

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-67468; File No. SR-NASDAQ-2012-062)

July 19, 2012

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Approving a Proposed Rule Change to Modify its Corporate Governance Rules

I. Introduction

On May 17, 2012, 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to modify an exception to Nasdaq Rule 5605 that allows a non-independent director of a listed company to serve on its audit committee, compensation committee or nominations committee under exceptional and limited circumstances.<sup>3</sup> The proposal was published for comment in the Federal Register on June 5, 2012.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

Nasdaq’s listing rules generally require that a listed company’s audit, compensation and nominations committees consist of “independent directors,”<sup>5</sup> as defined in Nasdaq Rule 5605(a)(2). A director is specifically prohibited from being considered independent under certain circumstances.<sup>6</sup> For example, a director who is currently, or during the prior three years

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

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

<sup>3</sup> See infra note 9 and accompanying text.

<sup>4</sup> See Securities Exchange Act Release No. 67076 (May 30, 2012), 77 FR 33261 (SR-NASDAQ-2012-062) (“Notice”).

<sup>5</sup> See paragraphs (c)(2)(A), (d), and (e)(1)(B) of Nasdaq Rule 5605.

<sup>6</sup> See Nasdaq Rule 5605(a)(2).

was, employed by the company, or a director who is a family member of an individual who is, or at any time during the prior three years was, employed as an executive officer<sup>7</sup> by the company, may not be considered independent.<sup>8</sup>

Nasdaq's listing rules also include an exception ("Exception") to permit a listed company, under exceptional and limited circumstances, with proper disclosure, and under specified conditions to allow one non-independent director to serve on the audit, compensation, or nominations committee for up to two years.<sup>9</sup> Currently, a listed company may not utilize the Exception for a non-independent director who would otherwise qualify if that director has a family member who is an employee of the listed company, even if that family member is not an executive officer of the company. Nasdaq notes, however, that the same family relationship would not otherwise preclude a director from being considered independent.<sup>10</sup> Nasdaq cites to the example of a director who, until one year ago, was employed by a listed company and who has a son who is a non-executive employee of the company. The director, under ordinary circumstances, cannot be considered independent until three years after the end of the director's employment.<sup>11</sup> Nasdaq notes that it is the director's own prior employment relationship that

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<sup>7</sup> "Executive Officer" means those officers covered in Rule 16a-1(f) under the Act, 17 CFR 240.16a-1(f). See Nasdaq Rule 5605(a)(1).

<sup>8</sup> A director is not, however, barred from being independent if he or she has a family member employed by the company, provided that the family member is not an executive officer of the company. See Nasdaq Rule 5605(a)(2)(C).

<sup>9</sup> See paragraphs (c)(2)(B), (d)(3) and (e)(3) of Nasdaq Listing Rule 5605. The Exception, however, does not permit a listed company to appoint to its audit committee a director who does not meet the independence criteria set forth in Section 10A(m)(3) of the Exchange Act, 15 U.S.C. 78j-1(m)(3), and Rule 10A-3 thereunder, 17 CFR. 240.10A-3(b)(1). See also Nasdaq Rule 5605(c)(2)(B)(ii).

<sup>10</sup> See paragraphs (a), (c)(2)(B), (d)(3) and (e)(3) of Nasdaq Rule 5605.

<sup>11</sup> See Nasdaq Rule 5605(a)(2)(A), which provides that a director who is, or at any time during the past three years was, employed by a listed company may not be considered independent.

precludes the director from being considered independent. The son's employment does not preclude the director from being considered independent. Thus, three years after the end of the director's employment, the company's board of directors ("board") may determine that the director is independent, even if the director's son is still a non-executive employee of the company at that time. Nonetheless, under the current rule, if the listed company sought to appoint this same director to its audit, compensation, or nominations committee pursuant to the Exception prior to the expiration of the three-year lookback period, it would be unable to do so solely because of the son's employment.

Nasdaq believes that this distinction in its listing rules is incongruous. If employment of a director's family member, other than as an executive officer, does not disqualify a director from being considered independent, the Exchange states that it sees no reason to preclude a listed company from relying on the Exception for that same director where the listed company's board determines that the director's membership on the relevant committee is required by the best interests of the company and its shareholders.<sup>12</sup>

Nasdaq proposes to amend paragraphs (c)(2)(B), (d)(3), and (e)(3) of Nasdaq Rule 5605 to allow a director who is a family member of a non-executive employee of a listed company to serve on the listed company's audit committee, compensation committee, or nominations committee under exceptional and limited circumstances as long as the listed company's board concludes that the director's membership on the relevant committee is required by the best interests of the company and its shareholders. Under the proposed rule change, the board would still be required, as under the current version of the Exception, to make an affirmative determination that the non-independent director's membership on a committee is required by the

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<sup>12</sup> See Notice, supra note 4.

