Corporate Governance Rule Proposals

Reflecting Recommendations from the

NYSE Corporate Accountability and Listing Standards Committee

As Approved by the NYSE Board of Directors August 1, 2002

The following is the principal text of the rule filing submitted by the Exchange to the Securities and Exchange Commission on August 16, 2002. It includes the proposed corporate governance standards, as well as the related changes made to certain other Exchange rules. It also includes the summary of the written comments received by the Exchange on the June 6, 2002 Report and recommendations of the Corporate Accountability and Listing Standards Committee. This summary of comments is a required part of the rule filing submitted to the SEC. The rule filing is subject to review and approval by the SEC, which includes an additional public comment period.

The New York Stock Exchange (the "Exchange" or "NYSE") has long pioneered advances in corporate governance. The NYSE has required companies to comply with listing standards for nearly 150 years, and has periodically amended and supplemented those standards when the evolution of our capital markets has demanded enhanced governance standards or disclosure. Now, in the aftermath of the "meltdown" of significant companies due to failures of diligence, ethics and controls, the NYSE has the opportunity – and the responsibility – once again to raise corporate governance and disclosure standards.

On February 13, 2002, Securities and Exchange Commission ("SEC") Chairman Harvey Pitt asked the Exchange to review its corporate governance listing standards. In conjunction with that request, the NYSE appointed a Corporate Accountability and Listing Standards Committee (the "Committee") to review the NYSE's current listing standards, along with recent proposals for reform, with the goal of enhancing the accountability, integrity and transparency of the Exchange's listed companies.

The Committee believed that the Exchange could best fulfill this goal by building upon the strength of the NYSE and its listed companies in the areas of corporate governance and disclosure. This approach recognizes that new prohibitions and mandates, whether adopted by the NYSE, the SEC or Congress, cannot guarantee that directors, officers and employees will always give primacy to the ethical pursuit of shareholders' best interests. The system depends upon the competence and integrity of corporate directors, as it is their responsibility to diligently oversee management while adhering to unimpeachable ethical standards. The Exchange now seeks to strengthen checks and balances and give diligent directors better tools to empower them and encourage excellence. In seeking to empower and encourage the many good and honest people that serve NYSE-listed companies and their shareholders as directors, officers and employees, the Exchange seeks to avoid recommendations that would undermine their energy, autonomy and responsibility.

The proposed new corporate governance listing requirements are designed to further the ability of honest and well-intentioned directors, officers and employees to perform their functions effectively. The resulting proposals will also allow shareholders to more easily and efficiently monitor the performance of companies and directors in order to reduce instances of lax and unethical behavior.

In preparing the recommendations it made to the NYSE Board, the Committee had the benefit of the testimony of 17 witnesses and written submissions from 21 organizations or interested individuals. The Committee also examined the excellent governance practices that many NYSE-listed companies have long followed. In addition, the Committee reviewed extensive commentary recommending improvement in corporate governance and disclosure, statements by the President of the United States and members of his Cabinet, as well as pending SEC proposals and legislation introduced in Congress.

On June 6, 2002, the Committee submitted its Report and initial recommendations to the NYSE Board of Directors.[1] President Bush, SEC Chairman Harvey Pitt, members of Congress, CEOs of listed companies, institutional investors and state pension funds, organizations such as the Business Roundtable and the Council of Institutional Investors, and leading academics and commentators expressed strong support for the Committee's initiatives. The Committee also received insightful and practical suggestions for the improvement of its recommendations from

[1] Report of the NYSE Corporate Accountability and Listing Standards Committee, June 6, 2002.

experts within the NYSE, listed companies, institutional investors, outside organizations and interested individuals. In addition to many face-to-face meetings and telephone calls, the Exchange received over 300 comment letters.

Many of the commentators argued for, or sought, guidance from the Exchange at a level of detail inconsistent with the role that the Committee was asked to fulfill. However, where appropriate the Committee reflected cogent comments in clarifications and modifications to its recommendations.

The proposals for new corporate governance listing standards for companies listed on the Exchange will be codified in a new section 303A of the Exchange's Listed Company Manual.[2]

The standards in Section 303A will apply to all companies listing common stock on the Exchange, and to business organizations in non-corporate form such as limited partnerships, business trusts and REITs. However, consistent with past practice regarding corporate governance standards, the Exchange does not apply such standards to passive business organizations in the form of trusts (such as royalty trusts), nor does it apply them to derivatives and special purpose securities such as those described in Sections 703.16, 703.19, 703.20 and 703.21 of the Listed Company Manual. The Exchange has traditionally applied its corporate governance standards to listed closed-end management companies. The Exchange considers the significantly expanded standards and requirements provided for in Section 303A to be unnecessary for closed-end management companies given the pervasive federal regulation applicable to them. However, closed-end management companies will be required to continue to comply with the audit committee requirements, as they are enhanced and expanded in subsections 6 and 7 of Section 303A.

Regarding the effective date of these new standards, companies that do not already have majority-independent boards will need time to recruit qualified independent directors. Accordingly, all listed companies are required to achieve majority-independence within 24 months of the date this standard is approved by the SEC. Companies listing in conjunction with their initial public offering must comply within 24 months of listing. Companies listing upon transfer from another market will have 24 months from the date of transfer in which to comply with this standard to the extent the market on which they were listed did not have the same requirement. To the extent the other market has a substantially similar requirement but also had a transition period from the effective date of the rule, which period had not yet expired, the company will have at least as long a transition period as would have been available to it on the other market. Companies will have the same 24-month period to comply with the new

[2] In its Report to the NYSE Board the Committee set forth basic principles followed in many cases by explanation and clarification. We are adopting the recommendations as standards in substantially the form they were made by the Committee and adopted by the NYSE Board. Accordingly, the format used will state a basic principle, with the additional explanation and clarifications included as "commentary". Readers are advised that the words "must" and "should" have been chosen with care when used. The use of the word "must" indicates a standard or practice with which companies are required to comply. The use of the word "should" indicates a standard or practice that the Exchange believes is appropriate for most if not all companies, but failure to employ or comply with such standard or practice will not constitute a violation of NYSE standards.

While many of the requirements set forth in this new rule are relatively specific, the Exchange is articulating a philosophy and approach to corporate governance that companies are expected to carry out as they apply the requirements to the specific facts and circumstances that they confront from time to time. Companies and their boards are expected to apply the requirements carefully and in good faith, making reasonable interpretations as necessary, and disclosing the interpretations that they make.

qualification standards applicable to audit committee members. As a general matter, the existing audit committee requirements provided for in Section 303 of the Manual shall continue to apply to NYSE listed companies pending the transition to the new rules.

While the above time periods are needed to recruit directors, the Exchange believes that listed companies, IPOs and transfers can much more quickly implement the other requirements of Section 303A. Certain provisions can be applied as soon as the SEC approves the filing, and this will be the case for stockholder approval of equity compensation plans specified in subsection 8 of Section 303A, and the related amendment to NYSE Rule 452 regarding broker voting of uninstructed shares. The provision for a public reprimand letter in subsection 12 of Section 303A will also be effective upon approval.

The remaining requirements can also be implemented quickly, although companies may need a modest period in which to do the work. Accordingly, all the following will be required within six months from SEC approval:

- Provide for executive sessions of non-management directors (subsection 3);
- Establish nomination and compensation committees with the requisite charters (subsections 4 and 5);
- Increase authority and responsibility of the audit committee, adopt the required audit committee charter, and establish an internal audit function (subsection 7);
- Adopt corporate governance guidelines and a code of business conduct and ethics (subsections 9 and 10);
- Foreign private issuer description of significant differences from NYSE standards (subsection 11); and
- CEO certification of compliance with listing standards (subsection 12).

Once those six months are expired, we will expect all newly listed companies, both IPOs and transfers, to have provided for these requirements by the time of listing on the Exchange.

This leaves only the issue of having nominating and compensation committees that are comprised solely of independent directors. The 24-month rubric will apply here, although we will require companies to have at least one independent director on each such committee within 12, rather than 24, months.

What follows are the requirements as proposed to be codified in Section 303A of the Listed Company Manual:

Section 303A

1. Listed companies must have a majority of independent directors.

Commentary: Effective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest.

A company of which more than 50% of the voting power is held by an individual, a group or another company need not have a majority of independent directors on its board or have nominating/corporate governance and compensation committees composed of independent directors.[3] A controlled company that chooses to take advantage of this exemption must disclose in its annual meeting proxy that it is a controlled company and the basis for that determination. However, all controlled companies must have at least a minimum three person audit committee composed entirely of independent directors, and otherwise comply with the audit committee requirements provided for in this Section 303A.

2. In order to tighten the definition of "independent director" for purposes of these standards:

(a) No director qualifies as "independent" unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). Companies must disclose these determinations.

Commentary: It is not possible to anticipate, or explicitly to provide for, all circumstances that might signal potential conflicts of interest, or that might bear on the materiality of a director's relationship to a listed company. Accordingly, it is best that boards making "independence" determinations broadly consider all relevant facts and circumstances. In particular, when assessing the materiality of a director's relationship with the company, the board should consider the issue not merely from the standpoint of the director, but also from that of persons or organizations with which the director has an affiliation. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships (among others). However, as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding.

The basis for a board determination that a relationship is not material must be disclosed in the company's annual proxy statement. In this regard, a board may adopt and disclose categorical standards to assist it in making determinations of independence and may make a general disclosure if a director meets these standards. Any determination of independence for a director who does not meet these standards must be specifically explained. For example, a board might disclose its determination that affiliation with a customer whose business accounts for less than a specified percentage of the company's revenues is, as a category, immaterial for purposes of determining independence. A company must disclose any standard it adopts. It may then make the general statement that the independent directors meet the standards set by the board without detailing particular aspects of the immaterial relationships between individual directors and the company. In the event that a director with a business or other relationship that does not fit within

[3] The Exchange notes that this exemption will affect a small percentage of its listed companies.

the disclosed standards is determined to be independent, a board must disclose the basis for its determination. This approach provides investors with an adequate means of assessing the quality of a board's independence and its independence determinations while avoiding excessive disclosure of immaterial relationships.

