

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-86969; File No. SR-NASDAQ-2019-049)

September 13, 2019

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Change to Amend the Definition of Family Member in Listing Rule 5605(a)(2) for Purposes of the Definition of Independent Director

I. Introduction

On May 29, 2019, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend the definition of “Family Member” for purposes of determining the independence of directors under Exchange Listing Rule 5605(a)(2). The proposed rule change was published for comment in the Federal Register on June 18, 2019.³ On August 1, 2019, the Commission extended the time period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change, to September 16, 2019.⁴ The Commission has received no comment letters on the proposal. This order institutes proceedings under Section 19(b)(2)(B) of the Act to determine whether to approve or disapprove the proposed rule change.

II. Background and Description of the Proposal

Nasdaq has proposed to amend the definition of Family Member in Nasdaq Rule 5605(a)(2), which is used for purposes of determining whether a director of a listed company

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 86095 (June 12, 2019), 84 FR 28379 (“Notice”).

⁴ See Securities Exchange Act Release No. 86545 (August 1, 2019), 84 FR 38704 (August 7, 2019).

qualifies as an Independent Director, to exclude stepchildren of directors from the Family Member definition.

Nasdaq listing rules have certain requirements for Independent Directors, including that a majority of the board of the directors of the company (the “Board”) be Independent Directors, and that the company’s audit, compensation and nominating committees⁵ be comprised solely of Independent Directors.⁶ “Independent Director” is defined in Nasdaq Rule 5605(a)(2) to mean a person other than an executive officer or employee of the company or any other individual having a relationship which, in the opinion of the company's Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. Rule 5605(a)(2) also provides a list of certain relationships that preclude a Board finding of independence, including the following:

- A director who accepted or who has a Family Member who accepted any compensation from the company in excess of \$120,000 during any period of twelve consecutive months within the three years preceding the determination of independence (with certain exceptions, including a Family Member who is an employee other than an executive officer);⁷
- A director who is a Family Member of an individual who is, or at any time during the past three years was, employed by the company as an executive officer;

⁵ If the company does not have a nominating committee, under Nasdaq Rule 5605(e)(1) nominees for directors must be selected or recommended by Independent Directors constituting a majority of the Board’s Independent Directors in a vote in which only Independent Directors participate.

⁶ See Nasdaq Rule 5605(b)-(e).

⁷ Nasdaq states in its rules that this criterion is generally intended to capture situations where a compensation is made directly to (or for the benefit of) the director or a Family Member of the director. See Nasdaq Rule IM-5605.

- A director who is, or has a Family Member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more (with certain exceptions);
- A director of the company who is, or has a Family Member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the company serve on the compensation committee of such other entity; and
- A director who is, or has a Family Member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during any of the past three years.⁸

Nasdaq Rule 5605(a)(2) currently defines Family Member as “a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.” As Nasdaq noted in its proposal, this definition includes stepchildren, as they are “children by... marriage.”⁹ Nasdaq proposes to re-define Family Member as “a person’s spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person’s home.” The same definition is used in the corresponding listing rules of the New York

⁸ Additional criteria of independence apply with respect to Board members and members of the audit and compensation committees, but are not relevant here. See Nasdaq Rule 5605.

⁹ See Notice, supra note 3, at 28379.

Stock Exchange (“NYSE”).¹⁰ Nasdaq assumes, without elaboration, that the term “children” excludes stepchildren.¹¹ Nasdaq also proposes to exclude domestic employees who share a director’s home, on the ground that the term is intended to capture familial, not commercial, relationships.¹²

Nasdaq acknowledges that Independent Directors over time have become a linchpin in American corporate governance and that it is important for investors to have confidence that individuals serving as Independent Directors do not have a relationship with the listed company that would impair their independence. In support of its proposal, Nasdaq indicates that including stepchildren within the definition of Family Member could capture attenuated relationships, such as where a director marries a person who has an adult child, and so has never acted in any capacity as a parent of that child. Nasdaq believes that, rather than prohibiting all stepchildren from being deemed independent, it would be appropriate for the Board to review these relationships on a facts and circumstances basis as contemplated by general provisions of the Independent Director definition. Nasdaq also states that it has heard from listed companies and their legal counsel that it can be burdensome to analyze potential differences in the meaning of the Nasdaq and NYSE definitions. Finally, Nasdaq asserts that its proposal is consistent with

¹⁰ See Section 303A.02 of the NYSE Listed Company Manual. For clarity, note that NYSE Section 303A.02 uses, and defines, the term “immediate family member”, which corresponds to Nasdaq’s term “Family Member”. See also Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (File Numbers SR-NYSE-2002-33 and SR-NASD-2002-141) (Commission order approving the current texts of the NYSE and Nasdaq definitions (“2003 Approval Order”).

