



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
INVESTOR ADVOCATE

February 12, 2016

Submitted Electronically (comments@nasdaq.com)

Stanley Higgins
Senior Director, Listing Qualifications
The NASDAQ Stock Market LLC
805 King Farm Blvd.
Rockville, MD 20850

**RE: Solicitation of Comments by the NASDAQ Listing and Hearing Review Council
about Shareholder Approval Rules**

Dear Mr. Higgins:

Pursuant to Section 4(g)(4) of the Securities Exchange Act of 1934 (“Exchange Act”), the Office of the Investor Advocate¹ at the U.S. Securities and Exchange Commission (“Commission” or “SEC”) is responsible for, among other things, analyzing the potential impact on investors of proposed rules of self-regulatory organizations (“SROs”).² In furtherance of this objective, we routinely review significant rulemakings of The NASDAQ Stock Market LLC (“Nasdaq” or the “Exchange”). We also make recommendations and utilize the public comment process to help ensure that the interests of investors are given appropriate weight as rules are being considered. As required by law, we report to Congress regarding our objectives and activities, which include a summary of the recommendations we make and the responses to those recommendations.³

We appreciate this opportunity to provide comments in regard to the Solicitation of Comments by the NASDAQ Listing and Hearing Review Council about Shareholder Approval Rules (hereafter, the “Nasdaq Request for Comment”). The Nasdaq Request for Comment broadly asks whether various provisions of the Exchange’s current shareholder approval rules – which generally require companies to obtain approval from shareholders prior to issuing securities in connection with certain acquisitions, equity-based compensation plans, changes of

¹This letter expresses solely the views of the Investor Advocate. It does not necessarily reflect the views of the Commission, the Commissioners, or staff of the Commission, and the Commission disclaims responsibility for this letter and all analyses, findings, and conclusions contained herein.

² 15 U.S.C. § 78d(g)(4).

³ 15 U.S.C. § 78d(g)(6).

control and certain private placements – continue to serve their original shareholder protection purpose and otherwise still ‘make sense’ given the evolution in the capital markets and securities laws since the rules’ adoption in 1990.⁴

The Nasdaq Request for Comment represents that this review is part of the Exchange’s ongoing effort to engage the public and foster a dialogue about Nasdaq rules. It also states that the Nasdaq Listing and Hearing Review Council believes it is appropriate and timely to review the Exchange’s shareholder approval rules to consider whether the rules can be updated and improved, without sacrificing the crucial investor protections they provide.⁵ We understand that the Nasdaq Listing and Hearing Review Council is seeking comment, input, and guidance from the public, including investors and companies, and their representatives.⁶

At this time, given the broad scope of the request, we would like to provide an overview of some of the considerations that would guide our evaluation of any concrete proposals resulting from this process concerning Nasdaq’s shareholder approval rules. In short, we believe that shareholder approval constitutes an important element in the corporate governance framework that helps protect investors and builds trust in markets and that any reduction or elimination of shareholder approval requirements could have a significant negative impact on investor protections. We are also concerned that board or independent committee approval may not be an effective substitute for approval by shareholders, whose interests are directly impacted by economic and ownership dilution, and that lowering Nasdaq’s qualitative listing standards could exacerbate a troubling “race to the bottom” among listing exchanges.

I. Background

The Exchange Act requires, in relevant part, that the rules of a national securities exchange be designed, in general, to protect investors and the public interest.⁷ Accordingly, the listing standards of an exchange should be designed to protect financial markets and the investing public. For an issuer, listing on an exchange provides an environment that, in comparison to being quoted in over-the-counter markets or remaining privately held, offers the potential for enhanced liquidity, transparency, and oversight. These benefits flow to investors. Thus, we generally support efforts to help companies become or remain listed on exchanges under appropriate circumstances. We also acknowledge that the Exchange Act permits markets to develop their own eligibility standards for securities traded on their markets and that these standards may differ among markets.