(b) In addition:

(i) No director who is a former employee of the listed company can be "independent" until five years after the employment has ended.

<u>Commentary:</u> A director who serves as an interim Chairman or CEO may be excluded from the definition of a "former employee" and thus be deemed independent immediately after his or her service as interim Chairman or CEO ends.

(ii) No director who is, or in the past five years has been, affiliated with or employed by a (present or former) auditor of the company (or of an affiliate) can be "independent" until five years after the end of either the affiliation or the auditing relationship.

(iii) No director can be "independent" if he or she is, or in the past five years has been, part of an interlocking directorate in which an executive officer of the listed company serves on the compensation committee of another company that concurrently employs the director.

(iv) Directors with immediate family members in the foregoing categories are likewise subject to the five-year "cooling-off" provisions for purposes of determining "independence."

<u>Commentary:</u> Employment of a family member in a non-officer[4] position does not preclude a board from determining that a director is independent. Such employment arrangements are common and do not present a categorical threat to director independence. In addition, if an executive officer dies or becomes incapacitated, his or her immediate family members may be classified as independent immediately after such death or determination of incapacity, provided that they themselves are otherwise independent. An "immediate family member" includes a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than employees) who shares such person's home.

3. To empower non-management directors to serve as a more effective check on management, the non-management directors of each company must meet at regularly scheduled executive sessions without management.

<u>Commentary:</u> To promote open discussion among the non-management directors, companies must schedule regular executive sessions in which those directors meet without management participation. ("Non-management" directors are all those who are not company officers, and includes such directors who are not independent by virtue of a material relationship, former status or family membership, or for any other reason.) Regular scheduling of such meetings is

[4] The Exchange notes that consistent with its current practice, the term "officer" is defined in Section 301 of the Listed Company Manual, as amended hereby, to have to meaning specified in the SEC Rule 16a-1(f), 17 CFR 240.16a-1(f). This same definition is found in the current Listed Company Manual in Section 303.02(E).

important not only to foster better communication among non-management directors, but also to prevent any negative inference from attaching to the calling of executive sessions. There need not be a single presiding director at all executive sessions of the non-management directors. If one director is chosen to preside at these meetings, his or her name must be disclosed in the annual proxy statement. Alternatively, a company may disclose the procedure by which a presiding director is selected for each executive session. For example, a company may wish to rotate the presiding position among the chairs of board committees. In order that interested parties may be able to make their concerns known to the non-management directors, a company must disclose a method for such parties to communicate directly with the presiding director or with the non-management directors as a group.

4. (a) Listed companies must have a nominating/corporate governance committee composed entirely of independent directors.

(b) The nominating/corporate governance committee must have a written charter that addresses:

(i) the committee's purpose – which, at minimum, must be to: identify individuals qualified to become board members, and to select, or to recommend that the board select, the director nominees for the next annual meeting of shareholders; and develop and recommend to the board a set of corporate governance principles applicable to the corporation.

(ii) the committee's goals and responsibilities – which must reflect, at minimum, the board's criteria for selecting new directors, and oversight of the evaluation of the board and management.

(iii) an annual performance evaluation of the committee.

Commentary: A nominating/corporate governance committee is central to the effective functioning of the board. New director and board committee nominations are among a board's most important functions. Placing this responsibility in the hands of an independent nominating/corporate governance committee can enhance the independence and quality of nominees. The committee is also responsible for taking a leadership role in shaping the corporate governance of a corporation.

If a company is legally required by contract or otherwise to provide third parties with the ability to nominate directors (for example, preferred stock rights to elect directors upon a dividend default, shareholder agreements, and management agreements), the selection and nomination of such directors need not be subject to the nominating committee process.

The nominating/corporate governance committee charter should also address the following items: committee member qualifications; committee member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board. In addition, the charter should give the nominating/corporate governance committee sole authority to retain and terminate any search firm to be used to identify director candidates, including sole authority to approve the search firm's fees and other retention terms.

Boards may allocate the responsibilities of the nominating/corporate governance committee, and the compensation committee described in subsection 5 hereof to committees of their own denomination, provided that the committees are composed entirely of independent directors. Any such committee must have a published committee charter. To avoid any confusion, the functions specified in subsection 7 hereof as belonging to the audit committee may not be allocated to a different committee.

As noted in subsection 1 of this Section 303A, controlled companies need not comply with the requirements of this subsection 4.

5. (a) Listed companies must have a compensation committee composed entirely of independent directors.

(b) The compensation committee must have a written charter that addresses:

(i) the committee's purpose – which, at minimum, must be to discharge the board's responsibilities relating to compensation of the company's executives, and to produce an annual report on executive compensation for inclusion in the company's proxy statement, in accordance with applicable rules and regulations.

(ii) the committee's duties and responsibilities – which, at minimum, must be to:

(A) review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives, and set the CEO's compensation level based on this evaluation.

(B) make recommendations to the board with respect to incentive-compensation plans and equity-based plans.

(iii) an annual performance evaluation of the compensation committee.

Commentary: In determining the long-term incentive component of CEO compensation, the committee should consider the company's performance and relative shareholder return, the value of similar incentive awards to CEOs at comparable companies, and the awards given to the listed company's CEO in past years. To avoid confusion, note that the compensation committee is not precluded from approving awards (with the ratification of the board) as may be required to comply with applicable tax laws (i.e., Rule 162(m)).[5]

The compensation committee charter should also address the following items: committee member qualifications; committee member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board.

Additionally, if a compensation consultant is to assist in the evaluation of director, CEO or senior executive compensation, the compensation committee charter should give that committee sole authority to retain and terminate the consulting firm, including sole authority to approve the firm's fees and other retention terms.

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[5] 26 U.S.C. §162(m) (2002).

As noted in subsection 1 of this Section 303A, controlled companies need not comply with the requirements of this subsection 5.

6. Add to the "independence" requirement for audit committee membership the requirement that director's fees are the only compensation an audit committee member may receive from the company.

Commentary: The Exchange will continue to require each company to have a minimum three person audit committee composed entirely of independent directors. Each member of the committee must be financially literate, as such qualification is interpreted by the company's board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee. In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the company's board interprets such qualification in its business judgment.[6]

While it is not the audit committee's responsibility to certify the company's financial statements or to guarantee the auditor's report, the committee stands at the crucial intersection of management, independent auditors, internal auditors and the board of directors. The Exchange supports additional directors' fees to compensate audit committee members for the significant time and effort they expend to fulfill their duties as audit committee members, but does not believe that any member of the audit committee should receive any compensation other than such director's fees from the company. If a director satisfies the definition of "independent director" (as provided in subsection 2 of this Section 303A), then his or her receipt of a pension or other form of deferred compensation from the company for prior service (provided such compensation is not contingent in any way on continued service) will not preclude him or her from satisfying the requirement that director's fees are the only form of compensation he or she receives from the company.

An audit committee member may receive his or her fee in cash and/or company stock or options or other in-kind consideration ordinarily available to directors, as well as all of the regular benefits that other directors receive. Because of the significantly greater time commitment of audit committee members, they may receive reasonable compensation greater than that paid to the other directors (as may other directors for other time-consuming committee work). Disallowed compensation for an audit committee member includes fees paid directly or indirectly for services as a consultant or a legal or financial advisor, regardless of the amount. Disallowed compensation also includes compensation paid to such a director's firm for such

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[6] Prior to the adoption of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002), the Committee had recommended that the audit committee chair be required to have accounting or financial management expertise. However, in light of the express provision in the Sarbanes-Oxley Act that at least one member of the audit committee qualify as a "financial expert," and the existing NYSE requirements that at least one member of the audit committee have "accounting or related financial management expertise," and that all members of the audit committee be financially literate, the Exchange has determined to await the SEC's interpretation of the definition of "financial expert" before acting on this recommendation. See Section 407 of the Sarbanes-Oxley Act and Section 303.01(B)(2)(b) of the Listed Company Manual.

The Committee Report of June 6, 2002 addressed the issue of the potential conflict of interest between a controlling shareholder and the public shareholders in the context of audit committees by recommending that an affiliate of a 20% or greater shareholder may be a non-voting member of the audit committee. In view of the provision of the Sarbanes-Oxley Act of 2002 disqualifying affiliated persons from service on the audit committee, the Board determined not to propose this provision at this time. See Section 301 of the Sarbanes-Oxley Act.

consulting or advisory services even if the director is not the actual service provider. Disallowed compensation is not intended to include ordinary compensation paid in another customer or supplier or other business relationship that the board has already determined to be immaterial for purposes of its basic director independence analysis. To eliminate any confusion, note that this requirement pertains only to audit committee qualification and not to the independence determinations that the board must make for other directors.

Because of the audit committee's demanding role and responsibilities, and the time commitment attendant to committee membership, each prospective audit committee member should evaluate carefully the existing demands on his or her time before accepting this important assignment. Additionally, if an audit committee member simultaneously serves on the audit committee of more than three public companies, and the NYSE-listed company does not limit the number of audit committees on which its audit committee members serve, then in each case, the board must determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee and disclose such determination in the annual proxy statement.

7. (a) Increase the authority and responsibilities of the audit committee, including granting it the sole authority to hire and fire independent auditors, and to approve any significant non-audit relationship with the independent auditors.

(b) The audit committee must have a written charter that addresses:

(i) the committee's purpose – which, at minimum, must be to:

(A) assist board oversight of (1) the integrity of the company's financial statements, (2) the company's compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence, and (4) the performance of the company's internal audit function and independent auditors; and

(B) prepare the report that SEC rules require be included in the company's annual proxy statement.

(ii) the duties and responsibilities of the audit committee – which, at minimum, must be to:

(A) retain and terminate the company's independent auditors (subject, if applicable, to shareholder ratification).

<u>*Commentary:*</u> In connection with this requirement, the audit committee must have the sole authority to approve all audit engagement fees and terms, as well as all significant non-audit engagements with the independent auditors. This requirement does not preclude the committee from obtaining the input of management, but these responsibilities may not be delegated to management.

