

Nasdaq Listing Qualifications  
c/o Stan Higgins  
805 King Farm Blvd.  
Rockville, MD 20850

15 February 2016

Re: Solicitation of Comments by the Nasdaq Listing and Hearing Review Council About  
Shareowner Approval Rules

Dear Mr. Higgins:

CFA Institute<sup>1</sup> is happy to comment on the shareowner approval rules discussed by Nasdaq's Listing and Hearing Review Council. We agree with Nasdaq that such rules should be periodically revisited as the capital markets, securities laws and the nature and type of share issuances have evolved since these rules were first adopted and will continue to do so in the future. CFA Institute represents the views of those investment professionals who are its members before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

### **Executive Summary**

Shareowner approval of material corporate actions is fundamental right enjoyed by shareowners worldwide. We appreciate the efforts by Nasdaq to update listing rules, but for the most part wish to see the current rules concerning shareowner approval stay as they are currently written. When dealing with a subject that has such a profound effect on shareowner rights, we encourage Nasdaq to work with shareowners to find a solution that protects the rights of shareowners and fits the needs of Nasdaq and its listed companies.

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<sup>1</sup> CFA Institute is a global, not-for-profit professional association of more than 135,000 investment analysts, advisers, portfolio managers, and other investment professionals in 145 countries, of more than 129,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 147 member societies in 73 countries and territories.

## Discussion

We agree that since these rules were first implemented, a number of investor protections have been instituted at Nasdaq-listed companies, including majority independent boards and stronger corporate governance standards. We have also seen an increase in investor-issuer engagement over the same time period along with more transparency and scrutiny over executive pay practices. These improvements in governance and shareowner rights, however, do not negate the continued need of certain rights that are fundamental to the protection of shareowner interests.

## Specific Comments

### Acquisitions

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

- *It has been suggested that the 20% threshold is restrictive. Should Nasdaq consider changing the rule to allow companies to issue a higher percentage of total shares outstanding or voting power without shareowner approval in connection with an acquisition? Why or why not?*

CFA Institute believes that the current standard of 20% is fair, and one that most investors would like to see lowered, not raised. Investors are concerned about their stakes in the companies they own being diluted. We believe that raising this level to greater than 20% would infringe on the ability of investors to guard against undue dilution of the stakes they own in the companies in their portfolios.

- *It has been suggested that given enhanced investor protection mechanisms and disclosure requirements surrounding related-party transactions, the heightened shareowner approval rules governing insider interest in an acquisition are no longer necessary. Should Nasdaq consider changing the rule to allow companies to issue more than 5% of voting power or total shares outstanding without shareowner approval where insiders have an interest in the assets to be acquired? Why or why not?*

CFA Institute believes the current 5% threshold should be retained. Approval of material related-party transactions are a fundamental right shareowners have sought and continue to seek around the world. Historically, many governance-related problems have arisen due to a lack of transparency about such transactions, or due to the inability of shareowners to approve or disapprove of such transactions. We do not think that lessening the power of shareowners to approve of related-party transactions is in the best interest of investors.

Issuers should have to disclose all business transactions completed or proposed in the past year between issuers and related parties, together with a description of the nature, size, and purpose of such transactions. In part, this is because management may use company assets to influence the manner in which board members vote on such important matters. These kinds of related-party transactions can create conflicts for board members when deciding whether to vote in the best interests of shareowners or in their own best interests.

Companies should have to seek shareowner approval for matters that directly affect shareowner wealth, while leaving matters relating to operational concerns to the board and management to decide. This strategy would require management to seek shareowner approval for issuance of stock options as compensation, compensation policies, mergers, acquisitions, divestitures, and capital structure decisions such as issuing large amounts of new equity shares or debt. Matters such as how to organize operating units, which products to develop, or non-capital decisions, would be left to management to decide.