⁴ Nasdaq, *Solicitation of Comments by the NASDAQ Listing and Hearing Review Council about Shareholder Approval Rules* (Nov. 18, 2015), <https://listingcenter.nasdaq.com/assets/Shareholder%20Approval%20Comment%20Solicitation.pdf>. See also Press Release, Nasdaq, Nasdaq Requests Comments for Shareholder Approval Rules (Nov. 18, 2015), <http://www.nasdaq.com/press-release/nasdaq-requests-comments-for-shareholder-approval-rules-20151118-00684>.

⁵ *Id.*

⁶ *Id.*

⁷ See 15 U.S.C. § 78f(b)(5).

As the Commission has stated previously, the development and enforcement of adequate standards governing the initial listing and maintenance of listing of securities is an activity of critical importance to financial markets and the investing public.⁸ Listing standards serve as a means for a marketplace to screen issuers and to provide listed status only to *bona fide* companies with sufficient float, investor base, and trading interest to maintain fair and orderly markets.⁹ In addition to those quantitative standards, qualitative requirements, such as audit committees, independent director oversight of executive compensation, a mandatory code of conduct, shareholder meetings (including proxy solicitation and quorum), review of related party transactions, shareholder approval (including voting rights), and disclosure policies should be designed to help ensure that companies trading on a national securities exchange will adequately protect the interests of public shareholders.¹⁰

Among the qualitative listing standards in Nasdaq's current rules, and as described in the Nasdaq Request for Comment, Nasdaq-listed companies are generally required to obtain shareholder approval prior to the issuance of additional shares in several scenarios, including:

Acquisitions. Nasdaq Rule 5635(a) generally requires a listed company to obtain shareholder approval in connection with an acquisition if the potential issuance is equal to 20 percent of the number of shares of common stock or voting power outstanding, or, if insiders have an interest in the target entity, 5 percent of the number of shares of common stock or voting power outstanding;

Change of Control. Nasdaq Rule 5635(b) requires shareholder approval prior to the issuance of securities when the issuance or potential issuance will result in a change of control. In determining whether an issuance will potentially result in a change of control, Nasdaq considers the voting power, ownership and board representation of investors receiving securities in the transaction;¹¹ and

Private Placements. Nasdaq Rule 5635(d) requires listed companies to obtain shareholder approval prior to the issuance of common stock or securities convertible into common stock equal to 20 percent or more of the common stock or voting power outstanding at a price less than the greater of book or market value of the stock.¹²

The Nasdaq Request for Comment notes that these specific shareholder approval requirements were adopted in 1990. As described at the time, Nasdaq's original adoption of

⁸ See, e.g., Securities Exchange Act Release No. 65225 (Aug. 30, 2011), 76 FR 55148 (Sept. 6, 2011), File No. SR-BATS-2011-018, <http://www.gpo.gov/fdsys/pkg/FR-2011-09-06/pdf/2011-22627.pdf> ("BATS Listing Approval Order").

⁹ See *id.* at 55152 n.30.

¹⁰ See *id.* at 55152.

¹¹ Nasdaq, *supra* note 4, at 4 (stating, "Nasdaq will also consider all facts and circumstances concerning a transaction, including whether there are any relationships or agreements between the company and the investors, and among the investors, and whether the investor is entitled to board representation.").

¹² The Nasdaq Request for Comment is not seeking comment on Nasdaq's rules concerning shareholder approval of equity compensation.

these requirements followed from a commitment to consider conforming its rules to the shareholder approval rules already adopted in 1989 by the New York Stock Exchange (“NYSE”).¹³ In 1989, NYSE amended its existing shareholder approval policies in several ways, mainly in connection with related party acquisitions and other general corporate transactions that involved the issuance of new company stock.¹⁴ For example, the NYSE raised its existing new issuance threshold to require shareholder approval only for transactions requiring new issuance of 20 percent of then-outstanding shares instead of 18.5 percent. NYSE also removed an approval requirement for transactions paid partially through other consideration (such that, in the event that the new share issuance was below the 20 percent threshold, no shareholder vote was required, even if the value of the entire transaction was greater than 20 percent of the value of the company’s outstanding shares).

