

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49911; File No. SR-CHX-2003-19]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 to the Proposed Rule Change by the Chicago Stock Exchange, Inc. Relating to Governance of Issuers on the Exchange

June 24, 2004.

#### I. Introduction

On July 28, 2003, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange"), filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend certain provisions of its rules relating to the governance of issuers that list securities on the CHX. The proposed rule change was published for comment in the **Federal Register** on October 28, 2003.<sup>3</sup> On November 24, 2003, the Exchange filed Amendment No. 1 to the proposal.<sup>4</sup> On December 1, 2003, the Commission partially approved the proposal, granted accelerated approval to Amendment No. 1, and solicited comments from interested persons on Amendment No. 1.<sup>5</sup> Specifically, the Commission approved the portions of the proposed rule change that implemented the requirements of Rule 10A-3 under the Act relating to audit committees of listed issuers;<sup>6</sup> amended CHX's listing maintenance standards; and added a provision relating to complaint procedures of audit committees of investment companies. The Commission received no comments on the proposal and Amendment No. 1.

On April 8, 2004, the CHX filed Amendment No. 2 to the proposed rule change.<sup>7</sup> On June 21, 2004, the CHX filed Amendment No. 3 to the proposed

rule change.<sup>8</sup> In Amendment Nos. 2 and 3, the CHX proposed additional enhancements to the proposal and revisions to a number of its provisions that were not approved in the Partial Approval Order. The substantive changes to the proposal made by Amendment Nos. 2 and 3 are summarized below. This Order approves the proposed rule change in its entirety, as amended; grants accelerated approval to Amendment Nos. 2 and 3; and solicits comments from interested persons on Amendment Nos. 2 and 3.

#### II. Description of the Proposal

In addition to the provisions of the proposed rule change that were approved in the Partial Approval Order, including those implementing the requirements of Rule 10A-3 under the Act, the CHX proposes further enhancements to the governance of issuers that list securities on the Exchange, which are set forth in CHX Article XXVIII, Rules 19 and 21 (collectively, the "CHX Governance Standards"). Specifically, the CHX seeks to amend its Tier I and Tier II listing standards to enhance the Exchange's requirements relating to the roles and responsibilities of independent directors; expand its existing provisions and add new requirements relating to independent board committees (including audit committees, nominating committees and compensation committees); and require the adoption by each listed issuer of a code of ethics applicable to directors, officers, and employees.

The Exchange believes that in most respects the proposed changes are substantially similar to rule changes relating to governance standards adopted, with Commission approval, by the National Association of Securities Dealers, Inc. ("NASD") through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), and by the American Stock Exchange LLC ("Amex").<sup>9</sup> A few of the proposed changes mirror similar rule changes adopted, with Commission approval, by the NYSE.<sup>10</sup> Summarized below are the principal categories of

change to the CHX Governance Standards:

#### *Definition of "Independence"*

Several existing and proposed rules of the Exchange require that specified roles and responsibilities in the governance of listed issuers be assigned to independent directors. Existing CHX rule language defines "independent director" in a manner that generally precludes any relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The proposed rule change would add that the board has the responsibility to make an affirmative determination that no such relationship exists.<sup>11</sup> In addition, the proposed amendments would specifically identify six categories of persons who could not be considered independent.

In general, persons who would not be considered independent would include: (i) A director employed by the issuer or its parent or subsidiary during the previous three years; (ii) a director who accepted (or who has a immediate family member who accepted) any payments from the issuer in excess of \$60,000 during the current year or any of the past three fiscal years (other than compensation for board or board committee service, payments arising solely from investments in the issuer's securities, compensation paid to an immediate family member who is an employee but not an executive officer, benefits under a tax-qualified retirement plan, non-discretionary compensation, or loans permitted by Section 13(k) of the Act);<sup>12</sup> (iii) a director who is an immediate family member of an individual who is, or who served at any time during the previous three years, as an executive officer of the issuer or its parent or subsidiary; (iv) a director who is (or has an immediate family member who is) a partner, controlling shareholder, or executive officer in any organization that received payments from the issuer, or that made payments to the issuer, for property or services<sup>13</sup> exceeding 5% of the recipient's consolidated gross revenues for the year or \$200,000, whichever is greater;<sup>14</sup> (v) a director who is (or who has an immediate family member who is)

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 48669 (October 21, 2003), 68 FR 61500.