¹¹ Nasdaq stated in its proposal that the category of “children... by marriage” was added to the definition of a Family Member inadvertently in the context of changes it adopted in 2003. See Notice, supra note 3, at 28379. See also 2003 Approval Order. According to Nasdaq, those changes were meant to simplify the existing definition of Family Member while not introducing any substantive differences, but did not succeed in doing so and resulted in an unwarranted expansion of the definition. See Notice at 28380.

¹² See id.

SEC Rule 10A-3, which addresses director independence for audit committee service, and which focuses only on payments to minor children or stepchildren, or stepchildren sharing a home with the director.

III. Proceedings to Determine Whether to Disapprove SR-NASDAQ-2019-049 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposal, as discussed below. Institution of disapproval proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved.

Pursuant to Section 19(b)(2)(B), the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis and input concerning the proposed rule change's consistency with the Act, and, in particular, with Section 6(b)(5) of the Act,¹³ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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.

Nasdaq is proposing to define a Family Member, for purposes of determining whether a director of a listed company qualifies as an Independent Director, as "a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person's home," and to interpret the term "children" as excluding stepchildren. Nasdaq provides an example where the

¹³ 15 U.S.C. 78f(b)(5).

stepchild relationship could be attenuated, namely where a person has become a stepchild of a director as an adult. In such cases, where there has never been a parental relationship, Nasdaq believes the blanket exclusion from a finding of independence is unwarranted. Nasdaq, however, does not address other scenarios captured by its proposal where the relationship between a director and the stepchild may be less attenuated, such as where the stepchild has been raised by the director from a young age but no longer shares the same home, or explain why those closer relationships no longer continue to be appropriate for the blanket exclusion.

Nasdaq also expresses concern that the differences between the Nasdaq and NYSE rules create unnecessary burdens on listed companies attempting to analyze potential differences in their meaning. Accordingly, Nasdaq is proposing to make the language of its definition of Family Member identical to the corresponding definition in NYSE rules. Nasdaq notes that, prior to the time it proposed its current definition of Family Member in 2003, the Nasdaq definition of Family Member and its NYSE counterpart were nearly identical. Nasdaq states that its current rule was intended to simplify the prior definition of Family Member without introducing any substantive changes from the prior rule.¹⁴

Nasdaq further takes the position that the inclusion of stepchildren in its current rule was inadvertent and unwarranted, and this is the basis for its proposed interpretation that the term “children” excludes stepchildren. As noted above, however, Nasdaq also affirms the fact that the current Nasdaq rule (which includes stepchildren in the definition of Family Member) was not intended to differ substantively from the NYSE rule, which uses the same language Nasdaq is proposing to adopt. This would appear to lead to the conclusion that the term “children” should

¹⁴ In approving the current NYSE and Nasdaq rules in 2003, the Commission noted that they were intended to “conform the Nasdaq and NYSE proposals more closely” and “harmonize more closely various provisions of their proposals to reduce the possibility of differing regulatory treatment.” See 2003 Approval Order, *supra* note 10, at 64176.

be interpreted as including stepchildren, rather than excluding them. Nasdaq does not explain this apparent contradiction, or the basis for its view that the express inclusion of stepchildren in its current rule was inadvertent. Nasdaq also does not address why its proposal that the term “children” be interpreted as excluding stepchildren, which potentially would create a situation where the Nasdaq and NYSE rules use identical language but have different interpretations, would not increase confusion and burdens on listed companies seeking to assess potential differences in the meanings of the Nasdaq and NYSE rules, rather than alleviate those burdens.

Finally, as noted above, Nasdaq asserts that its proposal is consistent with SEC Rule 10A-3, which addresses director independence for audit committee service, and which focuses only on payments to minor children or stepchildren, or stepchildren sharing a home with the director. The Commission notes that Nasdaq’s proposal in fact is more permissive than SEC Rule 10A-3, as it would permit a finding of independence if there is a company relationship with a minor stepchild of a director who is not sharing his or her home.

The Commission notes that, under the Commission’s Rules of Practice, the “burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder ... is on the self-regulatory organization [‘SRO’] that proposed the rule change.”¹⁵ The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,¹⁶ and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative

¹⁵ Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3)

¹⁶ See id.

finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.¹⁷

For the reasons discussed above, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the proposal should be approved or disapproved.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is inconsistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulation thereunder.

Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.¹⁸

Interested persons are invited to submit written data, views and arguments regarding whether the proposed rule change should be disapproved by [insert date 45 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 60 days from publication in the Federal Register].

¹⁷ See id.

¹⁸ Section 19(b) (2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

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 e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2019-049 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-NASDAQ-2019-049. This file number should be included on the subject line if e-mail 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 website (<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 website 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 such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make

available publicly. All submissions should refer to File Number SR-NASDAQ-2019-049 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Jill M. Peterson
Assistant Secretary

¹⁹ 17 CFR 200.30–3(a)(57).