HUNTON & WILLIAMS

Client Alert

December 2013

NASDAQ Adopts Amendments to Compensation Committee Independence Listing Standards

Summary

On December 11, 2013, the Securities and Exchange Commission (the "SEC") published amendments to the NASDAQ Stock Market ("NASDAQ") listing standards that, among other changes, remove the bright-line prohibition on a compensation committee member's receipt of compensatory fees.[1] Under the amended listing standards, the board of directors will need to consider the receipt of such fees, along with other relevant factors, when considering a director's independence for purposes of compensation committee membership. The amendments became effective immediately.

Description of Amendments

In January 2013, the SEC approved amendments to the NASDAQ listing standards related to compensation committees as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") and the rules promulgated by the SEC under Section 10C of the Securities Exchange Act of 1934, as amended.[2]

As adopted in January 2013, NASDAQ Rule 5605(d)(2)(A) required that boards of directors of NASDAQ-listed companies use a bright-line test to determine the independence of compensation committee members. This test prohibited a compensation committee member from accepting, directly or indirectly, any consulting, advisory or other compensatory fee from a company or any subsidiary, other than:

- fees received as a member of the compensation committee, the board of directors or any other board committee; or
- the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the company (provided that such compensation was not contingent in any way on continued service).

NASDAQ received feedback from NASDAQ-listed companies and others that the bright-line test imposed a burden on NASDAQ-listed companies' ability to recruit directors given the different requirements for board, audit committee and compensation committee composition, and that this additional burden could influence a company's choice of listing. In response, NASDAQ revised its listing standards to remove the bright-line prohibition and, in doing so, made the NASDAQ approach consistent with the approach of the New York Stock Exchange. Under revised NASDAQ Rule 5605(d)(2)(A), the board of directors of a NASDAQ-listed company, in affirmatively determining the independence of a compensation committee

---

[1] Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Listing Rules on Independence of Compensation Committee Members

[2] For a discussion of the January 2013 amendments, please see our client alert "NYSE and NASDAQ Adopt Listing Standard Amendments Related to Compensation Committees and Compensation Advisers."

member, must consider all factors specifically relevant to determining whether a director has a relationship to the company that is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to:

- the source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the company to such director; and

- whether such director is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary of the company.

Compensation committee members are still required to be "independent directors" under the general independence requirements found in NASDAQ Rule 5605(a)(2), which, among other things, imposes thresholds on the amount of fees that directors may receive from the company. As a result, the changes to NASDAQ Rule 5605(d) should not constitute substantive changes because the "independent director" definition already requires the board to make an affirmative determination that the director has no relationship with the company that would interfere with the exercise of independent judgment.

NASDAQ also revised the commentary to NASDAQ Rule 5605(d) to include whether any compensation or fees paid to the director would impair the director's ability to make independent judgments about the company's executive compensation as a factor in evaluating the sources of a director's compensation.

In evaluating any affiliate relationship, the revised commentary also provides that the board of directors should consider whether the affiliate 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, in each case, of a nature that would impair the director's ability to make independent judgments about the company's executive compensation.[3]

Timing of Compliance

As noted above, the amendments became effective immediately. The SEC, however, has solicited comments on the amendments that are due 21 days after publication in the Federal Register. NASDAQ-listed companies must comply with the amended NASDAQ compensation committee rules by the earlier of their first annual meeting after January 15, 2014 or October 31, 2014.

Contact

Scott H. Kimpel
skimpel@hunton.com

W. Lake Taylor, Jr.
tlake@hunton.com

[3] NASDAQ retained the existing language in the commentary to NASDAQ Rule 5605(d) that its view is that ownership of a company's stock by itself does not preclude the board from finding that a director is independent for purposes of serving on the compensation committee.