Nasdaq’s 1990 proposal, rather than completely conforming to the newly amended NYSE rules, qualified the NYSE shareholder approval rules in several ways.¹⁵ For example, Nasdaq’s proposal only applied the 20 percent threshold to acquisitions, rather than requiring listed companies to obtain shareholder approval for all corporate transactions involving such a substantial issuance of new shares. The Commission ultimately approved this and other qualifications, noting that Nasdaq had “recognize[d] that these differences exist and has concluded that they are appropriate for the [Nasdaq] market.”¹⁶ In its approval order for the qualified proposal, the Commission found that:

Although it is a close question whether the [Nasdaq]’s decision to limit the opportunity for shareholder approval of significant corporate transactions best furthers the goals of the [Exchange] Act, the Commission recognizes that individual markets should have flexibility in structuring their listing standards. In particular, where as here the [Nasdaq]’s NMS market is predominantly composed of less capitalized companies, the Commission does not believe that the [Exchange] Act compels the [Nasdaq] to have the same shareholder approval standards as the NYSE, at least where the basic safeguards have been [en]acted (sic).”

¹³ See Securities Exchange Act Release No. 27489 (Nov. 30, 1989), 54 FR 50550 (Dec. 7, 1989), File No. SR-NASD-89-42.

¹⁴ See Securities Exchange Act Release No. 27035 (July 14, 1989), 54 FR 30490 (July 20, 1989), File No. SR-NYSE-88-19.

¹⁵ See Securities Exchange Act Release No. 28232 (July 19, 1990), 55 FR 30346 (July 25, 1990), File No. SR-NASD-89-42, (“1990 Nasdaq Approval Order”).

¹⁶ See *id.* at 30346, n.6 (referencing April 1990 letter from NASD to the Commission). Since its creation in 1971 until 2000, the Nasdaq Stock Market was a wholly-owned subsidiary of the National Association of Securities Dealers (“NASD”) that operated under NASD’s supervision. By 2005, NASD had reduced its ownership in Nasdaq to about 26%, and, ultimately in 2006, the Commission approved the Nasdaq Stock Market LLC’s application to become a registered national securities exchange in its own right. See Securities Exchange Act Release No. 53128 (Jan. 13, 2006), 71 FR 3550 (Jan. 23, 2006), File No. 10-131, <https://www.gpo.gov/fdsys/pkg/FR-2006-01-23/pdf/E6-664.pdf>.

II. Evaluation

Although the Nasdaq Request for Comment does not propose any specific rule changes to its qualitative listing standards, we are concerned that the tone of the solicitation seems to invite only those comments that call for the elimination or diminution of investor protections in Nasdaq's existing shareholder approval rules. We appreciate, however, that Nasdaq has clarified publicly that it intends to take *all* comments into account, including those comments that would support the *status quo* or "no change" to the rules. As detailed below, we would encourage Nasdaq also to consider enhancements to its shareholder approval rules during this process.

A. Relevant Considerations

In general, we continue to believe that many corporate actions that directly and significantly impact shareholders' interests, including through economic and ownership dilution, should appropriately be subject to shareholder approval. Although some updates to the listing standards may be appropriate, we are not likely to support any final proposal from Nasdaq that raises the percentage thresholds or otherwise significantly alters other aspects of the qualitative listing rules, to the extent that they would result in the reduction of the number of corporate actions currently subject to shareholder approval for Nasdaq-listed companies.

We are generally concerned that board or committee approval may not be an effective substitute for the approval of shareholders, whose interests would be directly impacted by the potentially dilutive effect of such a transaction. Any potential indirect benefit to shareholders of allowing companies to raise additional capital quickly and inexpensively must be weighed against the potentially detrimental impact of a dilutive transaction on shareholders who would no longer have the right to approve the transaction. Moreover, the deterrent effect of shareholder approval requirements should not be underestimated. Issuers can be expected to be far less likely to engage in actions that would harm investors if they know that such actions must first be subject to shareholder approval.

