which Exchange members can directly petition and vote for representation on the Board. For the foregoing reasons, the Exchange believes that the proposed change to remove the Exchange Director positions and related concepts from its organizational documents is consistent with fair representation requirement under the Act. Specifically, Exchange members will continue to be represented on the Board and on key standing committees, and will have a voice in the selection of Member Representative Directors through the Member Nominating Committee and through their ability to petition and vote on alternate candidates. As noted above, the trading privileges associated with the Exchange Rights, as well as the Market Maker Rights, which are currently located in the Exchange's organizational documents, are already substantively in the Exchange's rulebook, and the Rules would be clarified to the extent such Rules refer back to the Current Governing Documents.

The Exchange also believes that the proposed Board and composition requirements set forth in the New Governing Documents is consistent with the requirements of Section 6(b)(3) of the Act, because the Public Director positions on the Board and on the ROC would include the representatives of issuers and investors with no material business relationship with a broker dealer or the Exchange. Further, the Exchange believes that the proposed compositional balance of the proposed committees continues to provide for the fair representation of members in the

administration of the affairs of the Exchange. In particular, all members of the new Member Nominating Committee must be associated persons of an Exchange member. In addition, at least 20% of the new QMC must be composed of Member Representative members. Moreover, the proposed compositional requirements provide that the Nominating Committee and the QMC must be compositionally balanced between Industry members and Non-Industry members. The proposed compositional requirements are designed to ensure that members are protected from unfair, unfettered actions by an exchange pursuant to its rules, and that, in general, an exchange is administered in a way that is equitable to all those who trade on its market or through its facilities.

Moreover, the Exchange believes that the new corporate governance framework and related processes proposed by the New Governing Documents are consistent with Section 6(b)(5) of the Act because they are identical to the framework and processes used by the Nasdaq Exchanges, which have been well-established as fair and designed to protect investors and the public interest. The Exchange believes that adopting the New Governing Documents based on the NSM model would streamline the Nasdaq Exchanges' governance process, create equivalent governing standards among HoldCo's SROs and also provide clarity to its members, which is beneficial to both investors and the public interest.

Finally, the proposed amendments to the Rules as discussed above are non-substantive changes to clarify the rule text where the Rule referred only to the Current LLC Agreement or to the Current Constitution, and also the technical amendments to renumber certain Rules.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

Because the Proposed Rule Change relates to the corporate governance of the Exchange and not to the operations of the Exchange, the Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

No written comments were either solicited or received.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) By order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2017-32 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090. All submissions should refer to File Number SR-ISE-2017-32. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal

office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ISE-2017-32 and should be submitted on or before May 23, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>120</sup>

**Eduardo A. Aleman,**

*Assistant Secretary.*

[FR Doc. 2017-08813 Filed 5-1-17; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80534; File No. SR-NYSEArca-2017-41]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Reflect Changes in the Name of, the Investment Objective for, and the Means of Achieving the Investment Objective Applicable to the PIMCO Total Return Active Exchange-Traded Fund

April 26, 2017.

Pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 ("Act")<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> notice is hereby given that, on April 17, 2017, NYSE Arca, Inc. ("Exchange" or "NYSE Arca") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to reflect changes in the name of, the investment objective for, and the means of achieving the investment objective applicable to, the PIMCO Total Return Active Exchange-Traded Fund (the "Fund"). The Fund is currently listed and traded on the Exchange under NYSE Arca Equities Rule 8.600. The proposed rule change is available on the

Exchange's Web site at [www.nyse.com](http://www.nyse.com), at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

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

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

###### 1. Purpose

The Commission has approved the listing and trading on the Exchange of shares ("Shares") of the Fund,<sup>4</sup> under NYSE Arca Equities Rule 8.600, which governs the listing and trading of Managed Fund Shares.<sup>5</sup> The Shares are

<sup>4</sup> See Securities Exchange Act Release Nos. 65988 (December 16, 2011), 76 FR 79741 (December 22, 2011) (SR-NYSEArca-2011-95) (notice of filing of proposed rule change relating to listing and trading of Shares of the Fund on the Exchange) ("First Prior Notice"); 66321 (February 3, 2012), 77 FR 6850 (February 9, 2012) (SR-NYSEArca-2011-95) (order approving listing and trading of Shares of the Fund on the Exchange) ("First Prior Order"). See also Securities Exchange Act Release Nos. 70905 (November 20, 2013) (SR-NYSEArca-2013-122) (notice of filing of proposed rule change relating to use of derivative instruments by the Fund) ("Second Prior Notice"); 72666 (July 24, 2014), 79 FR 44224 (July 30, 2014) (SR-NYSEArca-2013-122) (order approving proposed rule change as modified by Amendment No. 2 thereto relating to use of derivative instruments by the Fund) ("Second Prior Order"); 73331 (October 9, 2014), 79 FR 62213 (October 16, 2014) (SR-NYSEArca-2014-104) (notice of filing and immediate effectiveness of proposed rule change relating to use of derivatives by certain PIMCO exchange traded funds); 75475 (July 16, 2015), 80 FR 43507 (July 22, 2015) (SR-NYSEArca-2015-63) (notice of filing and immediate effectiveness of proposed rule change relating to a change in the size of a Creation Unit applicable to Shares of the Fund) (collectively, the "Prior Releases").

<sup>5</sup> A Managed Fund Share is a security that represents an interest in an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1) ("1940 Act") organized as an open-end investment company or similar entity that invests in a portfolio of securities selected by its investment adviser consistent with its investment objectives and policies. In contrast, an open-end investment company that issues Investment Company Units, listed and traded on the Exchange under NYSE Arca Equities Rule 5.2(j)(3), seeks to provide investment results that correspond generally to the price and yield

<sup>120</sup> 17 CFR 200.30-3(a)(12).

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

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

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