(B) at least annually, obtain and review a report by the independent auditor describing: the firm's internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or

professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor's independence) all relationships between the independent auditor and the company.

Commentary: After reviewing the foregoing report and the independent auditor's work throughout the year, the audit committee will be in a position to evaluate the auditor's qualifications, performance and independence. This evaluation should include the review and evaluation of the lead partner of the independent auditor. In making its evaluation, the audit committee should take into account the opinions of management and the company's internal auditors (or other personnel responsible for the internal audit function). In addition to assuring the regular rotation of the lead audit partner as required by law, the audit committee should further consider whether, in order to assure continuing auditor independence, there should be regular rotation of the audit firm itself. The audit committee should present its conclusions with respect to the independent auditor to the full board.

(C) discuss the annual audited financial statements and quarterly financial statements with management and the independent auditor, including the company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations."

(D) discuss earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies.

Commentary: The audit committee's responsibility to discuss earnings releases as well as financial information and earnings guidance may be done generally (i.e., discussion of the types of information to be disclosed and the type of presentation to be made). The audit committee need not discuss in advance each earnings release or each instance in which a company may provide earnings guidance.

(E) as appropriate, obtain advice and assistance from outside legal, accounting or other advisors.

Commentary: In the course of fulfilling its duties, the audit committee may wish to consult with independent advisors. The audit committee must be empowered to retain these advisors without seeking board approval.

(F) discuss policies with respect to risk assessment and risk management.

Commentary: While it is the job of the CEO and senior management to assess and manage the company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled. The audit committee should discuss the company's major financial risk exposures and the steps management has taken to monitor and control such exposures. The audit committee is not required to be the sole body responsible for risk assessment and management, but, as stated above, the committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken. Many companies, particularly financial companies, manage and assess their risk through mechanisms other than the audit committee. The processes these companies have in place should be reviewed in a general manner by the audit committee, but they need not be replaced by the audit committee.

(G) meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors.

Commentary: To perform its oversight functions most effectively, the audit committee must have the benefit of separate sessions with management, the independent auditors and those responsible for the internal audit function. As noted herein, all NYSE listed companies must have an internal audit function. These separate sessions may be more productive than joint sessions in surfacing issues warranting committee attention.

(H) review with the independent auditor any audit problems or difficulties and management's response.

Commentary: The audit committee must regularly review with the independent auditor any difficulties the auditor encountered in the course of the audit work, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management. Among the items the audit committee may want to review with the auditor are: any accounting adjustments that were noted or proposed by the auditor but were "passed" (as immaterial or otherwise); any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any "management" or "internal control" letter issued, or proposed to be issued, by the audit firm to the company. The review should also include discussion of the responsibilities, budget and staffing of the company's internal audit function.

(I) set clear hiring policies for employees or former employees of the independent auditors.

Commentary: Employees or former employees of the independent auditor are often valuable additions to corporate management. Such individuals' familiarity with the business, and personal rapport with the employees, may be attractive qualities when filling a key opening. However, the audit committee should set hiring policies taking into account the pressures that may exist for auditors consciously or subconsciously seeking a job with the company they audit.

(J) report regularly to the board of directors.

Commentary: The audit committee should review with the full board any issues that arise with respect to the quality or integrity of the company's financial statements, the company's compliance with legal or regulatory requirements, the performance and independence of the company's independent auditors, or the performance of the internal audit function.

(iii) an annual performance evaluation of the audit committee.

Commentary: While the fundamental responsibility for the company's financial statements and disclosures rests with management and the independent auditor, the audit committee must review: (A) major issues regarding accounting principles and financial statement presentations, including any significant changes in the company's selection or application of accounting principles, and major issues as to the adequacy of the company's internal controls and any special audit steps adopted in light of material control deficiencies; (B) analyses prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements; (C) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the company; and (D) earnings press releases (paying particular attention to any use of "pro forma," or "adjusted" non-GAAP, information), as well as financial information and earnings guidance provided to analysts and rating agencies.

(c) Each listed company must have an internal audit function.

Commentary: This requirement does not necessarily mean that a company must establish a separate internal audit department or dedicate employees to the task on a full-time basis; it is enough for a company to have in place an appropriate control process for reviewing and approving its internal transactions and accounting. A company may choose to outsource this function to a firm other than its independent auditor.

8. To increase shareholder control over equity-compensation plans, shareholders must be given the opportunity to vote on all equity-compensation plans, except inducement options, plans relating to mergers or acquisitions, and tax qualified and excess benefit plans.

Commentary: Equity-compensation plans can help align shareholder and management interests, and equity-based awards have become very important components of employee compensation. In order to provide checks and balances on the process of earmarking shares to be used for equity-based awards, and to provide shareholders a voice regarding the resulting dilution, the Exchange requires that all equity-compensation plans, and any material revisions to the terms of such plans (including the repricing of existing options), be subject to stockholder approval.

There are certain types of plans, however, which are appropriately exempt from this requirement. Employment inducement awards and option plans acquired in corporate acquisitions and mergers will not be subject to shareholder approval under this rule. The Exchange recognizes the urgency that may attach to the granting of options in the inducement or merger or acquisition context and the resulting impracticality of obtaining a shareholder vote in these situations. Because inducement awards and mergers or acquisitions are not routine occurrences, and are not likely to be abused, the Exchange does not consider that these exceptions alter the fundamental policy involved in this standard. Similarly, any plan intended to meet the requirements of Section 401(a)[7] or 423[8] of the Internal Revenue Code, as amended (e.g., ESOPs) or the definition of an "excess benefit plan" within the meaning of Section 3(36)[9] of the Employee Retirement Income Security Act is exempt from the shareholder approval requirement. Tax qualified equity purchase plans such as Section 401(a) plans and Section 423 plans are already regulated under internal revenue regulations which, in some cases, require shareholder approval. In the limited instances in which shareholder approval for these plans is not required, the transactions in which shares are acquired from and issued under the plans in question are either not dilutive to existing shareholders (i.e., the shares are not purchased at a discount to market price) or must be "expensed" (i.e., treated as a compensation expense). An

[7] 26 U.S.C. §401(a) (1988).

[8] 26 U.S.C. §423 (1988).

[9] 29 U.S.C. §1002 (1999).

excess benefit plan is a plan that is designed to work in parallel with a related qualified plan, to provide those benefits that exceed the limitation imposed by the Code on qualified plans.

In the circumstances in which equity compensation plans are not subject to shareholder approval, the plans must be subject to the approval of the company's compensation committee.[10]

In addition, the Exchange will preclude its member organizations from giving a proxy to vote on equity-compensation plans unless the beneficial owner of the shares has given voting instructions. This is codified in NYSE Rule 452.[11]

9. Listed companies must adopt and disclose corporate governance guidelines.

Commentary: No single set of guidelines would be appropriate for every company, but certain key areas of universal importance include director qualifications and responsibilities, responsibilities of key board committees, and director compensation. Given the importance of corporate governance, each listed company's website must include its corporate governance guidelines, the charters of its most important committees (including at least the audit, compensation and nominating committees) and the company's code of business conduct and ethics (see subsection 10 below). Each company's annual report must state that the foregoing information is available on its website, and that the information is available in print to any shareholder who requests it. Making this information publicly available should promote better investor understanding of the company's policies and procedures, as well as more conscientious adherence to them by directors and management.

The following subjects must be addressed in the corporate governance guidelines:

- **Director qualification standards.** These standards should, at minimum, reflect the independence requirements set forth in subsections 1 and 2 of this Section 303A. Companies may also address other substantive qualification requirements, including policies limiting the number of boards on which a director may sit, and director tenure, retirement and succession.

- **Director responsibilities.** These responsibilities should clearly articulate what is expected from a director, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.

- **Director access to management and, as necessary and appropriate, independent advisors.**

- **Director compensation.** Director compensation guidelines should include general principles for determining the form and amount of director compensation (and for reviewing those principles, as appropriate). The board should be aware that questions as to directors' independence may be raised when directors' fees and emoluments exceed what is customary. Similar concerns may be raised when the company makes substantial

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[10] For the sake of clarity, the Exchange notes that its traditional "treasury stock exception" will no longer be available with respect to this requirement.

[11] The NYSE will establish a working group to advise with respect to the need for, and design of, mechanisms to facilitate implementation of the proposal that brokers may not vote on equity compensation plans presented to shareholders without instructions from the beneficial owners. This will not delay the immediate effectiveness of the broker-may-not-vote proposal.

charitable contributions to organizations in which a director is affiliated, or enters into consulting contracts with (or provides other indirect forms of compensation to) a director. The board should critically evaluate each of these matters when determining the form and amount of director compensation, and the independence of a director.

- **Director orientation and continuing education.**

- **Management succession.** Succession planning should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO.

- **Annual performance evaluation of the board.** The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively.

10. Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.

Commentary: No code of business conduct and ethics can replace the thoughtful behavior of an ethical director, officer or employee. However, such a code can focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability.

Each code of business conduct and ethics must require that any waiver of the code for executive officers or directors may be made only by the board or a board committee and must be promptly disclosed to shareholders. This disclosure requirement should inhibit casual and perhaps questionable waivers, and should help assure that, when warranted, a waiver is accompanied by appropriate controls designed to protect the company. It will also give shareholders the opportunity to evaluate the board's performance in granting waivers.

Each code of business conduct and ethics must also contain compliance standards and procedures that will facilitate the effective operation of the code. These standards should ensure the prompt and consistent action against violations of the code.

Each company may determine its own policies, but all listed companies should address the most important topics, including the following:

- **Conflicts of interest.** A "conflict of interest" occurs when an individual's private interest interferes in any way – or even appears to interfere – with the interests of the corporation as a whole. A conflict situation can arise when an employee, officer or director takes actions or has interests that may make it difficult to perform his or her company work objectively and effectively. Conflicts of interest also arise when an employee, officer or director, or a member of his or her family, receives improper personal benefits as a result of his or her position in the company. Loans to, or guarantees of obligations of, such persons are of special concern. The company should have a policy prohibiting such conflicts of interest, and providing a means for employees, officers and directors to communicate potential conflicts to the company.