When new shares are sold at a discount from book or fair market value, it results in economic dilution. Economic dilution reduces the value of an existing shareholder's investment in the issuer because it spreads the underlying value of the company across a greater number of owners, and the new owner injects a less-than-proportionate share of capital into the business. In effect, the issuance results in an immediate transfer of value from existing shareholders to the new shareholder(s). In addition, existing investors in these companies would face potential dilution of their ownership control. This dilution of ownership control could ultimately result in decisions adverse to the interests of the original shareholders.

Significantly, our concerns stem in large part from the recognition that Nasdaq's shareholder approval rules do not exist in a vacuum, but rather in a highly competitive environment for corporate listings.¹⁷ Any proposal to reduce the investor protections currently

¹⁷ See, e.g., Concept Release Concerning Self-Regulation, Securities Exchange Act Release No. 50700 (Nov. 18, 2004), 69 FR 71256 (Dec. 8, 2004), File No. S7-40-04, <https://www.sec.gov/rules/concept/34-50700.htm> ("As with SRO competition for members and order flow, competition for issuers may cause an SRO to fail to discharge its self-regulatory responsibilities properly. This can take the form of admitting to trading issuers that fail to satisfy

afforded by Nasdaq’s qualitative listing standards could exacerbate a troubling “race to the bottom” among listing exchanges in connection with these and other qualitative standards. Our review of exchange rule filings yields numerous examples of exchanges lowering their qualitative listing standards over the last decade. For example, we have witnessed what appears to be a vicious circle, with other exchanges pointing to Nasdaq as the competitor justifying lowering their standards,¹⁸ and Nasdaq citing to competitive pressure from these same exchanges to justify lowering its own standards.¹⁹ We have also observed that the Commission, after approving a new lower standard for one particular exchange, may thereafter feel bound to permit other exchanges to similarly lower their qualitative listing standards. In effect, any approval order creates precedent for all similarly situated exchanges.²⁰ Disconcertingly, it could be difficult for the Commission to fully consider the cumulative impact on investor protection at the time it is presented with the “four corners” of a single exchange’s rule proposal that provides the staff with no such broad-based analysis.²¹

initial listing standards; delaying the delisting of issuers that no longer satisfy maintenance standards; failing to enforce listing standards (including the new issuer corporate governance standards); and reducing (or even eliminating) listing fees. This competition also can reveal itself in an unwillingness to restrict issuer activities or impose requirements that may be more stringent than similar rules of competitor SROs.”).

¹⁸ See, e.g., Securities Exchange Act Release Nos. 69970 (July 11, 2013), 78 FR 42813 (July 17, 2013), File No. NYSE-2013-47, <https://www.gpo.gov/fdsys/pkg/FR-2013-07-17/pdf/2013-17095.pdf> (“[NYSE] also notes that neither of the other two primary equities listing markets in the United States—[Nasdaq] and [NYSE MKT]—has a quorum requirement[.]”); 70246 (Aug. 22, 2013), 78 FR 53181 (Aug. 28, 2013), File No. SR-NYSE-2013-40, <https://www.gpo.gov/fdsys/pkg/FR-2013-08-28/pdf/2013-20956.pdf> (“Neither [Nasdaq] nor [NYSE MKT] has an internal audit function requirement for companies listing on their exchange”); and 76814 (Dec. 31, 2015), 81 FR 820 (Jan. 7, 2016), File No. SR-NYSE-2015-02, <https://www.gpo.gov/fdsys/pkg/FR-2016-01-07/pdf/2015-33313.pdf> (NYSE “states that neither [Nasdaq] nor NYSE MKT LLC ... has a rule ... requiring listed companies to obtain shareholder approval prior to 1% (or in certain cases 5%) share issuances in cash sales to a Proposed Exempted Party.”).