<sup>4</sup> See letter from Ellen J. Neely, Senior Vice President and General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated November 21, 2003 ("Amendment No. 1").

<sup>5</sup> Securities Exchange Act Release No. 48860 (December 1, 2003), 68 FR 68436 (December 8, 2003) ("Partial Approval Order").

<sup>6</sup> 17 CFR 240.10A-3.

<sup>7</sup> See letter from Ellen J. Neely, Senior Vice President and General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated April 7, 2004 ("Amendment No. 2").

<sup>8</sup> See letter from Ellen J. Neely, Senior Vice President and General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division, Commission, dated June 18, 2004 ("Amendment No. 3").

<sup>9</sup> See Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (approving changes to the corporate governance listing standards of Nasdaq and the New York Stock Exchange, Inc. ("NYSE")) and Securities Exchange Act Release No. 48863 (December 1, 2003), 68 FR 68432 (December 8, 2003) (approving changes to the corporate governance listing standards of the Amex).

<sup>10</sup> See Securities Exchange Act Release No. 48745, *supra*.

<sup>11</sup> See CHX Article XXVIII, proposed Rule 19(p)(3), as revised by Amendment No. 2.

<sup>12</sup> The exceptions for compensation for board committee service and for loans permitted by Section 13(k) were added by Amendment No. 2.

<sup>13</sup> See Amendment No. 2.

<sup>14</sup> The proposed rule would provide exceptions for payments arising solely from investments in the issuer's securities and, as revised by Amendment No. 2, for payments under non-discretionary charitable contribution matching programs.

employed as an executive officer of another entity, where, at any time<sup>15</sup> during the past three years, any of the executive officers of the issuer serve on the compensation committee of the other entity; and (vi) a director who is (or who has an immediate family member who is) a current partner of the issuer's outside auditor or who was a partner or employee of the issuer's outside auditor, who worked on the issuer's audit at any time during the past three years.<sup>16</sup> A separate CHX rule would apply to investment companies.<sup>17</sup> The proposed amendments would also define an immediate family member as a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and any person who has the same residence as the director in question.<sup>18</sup>

#### *Independent Board and Board Committees*

The proposed amendments would require most issuers to maintain a majority of independent directors on their boards, and small business issuers would be required to have boards consisting of at least 50% independent directors.<sup>19</sup> However, a controlled company would be exempt from these requirements.<sup>20</sup> Other temporary exceptions would apply where a single director ceases to be independent due to circumstances outside the person's reasonable control or where an issuer fails to meet the independence standard due to a single vacancy on the board.<sup>21</sup> The proposed rule would also require regularly convened executive sessions of the independent directors.<sup>22</sup>

<sup>15</sup> See Amendment No. 2.

<sup>16</sup> See Amendment No. 2.

<sup>17</sup> See CHX Article XXVIII, proposed Rule 19(p)(3)(G), which was added by Amendment No. 2. In the case of an investment company, in lieu of paragraphs (A)–(F) of proposed CHX Rule 19(p)(3), a director who is an "interested person" of the company, as defined in section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee, would not be considered independent under the proposed rule.

<sup>18</sup> See CHX Article XXVIII, proposed Rule 19(p)(2).

<sup>19</sup> See CHX Article XXVIII, proposed Rule 19(a).

<sup>20</sup> See CHX Article XXVIII, proposed Rule 19(a)(3)(A). Under the definition proposed in CHX Article XXVIII, Rule 19(p)(1), a "controlled company" would mean a company of which more than 50% of the voting power is held by an individual, group, or other company. See also *infra* notes 39–41 and accompanying text regarding other entities that would be exempt from these requirements.

<sup>21</sup> See CHX Article XXVIII, proposed Rule 19(a)(3)(B).

<sup>22</sup> A controlled company would be subject to this requirement. See Amendment No. 3.