- **Corporate opportunities.** Employees, officers and directors should be prohibited from (a) taking for themselves personally opportunities that are discovered through the use of corporate property, information or position; (b) using corporate property, information, or position for personal gain; and (c) competing with the company. Employees, officers and directors owe a duty to the company to advance its legitimate interests when the opportunity to do so arises.

- **Confidentiality.** Employees, officers and directors should maintain the confidentiality of information entrusted to them by the company or its customers, except when disclosure is authorized or legally mandated. Confidential information includes all non-public information that might be of use to competitors, or harmful to the company or its customers, if disclosed.

- **Fair dealing.** Each employee, officer and director should endeavor to deal fairly with the company's customers, suppliers, competitors and employees. None should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair-dealing practice.

- **Protection and proper use of company assets.** All employees, officers and directors should protect the company's assets and ensure their efficient use. Theft, carelessness and waste have a direct impact on the company's profitability. All company assets should be used for legitimate business purposes.

- **Compliance with laws, rules and regulations (including insider trading laws).** The company should proactively promote compliance with laws, rules and regulations, including insider trading laws. Insider trading is both unethical and illegal, and should be dealt with decisively.

- **Encouraging the reporting of any illegal or unethical behavior.** The company should proactively promote ethical behavior. The company should encourage employees to talk to supervisors, managers or other appropriate personnel when in doubt about the best course of action in a particular situation. Additionally, employees should report violations of laws, rules, regulations or the code of business conduct to appropriate personnel. To encourage employees to report such violations, the company must ensure that employees know that the company will not allow retaliation for reports made in good faith.

11. Listed foreign private issuers must disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards.

<u>*Commentary:*</u> Both SEC rules and NYSE policies have long recognized that foreign private issuers differ from domestic companies in the regulatory and disclosure regimes and customs they follow, and that it is appropriate to accommodate those differences. For this reason, the NYSE for many years has permitted listed non-U.S. companies to follow home-country practices with respect to a number of corporate governance matters, such as the audit committee requirement and the NYSE shareholder approval and voting rights rules. While the NYSE will continue to respect different approaches, listed foreign private issuers must make their U.S. investors aware of the significant ways in which their home-country practices differ from those followed by domestic companies under NYSE listing standards. However, listed foreign private issuers are not required to present a detailed, item-by-item analysis of these differences. Such a

disclosure would be long and unnecessarily complicated. Moreover, this requirement is not intended to suggest that one country's corporate governance practices are better or more effective than another. The Exchange simply believes that U.S. shareholders should be aware of the significant ways that the governance of a listed foreign private issuer differs from that of a U.S. listed company. The Exchange underscores that what is required is a brief, general summary of the significant differences, not a cumbersome analysis.[12]

Listed foreign private issuers may provide this disclosure either on their web site (provided it is in the English language and accessible from the U.S.) and/or in their annual report as distributed to shareholders in the U.S. (again, in the English language). If the disclosure is only made available on the web site, the annual report shall so state and provide the web address at which the information may be obtained.

12. Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards.

<u>*Commentary:*</u> The CEO's annual certification to the NYSE that he or she is unaware of any violation by the company of NYSE corporate governance listing standards will focus the CEO and senior management on the company's compliance with the listing standards.[13] Both this certification to the NYSE, and any CEO/CFO certifications required to be filed with the SEC regarding the quality of the company's public disclosure, must be disclosed in the listed company's annual report to shareholders.

13. The NYSE may issue a public reprimand letter to any listed company that violates an NYSE listing standard.

<u>*Commentary:*</u> Suspending trading in or delisting a company can be harmful to the very shareholders that the NYSE listing standards seek to protect; the NYSE must therefore use these measures sparingly and judiciously. For this reason it is appropriate for the NYSE to have the ability to apply a lesser sanction to deter companies from violating its corporate governance (or other) listing standards. Accordingly, the NYSE may issue a public reprimand letter to a company that it determines has violated an NYSE listing standard. For companies that repeatedly or flagrantly violate NYSE listing standards, suspension and delisting remain the ultimate penalties. For clarification, this lesser sanction is not intended for use in the case of

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[12] The NYSE will work with its counterparts throughout the world to strive for harmony in corporate governance principles, with the goal of establishing global principles to be implemented by global companies no matter where those companies are based.

[13] The Committee's original recommendations to the NYSE Board included a CEO certification that the company had established procedures for verifying the accuracy and completeness of the information provided to investors, that those procedures had been carried out, that the CEO had no reasonable cause to believe that the information provided to investors is not accurate and complete in all material respects, and that the CEO had reviewed with the company's board those procedures and the company's compliance with them. Given the recent SEC emergency order and the provisions of the Sarbanes-Oxley Act regarding CEO certifications relating to the quality of financial disclosure, the Committee recommended, and the NYSE agreed, that there was no purpose to requiring under NYSE rules a similar but separate certification regarding a company's public disclosure. See File No. 4-460: Order Requiring the Filing of Sworn Statements Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934 (June 27, 2002) and Sections 302 and 906 of the Sarbanes-Oxley Act. The Committee noted to the NYSE Board that there has been a great deal of concern expressed by commentators regarding the additional potential liability created by the various certification proposals and the Committee recommended, and the NYSE agreed, that the SEC should have exclusive authority to enforce the requirement of a CEO and CFO certification and that no certification should give rise to private rights of action.

companies that fall below the financial and other continued listing standards provided in Chapter 8 of the Listed Company Manual. The processes and procedures provided for in Chapter 8 will continue to govern the treatment of companies falling below those standards.

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Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Overview

Widespread Support for the Recommendations. The vast majority of commentators, including listed companies, institutional investors, and other interested organizations and individuals enthusiastically embraced the Committee's recommendations for new corporate governance and listing standards for the NYSE.

Concerns of Smaller Companies. While most large companies, law firms and institutions expressed general support for the proposals, commentators who characterized themselves as smaller businesses voiced concern. All of these companies complained that the recommendations seem to have been structured for a large-company model, without taking into account the disproportionate impact the proposed rules would have on smaller companies. In particular, they argued that the Committee's recommendations for separate nominating and compensation committees, together with its requirement of majority-independent boards, combined to effectively require that smaller companies enlarge their relatively small boards. These constituents were particularly concerned with the increased costs that compliance with the recommendations would entail. They argued that this will cause the diversion of shareholder value to unrelated third parties and the misdirection of board and management time and effort from productive to bureaucratic activities.

Difficulty of Obtaining Independent Directors. Several large companies expressed concern that the new rules will make it more difficult for companies to find quality independent directors because of the increased responsibilities and time commitment that the rules will require of independent directors (especially audit committee members), as well as a perceived increase in such directors' exposure to liability.

Majority-Independent Boards

Many commentators applauded the recommendation that listed companies be required to maintain majority-independent boards. However, numerous constituents, large and small, raised concerns that the requirement would have a variety of adverse consequences.

A. Controlled Companies

Most prominently, more than half of the commenting companies noted that the majority-independent board requirement would create insuperable difficulties for companies controlled by a shareholder or parent company. They argued that the rule would be inequitable as applied to them in that it would deprive a majority holder of its shareholder rights; unnecessary in that the

Committee's other recommendations (in particular the independent committee and disclosure requirements) would adequately protect minority shareholders; and undesirable in that it would reduce access to capital markets by discouraging spin-offs, by inducing some currently public companies to go private rather than lose control of their subsidiary, and by discouraging those who manage buyout funds and venture capital funds from using initial public offerings and NYSE listings as a means for achieving liquidity and raising capital. One company argued that the majority-independent board requirement would vitiate the ability of a parent to effectively manage its subsidiary, in the process denying to shareholders of the parent the benefits associated with its controlling stake in the subsidiary and requiring them instead to transfer control of the subsidiary to third parties.

Similarly, commentators suggested that companies that are majority-owned by officers and directors should be exempt from this recommendation. One such company argued that where corporate insiders own a majority of the stock of a company, the interests of outside minority shareholders can be adequately protected by the proposed requirement of an independent compensation committee. Family-owned companies also expressed concern with the majority-independence requirement because the proposal would limit the families' involvement with the board.

The provision in subsection 1 of Section 303A exempting controlled companies from the requirements to have a majority independent board and independent nominating and compensation committees is intended to address these concerns.

B. Shareholder Agreements and Multiple Classes of Stock

Companies with multiple classes of securities, some of which have a right of representation on the board, argued that they should not have to meet the majority-independence requirement because doing so would be in direct conflict with their equity structure and the shareholder rights embedded therein.

Companies with multiple classes of stock representing different constituencies also had difficulty with this recommendation. One company that recently gave organized labor the right to appoint a director to the board as part of a collective bargaining agreement requested that the NYSE allow grandfathering of such arrangements. This company noted that compliance with this recommendation would effect a retroactive change in the bargains that brought about these arrangements and might trigger stockholder approval requirements.

The Exchange clarified in subsection 4 of Section 303A that the selection and nomination of such directors need not be subject to the nominating committee process.

<u>Tighter "Independent Director" Definition</u>

Most commentators were in favor of tightening the definition of "independence," with only a quarter advocating the continued use of existing standards. Certain institutional investors praised with particular emphasis the five-year look-back on compensation committee interlocks. However, commentators have raised several general questions, described below, as well as numerous specific questions with respect to materiality determinations.

A. Share Ownership

Many commentators expressed a desire for additional clarification of the interaction between share ownership and independence.

Several commentators opposed viewing any degree of share ownership as a *per se* bar to "independence" (absent such other factors as an employment relationship or other financial or personal tie to the company). They argued that directors who own or represent institutions that own very significant economic stakes in the listed companies are often effective guardians of shareholders' interests not only as members of the full board but also of compensation and nominating committees, while directors whose only stake in the membership on the board is the director's fee may be unduly loyal to management. Several venture capitalists raised a similar concern that they will run afoul of the new independence definition, even though venture capitalists, acting as fiduciaries to funds with significant shareholdings, typically have all the qualities that the independent director definition is intended to ensure.