¹⁹ See, e.g., Securities Exchange Act Release Nos. 55822 (May 29, 2007), 72 FR 31361 (June 6, 2007), File No. SR-NASDAQ-2007-022, <https://www.gpo.gov/fdsys/pkg/FR-2007-06-06/pdf/E7-10791.pdf> (“Nasdaq also notes that the comparable rules of [NYSE] and [NYSE MKT] do not include an [audit committee] approval requirement [for related party transactions.]”); 58911 (Nov. 6, 2008), 73 FR 68473 (Nov. 18, 2008), File No. SR-NASDAQ-2008-085, <https://www.gpo.gov/fdsys/pkg/FR-2008-11-18/pdf/E8-27250.pdf> (“While the procedures for issuing delisting notices for Nasdaq late filers will be changed, as Nasdaq has stated in its filing, the changes are based on, and similar to, the NYSE’s current procedures for NYSE issuers that are late in filing their annual report[.]”); and 61446 (Jan. 29, 2010), 75 FR 6072 (Feb. 5, 2010), File No. SR-NASDAQ-2009-077, <https://www.gpo.gov/fdsys/pkg/FR-2010-02-05/pdf/2010-2500.pdf> (“Further, [Nasdaq] notes that the proposed longer compliance periods are in line with the compliance periods afforded by other exchanges [to listed companies.]”).

²⁰ See, e.g., Securities Exchange Act Rel. No. 76814 (Dec. 15, 2015), 81 FR 820 (Jan. 7, 2016), File No. SR-NYSE-2015-02, <https://www.gpo.gov/fdsys/pkg/FR-2016-01-07/pdf/2015-33313.pdf> (“If the Commission were not to allow the Exchange to provide the same flexibility to listed companies offered by other listing markets, the Exchange Act goal of facilitating fair competition among the exchanges could be undermined”).

²¹ See, e.g., Securities Exchange Act Rel. No. 61446 (Jan. 29, 2010), 75 FR 6072 (Feb. 5, 2010), File No. SR-NASDAQ-2009-077, <https://www.gpo.gov/fdsys/pkg/FR-2010-02-05/pdf/2010-2500.pdf> (“Finally, the Commission notes that while the additional, specific information ... on issues such as the historic enforcement of Nasdaq’s listing standards might be useful for many purposes, it agrees with Nasdaq that such data and information is not required in order for the Commission to find that the current proposed rule change is consistent with the Act”).

To address one specific concern in the Nasdaq Request for Comment – that the existing shareholder approval requirements may currently favor Nasdaq’s well-capitalized companies at the expense of its smaller companies – we would encourage Nasdaq to consider enhancing its qualitative listing standards for those well-capitalized companies listed on its Global Select Market to balance this equation, rather than lowering standards on its other tiers. The creation of the Global Select Market quantitative listing standards may be the most significant change for Nasdaq’s listing regime in the last 25 years, although it is not mentioned in the Nasdaq Request for Comment.

In 1990, as noted above, Nasdaq argued that NYSE’s qualitative listing rules, which generally provided greater opportunity for shareholder approval of significant corporate transactions, were not appropriate for Nasdaq because Nasdaq’s market was, at that time, composed predominately of less capitalized companies than NYSE. Based on our review, it appears that the Commission permitted Nasdaq’s existing shareholder approval rules to deviate from NYSE’s higher standards primarily because Nasdaq had not historically competed with NYSE in the quest to list well-capitalized companies.

However, over the past 25 years, that historical division has blurred. In 2007, Nasdaq created a Global Select Market tier with higher initial quantitative listing standards to compete more directly with NYSE for corporate listings. Nasdaq acknowledged that the creation of this new market segment would, in large part, “foster competition among exchanges,” but did not seek to enhance the *qualitative* listing standards that would apply to that new tier at the time.²² Now, the Nasdaq Request for Comment all but acknowledges that its shareholder approval rules disproportionately benefit these well-capitalized companies, yet only seeks comment on whether its qualitative requirements should be further lowered at the expense of investor protection.

