

places specified in Item III 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 proposes to amend certain provisions of the Exchange's rules to strengthen listing standards relating to shareholder approval for equity compensation plans.

Current CHX Article XXVIII, Rule 19, generally requires issuers to seek shareholder approval of stock option or purchase plans pursuant to which officers or directors might acquire stock. The Rule, however, contains an exception for broadly based plans or arrangements that include other employees, as well as for plans that meet a specific *de minimis* standard. To enhance investor confidence and to ensure that the Exchange's requirements for shareholder approval of equity compensation plans are not less stringent than those of other markets, the Exchange now proposes to delete both the *de minimis* exception and the exception for broadly based plans and proposes to expand the rule to require that shareholder approval be obtained whenever an equity compensation plan is established or materially amended, unless a specifically-defined exception applies.⁵ The Exchange proposes to make these requirements applicable to both its Tier I and Tier II issuers.⁶

Exceptions. The Exchange's revised rule would provide exceptions for: (1) Warrants or rights issued generally to all security holders of the company or stock purchase plans available on equal terms to all security holders;⁷ (2) certain tax qualified, non-discriminatory employee benefit plans, parallel non-qualified plans, plans that provide non-U.S. employees with the same benefits as tax qualified, nondiscriminatory employee benefit plans or parallel non-qualified plans or plans that merely provide a convenient way to purchase shares on the open market or from the issuer;⁸ (3)

certain plans or arrangements relating to an acquisition or merger;⁹ and (4) certain issuances given as material inducements to a person's decision to become an employee of the issuer, so long as the issuances are approved by the issuer's independent compensation committee or by a majority of its independent directors.¹⁰ Under the Exchange's proposal, as amended, each issuer must notify the Exchange, in writing, when it uses one of these exceptions.¹¹

The Exchange believes that these exceptions are narrowly-tailored and appropriate. The Exchange believes that shareholder approval should not be separately required under the Exchange's listing standards for tax qualified, nondiscriminatory employee benefit plans because those plans are regulated under the Internal Revenue Code and Treasury Department regulations, which may already contain provisions requiring shareholder approval. Where that approval is not required, the Exchange believes that the additional protections from any inappropriate use of these plans and parallel non-qualified plans is provided through the requirement that these plans be approved by the issuer's independent compensation committee or a majority of the issuer's independent directors. Similarly, the Exchange believes that shareholder approval of inducement grants to new employees and directors is not appropriate because of the impracticality of seeking shareholder approval during the recruiting process and because these transactions occur when the company has an arm's-length relationship with the new employee and its interests are directly aligned with the interests of its shareholders. The Exchange believes that the exceptions associated with mergers and acquisitions are appropriate because they do not result

contain definitions of the terms "tax qualified, non-discriminatory employee benefit plan" and "parallel nonqualified plan." See proposed CHX Rule 19(j)(1)(B).

⁹ This exception applies to plans or arrangements where an issuer is converting, replacing or adjusting outstanding options or other equity compensation awards to reflect a merger or acquisition or where the issuer is using shares available under certain plans acquired in acquisitions or mergers for certain post-transaction grants, as set out in proposed Interpretation and Policy .06(6) to CHX Rule 19(j). See proposed CHX Rule 19(j)(1)(C).

¹⁰ These issuances only qualify for the exception if they are made to a person not previously an employee or director of the issuer or following a bona fide period of non-employment or non-service. If an issuer uses this exception, it must promptly disclose, in a press release, the material terms of the grant, including the recipient of the grant and the number of shares included in the grant. See proposed CHX Rule 19(j)(1)(D).

¹¹ See proposed CHX Rule 19(j)(1)(E).

in any increase in the aggregate potential dilution of the combined enterprise.

In its proposed rules, the Exchange includes a definition of the types of "material revisions" of a plan that would cause shareholder approval to be required. Specifically, the rules confirm that a material revision includes, but is not limited to, a material increase in the number of shares to be issued under the plan (other than to reflect a reorganization, stock split, merger or similar transaction); a material increase in benefits to participants; a material expansion of the class of participants eligible to participate in the plan; and an expansion in the types of options or awards provided under the plan.¹² Additional provisions of the proposed rules provide issuers with further guidance about situations that require (or do not require) shareholder approval.¹³

As a final change, the Exchange proposes to amend CHX Article XXXIII, Rule 3, to mirror requirements now set out in NYSE Rule 452 to prohibit a member from giving a proxy to vote on a matter that establishes or materially amends an equity compensation plan, unless the member has instructions from the beneficial owners of those shares.

Effective date. The Exchange proposes that the changes to CHX Rules 19 and 21 become effective upon Commission approval and that existing equity compensation plans be grandfathered. Any material modifications to existing (*i.e.*, grandfathered) plans would be subject to applicable shareholder approval requirements of these rules. The Exchange proposes that its changes to Article XXXIII, Rule 3, take effect for any meeting of shareholders that occurs on or after the 90th day following Commission approval of the change.

¹² See proposed Interpretation and Policy .06(2) to CHX Rule 19(j).

¹³ For example, proposed Interpretation and Policy .06(3) to CHX Rule 19(j) confirms that where a plan contains an evergreen formula (for automatic increases in the shares available) or an automatic grant pursuant to a dollar-based formula, the plan cannot have a term in excess of ten years unless shareholder approval is obtained every ten years. Other provisions confirm that issuers should strive to make plan terms easy to understand when preparing plans and presenting them for shareholder approval and that an issuer is not permitted to use repurchased shares to fund option plans or grants without prior shareholder approval. See proposed Interpretation and Policy .06(4) and (5) to CHX Rule 19(j). The Commission notes that if a plan permits a specific action without further shareholder approval, it must be clear and specific enough to provide meaningful shareholder approval of those provisions.

⁵ Under the Exchange's proposal, as amended, an equity compensation plan is any plan or other arrangement that provides for the delivery of equity securities (either newly issued or treasury shares) of the listed company to any officer, director, employee or consultant as compensation for services. See proposed Interpretation and Policy .06(1) to CHX Rule 19(j).

⁶ Tier II governance standards are set out in CHX Rule 21.

⁷ This exception exists in the current CHX rule.

⁸ Sections (7) and (8) of proposed new Interpretation and Policy .06 to CHX Rule 19(j)