The question of the impact of ownership on independence was particularly vexing to companies with listed subsidiaries. They were concerned that a director who is deemed independent with respect to a parent company may not be considered independent with respect to the parent-controlled subsidiary.

The Exchange has clarified in subsection 2 of Section 303A that, since the concern is independence from management, ownership of even a significant amount of stock, by itself, is not necessarily a bar to an independence finding.

B. Safe Harbors for Independence Determinations

Several financial institutions specifically applauded the committee's recommendation that non-materiality determinations be made on a case-by-case basis and publicly disclosed and justified. However, a number of companies objected to the affirmative determination requirement, requesting that the NYSE specify a safe harbor for materiality. These companies cite the competing demands on the board's time and attention; the likelihood that the "no material relationship" requirement will unduly shrink the pool of qualified directorship candidates; and the possibility that the fact-specific inquiry required will expose directors to additional scrutiny and potential liability, which they may be unwilling to assume without additional compensation and/or protection.

Many commentators would like to be able to fulfill their affirmative determination requirement through the establishment of their own safe harbors. For example, one commentator attached a detailed safe harbor proposal covering various types of credit transactions. In addition, a vast majority of commenting banks and financial institutions asked for clarification regarding the treatment of loans to directors. In light of the existing regulatory framework that controls relationships between a bank and its directors and affiliated entities, banks desired to establish categorically that arm's-length loans to directors do not negate independence.

Numerous companies and organizations argue that if there are no material relationships, the NYSE should allow the statement of reasons for the board's determination of independence to be omitted from the proxy statement, and suggest that the rules should not require details of each relationship regardless of size.

The Exchange has clarified in subsection 2 of Section 303A that categorical standards are permissible.

C. Five-Year Cooling-Off Period

More than half of the companies commenting on this issue protested that five years is too long, advocating a two-to-three year period instead. Five companies, reflecting their individual circumstances, requested an exemption for interim CEOs who have served for less than one year. One commentator objected to subjecting all former employees to the cooling-off period, recommending that the prohibition be limited to former executive officers only.

Several commentators agreed with the five-year period for former employees, but found the period too long with respect to compensation committee interlocking directorates. Notably, one company thought that the five-year look-back on interlocking directorates would strain parent-subsidiary relations. Likewise, one parent of a controlled public subsidiary expressed its belief that its executives should be able to sit on the subsidiary's compensation committee to ensure that subsidiary's compensation policies are compatible with those of its parent. In addition, a few companies asked whether the inquiry ends by examining the present and past relationships at companies where directors are currently employed, or if one must search back for possible interlocks at companies that may have since been acquired or dissolved – pointing out that with the immediate family overlay to the rule, the latter inquiry could become extremely cumbersome.

Several financial institutions (along with several smaller companies) took issue with the blanket exclusion of family members for five years. One company argued that when a family member's relationship has terminated, there should be independence. Another commentator recommended that relatives of deceased or disabled former officers be classified as independent as long as they themselves have no financial involvement other than ownership in the company.

The Exchange has clarified several of these issues with specified provisions in subsection 2(b) of Section 303A.

<u>Non-Management Executive Sessions</u>

The great majority of the commentators objected to the executive session requirement, to the requirement to designate and disclose a presiding director for such sessions, or to both. They argued that the sessions (a) were unnecessary because the mandated audit, compensation and nominating committees would provide sufficient checks; (b) would bifurcate the board into two tiers, turning management directors into second-class directors; and (c) would deprive directors of guidance by management. In addition, they argued that mandating such sessions could result in mechanical, pro forma meetings.

The majority of commentators argued that the presiding director requirement would have a divisive effect. In addition, they argued that the requirement would deprive the board of needed flexibility; they would like the NYSE to allow any independent director to preside over a given executive session. Some commentators also complained that the presiding director requirement amounts to the NYSE's mandating separation of the roles of Chairman and CEO. (Conversely, one non-U.S. company urged the NYSE to require the designation of a "lead director", or to mandate separation of these roles.) One organization suggested that the NYSE should instead require that the corporate governance guidelines specify procedures for the selection of a chair for each executive session. Even commentators who did not vigorously object to the recommendation that a presiding director be designated objected to the requirement that such designation be publicly disclosed.

The Exchange has clarified in subsection 3 of Section 303A that no designation of a "lead director" is intended, and that companies have some flexibility in how they provide for conduct of the executive sessions.

General Comments on the Committee Requirements

More than half of all commentators thought that boards should have the flexibility to divide responsibilities among committees differently than as contemplated in the Report. In addition, a number of commentators were concerned that the recommendations have a tendency to blur the line between the roles of the board and management, involving the board too deeply in the day-to-day operations of listed companies.

A substantial number of commentators argued that the board as a whole should be allowed to retain its major oversight responsibilities, such as decisions on nominating director candidates, adopting governance guidelines, adopting incentive plans, and hiring outside consultants.

One company suggested that, as with the majority-independent director requirement, there should be a 24-month transition period for the requirements that audit, compensation and nominating committees be comprised entirely of independent directors.

The Exchange has clarified in subsection 4 of Section 303A that the nomination/corporate governance and compensation committee responsibilities may be allocated to other or different committees, as long as they have published charters.

Independent Nomination/Corporate Governance Committee

Approximately one-fifth of the commenting companies thought that nominating committees should not have to consist solely of independent directors, some arguing that a majority of non-management directors would be sufficient, some requesting that at least one insider be allowed on the nominating committee. Some commentators suggested that a nominating committee is not necessary.

Independent Compensation Committee

There was opposition to this recommendation from several companies. One company argued that the full board should set the salary of the CEO. Similarly, several commentators commented that although the procedure for determining CEO compensation could originate from the compensation committee, the results of the compensation committee's work should be presented to the entire board, with ultimate decision-making responsibility residing in the board as a whole. Another company objected to the committee's exclusive role in evaluation of CEO and senior executive compensation on the ground that management should be free to explore new compensation arrangements with consultants.

Audit Committee Member Qualification

There was a broad call from attorneys, associations and companies alike for clarification on the question of what constitutes "directors' fees." Questions arose in particular with respect to pension and other deferred compensation, long-term incentive awards, and compensation in the form of company products, use of company facilities and participation in plans available generally to the listed company's employees.

Several companies and law firms objected to the recommendation that audit committee members' fees be limited solely to directors' fees, arguing that this would reduce a company's access to its directors' expertise and suggesting instead a more liberal restriction, such as an annual cap on consulting fees.

The Exchange has clarified this issue in commentary to subsection 6 of Section 303A.

Though one institutional investor specifically applauded the 20% ownership ceiling for voting participation in the audit committee, approximately ten commentators objected on the ground that this would disqualify certain types of large shareholders, such as venture capital investors, who may be excellent audit committee members.

The requirement that the chair of the audit committee have accounting or related financial management expertise drew opposition from a number of commentators who felt that it was enough for one member of the committee to have such expertise. Several companies protested that the requirement unduly limits the number of candidates available to chair the audit committee and unnecessarily dictates which member should be chair.

As noted, the Exchange did not make proposals in these two areas in view of provisions in the recently adopted Sarbanes-Oxley legislation.

<u>Audit Committee Charter</u>

The majority of commentators were concerned about the capacity of the audit committee to handle the list of responsibilities assigned to it by the recommendation. There were also numerous requests for clarification as to whether the recommendation mandates review of all 10-Qs, press releases, and disclosures to analysts on a case-by-case basis, or whether the audit committee's task is rather to set policy with regard to the form of the financials in those releases. Commentators emphasized that the former alternative would be overly burdensome to the audit committee, would tie management's hands to the point where it would not be able to respond to analyst calls without first obtaining approval from the audit committee and would ultimately chill the distribution of information to the public.

The Exchange has clarified this issue in its commentary to subsection 7(b)(ii)(D) of Section 303A.

About a quarter of the commentators objected to the recommendation that sole authority to retain and terminate independent auditors be granted to the audit committee, suggesting that the entire board should be able to act on the recommendation of the audit committee and arguing that this would not pose any governance problems in light of the majority-independence requirement.

Some commentators rejected wholesale the committee's enumeration of minimum duties and responsibilities for the audit committee, arguing, for example, that the board should have the flexibility to allocate responsibility for the oversight of compliance with legal and regulatory requirements as it deems appropriate, and that the audit committee should not be obligated to assist board oversight of such compliance. Several commentators objected to the recommendation's requirement that the audit committee discuss policies with respect to risk assessment and management. For example, one company has a risk committee devoted solely to this purpose and would like the requirement to accommodate such arrangements.

The Exchange has clarified this issue in commentary to subsection 7(b)(ii)(F) of Section 303A.

Some commentators requested that the audit committee be allowed to delegate to a member or subcommittee some of the proposed responsibilities, particularly the review of guidance given to analysts and earnings releases, on the ground that without such delegation the roster of duties was too burdensome.

A few commentators pointed out that it was unclear whether and to what extent there would be an internal audit requirement.

The Exchange has clarified this matter in subsection 7(c) of Section 303A.

<u>Shareholder Vote on Equity Compensation Plans</u>

This recommendation received particular support from the institutional investor community. They urged the NYSE Board not to dilute either the shareholder vote requirement or the broker vote prohibition. However, numerous constituents expressed concerns about both recommendations.

A. Shareholder Approval

More than half of the larger companies, financial institutions and associations that commented on this issue maintained that only plans that offer options to officers and/or directors should be subject to shareholder approval. Many companies argued that subjecting broad-based equity compensation plans to the shareholder approval requirement would lessen their ability to compensate rank-and-file employees with stock options, putting NYSE-listed companies at a competitive disadvantage in the labor market. They urged that the board should be able to adopt stock option plans for non-executive employees without shareholder approval; some suggested instead a requirement that all plans be approved by an independent compensation committee.

Some commentators advocated exceptions for inducement awards or new hire grants (citing competitive employment markets) and tax-qualified plan awards (citing the alternative regulatory framework provided by the tax code), subject perhaps to approval by the independent compensation committee. One company suggested that there should be an exemption for situations where full-value stock is used to deliver an award that would otherwise be paid in cash. Another company noted that some plans are part of collective bargaining arrangements and urged that these be excluded from the shareholder approval requirement.

