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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-71037; File No. SR-NASDAQ-2013-147)

December 11, 2013

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Listing Rules on Independence of Compensation Committee Members

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> notice is hereby given that on November 26, 2013, The NASDAQ Stock Market LLC (“Nasdaq” 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 the Substance of the Proposed Rule Change

The Exchange proposes to amend its listing rules on compensation committee composition. Specifically, Nasdaq proposes to amend Nasdaq Listing Rule 5605(d)(2)(A) and IM-5605-6 to replace the prohibition on the receipt of compensatory fees by compensation committee members with a requirement that a board of directors instead consider the receipt of such fees when determining eligibility for compensation committee membership.

The text of the proposed rule change is available on the Exchange’s website at <http://nasdaq.cchwallstreet.com>, at the principal office of the Exchange and at the Commission’s Public Reference Room.

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

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

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

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”)<sup>3</sup> and Rule 10C-1 under the Act,<sup>4</sup> Nasdaq amended its listing rules (the “Amended Rules”) relating to compensation committee composition, responsibilities and authority earlier this year.<sup>5</sup> Rule 10C-1 required Nasdaq to consider, in determining independence requirements for compensation committee members, certain relevant factors, including the “source of compensation of a member of the board of directors of an issuer, including any consulting, advisory or other compensatory fee paid by the issuer to such member of the board of directors.”<sup>6</sup> Following consideration of this factor, Nasdaq adopted a prohibition on the receipt of compensatory fees by compensation committee members,<sup>7</sup> which is the same

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<sup>3</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>4</sup> 17 CFR 240.10C-1.

<sup>5</sup> See Securities Exchange Act Release No. 68640 (January 11, 2013), 78 FR 4554 (January 22, 2013) (SR-NASDAQ-2012-109).

<sup>6</sup> 17 CFR 240.10C-1(b)(1)(ii)(A).

<sup>7</sup> See Nasdaq Listing Rule 5605(d)(2)(A), which states that each compensation committee member must not accept directly or indirectly any consulting, advisory or other compensatory fee from the company or any subsidiary thereof.

standard applicable to audit committee members under Nasdaq's listing rules and Rule 10A-3 under the Act.<sup>8</sup>

During the rulemaking process, Nasdaq received limited comment on the prohibition on the receipt of compensatory fees by compensation committee members.<sup>9</sup> Over the past few months, however, Nasdaq has received feedback from listed companies and others that the prohibition on compensatory fees creates a burden on issuers at a time when regulatory burdens are higher than ever before. For example, there are companies in some industries (e.g., the energy and banking industries) where it is common to have directors who do a de minimis amount of business with the issuer and would, therefore, be ineligible to serve on the compensation committee under the Nasdaq rules. These companies may have difficulty recruiting a sufficient number of eligible directors to serve on their boards, given the different requirements for board, audit committee and compensation committee composition. Companies

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<sup>8</sup> See Nasdaq Listing Rule 5605(c)(2)(A), which states that each audit committee member must meet the criteria for independence set forth in Rule 10A-3(b)(1) under the Act. Under this rule, audit committee members may not accept directly or indirectly any consulting, advisory or other compensatory fee from the issuer or any subsidiary thereof. See 17 CFR 240.10A-3(b)(1).

<sup>9</sup> Specifically, Nasdaq received only two comments objecting to the prohibition. See (i) Letter from Harold R. Carpenter, CFO, Pinnacle Financial Partners, Nashville, Tennessee, dated November 5, 2012; and (ii) Letter from Robert B. Lamm, Chair, Securities Law Committee, Society of Corporate Secretaries and Governance Professionals, New York, New York, dated December 7, 2012. Nasdaq also received three comments that supported the prohibition, but argued that in considering a director's eligibility to serve on a compensation committee, a board should also consider fees paid to directors for service on the board and board committees. See (i) Letter from J. Robert Brown, Jr., University of Denver Sturm College of Law, dated October 30, 2012; (ii) Letter from Brandon J. Rees, Acting Director, Office of Investment, AFL-CIO, dated November 5, 2012; and (iii) Letter from Carin Zelenko, Director, Capital Strategies Department, International Brotherhood of Teamsters, dated November 5, 2012. All the comment letters are available at <http://www.sec.gov/comments/sr-nasdaq-2012-109/nasdaq2012109.shtml>.

and their representatives have indicated that this additional burden could influence a company's choice of listing venue.

After weighing these comments, Nasdaq proposes to remove the prohibition on the receipt of compensatory fees by compensation committee members. Nasdaq proposes to state instead that in affirmatively determining the independence of any director who will serve on the compensation committee, a company's board must consider the source of compensation of the director, including any consulting, advisory or other compensatory fee paid by the company to the director.<sup>10</sup> In IM-5605-6, Nasdaq proposes to state that when considering the sources of a director's compensation in determining independence for purposes of compensation committee service, the board should consider whether the director receives compensation from any person or entity that would impair the director's ability to make independent judgments about the company's executive compensation.

