Simpson Thacher

Memorandum

SEC Approves Proposed Nasdaq Rule Requiring Disclosure of Third-Party Compensation to Directors and Director Nominees

July 12, 2016

On July 1, 2016, the Securities and Exchange Commission ("SEC") approved a proposed rule filed by Nasdaq, as amended by Nasdaq on June 30, 2016, which would require listed companies to disclose annually any compensation or other payment provided by a third party to the company's directors or director nominees in connection with their candidacy for or service on the company's board of directors.[1] While recognizing that "there may be some overlap" with the SEC's disclosure requirements, the SEC approved Nasdaq's proposed rule change on an accelerated basis.[2] The rule will be effective July 31, 2016, though interested persons may comment on the rule change through July 28, 2016.[3]

I. The New Rule

- **Companies Subject to Nasdaq's New Rule.** The new disclosure requirement applies to each Nasdaq-listed company, except that a foreign private issuer may follow its home country practice in lieu of the requirements of Nasdaq's rule if it:
    - submits to Nasdaq "a written statement from an independent counsel in its home country certifying that the company's practices are not prohibited by the home country's laws"; and

[1] *See* Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 2, to Require Listed Companies to Publicly Disclose Compensation or Other Payments by Third Parties to Board of Director's Members or Nominees, Release No. 34-78223; File No. SR-NASDAQ-2016-013 (July 1, 2016).

[2] *See, e.g.*, Items 401(a), 402(a)(2) and 402(k) of Regulation S-K; Item 5(b) of Schedule 14A; and Item 5.02(d) of Form 8-K.

[3] *See id.* at 14; SR-NASDAQ-2016-013 Amendment No. 2 (June 30, 2016), at 7.

- discloses in its annual filings with the SEC (or, in certain circumstances, on its website) that it does not follow the requirements of Nasdaq's rule and briefly states the home country practice it follows instead.

- **The Required Disclosure.** Nasdaq's new rule requires each listed company to disclose the parties to and "the material terms of all agreements and arrangements between any director or nominee and any person or entity other than the company . . . relating to compensation or other payment in connection with that person's candidacy or service as a director." Nasdaq's proposal is intended to be construed broadly, such that non-cash compensation or other forms of payment (e.g., health insurance premiums or indemnification) would be included.

- **Location of the Disclosure.** Each listed company must make the required disclosure on its website or in its proxy or information statement for any shareholders' meeting at which directors are elected (or, if it does not file proxy or information statements, in Form 10-K or Form 20-F). A listed company may fulfill its disclosure obligation by including on its website a hyperlink to another website, "which must be continuously accessible." In the event that the website to which it links becomes inaccessible, or if the link becomes inoperable, "the company must promptly restore it or make other disclosure in accordance" with Nasdaq's rule.

- **Timing and Frequency of the Disclosure.** Initial disclosure pursuant to Nasdaq's new rule must be made no later than the date on which the company files or furnishes a proxy or information statement in connection with its next shareholders' meeting at which directors are elected (or, if it does not file proxy or information statements, no later than when the company files its next Form 10-K or Form 20-F). "Thereafter, a listed company must make this disclosure at least annually until the earlier of the resignation of the director or one year following the termination of the agreement or arrangement." Under the new rule, listed companies need not disclose new agreements or arrangements at the time they are entered into, so long as disclosure is made pursuant to the rule for the next shareholders' meeting at which directors are elected.

- **Situations in Which Disclosure is Not Required.** Nasdaq's rule provides three scenarios in which the disclosure of agreements or arrangements between third-parties and directors or director nominees is not required.

  - **Reimbursement of Expenses.** The new rule does not apply to agreements and arrangements that relate only to the reimbursement of expenses in connection with a nominee's candidacy as a director.

  - **Pre-existing relationship.** Disclosure is not required where the relevant agreement or arrangement existed prior to the nominee's candidacy and the relationship between the nominee and the third-party has been otherwise publicly disclosed (such as pursuant to Items 402(a)(2) or 402(k) of Regulation S-K or in a director's biographical summary contained in periodic reports filed

with the SEC). By way of example, Nasdaq places in this category "a director or a nominee for director being employed by a private equity or venture capital firm, or a fund established by such firm, where employees are expected to and routinely serve on the boards of the fund's portfolio companies and their remuneration is not materially affected by such service." Where disclosure is not required pursuant to this exception but the remuneration of the director or nominee is later "materially increased specifically in connection with such person's candidacy or service as a director of the company, only the difference between the new and previous level of compensation or other payment obligation need be disclosed."

  - **Disclosure Under the SEC's Rules.** Where an agreement or arrangement has been disclosed under Item 5(b) of Schedule 14A or Item 5.02(d)(2) of Form 8-K in the current fiscal year, the listed company is not required to make a separate disclosure pursuant to Nasdaq's rule. The listed company, however, still has an obligation under Nasdaq's rule to provide disclosure on an annual basis in future years.

- **Discovery of an Agreement or Arrangement That Should Have Been Disclosed.** In the event that a listed company discovers an agreement or arrangement that should have been, but was not, disclosed, the company must promptly make the required disclosure by filing a Form 8-K or 6-K, where required by the SEC's rules, or by issuing a press release. A company will not be deemed deficient with regard to Nasdaq's disclosure requirement if it has undertaken reasonable efforts to identify all third-party agreements and arrangements, "including by asking each director or nominee in a manner designed to allow timely disclosure," and makes the required disclosure promptly upon discovery of the agreement or arrangement, as outlined above. The company's remedial disclosure, however, does not satisfy the rule's ongoing annual disclosure requirement, regardless of its timing.
- **Remediating a Deficiency.** In cases where a company is considered deficient, the company must submit a plan to Nasdaq within 45 days "sufficient to satisfy Nasdaq staff that the company has adopted processes and procedures designed to identify and disclose relevant agreements and arrangements in the future." In the event that the company does not do so, "it would be issued a Staff Delisting Determination, which the company could appeal to a Hearings Panel."

II. Suggested Amendments to Directors & Officers ("D&O") Questionnaires

In light of the SEC's accelerated approval of Nasdaq's proposed rule – and to the extent their existing D&O questionnaires do not already address third-party compensation arrangements – Nasdaq-listed companies should consider amending their questionnaires to request from their directors and director nominees information required to be disclosed under the new rule. The following questions would elicit the required information:

- If you are a director or director nominee, are there any agreements, arrangements or understandings between you and any person or entity (other than the company) relating to compensation or other

payment (including non-cash payment) in connection with your candidacy or service as a director?

- If yes, please describe below all material terms of the agreement, arrangement or understanding and name the other person(s) that are parties to this agreement, arrangement or understanding.

Now may also be a good time for all public companies to review their D&O questionnaires to ensure that they elicit the information required by SEC rules regarding third-party compensation arrangements.

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-212-455-3815 or yafit.cohn@stblaw.com, or any other member of the Firm's Public Company Advisory Practice.

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