Under the proposal, nomination of the issuer's directors would be determined, or recommended for board determination, by either a majority of independent directors or a nominating committee comprised solely of independent directors.<sup>23</sup> Furthermore, each issuer would be required to adopt a formal written charter or board resolution, as applicable, addressing the nominations process and any related matters as may be required under the federal securities laws.<sup>24</sup> The nominating process set forth in the rule would not need to be followed in cases where the right to nominate a director legally belongs to a third party.<sup>25</sup>

The proposal would also require that the compensation of the issuer's chief executive officer ("CEO") and other officers be determined or recommended to the board for determination by a majority of independent directors or by a compensation committee comprised solely of independent directors.<sup>26</sup> An issuer's CEO would not be permitted to be present during voting or deliberations regarding his or her own compensation.<sup>27</sup>

#### *Audit Committee Requirements*

The proposed amendments would expand existing CHX requirements

<sup>23</sup> See CHX Article XXVIII, proposed Rule 19(c). See Amendment No. 2, which added the phrase, "or recommended for board determination."

<sup>24</sup> See CHX Article XXVIII, proposed Rule 19(c)(2), which was added by Amendment No. 2.

<sup>25</sup> Controlled companies and certain other entities would be exempt from these requirements. See *infra* notes 39–41 and accompanying text. In addition, the rule would incorporate an exception that would permit certain persons to serve on the nominating committee if the issuer's board, under exceptional and limited circumstances, determines that a person's membership on the committee is required by the best interests of the company and its shareholders and the board discloses the nature of the relationship and the basis for its determination in the next annual meeting proxy statement or other applicable annual disclosure filed with the Commission following that determination. A nominating committee member appointed under these circumstances could not serve longer than two years, unless he or she ultimately satisfies the definition of an independent director. See CHX Article XXVIII, proposed Rule 19(c)(3).

<sup>26</sup> See CHX Article XXVIII, proposed Rule 19(d). See also Amendment No. 2, which added the phrase, "or recommended to the board for determination," and made other revisions. Controlled companies and certain other entities would be exempt from these requirements. See *infra* notes 39–41 and accompanying text. Also, a specific exception would exist to allow certain persons to serve on the compensation committee in exceptional and limited circumstances, similar to the exception regarding nominating committees discussed at *supra* note 25. See CHX Article XXVIII, proposed Rule 19(d)(3).

<sup>27</sup> See proposed CHX Article XXVIII, proposed Rule 19(d)(1), as revised by Amendment No. 2. The CEO would be permitted to participate in the deliberations relating to the compensation of other officers, but would not be allowed to vote. See CHX Article XXVIII, proposed Rules 19(d)(2).

relating to audit committee composition and would include new requirements relating to that committee's role and authority.<sup>28</sup> Under the proposal, each listed issuer would be required to establish and maintain an audit committee of at least three members (two members for small business issuers).

Each audit committee member would continue to be required to meet the requirements of Rule 10A–3, as set forth in provisions of the proposed rule change that were approved in the Partial Approval Order.<sup>29</sup> In addition, subject to limited exceptions, each member of an issuer's audit committee would be required: (i) To be an independent director as defined by the proposed new CHX provisions discussed above; (ii) not to have participated, at any time during the past three years, in the preparation of the financial statements of the issuer or any current subsidiary of the issuer; and (iii) to be able to read and understand fundamental financial statements, including a company's balance sheet, income statement and cash flow statement.<sup>30</sup> At least one member of the audit committee would be required to have accounting or related financial management expertise, as the issuer's board of directors interprets that qualification in its business judgment.<sup>31</sup>

The proposed amendment also would require each issuer's audit committee to certify that it has adopted a formal written charter that specifies certain minimum purposes, duties, and responsibilities of the committee, including those that are required by Rule 10A–3. Under the proposal, the audit committee would be required to review and reassess the written charter on an annual basis.<sup>32</sup>

Audit committees for investment companies additionally would be required to establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or

<sup>28</sup> See CHX Article XXVIII, proposed Rule 19(b). See *infra* notes 39–41 and accompanying text regarding the applicability to certain issuers of the proposed rules discussed in this section.

<sup>29</sup> See CHX Article XXVIII, proposed Rule 19(b)(1).

<sup>30</sup> *Id.* Item (ii) was added by Amendment No. 2.

