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ONE HUNDRED EIGHTH CONGRESS

**U.S. House of Representatives**  
**Committee on Energy and Commerce**  
**Washington, DC 20515-6115**

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May 12, 2004

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The Honorable William H. Donaldson  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Dear Chairman Donaldson:

I am writing with respect to the April 8, 2004 report, Securities Markets: Opportunities Exist to Enhance Investor Confidence and Improve Listing Program Oversight, GAO-04-75, which was prepared by the U.S. General Accounting Office (GAO) at my request and that of Reps. Barney Frank and Paul E. Kanjorski. The initial request predated the 2001 terrorist attacks but was expanded to respond to the critical investor-protection issues raised in the wake of that terrible event as well as the collapse of several major U.S. corporations as a result of accounting debacles and major corporate governance failures.

The resulting 117-page GAO report that was released yesterday provides updated information on (1) the actions of the three largest U.S. securities markets -- the American Stock Exchange (Amex), the Nasdaq Stock Market, Inc. (NASDAQ), and the New York Stock Exchange (NYSE) -- to address recommendations from the Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE) for improving their market's equity listing programs, (2) the extent to which OCIE uses self-regulatory organization SRO internal review reports in its inspection process, (3) SEC's oversight of NASDAQ's moratorium on the enforcement of certain of its listing standards, and (4) actions the SROs have taken to strengthen corporate governance for their issuers and themselves. The report includes 12 recommendations, with which the SEC expressed general agreement (SEC comment letter, pp. 101-103), while the SROs expressed concerns, and in some cases opposition, to those relating to notifying the public of noncompliance with listing standards and to enhancing board independence by requiring a super majority of independent directors and separating the positions of chief executive officer and board chairman (SRO comment letters, pp. 104-117).

Ranking Member Frank of the Committee on Financial Services and Ranking Member Kanjorski of its Capital Markets Subcommittee, which now have jurisdiction over these issues, have indicated that they will follow up on selected portions of the report in the near future. My comments on the report are as follows:

1. GAO notes at page 66 that: "Investors need timely and ongoing information on the listing status of issuers for use in making investment decisions. In the absence of such information, they might logically assume that all issuers comply with the listing standards of their markets." I wholeheartedly agree. GAO has determined that: "In the absence of voluntary action by the SROs, further SEC action is warranted to ensure that the public receives early and ongoing notice of an issuer's noncompliance with its market's listing standards." (p.67) I agree and believe that the SEC should commit to a firm time frame for such action.

2. GAO found that "SEC acted within its authority and followed its applicable regulations" with respect to the enforcement moratorium on NASDAQ's continued listing standards for bid-price and market value of publicly-held shares as well as subsequent changes, and that the rules "met their objective of allowing noncompliant issuers more time to trade." (p. 67) At page 40, GAO reports, however: "In its approval order, SEC said that the length of the extended compliance periods under the new rule raises investor protection concerns. According to SEC, if a listing standard is suspended for too long, the standard is not transparent and the investor protection principles underlying the premise of listing standards would be compromised." I am troubled by the implication of these observations and believe that this area deserves careful attention. In that regard, GAO issues this warning on page 67: "2 years is a long time to allow a noncompliant issuer to continue trading in the absence of a means of providing the public early and ongoing notification of the issuer's listing status." I agree with this observation and urge continued efforts to reach a viable solution whether through implementation of modifiers, indicators, or another solution. The recently adopted amendments requiring issuers to file a Form 8-K within 4 days of being notified by the SRO of their noncompliance with either a quantitative or qualitative listing standard is a huge step in the right direction.

3. GAO found that OCIE does not routinely use SROs' internal review reports in planning and conducting inspections and that this is inconsistent with the standards of organizations with functions similar to OCIE (p. 28). The Government Auditing Standards, also called the Yellow Book, recommend the use of internal review reports in conducting performance and other types of review (pp. 29-30). Both the SEC (p. 102) and NYSE (pp. 115-116) comment letters argue, among other things, that the routine use of these reports would have a "chilling effect" on the flow of information between SRO internal review staff and other SRO employees. I disagree. These reports, if well done, are a useful source of "red flags." I strongly agree with GAO's observation that: "these reports could aid OCIE in determining the

objectives and scope of inspections designed to assess the SROs' effectiveness in fulfilling their oversight responsibilities." (p. 67) This is particularly true if both the SEC and the SROs are missing the seeds of the same debacles.

