

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-88210; File No. SR-NASDAQ-2019-049)

February 13, 2020

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 3, 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 a family member for purposes of determining the independence of directors under Nasdaq 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 On September 13, 2019, the Commission instituted an order instituting proceedings under Section 19(b)(2)(B) of the Act (“OIP”) to determine whether to approve or disapprove the

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).

proposed rule change.⁵ The Commission received one comment letter, from Nasdaq, in response to the OIP.⁶ On December 12, 2019, the Commission designated a longer period for Commission action on the proposed rule change.⁷ On January 30, 2020, Nasdaq filed Amendment No. 1 to the proposed rule change, which the Exchange subsequently withdrew. On January 31, 2020, Nasdaq filed Amendment No. 2 to the proposed rule change, which the Exchange subsequently withdrew.⁸ On February 11, 2020, Nasdaq filed Amendment No. 3 to the proposed rule change. The Commission is publishing notice of the filing of Amendment No. 3 to solicit comment from interested persons and is approving the proposed rule change, as modified by Amendment No. 3, on an accelerated basis.

II. Description of the Proposal, as Modified by Amendment No. 3

Nasdaq has proposed to amend its definition of “Family Member” for purposes of determining whether a director is independent under Nasdaq Rule 5605(a)(2) to mean a person’s

⁵ See Securities Exchange Act Release No. 86969 (September 13, 2019), 84 FR 49353 (September 19, 2019).

⁶ See letter from Jeffrey S. Davis, Senior Vice President and Senior Deputy General Counsel, Nasdaq, to Vanessa A. Countryman, Secretary, Commission, dated November 12, 2019.

⁷ See Securities Exchange Act Release No. 87721 (December 12, 2019), 84 FR 69401 (December 18, 2019).

⁸ In Amendment No. 3, Nasdaq provided additional clarification and justification in support of the proposed rule change, including a statement that it was proposing to interpret the term “children” to exclude stepchildren; deleted and revised certain language in the original proposal; and clarified that the proposed rule change to Nasdaq Rule 5605(a)(2) will not affect the additional independence criteria for audit committee members set forth in Nasdaq Rule 5605(c)(2), which incorporate the independence requirements of Rule 10A-3 under the Act, 17 CFR 240.10A-3. Amendment No. 3 replaces and supersedes the original proposal in its entirety and is available at: http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2019/SR-NASDAQ-2019-049_Amendment_3.pdf.

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. As stated by Nasdaq, the purpose of the proposed rule change is to exclude domestic employees who share the director's home, and stepchildren who do not share the director's home, from the types of relationships that always preclude a finding that a director is independent.⁹

Nasdaq rules require companies listing on the Exchange to meet certain standards, 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 committees¹⁰ be comprised solely of Independent Directors.¹¹ "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 precludes a Board finding of independence in specified situations where a director or a director's Family Member, as defined in the rule, has (or has had), certain relationships with the listed company. This list of relationships, commonly referred to as "bright-line tests", includes the following:

⁹ See Amendment No. 3, *supra* note 8, at 5.

¹⁰ 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.

¹¹ See Nasdaq Rule 5605(b)-(e).

- 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);¹²
- 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;
- 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.¹³

¹² Nasdaq's rules state 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.

¹³ Nasdaq Rule 5605(a)(2)(A) also prohibits a director who is, or at any time during the past three years was, employed by the company. Additional criteria of independence apply

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 noted by Nasdaq in its proposal, this definition includes stepchildren, as they are “children by... marriage.” It also includes domestic employees who reside in a person’s home.

Nasdaq has proposed to re-define a Family Member to mean “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.” According to Nasdaq, this definition would make its definition of Family Member identical to the definition of “immediate family member” in the corresponding corporate governance rules of the New York Stock Exchange (“NYSE”).¹⁴ Nasdaq has proposed further to interpret the term “children” to exclude stepchildren.¹⁵ As noted by Nasdaq, however, the relationship of a stepchild who shares the same home with a director would continue to be considered a Family Member relationship under the bright-line tests, because the definition of a Family Member will include anyone (other than domestic employees) who shares the director’s home.¹⁶ Nasdaq has also

with respect to Board members and members of the audit and compensation committees. See Nasdaq Rule 5605.