### **Change of control**

Nasdaq Rule 5635(b) requires listed companies to seek and receive shareowner approval prior to the issuance of securities when the issuance or potential issuance will or could result in a change of control. In determining whether an issuance will potentially result in a change of control, Nasdaq considers the voting power structure of a subject company, its ownership and the board representation of investors receiving securities in the transaction. Nasdaq also will consider all facts and circumstances concerning such a transaction, including whether there are any relationships or agreements between the subject company and investors in the subject issuance, and among these investors, and whether they are entitled to board representation.

While there is no bright-line test or safe-harbor within the rule, Nasdaq will generally conclude that a change of control would occur for purposes of shareowner approval rules when, as a result of the issuance, an investor or a group of investors would own, or have the right to acquire, 20% or more of the outstanding shares of common stock of the subject company, or of the company's voting power and such ownership or voting power would be the largest position.

- *Would a bright-line test or safe-harbor be beneficial to investors and companies to define when a transaction will result in a change of control?*

We believe that such a bright-line test or safe harbor would be beneficial to shareowners. If, on the other hand, a bright-line rule is not adopted, investors would need more detail about the guidelines used to determine whether an issuance will potentially result in a change of control. Investors need to know that such decisions are not made arbitrarily, and that a consistent framework is used for making such decisions.

As we stated above, companies should have to seek shareowner approval for matters that directly affect shareowner wealth.

## **Private Placements**

Nasdaq Rule 5635(d) requires listed companies to obtain shareowner approval prior to the issuance of common stock or securities convertible into common stock equal to 20% 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.

- *NASDAQ rules measure market value by reference to the company's closing bid price. It has been suggested that this is not the best measure of market value for purposes of the shareowner approval rules and that Nasdaq should instead allow or require the use of: the Last Sale Price (which may be more transparent), the Nasdaq Official Closing Price (which may be more representative of the market), a volume-weighted average of closing prices over a period of days (which may address single-day anomalies), or other market measurements. Should Nasdaq continue to use the company's closing bid price to measure market value? If not, what other measures are more appropriate and why? If a volume-weighted average is preferable, how long is an appropriate measurement period?*

Our preferred measurement system would be one that mitigates one-day price swings, such as the volume-weighted average of closing prices over the prior five trading days. At the same time, we recognize that the choice of any measurement period will be arbitrary.

The more important considerations from our perspective would be that there be a single measurement criteria, that it be known in advance, and that it apply to all companies listed on Nasdaq. This would mitigate the potential for arbitrary application of measurements that benefit insiders at the expense of outside shareowners.

- *It has been suggested that shareowner approval should not be required for an issuance at a price below the book value of a security. Should Nasdaq eliminate the book value measurement for purposes of determining if shareowner approval is required? Why or why not?*

Depending on the size of the issuance, we believe approval of shareowners should be required for any issuance at or below the current market value of a listed company. The book value of a company under Generally Accepted Accounting Principles may or may not provide an accurate reflection of that company's market value. However, in many cases book value understates market value and thus could be used to sell shares to insiders and related parties at discounts to market value without triggering shareowner

approval. Elimination of the book value measurement may, therefore, reduce this possibility.

At the same time, Nasdaq will need to provide an alternative measurement mechanism for issuers. For that, we suggest, as stated above, that any issuance at or below current market value of a listed company should trigger the shareowner approval process.

- *It has been suggested that the shareowner approval rules disproportionately affect smaller companies, which generally can raise less money before exceeding the 20% tests. Should Nasdaq consider changing the rule to allow smaller companies to issue a higher percentage of voting power or total shares outstanding without shareowner approval?*

CFA Institute believes the same rules should apply to all companies listed on Nasdaq. Different markets or different exchanges may have different rules, but we believe that shareowners should be safe in the expectation that all Nasdaq-listed companies operate under the same sets of rules.