In addition, there were a number of detailed questions regarding plans approved prior to effectiveness of the new rules, amendments to plans, and plans run by an acquired company.

The Exchange has clarified that inducement options, plans acquired in mergers, and tax qualified plans would be exempt, but all other plans would require shareholder approval.

B. Elimination of Broker Voting

The institutional investor community gave strong support to this proposal. Many large companies, however, strongly urged the NYSE to maintain its existing rules, fearing primarily the increased proxy costs and increased uncertainty that the proposed change would entail. Large and small companies alike cited quorum difficulties and solicitation expenses that result when brokers are not allowed to vote uninstructed shares after a 10-day period. One such commentator warned that because of retail investor confusion about voting mechanics, there is a risk that the elimination of the discretionary broker vote will disenfranchise investors if not accompanied by an aggressive and vigorous program to educate them about how to vote their shares. Many commentators also expressed concern that institutional shareholders may simply vote their shares in accordance with strict internal or third-party guidelines or policies, rather than giving each plan individual consideration. One organization suggested proportional or mirror voting by brokers of uninstructed shares.

Required Adoption and Disclosure of Corporate Governance Guidelines

A number of commentators argued that companies should have broader discretion in drafting their governance guidelines.

Required Adoption and Disclosure of a Code of Business Conduct and Ethics

Many of those who commented on this recommendation urged that only material waivers of the business ethics policy be required to be disclosed.

Disclosure by Foreign Private Issuers

Two commentators urged tougher treatment of foreign companies, with one suggesting that exemptions from listing requirements for foreign private issuers should be the exception rather than the rule.

CEO Certification

More than half of the commenting companies and organizations opposed this recommendation. The overwhelming majority of comments protested that the requirement would duplicate the recent SEC rules requiring CEO certification for periodic reports. They opposed the expansion of the certification requirement to all statements made by the company to investors and urged the NYSE to defer final action on this subject until the SEC issues a final rule, or to coordinate its action on this issue with the SEC, so as to avoid different standards by different regulatory bodies. Some commentators suggested language enabling the CEO to rely on the CFO, external auditors, internal auditors, the audit committee, inside and outside counsel and other consultants in making his certification.

A few commentators expressed concern that the recommendation raised potential for pernicious private litigation and urged the NYSE to make clear that the certification requirement, if adopted, creates no private cause of action.

The Exchange has decided not to require its own CEO certification of financials in light of the certifications required by the Sarbanes-Oxley legislation and SEC rules.

Public Reprimand Letter from NYSE

Several companies stressed the importance of providing offenders with due process through notice and an opportunity to cure prior to any public reprimand.

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Text of the Proposed Rule Change
(All language is new)

Listed Company Manual

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303.00 Corporate Governance Standards

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303A

1. Listed companies must have a majority of independent directors.

Commentary: Effective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest.

A company of which more than 50% of the voting power is held by an individual, a group or another company need not have a majority of independent directors on its board or have nominating/corporate governance and compensation committees composed of independent directors. A controlled company that chooses to take advantage of this exemption must disclose in its annual meeting proxy that it is a controlled company and the basis for that determination. However, all controlled companies must have at least a minimum three person audit committee composed entirely of independent directors, and otherwise comply with the audit committee requirements provided for in this Section 303A.

2. In order to tighten the definition of "independent director" for purposes of these standards:

(a) No director qualifies as "independent" unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). Companies must disclose these determinations.

Commentary: It is not possible to anticipate, or explicitly to provide for, all circumstances that might signal potential conflicts of interest, or that might bear on the materiality of a director's relationship to a listed company. Accordingly, it is best that boards making "independence" determinations broadly consider all relevant facts and circumstances. In particular, when assessing the materiality of a director's relationship with the company, the board should consider the issue not merely from the standpoint of the director, but also from that of persons or organizations with which the director has an affiliation. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships (among others). However, as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding.

The basis for a board determination that a relationship is not material must be disclosed in the company's annual proxy statement. In this regard, a board may adopt and disclose categorical standards to assist it in making determinations of independence and may make a general disclosure if a director meets these standards. Any determination of independence for a director who does not meet these standards must be specifically explained. For example, a board might disclose its determination that affiliation with a customer whose business accounts for less than a specified percentage of the company's revenues is, as a category, immaterial for purposes of determining independence. A company must disclose any standard it adopts. It may then make the general statement that the independent directors meet the standards set by the board without detailing particular aspects of the immaterial relationships between individual directors and the company. In the event that a director with a business or other relationship that does not fit within the disclosed standards is determined to be independent, a board must disclose the basis for its determination. This approach provides investors with an adequate means of assessing the quality of a board's independence and its independence determinations while avoiding excessive disclosure of immaterial relationships.

(b) In addition:

(i) No director who is a former employee of the listed company can be "independent" until five years after the employment has ended.

Commentary: A director who serves as an interim Chairman or CEO may be excluded from the definition of a "former employee" and thus be deemed independent immediately after his or her service as interim Chairman or CEO ends.

(ii) No director who is, or in the past five years has been, affiliated with or employed by a (present or former) auditor of the company (or of an affiliate) can be "independent" until five years after the end of either the affiliation or the auditing relationship.

(iii) No director can be "independent" if he or she is, or in the past five years has been, part of an interlocking directorate in which an executive officer of the listed company serves on the compensation committee of another company that concurrently employs the director.

(iv) Directors with immediate family members in the foregoing categories are likewise subject to the five-year "cooling-off" provisions for purposes of determining "independence."

Commentary: Employment of a family member in a non-officer position does not preclude a board from determining that a director is independent. Such employment arrangements are common and do not present a categorical threat to director independence. In addition, if an executive officer dies or becomes incapacitated, his or her immediate family members may be classified as independent immediately after such death or determination of incapacity, provided that they themselves are otherwise independent. An "immediate family member" includes a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than employees) who shares such person's home.

3. To empower non-management directors to serve as a more effective check on management, the non-management directors of each company must meet at regularly scheduled executive sessions without management.

<u>*Commentary:*</u> To promote open discussion among the non-management directors, companies must schedule regular executive sessions in which those directors meet without management participation. ("Non-management" directors are all those who are not company officers, and includes such directors who are not independent by virtue of a material relationship, former status or family membership, or for any other reason.) Regular scheduling of such meetings is important not only to foster better communication among non-management directors, but also to prevent any negative inference from attaching to the calling of executive sessions. There need not be a single presiding director at all executive sessions of the non-management directors. If one director is chosen to preside at these meetings, his or her name must be disclosed in the annual proxy statement. Alternatively, a company may disclose the procedure by which a presiding director is selected for each executive session. For example, a company may wish to rotate the presiding position among the chairs of board committees. In order that interested parties may be able to make their concerns known to the non-management directors, a company must disclose a method for such parties to communicate directly with the presiding director or with the non-management directors as a group.

4. (a) Listed companies must have a nominating/corporate governance committee composed entirely of independent directors.

(b) The nominating/corporate governance committee must have a written charter that addresses:

(i) the committee's purpose – which, at minimum, must be to: identify individuals qualified to become board members, and to select, or to recommend that the board select, the director nominees for the next annual meeting of shareholders; and develop and recommend to the board a set of corporate governance principles applicable to the corporation.

(ii) the committee's goals and responsibilities – which must reflect, at minimum, the board's criteria for selecting new directors, and oversight of the evaluation of the board and management.

(iii) an annual performance evaluation of the committee.

<u>*Commentary:*</u> A nominating/corporate governance committee is central to the effective functioning of the board. New director and board committee nominations are among a board's most important functions. Placing this responsibility in the hands of an independent nominating/corporate governance committee can enhance the independence and quality of nominees. The committee is also responsible for taking a leadership role in shaping the corporate governance of a corporation.

If a company is legally required by contract or otherwise to provide third parties with the ability to nominate directors (for example, preferred stock rights to elect directors upon a dividend default, shareholder agreements, and management agreements), the selection and nomination of such directors need not be subject to the nominating committee process.

The nominating/corporate governance committee charter should also address the following items: committee member qualifications; committee member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board. In addition, the charter should give the nominating/corporate governance committee sole authority to retain and terminate any search firm to be used to identify director candidates, including sole authority to approve the search firm's fees and other retention terms.

Boards may allocate the responsibilities of the nominating/corporate governance committee, and the compensation committee described in subsection 5 hereof to committees of their own denomination, provided that the committees are composed entirely of independent directors. Any such committee must have a published committee charter. To avoid any confusion, the functions specified in subsection 7 hereof as belonging to the audit committee may not be allocated to a different committee.

As noted in subsection 1 of this Section 303A, controlled companies need not comply with the requirements of this subsection 4.

5. (a) Listed companies must have a compensation committee composed entirely of independent directors.

(b) The compensation committee must have a written charter that addresses:

(i) the committee's purpose – which, at minimum, must be to discharge the board's responsibilities relating to compensation of the company's executives, and to produce an annual report on executive compensation for inclusion in the company's proxy statement, in accordance with applicable rules and regulations.

(ii) the committee's duties and responsibilities – which, at minimum, must be to:

(A) review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives, and set the CEO's compensation level based on this evaluation.

(B) make recommendations to the board with respect to incentive-compensation plans and equity-based plans.

(iii) an annual performance evaluation of the compensation committee.

<u>Commentary:</u> In determining the long-term incentive component of CEO compensation, the committee should consider the company's performance and relative shareholder return, the value of similar incentive awards to CEOs at comparable companies, and the awards given to the listed company's CEO in past years. To avoid confusion, note that the compensation committee is not precluded from approving awards (with the ratification of the board) as may be required to comply with applicable tax laws (i.e., Rule 162(m)).

The compensation committee charter should also address the following items: committee member qualifications; committee member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board.

Additionally, if a compensation consultant is to assist in the evaluation of director, CEO or senior executive compensation, the compensation committee charter should give that committee sole authority to retain and terminate the consulting firm, including sole authority to approve the firm's fees and other retention terms.