¹⁴ See Section 303A.02 of the NYSE Listed Company Manual, which states in this regard: “An ‘immediate family member’ includes 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.” See also Amendment No. 3, at 8, in which Nasdaq stated, among other things, that it had heard from its listed companies and their legal counsel that the current situation, where each market has a different definition, complicates the preparation by listed companies of director and officer questionnaires that the companies need in order to analyze director independence.

¹⁵ See Amendment No. 3, supra note 8, at 7.

¹⁶ See id.

proposed to exclude domestic employees who reside in a director's home from the definition of Family Member.

Concerning the aspect of the proposed rule change relating to stepchildren, Nasdaq noted in its proposal that, over time, it had concluded that inclusion of stepchildren in the definition of Family Member for the purposes of the bright-line tests makes the definition over-inclusive. The Exchange further stated that it believes that a director's relationship with his or her stepchildren may or may not interfere with the director's exercise of independent judgment, depending on the facts and circumstances of the situation.¹⁷

The Exchange acknowledged in its proposal that if a stepchild has been a dependent of a director or was part of the director's household since being a minor, the director's relationship with that stepchild is likely to be similar to a relationship with a biological child. However, the Exchange maintained, if the director married a person who has an adult child, the director never acted in any capacity as a parent of this stepchild, and the stepchild never shared the director's household, then the director and stepchild are likely to have an attenuated relationship that is unlike the relationship of a parent and a child.¹⁸

Nasdaq has concluded, therefore, that a stepchild relationship should not preclude a director from being considered independent in all circumstances. The Exchange believes, rather, that a company's Board is in the best position to determine whether a given relationship between a director and stepchild is likely to interfere with the director's exercise of independent judgment in carrying out his or her responsibilities based on the facts and circumstances.¹⁹ The

¹⁷ See id.

¹⁸ See id.

¹⁹ See id., at 7-8.

Exchange noted in its proposal that, under Nasdaq Rule 5605(a)(2) and IM-5605, the Board must affirmatively determine that no relationship exists that would interfere with such independent judgment.²⁰

Nasdaq added that the proposed rule change to the definition of Family Member for purposes of the bright-line tests of independence in Nasdaq Rule 5605(a)(2) would not affect the additional independence criteria for audit committee members set forth in Nasdaq Rule 5605(c)(2), which incorporate the independence requirements of the Rule 10A-3 under the Act.²¹

Concerning the aspect of the proposed rule change that relates to domestic employees who share a director's home, Nasdaq stated that the term Family Member was not intended to capture commercial relationships. Here, too, the Exchange expressed the belief that it is appropriate for the Board to review a relationship between a director and a domestic employee under a facts and circumstances test.²²

III. Summary of Comment Letter

As previously noted, the Commission received one comment letter, from Nasdaq, in response to the OIP. In its letter, Nasdaq stated, among other things, that it and NYSE appear to agree that stepchildren should be excluded from the definition of Family Member (in Nasdaq's rules) and immediate family member (in NYSE's rules). Nasdaq believes that "NYSE interprets the term 'children' to exclude stepchildren, particularly in situation where the stepchild

²⁰ See id., at 10.

²¹ Nasdaq Rule 5605(c)(2) requires that each Company must have, and certify that it has and will continue to have, an audit committee of at least three members, each of whom must, among other requirements, meet the criteria for independence set forth in Rule 10A-3(b)(1) under the Act, in addition to the requirements of Nasdaq Rule 5605(a)(2). See also Nasdaq Rule IM-5605-4 (Audit Committee Composition).