- *Nasdaq interprets its rules to require shareowner approval if any shares are issued to an officer or director in a private placement at a discount to market value. It has been noted that new investors often demand that insiders, including officers and directors, invest on the same terms that the investors have negotiated. Should Nasdaq consider changing its rules to allow such insiders to participate in a private placement without shareowner approval, where the insiders participate on the same terms negotiated by the other investors? If so, how much of such a transaction should the insiders be allowed to purchase? Are any other limits on such transactions appropriate?*

On the one hand, we believe the rules should ensure that insiders invest on the same terms as their shareowners. At the same time, however, we believe such transactions should trigger shareowner approval rules.

- *It has been suggested that the investor protections of the shareowner approval rules could be best achieved with a sliding scale, where the number of shares that could be issued without shareowner approval is based on the size of the discount to market price. Thus, a greater number of shares could be issued without shareowner approval if the shares are issued at a nominal discount, whereas few shares could be issued if there is a substantial discount. Should Nasdaq consider changing its rule to allow such a sliding scale when determining whether shareowner approval is required? If so, how should such a rule be structured? Are there other factors that should lead to a sliding scale, where more shares could be issued without shareowner approval, such as approval of the transaction by the company's independent directors or significant participation by retail investors in the transaction?*

Investors' concerns about dilution relate to two principal factors: value dilution and ownership dilution. While the latter can occur without producing the former – large

quantities of shares sold at current market value – the former is usually combined with the latter – large number of shares sold at discounts to market value. In both cases, shareowners' interests are diminished.

We believe the rules should stay as they currently are. Shareowner approval based on a sliding scale needlessly complicates the shareowner approval process. Companies should have to seek shareowner approval for matters that directly affect shareowner wealth. A small discount on a large number of shares still has the potential to greatly impact shareowner wealth and would still need shareowner approval.

- *When determining whether or not to aggregate two or more transactions for purposes of the shareowner approval rules, Nasdaq looks to the following factors: timing of the issuances; facts surrounding the initiation of the subsequent transaction(s); commonality of investors; existence of any contingencies between the transactions; specified use of proceeds for each of the transactions; and the timing of the board of directors' approvals. Generally Nasdaq does not aggregate transactions that are more than six months apart. It has been suggested that Nasdaq establish a bright line test for a specific time period after which two or more transactions would not be aggregated for purposes of the shareowner approval rules, unless governed by the same agreement. Should Nasdaq establish such a bright line time period? If yes, should this period be shorter than six months? If no, please explain why not.*

Yes, a bright line rule would be helpful to both shareowners and issuers. We believe this bright line should extend no less than three months. In many cases, this will mean that two such transactions will occur in the same reporting period. However, we believe transactions straddling the end of one reporting period and the beginning of another should still be aggregated.

- *It has been suggested that a stable shareowner base of long-term holders is an indication of implied approval by shareowners of how the Company is managed and that companies with such support and approval should be allowed greater latitude to issue shares before shareowner approval is required. For example, companies with a stable shareowner base could be permitted to create a committee comprised of representatives of long-term holders empowered to consent to certain types of transactions in lieu of shareowner approval. Alternatively, companies with a stable shareowner base could be held to higher thresholds than the 20% requirement before needing shareowner approval for a private placement. Should Nasdaq consider proposing a rule to modify the shareowner approval requirements for a company with a stable shareowner base? Why or why not? If so, how should a stable shareowner base be defined and monitored?*

CFA Institute believes that the same standards should be applied to all companies on an exchange or in a given market so that all investors and issuers know what the rules are

and generally play by the same rules. The proposal to treat companies with a “stable shareowner base” differently is potentially problematic as the definition of “stable shareowner base” will likely be hard to define, and may lend itself to arbitrary definitions that change over time.

### **Concluding Remarks**

CFA Institute welcomes the opportunity to comment on Nasdaq’s shareowner approval rules. Should you have questions or would like to discuss these matters further, please do not hesitate to contact us.

Yours faithfully,

*/s/James Allen*

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