best interests of the company and its shareholders. Nasdaq states that it expects the board, in making such a determination, to consider any family relationship between the non-independent director and a non-executive employee of the company.<sup>13</sup>

Under the proposed rule change, a listed company, other than a foreign private issuer, that relies on the Exception for an audit committee member would continue to be required to comply with the disclosure requirements set forth in Item 407(d)(2) of Regulation S-K.<sup>14</sup> A foreign private issuer that relies on the Exception for an audit committee member would continue to be required to disclose in its next annual report (e.g., Form 20-F or 40-F) the nature of the relationship that makes the committee member not independent and the reasons for the board's determination to rely on the Exception.<sup>15</sup>

Similarly, a listed company that relies on the Exception for a compensation or nominations committee member would continue to be required to disclose either on or through the company's website or in the proxy statement for the next annual meeting of the company (or, if the company does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship that makes the committee member not independent and the reasons for the determination to rely on the Exception.<sup>16</sup> A listed company that relies on the Exception for a compensation or nominations committee member also would continue to be required to provide any disclosure

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<sup>13</sup> Under both the current and proposed versions of the Exception, a listed company could not rely on the Exception for a director who has a family member who is an executive officer of the listed company. In addition, under both the current and proposed versions of the Exception for audit committees, a listed company could not rely on the Exception for a director who does not meet the criteria in Section 10A(m)(3) of the Act and the rules thereunder to allow the director to serve on the audit committee. See 15 U.S.C. 78j-1(m)(3) and 17 CFR 240.10A-3(b)(1).

<sup>14</sup> See Nasdaq Rule 5605(c)(2)(B).

<sup>15</sup> Id.

<sup>16</sup> See paragraphs (d)(3) and (e)(3) of Nasdaq Rule 5605.

required by Instruction 1 to Item 407(a) of Regulation S-K regarding its reliance on the Exception.<sup>17</sup>

Finally, the proposed rule change would replace the term “officer” with the defined term “Executive Officer” in paragraphs (c)(2)(B), (d)(3), and (e)(3) of Nasdaq Rule 5605. Nasdaq notes that it has always interpreted these terms in the same manner.<sup>18</sup>

### III. Discussion and Commission Findings

After carefully reviewing the proposed rule change, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>19</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>20</sup> which, among other things, requires that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.<sup>21</sup>

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<sup>17</sup> Id.

<sup>18</sup> See Notice, supra note 4.

<sup>19</sup> In approving this proposed rule change, the Commission has considered the proposed rule change’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> The Commission notes that it recently adopted new Rule 10C-1 under the Act, relating to the independence of compensation committees of listed issuers. See Securities Exchange Act Release No. 67220 (June 20, 2012), 77 FR 28422 (June 27, 2012). In accordance with Section 10C of the Act, which was added by Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, new Rule 10C-1 directs each national securities exchange to establish listing standards that, among other things, require each member of a listed issuer’s compensation committee to be a member of the board of directors and to be “independent,” as defined in the listing standards of the

As the Exchange notes, in ordinary circumstances, when a family member of a director is employed by the listed company, but not as an executive officer, the director may still be deemed independent. The Exchange believes that it is incongruous for the same relationship to preclude a company from relying on the Exception where the requirements of the Exception otherwise are satisfied. The Commission believes that the Exchange's view is not unreasonable. In approving the proposed rule change, the Commission notes that in any instance in which a listed company relies on the Exception, the company's board would continue to be required under the proposal to affirmatively determine that the director does not have any relationship which, in the opinion of the board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.<sup>22</sup>

The Commission further notes that a listed company is permitted to use the Exception only if its board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the company and its shareholders. Moreover, the Commission notes that any time an issuer relies on the Exception, it is required to make the public disclosures indicated above.

Finally, the Commission believes that replacing the undefined term "officer" with the defined term "Executive Officer," in keeping with the Exchange's longstanding interpretation of its listing rules, clarifies the applicability of the listing rules.

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exchange adopted in accordance with Rule 10C-1. The exchanges must file with the Commission, no later than September 25, 2012, proposed rule changes that comply with the requirements of Rule 10C-1, and must have final rules or rule amendments that comply with Rule 10C-1 approved by the Commission no later than June 27, 2013. The Commission expects that, in submitting a proposed rule change in compliance with Rule 10C-1, Nasdaq will discuss whether and how its proposed rule change would relate to the Exception and the Exchange's instant proposed rule change with respect to compensation committees.

<sup>22</sup> See Nasdaq Rule 5605(a)(2).

For the reasons discussed above, the Commission finds that the rule change is consistent with the Act.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>23</sup> that the proposed rule change (SR-NASDAQ-2012-062), be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>23</sup> 15 U.S.C. 78s(b)(2).

<sup>24</sup> 17 CFR 200.30-3(a)(12).