As noted in subsection 1 of this Section 303A, controlled companies need not comply with the requirements of this subsection 5.

6. Add to the "independence" requirement for audit committee membership the requirement that director's fees are the only compensation an audit committee member may receive from the company.

Commentary: The Exchange will continue to require each company to have a minimum three person audit committee composed entirely of independent directors. Each member of the committee must be financially literate, as such qualification is interpreted by the company's board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee. In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the company's board interprets such qualification in its business judgment.

While it is not the audit committee's responsibility to certify the company's financial statements or to guarantee the auditor's report, the committee stands at the crucial intersection of management, independent auditors, internal auditors and the board of directors. The Exchange supports additional directors' fees to compensate audit committee members for the significant time and effort they expend to fulfill their duties as audit committee members, but does not believe that any member of the audit committee should receive any compensation other than such director's fees from the company. If a director satisfies the definition of "independent director" (as provided in subsection 2 of this Section 303A), then his or her receipt of a pension or other form of deferred compensation from the company for prior service (provided such compensation is not contingent in any way on continued service) will not preclude him or her from satisfying the requirement that director's fees are the only form of compensation he or she receives from the company.

An audit committee member may receive his or her fee in cash and/or company stock or options or other in-kind consideration ordinarily available to directors, as well as all of the regular benefits that other directors receive. Because of the significantly greater time commitment of audit committee members, they may receive reasonable compensation greater than that paid to the other directors (as may other directors for other time-consuming committee work). Disallowed compensation for an audit committee member includes fees paid directly or indirectly for services as a consultant or a legal or financial advisor, regardless of the amount. Disallowed compensation also includes compensation paid to such a director's firm for such consulting or advisory services even if the director is not the actual service provider. Disallowed compensation is not intended to include ordinary compensation paid in another customer or supplier or other business relationship that the board has already determined to be immaterial for purposes of its basic director independence analysis. To eliminate any confusion, note that this requirement pertains only to audit committee qualification and not to the independence determinations that the board must make for other directors.

Because of the audit committee's demanding role and responsibilities, and the time commitment attendant to committee membership, each prospective audit committee member should evaluate carefully the existing demands on his or her time before accepting this important assignment. Additionally, if an audit committee member simultaneously serves on the audit committee of more than three public companies, and the NYSE-listed company does not limit the number of audit committees on which its audit committee members serve, then in each case, the board must determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee and disclose such determination in the annual proxy statement.

7. (a) Increase the authority and responsibilities of the audit committee, including granting it the sole authority to hire and fire independent auditors, and to approve any significant non-audit relationship with the independent auditors.

(b) The audit committee must have a written charter that addresses:

(i) the committee's purpose – which, at minimum, must be to:

(A) assist board oversight of (1) the integrity of the company's financial statements, (2) the company's compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence, and (4) the performance of the company's internal audit function and independent auditors; and

(B) prepare the report that SEC rules require be included in the company's annual proxy statement.

(ii) the duties and responsibilities of the audit committee – which, at minimum, must be to:

(A) retain and terminate the company's independent auditors (subject, if applicable, to shareholder ratification).

<u>Commentary:</u> In connection with this requirement, the audit committee must have the sole authority to approve all audit engagement fees and terms, as well as all significant non-audit engagements with the independent auditors. This requirement does not preclude the committee from obtaining the input of management, but these responsibilities may not be delegated to management.

(B) at least annually, obtain and review a report by the independent auditor describing: the firm's internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor's independence) all relationships between the independent auditor and the company.

<u>Commentary:</u> After reviewing the foregoing report and the independent auditor's work throughout the year, the audit committee will be in a position to evaluate the auditor's qualifications, performance and independence. This evaluation should include the review and evaluation of the lead partner of the independent auditor. In making its evaluation, the audit

committee should take into account the opinions of management and the company's internal auditors (or other personnel responsible for the internal audit function). In addition to assuring the regular rotation of the lead audit partner as required by law, the audit committee should further consider whether, in order to assure continuing auditor independence, there should be regular rotation of the audit firm itself. The audit committee should present its conclusions with respect to the independent auditor to the full board.

(C) discuss the annual audited financial statements and quarterly financial statements with management and the independent auditor, including the company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations."

(D) discuss earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies.

Commentary: The audit committee's responsibility to discuss earnings releases as well as financial information and earnings guidance may be done generally (i.e., discussion of the types of information to be disclosed and the type of presentation to be made). The audit committee need not discuss in advance each earnings release or each instance in which a company may provide earnings guidance.

(E) as appropriate, obtain advice and assistance from outside legal, accounting or other advisors.

Commentary: In the course of fulfilling its duties, the audit committee may wish to consult with independent advisors. The audit committee must be empowered to retain these advisors without seeking board approval.

(F) discuss policies with respect to risk assessment and risk management.

Commentary: While it is the job of the CEO and senior management to assess and manage the company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled. The audit committee should discuss the company's major financial risk exposures and the steps management has taken to monitor and control such exposures. The audit committee is not required to be the sole body responsible for risk assessment and management, but, as stated above, the committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken. Many companies, particularly financial companies, manage and assess their risk through mechanisms other than the audit committee. The processes these companies have in place should be reviewed in a general manner by the audit committee, but they need not be replaced by the audit committee.

(G) meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors.

Commentary: To perform its oversight functions most effectively, the audit committee must have the benefit of separate sessions with management, the independent auditors and those responsible for the internal audit function. As noted herein, all NYSE listed companies must have an internal audit function. These separate sessions may be more productive than joint sessions in surfacing issues warranting committee attention.

(H) review with the independent auditor any audit problems or difficulties and management's response.

Commentary: The audit committee must regularly review with the independent auditor any difficulties the auditor encountered in the course of the audit work, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management. Among the items the audit committee may want to review with the auditor are: any accounting adjustments that were noted or proposed by the auditor but were "passed" (as immaterial or otherwise); any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any "management" or "internal control" letter issued, or proposed to be issued, by the audit firm to the company. The review should also include discussion of the responsibilities, budget and staffing of the company's internal audit function.

(I) set clear hiring policies for employees or former employees of the independent auditors.

Commentary: Employees or former employees of the independent auditor are often valuable additions to corporate management. Such individuals' familiarity with the business, and personal rapport with the employees, may be attractive qualities when filling a key opening. However, the audit committee should set hiring policies taking into account the pressures that may exist for auditors consciously or subconsciously seeking a job with the company they audit.

(J) report regularly to the board of directors.

Commentary: The audit committee should review with the full board any issues that arise with respect to the quality or integrity of the company's financial statements, the company's compliance with legal or regulatory requirements, the performance and independence of the company's independent auditors, or the performance of the internal audit function.

(iii) an annual performance evaluation of the audit committee.

Commentary: While the fundamental responsibility for the company's financial statements and disclosures rests with management and the independent auditor, the audit committee must review: (A) major issues regarding accounting principles and financial statement presentations, including any significant changes in the company's selection or application of accounting principles, and major issues as to the adequacy of the company's internal controls and any special audit steps adopted in light of material control deficiencies; (B) analyses prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements; (C) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the company; and (D) earnings press releases (paying particular attention to any use of "pro forma," or "adjusted" non-GAAP, information), as well as financial information and earnings guidance provided to analysts and rating agencies.

(c) Each listed company must have an internal audit function.

Commentary: This requirement does not necessarily mean that a company must establish a separate internal audit department or dedicate employees to the task on a full-time basis; it is enough for a company to have in place an appropriate control process for reviewing and approving its internal transactions and accounting. A company may choose to outsource this function to a firm other than its independent auditor.

8. To increase shareholder control over equity-compensation plans, shareholders must be given the opportunity to vote on all equity-compensation plans, except inducement options, plans relating to mergers or acquisitions, and tax qualified and excess benefit plans.

Commentary: Equity-compensation plans can help align shareholder and management interests, and equity-based awards have become very important components of employee compensation. In order to provide checks and balances on the process of earmarking shares to be used for equity-based awards, and to provide shareholders a voice regarding the resulting dilution, the Exchange requires that all equity-compensation plans, and any material revisions to the terms of such plans (including the repricing of existing options), be subject to stockholder approval.

There are certain types of plans, however, which are appropriately exempt from this requirement. Employment inducement awards and option plans acquired in corporate acquisitions and mergers will not be subject to shareholder approval under this rule. The Exchange recognizes the urgency that may attach to the granting of options in the inducement or merger or acquisition context and the resulting impracticality of obtaining a shareholder vote in these situations. Because inducement awards and mergers or acquisitions are not routine occurrences, and are not likely to be abused, the Exchange does not consider that these exceptions alter the fundamental policy involved in this standard. Similarly, any plan intended to meet the requirements of Section 401(a) or 423 of the Internal Revenue Code, as amended (e.g., ESOPs) or the definition of an "excess benefit plan" within the meaning of Section 3(36) of the Employee Retirement Income Security Act is exempt from the shareholder approval requirement. Tax qualified equity purchase plans such as Section 401(a) plans and Section 423 plans are already regulated under internal revenue regulations which, in some cases, require shareholder approval. In the limited instances in which shareholder approval for these plans is not required, the transactions in which shares are acquired from and issued under the plans in question are either not dilutive to existing shareholders (i.e., the shares are not purchased at a discount to market price) or must be "expensed" (i.e., treated as a compensation expense). An excess benefit plan is a plan that is designed to work in parallel with a related qualified plan, to provide those benefits that exceed the limitation imposed by the Code on qualified plans.

In the circumstances in which equity compensation plans are not subject to shareholder approval, the plans must be subject to the approval of the company's compensation committee.

In addition, the Exchange will preclude its member organizations from giving a proxy to vote on equity-compensation plans unless the beneficial owner of the shares has given voting instructions. This is codified in NYSE Rule 452.