<sup>31</sup> See CHX Article XXVIII, proposed Rule 19(b)(1)(B), added by Amendment No. 2. A director who qualifies as a financial expert under Item 401(h) of Regulation S–K or Item 401(e) of Regulation S–B (or any successor provisions to those items) would be presumed to have accounting or related financial management expertise.

<sup>32</sup> See CHX Article XXVIII, proposed Rule 19(b)(3).

any other provider of accounting related services for the investment company, as well as employees of the investment company. This responsibility would be required to be addressed in the audit committee's charter.

#### *Approval of Related Party Transactions*

The rules, as amended, would require that each issuer conduct an appropriate review of all related party transactions on an ongoing basis and review potential conflict of interest situations where appropriate. Issuers would be permitted to use the company's audit committee or another independent body of the board of directors for this review.<sup>33</sup>

#### *Code of Business Conduct and Ethics*

Under the proposed rules, each issuer would be required to adopt a code of conduct and ethics that applies to its directors, officers, and employees.<sup>34</sup> The code would be required to comply with the definitions of Section 406(c) of the Sarbanes-Oxley Act and the rules thereunder and would be required to provide for an enforcement mechanism that meets specific requirements.<sup>35</sup> Waivers of the code for directors and officers would need to be approved by the issuer's board of directors and be made publicly available.<sup>36</sup> In addition, the code itself would be required to be made publicly available.<sup>37</sup>

#### *Governance-Related Certifications*

The proposed amendments would contain a requirement that each issuer's CEO certify, on an annual basis, that he or she is not aware of any violation by the issuer of any standard set forth in CHX Article XXVIII, Rules 19(a)–(e). Furthermore, such CEO would be

<sup>33</sup> A provision in the portion of the proposed rule change approved in the Partial Approval Order required the audit committee to conduct a review of all related party transactions and to review potential conflict of interest situations where appropriate. The Exchange modified this provision in Amendment No. 2 to permit such review to be conducted by another independent body of the board of directors. The provision, as amended, would appear as new paragraph (o) and be removed from the audit committee section of CHX Rule 19. See also *infra* notes 39–41 and accompanying text.

<sup>34</sup> See *infra* notes 39–41 and accompanying text regarding entities that would be exempt from this requirement.

<sup>35</sup> The enforcement mechanism, added as a requirement by Amendment No. 2, would be required to be designed to ensure prompt and consistent enforcement of the code, protections for persons reporting questionable behavior, clear standards for compliance, and a fair process by which to determine violations.

<sup>36</sup> For most issuers, waivers would need to be disclosed to shareholders in a Form 8-K within five business days. Foreign private issuers would be required to disclose waivers in a Form 6-K or in the next Form 20-F. See Amendment No. 2.

<sup>37</sup> See CHX Article XXVIII, proposed Rule 19(e).

required to promptly notify the Exchange if any executive officer of the issuer becomes aware of any material non-compliance by the issuer with those standards.<sup>38</sup>

#### *Applicability*

The CHX Governance Standards would apply to all companies listing securities on the Exchange, with particular exemptions for controlled companies, limited partnerships, companies in bankruptcy, management investment companies, and foreign issuers.<sup>39</sup> Passive business organizations (such as royalty trusts) would not be subject to these standards, nor would the standards apply to derivatives or special purpose securities, if those entities are exempt from the requirements of Rule 10A–3 under the Act.<sup>40</sup> Furthermore, under the proposal, foreign issuers would be permitted to comply with their home country practices with respect to corporate governance, except to the extent that Rule 10A–3 requires compliance with specific audit committee requirements.<sup>41</sup> As further discussed

<sup>38</sup> See CHX Article XXVIII, proposed Rule 19(f). See also *infra* notes 39–41 and accompanying text.

