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HOLIDAY GIFT TO ISSUERS: NASDAQ FILES AMENDMENTS TO LISTING RULES ON COMPENSATION COMMITTEE COMPOSITION

December 2013

On Wednesday, December 11, 2013, the Securities and Exchange Commission (SEC) **gave notice** that, on November 26, 2013, The NASDAQ Stock Market, LLC (NASDAQ) filed **a proposal** with the SEC to amend its listing rules on compensation committee composition. Of most significance in the amendments, NASDAQ amends its listing rules to remove the outright prohibition on the receipt of compensatory fees by compensation committee members and replaces it with a requirement that a board need only *consider* the receipt of such fees when determining eligibility for compensation committee membership. Such a change brings the NASDAQ listing rules more in line with the New York Stock Exchange's more flexible rules relating to compensation committee composition.

Effective Date and Comment Period

The amendments became effective immediately pursuant to Rule 19b-4(f)(6) under the Securities Exchange Act of 1934, as amended (Exchange Act). Comments on the rules, however, may still be provided during a 21-day comment period from the date of Federal Register publication. The rules were made effective immediately to enable listed companies to meet the compliance deadline for NASDAQ's listing rules on compensation committee director independence, which remains the earlier of (i) the company's first annual meeting held after January 15, 2014 or (ii) October 31, 2014.

Background

- The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), and corresponding Rule 10C-1 under the Exchange Act, required NASDAQ (and other exchanges) to amend its listing rules relating to the composition, responsibilities and authority of compensation committees, which NASDAQ completed earlier this year.
- In January 2013, NASDAQ adopted, among other things, a prohibition on compensation committee members receiving compensatory fees, consistent with its independence requirements for audit committee members.
- In recent months, however, NASDAQ received a number of comments that the prohibition creates a significant burden on issuers, including that companies in some industries may have difficulty attracting eligible directors to serve on their boards in light of the different requirements for composition of the board and audit and compensation committees. The comments also indicated that such a prohibition on compensatory fees could influence companies' choice of stock exchange for listing their securities.

NASDAQ's Amendments

- After considering the feedback, NASDAQ has amended its listing rules to remove the prohibition on compensation committee members receiving compensatory fees and instead to provide that, in determining the independence of any director serving on a listed company's compensation committee, the board must consider all sources of compensation paid to the director, including consulting, advisory or compensatory fees paid to the director by the company.
- Correspondingly, the NASDAQ amendments provide that, when considering the sources of a compensation committee member's compensation for purposes of determining independence, the board should consider whether compensation from any person or entity would impair the director's ability to make independent judgments about the company's executive compensation.
- NASDAQ also removed the carve-out from the current definition of compensatory fees so that boards will be required to consider: (1) fees received as a member of the compensation committee, the board or any other committee, and (2) receipt of fixed amounts of compensation under a retirement plan for prior services with the company in determining whether such aggregate compensation would impair the director's judgment as a member of the compensation committee.
- NASDAQ's amendments also make the independence from management and affiliation consideration in relation to compensation committee independence more clear. In assessing the independence of any compensation committee member, the board must consider all factors that could affect a committee member's judgment regarding executive compensation. The amendments expand the concept to provide that when considering, for purposes of compensation committee independence, any director's affiliate relationships, the board should consider whether the relationship places the director under the direct or indirect control of the company or its senior management, or creates a direct relationship between the director and members of senior management, that would impair a committee member's judgment regarding executive compensation. However, NASDAQ stated its belief that substantively, the affiliation prong will remain unchanged following this rule change.

NASDAQ-listed companies that have already amended their compensation committee charters to comply with the listing rules as amended earlier this year relating to compensation committees may have to again reassess and/or amend their charters to bring them in line with the new NASDAQ rules.

For additional information about the NASDAQ proposal, please contact your principal Squire Sanders lawyer or any of the lawyers listed in this publication.

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