CADWALADER

Quorum

Insights Into Corporate Governance, M&A and Securities Law

SEC Approves Nasdaq Corporate Governance Rule Amendments to Cure Periods and Phase-In Schedules


By **Emily Dworkin**
Associate | Corporate


By **Erica Hogan**
Partner | Corporate

On August 26, 2024, the U.S. Securities and Exchange Commission (SEC) issued an order approving proposed amendments by The Nasdaq Stock Market LLC (Nasdaq) to clarify and modify the phase-in schedules for certain corporate governance requirements and clarify the applicability of certain cure periods where companies fail to meet the majority independent board, audit committee composition or compensation committee requirements. The proposed amendments were submitted to the SEC by Nasdaq on May 8, 2024 and are generally consistent with rules that have previously been approved for the New York Stock Exchange. Nasdaq Listing Rules provide companies seeking to list on Nasdaq with “phase-in” schedules for compliance with certain Nasdaq corporate governance requirements. The revised phase-in schedules aim to provide a more manageable implementation timeline for companies.

Phase-In Schedules

Initial Public Offerings. The amendments include the following modifications to the independent director and committee requirements for initial public offering (IPO) companies:

- As amended, (i) one member of the audit committee must satisfy the heightened independence and other requirements of Rule 10A-3 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) by the date the company's securities first trade on Nasdaq (the “Listing Date”); (ii) a majority of members must satisfy the requirements within 90 days of the effective date of its registration statement; and (iii) all members must satisfy the requirements within one year of the effective date of its registration statement.

- IPO companies can now satisfy the requirement that the audit committee consist of a minimum of three members by designating at least one member by the Listing Date, at least two members within 90 days of the Listing Date, and at least three members within a year of the Listing Date.

- IPO companies can now satisfy the previous requirement of having one independent director on the compensation and nominations committees at the time of listing by appointing an independent director by the earlier of (i) the IPO closing date or (ii) five business days from the Listing Date.

Emerging From Bankruptcy. Nasdaq Listing Rule 5615(b)(2) was amended to codify its previous position that a company emerging from bankruptcy must comply with the audit committee composition requirements set forth in Nasdaq Listing Rule 5605(c)(2)8 by the Listing Date unless an exemption is available pursuant to Rule 10A-3 of the Exchange Act.

Transferring from National Securities Exchanges. Nasdaq Listing Rule 5615(b)(3) provides that companies that are transferring from other exchanges with substantially similar requirements are granted the balance of any grace period afforded by the other exchange. Companies that are transferring from other exchanges that do not have substantially similar requirements are afforded one year from the Listing date to comply. The amendments clarify that the phase-ins apply only where a company transfers securities registered under Exchange Act Section 12(b) from another national securities exchange. A new provision has been added to address phase-in schedules for companies previously registered pursuant to Exchange Act Section 12(g).

Listing in Connection with a Carve-out or Spin-off Transaction. New Nasdaq Rule 5615(b)(4) provides that a company listing in connection with a carve-out or spin-off transaction is permitted to phase-in certain requirements, such as the majority independent board requirement, the independent nominations, compensation, and audit committees' requirements, and the number of compensation and audit committee members' requirements, in a similar manner as IPO companies.

Ceasing to Qualify as a Foreign Private Issuer. Under the Exchange Act, companies are required to test their status as foreign private issuers annually at the end of their most recently completed second fiscal quarters (the determination date). The amendments provide that companies ceasing to be foreign private issuers have six months from the determination date to meet domestic corporate governance standards such as the majority independent board and executive sessions requirements in Nasdaq Rule 5605(b), the independent compensation and nominations committee requirements in Nasdaq Rules 5605(d)(2) and (e)(1)(B), and the audit committee requirements in Nasdaq Rule 5605(c)(2).

Cure Periods

Nasdaq Listing Rules 5605(b)(1)(A), 5605(c)(4), and 5605(d)(4) provide cure periods that apply where companies fail to meet the majority independent board, audit committee composition, or compensation committee requirements as a result of one vacancy or one member losing independence due to factors beyond their control. The recent rule change introduces a new provision stipulating that companies cannot access these cure periods immediately after their phase-in period under Nasdaq Rule 5615(b) expires, unless they demonstrated compliance during the phase-in but later fell out of compliance. If a company relies on the phase-in period but does not show compliance before it ends, Nasdaq Rule 5810(c)(E) has been updated to state that the Listing Qualifications Department may issue a Staff Delisting Determination letter to delist the company's securities.