<sup>39</sup> See CHX Article XXVIII, Rule 19, proposed Interpretations and Policies .02 and .03. In Amendment No. 2, the CHX revised these proposed exemptions to make them consistent with those approved for other self-regulatory organizations ("SROs"). Under the revised proposal, for example, closed-end management investment companies that are registered under the Investment Company Act of 1940 would not be required to comply with sections (a) through (f) of CHX Rule 19, except that these issuers would be required to meet the requirements of Rule 10A–3 under the Act and other specified audit committee standards and to notify the Exchange of non-compliance with the applicable requirements, among other provisions. See CHX Article XXVIII, Rule 19, proposed Interpretation and Policy .03(2)(A). Similarly, open-end funds would not be required to comply with sections (a) through (f) of CHX Rule 19, except that they would be required to comply with the audit committee requirements of Rule 10A–3 under the Act and to establish complaint procedures for employees of third-party service providers and address these procedures in the audit committee charter. See CHX Article XXVIII, Rule 19, proposed Interpretation and Policy .03(2)(C). The Exchange believes that registered management investment companies are already subject to significant regulation, and, as a result, should not be required to adhere to all of the proposed governance standards. However, the Exchange believes that they should be required to meet specified requirements. Furthermore, business development companies, which are a type of closed-end management investment company defined in Section 2(a)(48) of the Investment Company Act of 1940 that are not registered under that Act, would be required to comply with all of the provisions of CHX Rule 19.

<sup>40</sup> See CHX Article XXVIII, Rule 19, proposed Interpretation and Policy .03(3).

<sup>41</sup> Foreign issuers would be required to provide English language disclosure of any significant ways in which their corporate governance practices differ from those required for domestic issuers under CHX Rule 19. This disclosure could be provided either

below, to the extent consistent with Rule 10A–3, additional specific exemptions would exist for dual and multiple listings, where the same or another class of security of the company is already listed on another national securities exchange or national securities association that has similar governance-related requirements.<sup>42</sup> As already noted, the proposed CHX Governance Standards would apply to companies that list securities under Tier I or Tier II of the CHX's listing standards.

#### *Application of Standards to Issuers With Dual or Multiple Listings*

The proposed rule change would further provide that, if an issuer is listed on a national securities exchange or national securities association with listing standards substantially similar to the CHX Governance Standards, the issuer would not be required to separately meet the CHX Governance Standards.<sup>43</sup> The proposed rule text would contain specific criteria that must be considered when determining whether another market's governance standards are "substantially similar."<sup>44</sup>

#### *Schedule for Effectiveness of Proposed Rule Changes*

The CHX proposes that the proposed rule changes to CHX Governance Standards that are the subject of this Order become effective in accordance with the timetable set forth in CHX Article XXVIII, Rule 19, proposed Interpretation and Policy .05, as amended by Amendment No. 2.<sup>45</sup> In

on the issuer's website or in the annual report distributed to shareholders in the U.S. If the disclosure is made only on an issuer's website, the issuer would be required to note that fact in its annual report and provide the web address at which the disclosure may be reviewed. See CHX Article XXVIII, Rule 19, proposed Interpretation and Policy .03(4), added by Amendment No. 2.

<sup>42</sup> See CHX Article XXVIII, Rule 19, proposed Interpretation and Policy .04.

<sup>43</sup> See CHX Article XVIII, Rule 19, proposed Interpretation and Policy .04. The Exchange has represented that it will have surveillance procedures sufficient to confirm that an issuer relying on this provision is in compliance with the governance standards of the other listing market. Consistent with Rule 10A–3 under the Act, the exemption would not apply to the Exchange's requirements relating to audit committees or to an issuer's obligations to notify the Exchange if there is material non-compliance with the audit committee requirements.

<sup>44</sup> In Amendment No. 2, the CHX added that, among these criteria, the listing standards of the other market must include a code of business conduct and ethics that complies with the definition of a "code of ethics" set out in Section 406(c) of the Sarbanes-Oxley Act and the rules thereunder. See CHX Article XVIII, Rule 19, proposed Interpretation and Policy .04.