9. Listed companies must adopt and disclose corporate governance guidelines.

Commentary: No single set of guidelines would be appropriate for every company, but certain key areas of universal importance include director qualifications and responsibilities, responsibilities of key board committees, and director compensation. Given the importance of corporate governance, each listed company's website must include its corporate governance guidelines, the charters of its most important committees (including at least the audit, compensation and nominating committees) and the company's code of business conduct and ethics (see subsection 10 below). Each company's annual report must state that the foregoing information is available on its website, and that the information is available in print to any shareholder who requests it. Making this information publicly available should promote better investor understanding of the company's policies and procedures, as well as more conscientious adherence to them by directors and management.

The following subjects must be addressed in the corporate governance guidelines:

- **Director qualification standards.** These standards should, at minimum, reflect the independence requirements set forth in subsections 1 and 2 of this Section 303A. Companies may also address other substantive qualification requirements, including policies limiting the number of boards on which a director may sit, and director tenure, retirement and succession.

- **Director responsibilities.** These responsibilities should clearly articulate what is expected from a director, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.

- **Director access to management and, as necessary and appropriate, independent advisors.**

- **Director compensation.** Director compensation guidelines should include general principles for determining the form and amount of director compensation (and for reviewing those principles, as appropriate). The board should be aware that questions as to directors' independence may be raised when directors' fees and emoluments exceed what is customary. Similar concerns may be raised when the company makes substantial charitable contributions to organizations in which a director is affiliated, or enters into consulting contracts with (or provides other indirect forms of compensation to) a director. The board should critically evaluate each of these matters when determining the form and amount of director compensation, and the independence of a director.

- **Director orientation and continuing education.**

- **Management succession.** Succession planning should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO.

- **Annual performance evaluation of the board.** The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively.

10. Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.

Commentary: No code of business conduct and ethics can replace the thoughtful behavior of an ethical director, officer or employee. However, such a code can focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability.

Each code of business conduct and ethics must require that any waiver of the code for executive officers or directors may be made only by the board or a board committee and must be promptly disclosed to shareholders. This disclosure requirement should inhibit casual and perhaps questionable waivers, and should help assure that, when warranted, a waiver is accompanied by appropriate controls designed to protect the company. It will also give shareholders the opportunity to evaluate the board's performance in granting waivers.

Each code of business conduct and ethics must also contain compliance standards and procedures that will facilitate the effective operation of the code. These standards should ensure the prompt and consistent action against violations of the code.

Each company may determine its own policies, but all listed companies should address the most important topics, including the following:

- **Conflicts of interest.** A "conflict of interest" occurs when an individual's private interest interferes in any way – or even appears to interfere – with the interests of the corporation as a whole. A conflict situation can arise when an employee, officer or director takes actions or has interests that may make it difficult to perform his or her company work objectively and effectively. Conflicts of interest also arise when an employee, officer or director, or a member of his or her family, receives improper personal benefits as a result of his or her position in the company. Loans to, or guarantees of obligations of, such persons are of special concern. The company should have a policy prohibiting such conflicts of interest, and providing a means for employees, officers and directors to communicate potential conflicts to the company.

- **Corporate opportunities.** Employees, officers and directors should be prohibited from (a) taking for themselves personally opportunities that are discovered through the use of corporate property, information or position; (b) using corporate property, information, or position for personal gain; and (c) competing with the company. Employees, officers and directors owe a duty to the company to advance its legitimate interests when the opportunity to do so arises.

- **Confidentiality.** Employees, officers and directors should maintain the confidentiality of information entrusted to them by the company or its customers, except when disclosure is authorized or legally mandated. Confidential information includes all non-public information that might be of use to competitors, or harmful to the company or its customers, if disclosed.

- **Fair dealing.** Each employee, officer and director should endeavor to deal fairly with the company's customers, suppliers, competitors and employees. None should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair-dealing practice.

- **Protection and proper use of company assets.** All employees, officers and directors should protect the company's assets and ensure their efficient use. Theft, carelessness and waste have a direct impact on the company's profitability. All company assets should be used for legitimate business purposes.

- **Compliance with laws, rules and regulations (including insider trading laws).** The company should proactively promote compliance with laws, rules and regulations, including insider trading laws. Insider trading is both unethical and illegal, and should be dealt with decisively.

- **Encouraging the reporting of any illegal or unethical behavior.** The company should proactively promote ethical behavior. The company should encourage employees to talk to supervisors, managers or other appropriate personnel when in doubt about the best course of action in a particular situation. Additionally, employees should report violations of laws, rules, regulations or the code of business conduct to appropriate personnel. To encourage employees to report such violations, the company must ensure that employees know that the company will not allow retaliation for reports made in good faith.

11. Listed foreign private issuers must disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards.

Commentary: Both SEC rules and NYSE policies have long recognized that foreign private issuers differ from domestic companies in the regulatory and disclosure regimes and customs they follow, and that it is appropriate to accommodate those differences. For this reason, the NYSE for many years has permitted listed non-U.S. companies to follow home-country practices with respect to a number of corporate governance matters, such as the audit committee requirement and the NYSE shareholder approval and voting rights rules. While the NYSE will continue to respect different approaches, listed foreign private issuers must make their U.S. investors aware of the significant ways in which their home-country practices differ from those followed by domestic companies under NYSE listing standards. However, listed foreign private issuers are not required to present a detailed, item-by-item analysis of these differences. Such a disclosure would be long and unnecessarily complicated. Moreover, this requirement is not intended to suggest that one country's corporate governance practices are better or more effective than another. The Exchange simply believes that U.S. shareholders should be aware of the significant ways that the governance of a listed foreign private issuer differs from that of a U.S. listed company. The Exchange underscores that what is required is a brief, general summary of the significant differences, not a cumbersome analysis.

Listed foreign private issuers may provide this disclosure either on their web site (provided it is in the English language and accessible from the U.S.) and/or in their annual report as distributed to shareholders in the U.S. (again, in the English language). If the disclosure is only made available on the web site, the annual report shall so state and provide the web address at which the information may be obtained.

12. Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards.

Commentary: The CEO's annual certification to the NYSE that he or she is unaware of any violation by the company of NYSE corporate governance listing standards will focus the CEO and senior management on the company's compliance with the listing standards. Both this certification to the NYSE, and any CEO/CFO certifications required to be filed with the SEC regarding the quality of the company's public disclosure, must be disclosed in the listed company's annual report to shareholders.

13. The NYSE may issue a public reprimand letter to any listed company that violates an NYSE listing standard.

Commentary: Suspending trading in or delisting a company can be harmful to the very shareholders that the NYSE listing standards seek to protect; the NYSE must therefore use these measures sparingly and judiciously. For this reason it is appropriate for the NYSE to have the ability to apply a lesser sanction to deter companies from violating its corporate governance (or other) listing standards. Accordingly, the NYSE may issue a public reprimand letter to a company that it determines has violated an NYSE listing standard. For companies that repeatedly or flagrantly violate NYSE listing standards, suspension and delisting remain the ultimate penalties. For clarification, this lesser sanction is not intended for use in the case of companies that fall below the financial and other continued listing standards provided in Chapter 8 of the Listed Company Manual. The processes and procedures provided for in Chapter 8 will continue to govern the treatment of companies falling below those standards.

Exhibit A-2

Text of the Proposed Rule Change
(New language is underscored, deletions are [bracketed])

Listed Company Manual

* * * *

301.00 Introduction

* * * *

This section describes the Exchange's policies and requirements with respect to independent [audit committees] directors, [ownership interests of corporate directors and officers,] shareholders' voting rights, and other matters affecting [shareholders' ownership interests and the maintenance of fair and orderly markets in listed securities] corporate governance.

When used in this Section 3, "officer" shall have the meaning specified in Rule 16a-1(f) under the Securities Exchange Act of 1934, or any successor rule.

303.00 Corporate Governance Standards

Pending the implementation of the new corporate governance standards set forth in Section 303A infra, in accordance with the transition provisions adopted by the Exchange, the standards contained in this Section 303.00 will continue to apply.

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312.00 Shareholder Approval Policy

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312.03 Shareholder Approval

Shareholder approval is a prequisite to listing in [four] three situations:

(a) This section is reserved. New provisions regarding shareholder approval of equity compensation plans are now contained in subsection 8 of Section 303A. [Shareholder approval is required with respect to a stock option or purchase plan, or any other arrangement, pursuant to which officers or directors may acquire stock (collectively, a "Plan") except:

(1) for warrants or rights issued generally to security holders of the company;
(2) pursuant to a broadly-based Plan;

(3) where options or shares are to be issued to a person not previously employed by the company, as a material inducement to such person's entering into an employment contract with the company; or

(4) pursuant to a Plan that provides that (i) no single officer or director may acquire under the Plan more than one percent of the shares of the issuer's common stock outstanding at the time the Plan is adopted, and (ii) together with all Plans of the issuer (other than Plans for which shareholder approval is not required under subsections (1) to (3) above), does not authorize the issuance of more than five percent of the issuer's common stock outstanding at the time the Plan is adopted.]

Exhibit A-3

Text of the Proposed Rule Change
(New language is underscored, deletions are [bracketed])

NYSE Constitution and Rules

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Rule 452
Giving Proxies by Member Organization

A member organization shall give or authorize the giving of a proxy for stock registered in its name, or in the name of its nominee, at the direction of the beneficial owner. If the stock is not in the control or possession of the member organization, satisfactory proof of the beneficial ownership as of the record date may be required.

* * * *

Supplementary Material:

Giving a Proxy To Vote Stock

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.11 When member organization may not vote without customer instructions. In the list of meetings of stockholders appearing in the Weekly Bulletin, after proxy material has been reviewed by the Exchange, each meeting will be designated by an appropriate symbol to indicate either (a) that members may vote a proxy without instructions of beneficial owners, (b) that members may not vote specific matters on the proxy, or (c) that members may not vote the entire proxy.

Generally speaking, a member organization may not give a proxy to vote without instructions from beneficial owners when the matter to be voted upon:

* * * *

(12) [authorizes issuance of stock, or options to purchase stock, to directors, officers, or employees in an amount which exceeds 5% of the total amount of the class outstanding] authorizes the implementation of any equity compensation plan, or any material revision to the terms of any existing equity compensation plan (whether or not stockholder approval of such plan is required by subsection 8 of Section 303A of the Exchange's Listed Company Manual);

* * * *