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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-86095; File No. SR-NASDAQ-2019-049]

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Amend the Definition of Family Member in Listing Rule 5605(a)(2) for Purposes of the Definition of Independent Director

June 12, 2019

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 May 29, 2019, 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 Substance of the Proposed Rule Change

The Exchange proposes to modify the definition of a “Family Member” for purposes of Listing Rule 5605(a)(2).

The text of the proposed rule change is set forth below. Proposed new language is underlined.

### **The Nasdaq Stock Market Rules**

\* \* \* \* \*

#### **5605. Board of Directors and Committees**

##### **(a) Definitions**

###### **(1) No change.**

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

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

(2) "Independent Director" means 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 of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. For purposes of this rule, "Family Member" means a person's spouse, parents, children,[ and] siblings, [whether by blood, marriage or adoption, or anyone residing in ]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 following persons shall not be considered independent:

(A) - (G) No change.

\* \* \* \* \*

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.

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

Nasdaq is proposing to modify the definition of a "Family Member" for purposes of director independence under Listing Rule 5605(a)(2) to exclude stepchildren by reverting to the

language of the rule before it was paraphrased. Currently, the rule provides that “children... by marriage,” or stepchildren, are considered Family Members. Nasdaq believes this category was added to the definition of a Family Member inadvertently and that such an expansion of the definition is unwarranted.

Rule 5605(a) provides a list of certain relationships that preclude a board from finding that a director is independent. These objective measures provide transparency to investors and companies, facilitate uniform application of the rules, and ease administration. Nasdaq’s rules preclude a director from being considered independent if the director has a Family Member who (i) 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)<sup>3</sup>; (ii) 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)<sup>4</sup>; (iii) 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 served on the compensation committee of such other entity<sup>5</sup>; or (iv) 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.<sup>6</sup> Nasdaq’s rules also preclude a director from being considered independent if such director is a Family Member of an

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<sup>3</sup> Listing Rule 5605(a)(2)(B).

<sup>4</sup> Listing Rule 5605(a)(2)(D).

<sup>5</sup> Listing Rule 5605(a)(2)(E).

<sup>6</sup> Listing Rule 5605(a)(2)(F).

individual who is, or at any time during the past three years was, employed by the Company as an Executive Officer.<sup>7</sup>

Currently, for purposes of Nasdaq Rules, Family Member means a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.<sup>8</sup> This definition includes stepchildren, as they are "children by... marriage."

When Nasdaq first adopted this rule in 1999, Family Member was defined as a person's spouse, parents, children, siblings, mother-in-law, father-in-law, brother-in-law, sister-in-law, and anyone who resides in such person's home.<sup>9</sup> The rule was subsequently amended to include sons-in-law and daughters-in-law in the definition of a Family Member.<sup>10</sup> At that point, the New York Stock Exchange's ("NYSE") definition of an "immediate family member," which is still in effect, and Nasdaq's definition of the Family Member became nearly identical.<sup>11</sup>

In 2002, Nasdaq undertook a comprehensive review of its corporate governance rules and adopted a package of corporate governance reforms.<sup>12</sup> At about the same time, NYSE

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<sup>7</sup> Listing Rule 5605(a)(2)(C).

<sup>8</sup> Listing Rule 5605(a)(2).

<sup>9</sup> See Securities Exchange Act Release No. 41982 (October 6, 1999), 64 FR 55510 (October 13, 1999).

<sup>10</sup> See Securities Exchange Act Release No. 42231 (December 14, 1999), 64 FR 71523 (December 21, 1999).

<sup>11</sup> Section 303A.02 of the NYSE Listed Company Manual states that "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."

<sup>12</sup> On October 9, 2002, the NASD, through its subsidiary, The Nasdaq Stock Market, Inc., filed with the Commission a proposed rule change to amend NASD Rules to modify requirements relating to board independence and independent committees. See Securities Exchange Act Release No. 47516 (March 17, 2003), 68 FR 14451 (March 25, 2003) (SR-NASD-2002-141) ("Nasdaq Independent Director Proposal").

implemented similar changes to its listing standards.<sup>13</sup> The Commission discussed and approved both the Nasdaq Independent Director Proposal and the NYSE Corporate Governance Proposal in one order (the “Order”).<sup>14</sup>

As part of the Nasdaq Independent Director Proposal, Nasdaq changed the definition of Family Member to mean “a person’s spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person’s home.” This change was meant to simplify the existing definition of a Family Member, while not introducing any substantive changes and Nasdaq did not discuss any potential substantive change to the definition in its rule filing. Similarly, NYSE retained unchanged the definition of the immediate family member in the NYSE Corporate Governance Proposal. In the Order, the Commission reviewed and analyzed both Nasdaq’s new definition of the Family Member and the NYSE’s existing definition and did not note any potential differences.<sup>15</sup>

Over time, Nasdaq has heard from its listed companies and their legal counsel that the change to the definition of a Family Member did not simplify the application of the rule. Instead, while preparing director and officer questionnaires the companies’ legal counsel often need to analyze potential differences in the meaning of Nasdaq’s definition of a Family Member and NYSE’s definition of an immediate family member. In particular, this burdensome analysis occurs when a company transfers its listing from one national securities exchange to another. In such case, a director may have already filled out an annual questionnaire based on the

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<sup>13</sup> See Securities Exchange Act Release No. 47672 (April 11, 2003) 68 FR 19051 (April 17, 2003) (“NYSE Corporate Governance Proposal”).