We believe that any apparent disproportionate impact of Nasdaq’s shareholder approval rules on smaller listed companies could be better addressed by raising the shareholder approval requirements for the well-capitalized companies listed on Nasdaq’s Global Select Market. It is unfortunate that Nasdaq did not harmonize its standards with NYSE’s higher qualitative standards for that tier in 2006; however, there is no reason that oversight cannot be remedied now. Further lowering the qualitative listing standards on the other tiers, as the Nasdaq Request for Comment appears to suggest, would be an incongruous response to what otherwise should have been a “race to the top” when Nasdaq adopted its higher Global Select Market quantitative listing standards.

Finally, we recommend that Nasdaq consider the indirect impacts of any rule change that would substitute shareholder approval with some form of board committee approval. For example, the Commission has previously recognized that there are incremental costs associated with requiring an audit committee to perform additional functions, such as more frequent

²² See Securities Exchange Act Release No. 53799 (May 12, 2006), 71 FR 29195 (May 19, 2006) (File No. SR-NASDAQ-2006-007), <https://www.gpo.gov/fdsys/pkg/FR-2006-05-19/pdf/06-4689.pdf>.

committee meetings and an increased workload on audit committee members.²³ Last year, SEC Chair Mary Jo White noted that “[l]isting requirements and SEC rules, as well as how companies address various enterprise risks, are placing heavy demands on audit committees” and expressed her “growing concerns about the amount of work required of some audit committees” because the increasing workload “may dilute an audit committee’s ability to focus on its core responsibilities.”²⁴ Industry opinion supports this concern. For example, the KPMG Audit Committee Institute reported that 75 percent of the 1,500 audit committee members responding to its 2015 Global Audit Committee Survey indicated that the amount of time required to carry out their audit committee responsibilities had increased moderately (51 percent) or significantly (24 percent) over the past two years.²⁵ And 40 percent of survey respondents stated that it is becoming increasingly difficult to oversee all the major risks on its agenda given the committee’s agenda time and expertise.

We urge Nasdaq to carefully consider whether independent directors can serve as an adequate substitute for shareholder approval in transactions that may involve heightened risks to shareholders. Although corporations have taken significant strides to increase the number of independent board members, some have observed instances in which directors met the formal listing standards of independence but nonetheless still had significant ties to the CEO or the company.²⁶ If directors with personal or professional conflicts of interest can be deemed “independent,” shareholders may take little comfort from the fact that important matters are approved by independent directors in lieu of a shareholder vote.

B. Academic Literature

In its current form, the Nasdaq Request for Comment does not describe potentially relevant academic literature on the subject of shareholder approval for corporate transactions,

²³ See Final Rule, Strengthening the Commission’s Requirements Regarding Auditor Independence, Securities Exchange Act Release No. 47265 (Jan. 28, 2003), 68 FR 6006, 6038 (Feb. 5, 2003), File No. S7-49-02, <https://www.gpo.gov/fdsys/pkg/FR-2003-02-05/pdf/03-2364.pdf>.

²⁴ See Mary Jo White, Chair, Commission, Keynote Address at the 2015 AICPA National Conference: Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility (Dec. 9, 2015), <https://www.sec.gov/news/speech/keynote-2015-aicpa-white.html>. See also James Schnurr, Chief Accountant, Commission, Remarks Before the UCI Audit Committee Summit, <https://www.sec.gov/news/speech/schnurr-speech-uci-audit-committee-summit.html>.

²⁵ See KPMG AUDIT COMMITTEE INST., GLOBAL BOARDROOM INSIGHTS: AUDIT COMMITTEE WORKLOAD, KEEPING AN EYE ON THE BALL (2014), <https://www.kpmg.com/FR/fr/IssuesAndInsights/ArticlesPublications/Documents/ACI-Global-Boardroom-Insights-5.pdf>.