²² See Amendment No. 3, supra note 8, at 10.

relationship is attenuated, namely where a person has become a stepchild of a director as an adult.” Nasdaq stated that it based this understanding on information that it said was provided by practitioners that represent companies listed on both Nasdaq and NYSE and from companies previously listed on NYSE. Nasdaq further noted that the Commission has previously approved the proposed definition as consistent with Section 6(b)(5) of the Act and added that it believes that Commission disapproval of its proposed rule change would promote unfair competition.

IV. Discussion and Commission Findings

After careful review, 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.²³ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,²⁴ 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.

As discussed above, Nasdaq has proposed to define a Family Member, for purposes of the bright-line tests of whether a director qualifies as an Independent Director, to mirror the definition of “immediate family member” under NYSE’s rules. The Commission notes that other exchanges, too, use the same or similar language in their corporate governance rules, all of

²³ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁴ 15 U.S.C. 78f(b)(5).

which have been approved by the Commission as consistent with the Act.²⁵ The Commission notes, in addition, that it has received no comments, other than the aforementioned letter from the Exchange, in support of its proposal in response to the OIP.

As to Nasdaq's proposal to interpret the term "children" to exclude stepchildren from the definition of Family Member, Nasdaq explained in support of its proposal that in some cases a stepchild has been a dependent or was part of the director's household since being a minor and the director/stepchild relationship is likely then to be similar to a relationship with a biological child, who is covered by the bright-line tests, while in other cases the director and stepchild relationship is attenuated, as in a situation where the director is married to a person who has an adult child who never shared the director's household, and the director never acted in any capacity as a parent to the stepchild. As a result of these different fact patterns, Nasdaq believes it is appropriate to leave to the Board the determination as to whether such a relationship is likely to interfere with the director's exercise of independent judgement in carrying out the director's responsibilities, based on the Board's analysis of the facts and circumstances of the director/stepchild relationship. Nasdaq has further noted that a stepchild who shares a home with the director would continue to be covered by the bright-line tests through the definition of

²⁵ See, e.g., Securities Exchange Act Release Nos. 48863 (Dec. 1, 2003), 68 FR 68432 (Dec. 8, 2003) (order approving File No. SR-Amex-2003-65, now incorporated in NYSE American LLC Company Guide at Section 803, Commentary .01); 49810 (June 4, 2004), 69 FR 32647 (June 10, 2004) (order approving SR-PCX-2003-35, now incorporated in the rules of NYSE Arca, Inc., at Rule 5.3-E(k)(5)(H)); and 49911 (June 24, 2004), 69 FR 39989 (July 1, 2004) (order approving File No. SR-CHX-2003-19, now incorporated in the rules of NYSE Chicago, Inc., at Article 22, Rule 19(o)). In addition to approving Nasdaq's proposed new rule text defining Family Member for purposes of the bright-line tests, which mirrors the rule language of these other exchanges, the Commission is also approving Nasdaq's interpretation of "children" as excluding stepchildren, an interpretation that the Commission has not approved previously for other exchanges.

Family Member, which still includes anyone, other than a domestic employee, who shares the director's home. Additionally, the Commission notes that, as Nasdaq points out, the Exchange's rules place a responsibility on the Board of a listed company to make an affirmative determination, beyond applying the bright-line tests, that any individual serving as an independent director has no relationship that would impair his or her independence.²⁶

In addition, the Commission notes that, in the proposal as modified by Amendment No. 3, the Exchange stated that, to comply with the Exchange's rules, it will expect the Boards of its listed companies to continue to elicit through director questionnaires the information necessary to make independence determinations, which, it states, will need to include questions about stepchild relationships. The Commission believes that this should help to ensure that listed companies inquire about stepchild relationships so that such companies can discern the essential facts and circumstances to be able to make the affirmative findings necessary under Nasdaq rules to determine a director is independent. This is important given that Nasdaq will no longer be including stepchildren within the blanket exclusions of the Family Member relationships identified in the bright-line tests that automatically disqualify a director from being independent. The Commission notes that the proposal, in the narrow context of excluding stepchildren who do not share the director's home from the definition of Family Member for purposes of the bright-line tests, should provide additional flexibility to Boards by permitting them to consider the independence of a director based on the particular facts and circumstances of a director and stepchild relationship, while at the same time continuing to require Boards to have the