<sup>14</sup> See Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003).

<sup>15</sup> Id.

exchange's definition of a family member, but may need to answer additional questions because the definition of the exchange the listing is transferred to is phrased differently.

In particular, Nasdaq has discovered that the revised definition of a Family Member was broader than the prior version and now inadvertently includes stepchildren of a director because such individuals are "children... by marriage" even though they are not "sons-in-law" or "daughters-in-law" or any other category from the old definition. In one situation that Nasdaq observed the director married a person who had an adult child. Because the director never acted in any capacity as a parent of this stepchild, and the stepchild never shared the director's household, the director and stepchild had an attenuated relationship. Accordingly, Nasdaq believes that such a relationship should not preclude a director from being considered independent in all circumstances.

Nasdaq believes that the analysis of the potential differences in the definition of family members is an unnecessary and unintentional burden on listed companies because Nasdaq's current definition of a Family Member was meant to paraphrase the then-existing definition of a Family Member, while not introducing any substantive changes. In addition, as described above, the Commission reviewed and analyzed both Nasdaq's new definition of a Family Member and the NYSE's existing definition of an immediate family member, which is nearly identical to the Nasdaq's old definition of a Family Member, and did not note any potential differences. Accordingly, Nasdaq is proposing to modify the definition of a Family Member for purposes of director independence under Listing Rule 5605(a)(2) to revert to the language of the rule before it was paraphrased.

Nasdaq is also proposing to modify the definition of a "Family Member" for purposes of director independence under Listing Rule 5605(a)(2) to exclude domestic employees who share a

director's home. Nasdaq believes that the definition of a Family Member should not include a domestic employee who shares a director's home because this definition is intended to capture familial, not commercial, relationships.

Notwithstanding these changes, Nasdaq notes that a company's board must, under the Rule and IM-5605, affirmatively determine that no relationship exists that would interfere with the exercise of independent judgment in carrying out the director's responsibilities. Nasdaq believes that it is appropriate for the board to review a potential relationship between a director and a domestic employee or a child of the director's spouse under such facts and circumstances test.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>16</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>17</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, by removing the impediments to a free in [sic] open market where a "bright line" independence test prohibits some directors from being deemed independent in circumstances where the relationship with a Family Member is attenuated, non-existent, or commercial in nature. Nasdaq also believes that the proposed rule change is designed to remove impediments to and perfect the mechanism of a free and open market by aligning Nasdaq's and NYSE's corporate governance requirements more closely, by contrast to current differently phrased definitions of a Family Member on Nasdaq and an immediate family member on NYSE

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<sup>16</sup> 15 U.S.C. 78f(b).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

and inclusion of a domestic employee who shares the director's home in Nasdaq's definition of a Family Member, where such differences pose an unnecessary burden on listed companies.

Specifically, Nasdaq listing rules currently prohibit a director from being deemed independent in certain circumstances by including stepchildren of the directors' spouse [sic] in the definition of a Family Member, as described in more detail above. The rule also prohibits a domestic employee who shares the director's home from being deemed independent by including such employee in the definition of a Family Member.

Independent directors over time became a linchpin in the American corporate governance. 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. As the importance of independent directors for listed companies increased, so did the directors' workload and the risk of litigation. In this environment, Nasdaq believes that it is appropriate not to prohibit directors from being considered independent based on certain commercial or attenuated familial relationships, but instead allow the board to review such a relationship and affirmatively determine a relationship exists that would interfere with the exercise of independent judgment in carrying out the director's responsibilities.

Additionally, as proposed, Listing Rule 5605(a)(2) would remain consistent with the SEC Rule 10A-3 promulgated under the Act.<sup>18</sup> In particular, Rule 10A-3(e)(8) provides that a director is no longer considered independent for audit committee service upon, among other things, indirect acceptance of compensatory payments to "spouses, minor children or stepchildren or children or stepchildren sharing a home with the member." Thus, the SEC's audit committee independence rule focuses only on payments to "minor children or stepchildren" or "stepchildren

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<sup>18</sup> 17 CFR 240.10A-3.

sharing a home with the member” and would not capture the activities of a stepchild of a director, particularly one who does not nor has ever shared a household. Similarly, Rule 10A-3 does not capture the activities of directors’ domestic employees.

Following the proposed rule change, Nasdaq’s definition of the Family Member will be became identical with the NYSE’s definition of an “immediate family member,” the definition that the Commission has previously approved.<sup>19</sup>

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 proposed rule change would eliminate requirements that burden issuers without an offsetting benefit in protecting shareholders. All listed companies would be affected in the same manner by these changes. As such, these changes are neither intended to, nor expected to, impose any burden on competition.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

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<sup>19</sup> See footnote 14, above.

#### **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-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 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].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

Eduardo A. Aleman  
Deputy Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).

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