Nasdaq proposes to remove the exception in the current rule that states that compensatory fees do not include: (i) fees received as a member of the compensation committee, the board of directors or any other board committee; or (ii) the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the company

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<sup>10</sup> Nasdaq also proposes to add language to IM-5605-6 to state that for purposes of the affirmative independence determination described in Rule 5605(d)(2)(A), any reference to the defined term "Company" includes any parent or subsidiary of the company. The term "parent or subsidiary" is intended to cover entities the company controls and consolidates with the company's financial statements as filed with the Commission (but not if the company reflects such entity solely as an investment in its financial statements). This language is copied from IM-5605, which explains the interpretation of the definition of Independent Director in Rule 5605(a)(2). Since Rule 5605(d)(2)(A) describes an additional independence test for compensation committee members, Nasdaq believes it would be useful to repeat its construction of the term "Company" for independence purposes in the interpretive material for this rule.

(provided that such compensation is not contingent in any way on continued service).<sup>11</sup> As a result, boards of director [sic] should consider such fees, in aggregate with all other sources of compensation of the director, to determine whether such compensation would impair the director's judgment as a member of the compensation committee. This proposal is consistent with the approach of other exchanges, which do not exempt any types of fees from the analysis of compensation committee eligibility.<sup>12</sup> In addition, during the rulemaking process on the Amended Rules, Nasdaq received several comments arguing that in determining eligibility for compensation committee membership, a board should consider the fees paid to directors for their service on the board or board committees.<sup>13</sup>

Nasdaq's overall proposal is consistent with the Dodd-Frank Act and Rule 10C-1, which required Nasdaq to consider compensatory fees when determining eligibility for compensation committee membership, but did not require a prohibition on such fees. Even with the proposed change, a compensation committee member will not be allowed to receive unlimited fees from a company since such a member must continue to be an Independent Director as defined under Nasdaq Listing Rule 5605(a)(2).<sup>14</sup> That definition excludes any director who: (i) accepted any compensation from the company in excess of \$120,000 during any period of twelve consecutive months within the prior three years;<sup>15</sup> or (ii) is a partner in, or a controlling shareholder or an

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<sup>11</sup> See Nasdaq Listing Rule 5605(d)(2)(A).

<sup>12</sup> See Section 303A.02(a)(ii)(A) of the NYSE Listed Company Manual; see also BATS Rule 14.10(c)(4)(A)(i)(a); see also NYSE Arca Equities Rule 5.3(k)(4)(ii); see also Section 805(c)(1) of the NYSE MKT Company Guide.

<sup>13</sup> See footnote 9, supra.

<sup>14</sup> See Nasdaq Listing Rule 5605(d)(2)(A).

<sup>15</sup> See Nasdaq Listing Rule 5605(a)(2)(B). Nasdaq notes that this rule excludes compensation for board or board committee service from the \$120,000 cap. However, any compensation for board or board committee service still must be considered for

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.<sup>16</sup> Boards of directors would be required to consider, based on the company's and the director's unique circumstances, whether the receipt of any fees, even fees below these caps, would impair the director's ability to make independent judgments about the company's executive compensation, and therefore render the director ineligible to serve on the compensation committee.

In addition, the proposal is consistent with Nasdaq's approach to affiliation, which is the other specific factor enumerated in Rule 10C-1 that Nasdaq was required to consider in determining eligibility for compensation committee membership. The Amended Rules require that boards of directors consider affiliation in determining compensation committee membership, but they do not include any outright prohibitions in this regard.<sup>17</sup> Nasdaq is proposing some minor wording changes to Rule 5605(d)(2)(A) to make the affiliation prong more clear, in light of the revisions to the prong relating to compensatory fees; however, Nasdaq believes that substantively, the affiliation prong will remain unchanged following this proposed rule change. Nasdaq also proposes to add text to IM-5605-6 to state that when considering any affiliate relationship a director has with the company, a subsidiary, or an affiliate of a subsidiary, in determining independence for purposes of compensation committee service, the board should consider whether the affiliate relationship places the director under the direct or indirect control

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purposes of affirmatively determining the independence of any director who will serve on the compensation committee.

<sup>16</sup> See Nasdaq Listing Rule 5605(a)(2)(D).

<sup>17</sup> See Nasdaq Listing Rule 5605(d)(2)(A).

of the company or its senior management, or creates a direct relationship between the director and members of senior management, in each case of a nature that would impair the director's ability to make independent judgments about the Company's executive compensation.<sup>18</sup>

Nasdaq also proposes to add language to Rule 5605(d)(2)(A) to clarify that in affirmatively determining the independence of any director who will serve on the compensation committee, the board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member. Nasdaq does not believe this is a substantive change since the existing rule requires compensation committee members to be Independent Directors as defined under Rule 5605(a)(2). This definition requires, among other things, that a company's board make an affirmative determination that the director has no relationship which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The responsibilities of a director who serves on the compensation committee would include any responsibilities relating to compensation committee membership. However, Nasdaq believes it will be helpful to clarify this requirement in the text of Rule 5605(d)(2)(A), which describes the requirements for compensation committee composition.