²⁶ See supra, text accompanying note 20.

responsibility to ensure that such a relationship would not interfere with or impair a Board member's independence.²⁷

The Commission also notes that the Exchange's proposal would permit a finding of independence if there is a company relationship with the minor stepchild of a director who is not sharing the director's home, while Rule 10A-3 and Exchange Rule 5605(c)(2), which incorporates the independence requirements of Rule 10A-3, could preclude a finding of independence in such case for a director serving as a member of an audit committee. Exchange Rule 5605(c)(2) also incorporates the independence requirements of Rule 5605(a)(2) for a director serving on the audit committee. In the proposal as modified by Amendment No. 3, to avoid any confusion, Nasdaq has made clear that the change it is proposing to the interpretation of Family Member concerning stepchildren in Nasdaq Rule 5605(a)(2), for purposes of the bright-line tests in that provision, will not affect the additional independence criteria for audit committee members in Nasdaq Rule 5605(c)(2), incorporating the provisions of Rule 10A-3.²⁸

Finally, the Commission believes that it is reasonable for Nasdaq to exclude domestic employees who share a director's home from the definition of Family Member, as do other exchanges. The Commission notes that Nasdaq stated in its proposal that it believes that it is appropriate for a company's Board to review a relationship between a director and a domestic employee who shares the director's home under a facts and circumstances test, as in the case of a

²⁷ See Nasdaq Rule 5605(a)(2) and IM-5605.

²⁸ The Commission would expect the Exchange to make clear to its listed companies that the proposed broader exclusion from the definition of Family Member, as it applies to minor stepchildren not sharing the director's home, may not be applied for purposes of determining the independence of audit committee members, where the stricter standards of Rule 10A-3, as well as Exchange Rule 5605(c)(2), still apply.

stepchild relationship.²⁹ The Commission also notes that this proposed provision is consistent with the rules of other exchanges.³⁰ As noted above with respect to other relationships, the Board would continue to need to make an affirmative determination that such a domestic employee relationship with the director does not interfere with the director's independence, pursuant to the requirements in Exchange Rule 5605(a)(2) and IM 5605.

V. Accelerated Approval of the Proposed Rule Change, as Modified by Amendment No. 3

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 3, prior to the thirtieth day after the date of publication of notice of the filing of Amendment No. 3 in the Federal Register. Amendment No. 3 provided clarifications and additional information regarding the justification of the proposal and also made clear that the proposed rule change would not impact the applicability of the Exchange's additional independence criteria for audit committee members set forth in Nasdaq Rule 5605(c)(2), which incorporate the independence requirements of Rule 10A-3. In Amendment No. 3, Nasdaq also stated that Boards of its listed companies will be expected to elicit the information necessary for Boards to make independence determinations and specifically ask about stepchild relationships. The Commission also notes that the proposed rule language being adopted herein was noticed for comment in the Federal Register and no comments were received in response to that notice. The clarifications and additional justification in Amendment No. 3 have assisted the Commission in evaluating the proposal under the Act. Accordingly, the Commission finds good cause, pursuant

²⁹ See Amendment No. 3, supra note 8, at 10.

³⁰ See supra, note 25.

to Section 19(b)(2) of the Act,³¹ to approve the proposed rule change, as modified by Amendment No. 3, on an accelerated basis.

VI. Solicitation of Comments on Amendment No. 3 to the Proposed Rule Change

Interested persons are invited to submit written data, views, and arguments concerning whether Amendment No. 3 to 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 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

³¹ 15 U.S.C. 78s(b)(2).

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. 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].

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³² that the proposed rule change (SR-NASDAQ-2019-049), as modified by Amendment No. 3, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³³

Jill M. Peterson
Assistant Secretary

³² 15 U.S.C. 78s(b)(2).

³³ 17 CFR 200.30–3(a)(57).