<sup>45</sup> The audit committee requirements approved in the Partial Approval Order, as mandated by Rule

general, following Commission approval of the proposed rule changes, these new governance standards would become effective on the earlier of the issuer's first annual shareholders meeting after July 1, 2004 or January 31, 2005. Foreign private issuers and small business issuers would have until July 31, 2005 to comply. If an issuer, however, has a board with staggered terms, and a change is required with respect to a director whose term does not expire within these periods, the issuer would have until its second annual meeting after the date specified above, but not later than December 31, 2005, to comply with the requirements of section (a) regarding boards of directors. Issuers listing on the Exchange in connection with an initial public offering would be required to comply with the CHX Governance Standards within time frames generally consistent with the exemptions in Rule 10A-3 under the Act.<sup>46</sup> Issuers transferring from another marketplace with substantially different governance standards generally would be required to comply with CHX Governance Standards within one year after listing on the CHX.<sup>47</sup>

#### *Summary of Revisions Made by Amendment Nos. 2 and 3*

Summarized below are the significant revisions of the proposal made by Amendment Nos. 2 and 3, most of which have already been noted in the discussion above. Amendment No. 2 revised the proposal to:

- Require a listed issuer's board to make an affirmative determination of a director's independence, and require the issuer to disclose the directors who have been determined to be independent;<sup>48</sup>
- Exclude compensation for board committee service or a loan permitted by Section 13(k) of the Act from payments that would preclude a finding that a director is independent;<sup>49</sup>

10A-3 under the Act, become effective as set forth in Rule 10A-3.

<sup>46</sup> Specifically, for each applicable committee that the issuer establishes (such as a nominating committee or compensation committee), the issuer would be required to have one independent member at the time of listing, a majority of independent members within 90 days of listing, and all independent members within one year. These issuers would be required to meet the majority independent board requirement (50% for small business issuers) within one year after listing on the Exchange. It should be noted, however, that investment companies are not afforded these exemptions under Rule 10A-3.

<sup>47</sup> An issuer transferring to the CHX from another market with substantially similar governance standards would be required to comply with such governance standards at the time the issuer lists with the CHX, or within any transition period that was provided by the other marketplace.

<sup>48</sup> See *supra* note 11.

<sup>49</sup> See *supra* note 12.

- Exclude non-discretionary charitable contribution matching programs from payments that would preclude a finding that a director is independent;<sup>50</sup>

- Include certain employment or partnership relationships of immediate family members with an issuer's outside auditor that would preclude a finding that a director is independent, and clarify the eligibility of former partners of an auditor who did not work on the audit;<sup>51</sup>

- Add a definition of independent director for registered management investment companies;<sup>52</sup>

- Include a requirement that each issuer adopt a formal written charter or board resolution, as applicable, addressing the nominations process and related matters;<sup>53</sup>

- Preclude a director holding 20% or more of an issuer's stock from serving on the nominating committee despite being an officer of the issuer;<sup>54</sup>

- Require each member of an issuer's audit committee not to have participated, in the past three years, in the preparation of the financial statements of the issuer or any current subsidiary, and require at least one member of the committee to have financial expertise;<sup>55</sup>

- Permit an issuer to use the company's audit committee or another independent body of the board of directors for the review of related party transactions;<sup>56</sup>

- Require an issuer's code of ethics to provide for an enforcement mechanism that meets specific requirements and clarify the disclosure obligations of the issuer with respect to waivers of the code;<sup>57</sup>

- Require foreign issuers to provide English language disclosure of significant ways in which their corporate governance practices differ from those required for domestic issuers;<sup>58</sup>

- Establish a revised schedule for the proposed rules to take effect, as discussed above;<sup>59</sup> and

- Set forth in a separate provision the governance requirements that are

<sup>50</sup> See *supra* note 14.

<sup>51</sup> See *supra* note 16.

<sup>52</sup> See *supra* note 17.

<sup>53</sup> See *supra* note 24.

<sup>54</sup> The proposal initially included a provision that would have permitted such a director to serve on the nominating committee under certain limited circumstances, despite his or her failure to meet the independence standard.

<sup>55</sup> See *supra* notes 30 and 31.

<sup>56</sup> See *supra* note 33.

<sup>57</sup> See *supra* notes 35-36.

<sup>58</sup> See *supra* note 41.