²⁶ Theo Francis & Joann S. Lublin, *Boards Get More Independent, but Ties Endure*, WALL ST. J., Jan. 19, 2016, <http://www.wsj.com/articles/boards-get-more-independent-but-ties-endure-1453234607>. See also, e.g., Claire A. Hill & Brett H. McDonnell, *Disney, Good Faith, and Structural Bias*, 32 J. CORP. L. 833, 845-46 (2007) (detailing the relationships between Disney CEO Michael Eisner and nominally independent Disney directors that rendered “the bulk of the Disney board . . . not independent in any common sense use of the term”); Byoung-Hyoun Hwang & Seoyoung Kim, *It Pays to Have Friends*, 93 J. FIN. ECON. 138, 139 (2009) (on a number of metrics, independent directors who share important background characteristics with their CEOs do worse as monitors than socially independent directors.).

and it makes no attempt to review or provide empirical evidence relating to the topic. As the proposal does have the potential to impact corporate governance, issuance behavior, investor oversight, and other areas, it consequentially has the potential to impact investors in either a positive or a negative way.

A thorough review of the academic literature, particularly the relevant literature from economics and finance, seems a necessary precondition for consideration of any significant rule change. There is widely developed literature on a variety of corporate governance issues, in particular, topics related to shareholder voting (and hence oversight) of management decisions. As one example, *see* Lilian K. Ng, Valeriy Sibilkov, Qinghai Wang, and Nataliya S. Zaiats, [Does Shareholder Approval Requirement of Equity Compensation Plans Matter?](#) (2011).²⁷ While this paper is not specific to the topic of shareholder voting on issuance activity, it does highlight potential concerns related to shareholder oversight. An emerging literature also appears to be evolving more directly related to the study of the topic. We continue to review this literature and encourage Nasdaq to do likewise.

C. The Impact of Any Proposed Rule Change to Nasdaq’s Qualitative Listing Standards on Investor Protection and Capital Formation

In its current form, the Nasdaq Request for Comment does not provide sufficient information for interested parties to provide meaningful comment regarding the potential impacts on investor protection and capital formation. We would recommend Nasdaq provide information and data to facilitate an evidence-based policymaking process. For example, the public might benefit from considering, on an annual basis, how often Nasdaq-listed companies seek to and ultimately make acquisitions. It would be useful to consider how often those acquisitions were funded through new share issuances and how often the acquisitions required share issuances of more than 20 percent (or 5 percent for related party acquisitions) since 1990. One might consider how those acquiring companies compare to the average Nasdaq-listed company, considering concepts such as industries and geography, market capitalization, earnings, and ownership profile, and how those companies performed relative to their peers.

To engage in that kind of analysis, however, a commenter would require sufficient underlying data, and perhaps a chronological history of Nasdaq’s rule changes related to the approval of share issuances. If that data were available, but the Nasdaq Listing and Hearing Review Council could not commit the resources to fully examine it, our office may be able to provide assistance. We view this as an important undertaking, and we are currently considering examining other sources of data on our own, but we would welcome a collaborative approach.

²⁷ J. of Corp. Fin., Vol. 17, 2011, 1510-1530. Available at SSRN: <http://ssrn.com/abstract=1922895> or <http://dx.doi.org/10.2139/ssrn.1922895> (“This paper studies the impact of the 2003 SEC Regulation requiring shareholder approval of all equity-based executive compensation plans on executive compensation policies and practices at S&P 500 firms. ... The quality of equity compensation proposals improves in the after-regulation period, and shareholders exhibit greater scrutiny and monitoring of executive compensation through increased voting rights”).