4. The GAO report discusses in some detail the Congressional, SEC, and SRO efforts over the past three years to strengthen corporate governance, and I commend the SEC and SROs for completed and ongoing actions in that regard. One area of concern remains the ability of directors to provide active and independent oversight of management. This will remain an ongoing and difficult balancing act. But the SEC's primary mandate is and must remain the protection of investors. More remains to be done.

First, GAO recommends that the SEC work with the SROs to further enhance board independence by giving serious consideration to requiring issuers, through listing standards, to establish a super majority of independent directors and to separate the positions of CEO and chairman. The GAO report states at page 74:

As SEC has noted, and we agree, with a super majority of independent directors and an independent board chairman, independent directors will set the board agenda as well as have the power to control the outcome of board votes. Although the SEC and we recognize that such actions do not guarantee effective management, we both agree that greater board independence could promote board decision making that is aligned with shareholders' interests, thereby enhancing board accountability.

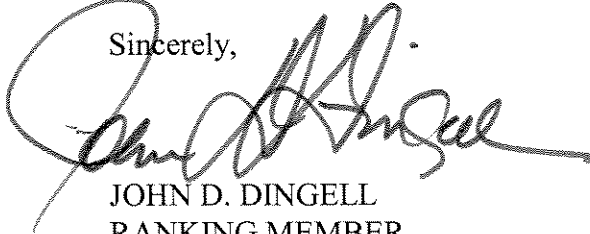
GAO acknowledges that "some issuers would not be in a position to immediately implement these best practices" (p. 74) and NASDAQ notes that it might prove "unduly burdensome" for smaller issuers (p. 110). I encourage the SEC and SROs to continue a dialogue with corporate America and shareholders as to how to achieve the best possible model of corporate accountability, along with a requirement that issuer's disclose annually any deviations from that model and the reasons therefore.

Second, GAO notes that "[f]or at least 60 years, shareholders have sought greater access to the issuer's proxy as a means of replacing ineffective or unresponsive directors and improving board accountability," and discusses the SEC's proposed rulemaking in this area. The proposed rule includes triggers that, when activated, require disclosure in an issuer's proxy materials of director nominees made by long-term shareholders or groups of long-term shareholders, with significant holdings. I commend the SEC for this courageous and appropriate action. It is long overdue. However, recent press reports, e.g., "SEC Feels Pressure To Weaken Some Rules," New York Times, Monday, May 10, 2004, at C1, indicate that your agency "has come under intense pressure from business and some members of the Bush administration to water down proposed rules." If true, this is wrong. They should be working with you and investors, not against you. I strongly agree with the views of the Council of Institutional Investors whose comment letter states: "We agree that the rule should be carefully crafted to protect against

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excesses and abuses. However, we urge the SEC to ensure that refinements to the proposal don't narrow the rule so significantly as to render it essentially meaningless or useless." I urge prompt adoption of the rule consistent with this touchstone.

I remain, and have been throughout my public career, a tireless advocate for investor protection, including the critical need for strong and vigilant SEC and SROs. While the Committee on Energy and Commerce no longer has a direct legislative role in these matters, I have a continuing interest in these issues and stand ready to support your endeavors. Thank you for your attention to my views and requests.

Sincerely,  
  
JOHN D. DINGELL  
RANKING MEMBER

Enclosure

cc: The Honorable David M. Walker, Comptroller General  
U.S. General Accounting Office

The Honorable Barney Frank, Ranking Member  
Committee on Financial Services

The Honorable Paul E. Kanjorski, Ranking Member  
Subcommittee on Capital Markets, Insurance,  
and Government Sponsored Enterprises  
Committee on Financial Services

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Previous GAO Reports on Listing Issues Requested by Rep. Dingell:

American Stock Exchange: More Changes Needed in Screening Emerging Companies for the Marketplace, GAO/GGD-94-72 (May 25, 1994).

Securities Regulation: Oversight of SROs' Listing Procedures Could Be Improved, GAO/GGD-98-45 (February 6, 1998).

Securities Regulation: Actions Taken to Improve Nasdaq Listing Procedures, GAO/GGD-99-53 (April 26, 1999).