Finally, Nasdaq proposes a minor edit to the first sentence of Rule 5605(d)(2)(A) to split

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<sup>18</sup> Nasdaq proposes to retain existing language in IM-5605-6 that states that while a board may conclude differently with respect to individual facts and circumstances, Nasdaq does not believe that ownership of a company's stock by itself, or possession of a controlling interest through ownership of a company's stock, precludes a board finding that it is appropriate for a director to serve on the compensation committee. In fact, it may be appropriate for certain affiliates, such as representatives of significant stockholders, to serve on compensation committees since their interests are likely aligned with those of other stockholders in seeking an appropriate executive compensation program.

it into two sentences in light of the revisions to the rule described above.<sup>19</sup> This edit clarifies that each compensation committee must consist of at least two members, and each committee member must be an Independent Director as defined under Rule 5605(a)(2).

Companies are required to comply with the compensation committee composition aspects of the Amended Rules by the earlier of their first annual meeting after January 15, 2014, or October 31, 2014.<sup>20</sup> As a result, Nasdaq believes it is important to implement the proposed change now, before companies propose changes to board and committee composition in connection with their 2014 annual meetings.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>21</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>22</sup> in particular, in that it 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. Specifically, the proposal removes impediments to and perfects the mechanism of a free and open market by allowing boards of directors greater flexibility in determining eligibility for compensation committee membership, consistent with the requirements of the Dodd-Frank Act and Rule 10C-1. Nasdaq will continue to protect investors and the public interest by maintaining overall caps on the amount of compensatory fees that may be received by a compensation committee member from a company. However, a board of

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<sup>19</sup> Nasdaq also proposes conforming edits to IM-5605-6.

<sup>20</sup> See Nasdaq Listing Rule 5605(d)(6). During the transition period, companies that are not yet required to comply with a particular provision of revised Rule 5605(d) and IM-5605-6 must continue to comply with the corresponding provision, if any, of Rule 5605A(d) and IM-5605A-6.

<sup>21</sup> 15 U.S.C. 78f(b).

<sup>22</sup> 15 U.S.C. 78f(b)(5).

directors must consider, given the particular circumstances of a company and/or a director, whether any fees, even fees below the overall caps, would impair the director's ability to make independent judgments about the company's executive compensation, and therefore render the director ineligible to serve on the compensation committee.

In addition, Nasdaq proposes other changes in the rule to clarify its interpretation of the additional independence test for compensation committee members in light of the change discussed above. Specifically, Nasdaq proposes to: (i) delete an exception for certain types of compensatory fees that may be received by a compensation committee member; (ii) clarify the standard a board must use when considering certain affiliate relationships of a compensation committee member; (iii) explicitly state that as part of the independence test, a board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member; (iv) reiterate the definition of the term "Company" for purposes of the independence test; and (v) clarify that each compensation committee must be an Independent Director as defined under Rule 5605(a)(2). These changes will make Nasdaq's compensation committee composition requirements more transparent and easier to understand. As a result, the changes will protect investors and the public interest.

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

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. The Dodd-Frank Act and Rule 10C-1 under the Act required each national securities exchange to adopt similar rules to Nasdaq's Amended Rules. Like Nasdaq, each other exchange was required to

consider compensatory fees when determining eligibility requirements for compensation committee membership. Other than Nasdaq and NASDAQ OMX BX,<sup>23</sup> which is not currently operational as a listing market, no other exchange prohibits compensatory fees to members of the compensation committee.<sup>24</sup> This change will harmonize Nasdaq's rule regarding compensation committee composition with the more flexible rules of the other exchanges. As a result, this proposal removes a potential competitive advantage for the other exchanges and thereby enhances competition among exchanges.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>25</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>26</sup>

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<sup>23</sup> Like Nasdaq, NASDAQ OMX BX adopted an outright prohibition on the receipt of compensatory fees by compensation committee members. See BX Venture Market Listing Rule 5605(d)(2)(A). However, Nasdaq expects that NASDAQ OMX BX will file a proposed rule change to conform its rule to the Nasdaq rule.

<sup>24</sup> See Section 303A.02(a)(ii)(A) of the NYSE Listed Company Manual; see also BATS Rule 14.10(c)(4)(A)(i)(a); see also NYSE Arca Equities Rule 5.3(k)(4)(ii); see also Section 805(c)(1) of the NYSE MKT Company Guide.

<sup>25</sup> 15 U.S.C. 78s(b)(3)(a)(ii).

<sup>26</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2013-147 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-NASDAQ-2013-147. 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 at 100 F Street, NE, Washington, DC 20549-1090 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 offices 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-NASDAQ-2013-147, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>27</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>27</sup> 17 CFR 200.30-3(a)(12).