III. Comments from Members of the Investor Advisory Committee

We appreciate that Nasdaq representatives appeared in person to discuss publicly the Nasdaq Request for Comment at the SEC's Investor Advisory Committee ("IAC") meeting on January 21, 2016. Although the IAC has not formally adopted recommendations in response to the Request for Comment, we urge Nasdaq to take the oral comments and concerns expressed by the members of the IAC during that meeting into account during this process. The webcast of the IAC meeting is archived and remains publicly available on the Commission's website. We believe the IAC's discussion provides valuable insights into the views of investors, and we see no reason why the hour-long substantive discussion during the meeting could not be afforded the same weight as any other feedback in this process.²⁸

Several members of the IAC expressed concerns about lowering listing standards. For example, Roy Katzovicz, Chair of the IAC's Investor as Owner subcommittee, decried what he described as a detrimental race to the bottom since the exchanges have become for-profit entities.²⁹ Jay Robert Brown, Jr., Secretary of the IAC, warned that approval of a rule reducing listing standards for one exchange is "tantamount to approving it for everybody."³⁰

Independent Boards and Shareholder Lawsuits. Mr. Katzovicz argued that neither the independent board rules nor the opportunity to later initiate a lawsuit provided an appropriate level of investor protection. Mr. Brown agreed that an independent board rule does not provide sufficient investor protection considering underlying board and company connections. He argued that the independent board does not sufficiently replace the material shareholder protection offered in the 20 percent approval requirement. Steven Wallman, Chair of the IAC's Market Structure Subcommittee, also expressed concern that a lawsuit after the fact would not be adequate shareholder protection.

20 Percent Threshold. Mr. Katzovicz stated that he was not in favor of changing the 20 percent shareholder approval requirement, even though he recalled the rule having personally prevented him from engaging in certain corporate transactions in the past. He observed that the 20 percent rule was in line with Delaware precedent and was an appropriate investor protection. Mr. Katzovicz suggested the longstanding stability of the rule provided protection for investors and shaped the markets.

IAC member Damon Silvers stated that the standards are core rules widely considered helpful for fair corporate governance. He expressed an interest in gaining a fuller understanding of what Nasdaq perceived had changed since the original rules were proposed that would support lowering the standards. Mr. Wallman, on the other hand, praised Nasdaq for considering whether or not the existing rules remained appropriate and urged NASDAQ to detail what the burdens to issuers are under the current rule other than the costs of soliciting shareholder votes.

²⁸ See SEC Investor Advisory Committee Meeting (Jan. 21, 2016), https://www.sec.gov/video/webcast-archive-player.shtml?document_id=investor-advisory-committee-012116 (03:29:30-04:27.46).

²⁹ *Id.*

³⁰ *Id.*

Book value. IAC member Joseph V. Carcello was interested in better understanding why Nasdaq believed book value might no longer be an appropriate valuation metric for calculating the 20 percent threshold. Mr. Carcello suggested that book value may be even more appropriate today than when the rule was originally proposed. Mr. Katzovicz commented that there may be a more appropriate valuation method than book value and proposed a volume-weighted average price over a five to ten day trading period. Mr. Wallman also questioned whether book value was the appropriate measure.

IV. Conclusion

We appreciate the Nasdaq Listing and Hearing Review Council's open and public engagement concerning potential changes to its qualitative listing standards for operating companies. Because such changes could have a significant impact on the behavior of issuers and investors, they deserve a thorough and data-driven consideration by all parties before adoption.

On a broader note, we encourage Nasdaq to embrace this type of engagement process more frequently when it is beginning to consider significant changes to any of its rules that so directly impact issuers and investors. We believe the informal Request for Comment process has served to improve the rulemaking process with regard to significant proposals from both the Financial Industry Regulatory Authority and the Municipal Securities Rulemaking Board.

Should you have any questions, please do not hesitate to contact me or Senior Counsel Adam Moore at (202) 551-3302.

Sincerely,



Rick A. Fleming
Investor Advocate

cc (electronically): Robert Greifeld, Chief Executive Officer, NASDAQ
Dr. Frank M. Hatheway, Chief Economist, NASDAQ

Stephen Luparello, Director, Division of Trading and Markets

Kurt N. Schacht, Chair, SEC Investor Advisory Committee