<sup>59</sup> See *supra* notes 45-47 and accompanying text.

applicable to listed issuers until the provisions of the proposed rule change become effective.<sup>60</sup>

Amendment No. 2 further made additional clarifications to the definition of independent director<sup>61</sup> and to the roles of nominating and compensation committees;<sup>62</sup> revised the provisions concerning the applicability of the CHX Governance Standards to management investment companies;<sup>63</sup> and revised the provisions concerning the listing criteria for issuers of securities that are dually listed on the CHX and other markets, as discussed above.<sup>64</sup> In general, Amendment No. 2 incorporated a number of textual revisions to clarify the need of issuers to comply with the requirements of Rule 10A-3 under the Act, and included alternative methods for issuers that do not file annual proxies to make disclosures required under the rules.<sup>65</sup> Amendment No. 3 revised the proposal to require the independent directors of a controlled company to have regularly scheduled meetings at which only independent directors are present.<sup>66</sup>

### III. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>67</sup> In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act<sup>68</sup> in that it is designed, among other things, to facilitate transactions in securities, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and does not permit unfair discrimination among issuers.

In the Commission's view, the proposed rule change, as amended, will foster greater transparency,

<sup>60</sup> See proposed Interpretation .05(5) to CHX Article XXVIII, Rule 19.

<sup>61</sup> See *supra* notes 13, 15, and 16.

<sup>62</sup> See *supra* notes 23 and 26.

<sup>63</sup> See *supra* note 39.

<sup>64</sup> See *supra* notes 43-44 and accompanying text.

<sup>65</sup> In Amendment No. 2, the CHX also made changes of a technical, non-substantive nature to some of the text approved in the Partial Approval Order.

<sup>66</sup> See *supra* note 22.

<sup>67</sup> 15 U.S.C. 78f(b). In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>68</sup> 15 U.S.C. 78f(b)(5).

accountability, and objectivity in the oversight by, and decision-making processes of, the boards and key committees of CHX listed issuers. The proposal, as amended, also will promote compliance with high standards of conduct by the issuers' directors and management. The Commission notes that the CHX has amended its proposal to significantly harmonize it with rule changes recently approved by the Commission for the NYSE, NASD, and the Amex.<sup>69</sup> The Commission also believes that the proposed rule change, as amended, is consistent with Rule 10A-3 under the Act.<sup>70</sup>

The CHX has requested that the Commission grant accelerated approval to the changes in Amendment Nos. 2 and 3. The Commission believes that the revisions proposed in Amendment Nos. 2 and 3 significantly align the corporate governance standards proposed for companies listed on the CHX with the standards approved by the Commission for companies listed on other SROs.<sup>71</sup> The Commission believes it is appropriate to accelerate approval of these amendments so that the comprehensive set of strengthened corporate governance standards for companies listed on the CHX may be implemented on generally the same timetable (with some modification of certain deadlines) as that for similar standards adopted for issuers listed on other SROs. The Commission therefore finds good cause, consistent with Section 19(b)(2) of the Act,<sup>72</sup> to approve Amendment Nos. 2 and 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether Amendment Nos. 2 and 3 are consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CHX-2003-19 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-CHX-2003-19. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the CHX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CHX-2003-19 and should be submitted on or before July 22, 2004.

#### V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>73</sup> that the proposed rule change (SR-CHX-2003-19), as amended, be, and hereby is, approved, and that Amendment Nos. 2 and 3 to the proposed rule change be, and hereby are, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>74</sup>

**Margaret H. McFarland**,  
*Deputy Secretary*.

[FR Doc. 04-14899 Filed 6-30-04; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49915; File No. SR-NYSE-2004-28]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc. To Extend a Pilot Relating to Voluntary Supplemental Procedures for Selecting Arbitrators

June 25, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 14, 2004, the New York Stock Exchange, Inc. ("NYSE" or "the Exchange") filed with the Securities and Exchange Commission the proposed rule change as described in Items I and II below, which items have been prepared by the Exchange. The Exchange filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of an extension until January 31, 2005, of a pilot regarding Voluntary Supplemental Procedures for Selecting Arbitrators ("Supplemental Procedures" or "pilot program").

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below.

<sup>74</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>69</sup> See *supra* note 9.

<sup>70</sup> See Partial Approval Order, *supra* note 5.

<sup>71</sup> See *supra* note 9.

<sup>72</sup> 15 U.S.C. 78s(b)(2).

<sup>73</sup> 15 U.S.C. 78s(b)(2).