information. The six-month pilot should help the Exchange to provide information to the Commission to ensure that these benefits exist, and provide for fair access with adequate monitoring of the orders being taken, and information being provided, over the portable phones.[24]

Finally, the Commission finds good cause for approving Amendment No. 2 prior to the thirtieth day after the date of publication of the notice of filing thereof in the **Federal Register**.[25] Since the NYSE is also proposing in a separate rule filing to eliminate the exception to NYSE Rule 123(e), which provided that orders in ETFs must be entered into FESC within 90 seconds of execution,[26] the Commission believes that good cause exists to approve the portion of Amendment No. 2 that would allow the use of Exchange-provided and authorized portable phones for orders in ETFs on the Floor. As noted above, the prohibition of using portable phones for ETF orders was based on the 90-second delay for inputting ETF orders in FESC. Because this exception to FESC has been eliminated, the Commission believes that portable phones can be used for ETF orders as with other equity securities.[27] In addition, the Commission believes that it is beneficial to investors and Exchange members that the NYSE specified, in Amendment No. 2, a general time frame of approximately May 1, 2003 to implement the pilot program and of August 1, 2003 to complete the study of communications on the Exchange Floor. This should help firms and brokers in planning for the upcoming changes. Finally, we believe notice for NYSE members, the Division, and OCIE one week prior to the pilot program's implementation will be beneficial to market participants and the Commission. Based on the above, we believe good cause exists to grant accelerated approval to Amendment No. 2, consistent with sections 19 and 6(b) of the Act.[28]

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2, including whether Amendment No. 2 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to Amendment No. 2 that are filed with the Commission, and all written communications relating to Amendment No. 2 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR-NYSE–2002–11 and should be submitted by May 8, 2003.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[29] that the proposed rule change and Amendment No. 1 (SR-NYSE–2002–11) be, and it hereby is, approved, and that Amendment No. 2 be, and it hereby is, approved on an accelerated basis, as a pilot program for six months beginning on or about May 1, 2003.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[30]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 03–9472 Filed 4–16–03; 8:45 am]

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[24] In addition, as noted above, the Commission received one comment letter in support of the proposed rule change and Amendment No. 1. This commenter stated that the proposal would improve the overall quality of the flow of information and the efficiency of the communication process between the Exchange Floor and off-Floor participants, including both ''direct access'' investors and ''upstairs'' trading desks of NYSE member organizations. Furthermore, the commenter considered the use of portable phones to communicate directly to and from the Floor as enabling vigorous competition, innovative trading services, and faster executions on the Floor. *See* Morgan Stanley Letter, *supra* note 5. The commenter also suggested that the Exchange should aim to implement the rule change as fully contemplated and not make calls on portable phones linked through the booth, as some market participants might desire. In response, the Exchange stated that they were aware of certain market participants who preferred that phone calls between Floor brokers and off-Floor participants be connected through a Floor booth intermediary, and that, while technologically Floor brokers would have the ability on their portable phones to conference in Floor booth intermediaries on calls, such action is not required by this proposal. Telephone conversation between Jeff Rosenstrock, Attorney, NYSE, and Cyndi Rodriguez, Special Counsel, Division, Commission, on April 11, 2003.

[25] 15 U.S.C. 78s(b)(2).

[26] *See* notes 9 and 10, and accompanying text.

[27] During the pilot, the NYSE should address whether additional surveillance would be needed because of the derivative nature of the ETFs.

[28] 15 U.S.C. 78s and 15 U.S.C. 78f(b).

[29] 15 U.S.C. 78s(b)(2).

[30] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47672; File No. SR–NYSE–2002–33]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Relating to Corporate Governance

April 11, 2003.

Pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 (''Act'') and Rule 19b–4 thereunder,[2] notice is hereby given that on August 16, 2002, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange''), filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, III below, which Items have been prepared by the NYSE. On April 4, 2003, the NYSE submitted Amendment No. 1 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The NYSE proposes to amend its Listed Company Manual (''Manual'') to implement significant changes to its listing standards aimed at helping to restore investor confidence by empowering and ensuring the independence of directors and strengthening corporate governance practices. The text of the proposed rule change is below. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

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

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated April 3, 2003 (''Amendment No. 1''). Amendment No. 1 replaces the original filing in its entirety. Telephone call between Annemarie Tierney, Office of General Counsel, NYSE, and Jennifer Lewis, Attorney, Division, Commission, on April 9, 2003.

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.

303A

General Application

Companies listed on the Exchange must comply with certain standards regarding corporate governance as codified in this Section 303A. Consistent with the NYSE's traditional approach, as well as the requirements of the Sarbanes-Oxley Act of 2002, certain provisions of Section 303A are applicable to some listed companies but not to others.

Equity Listings

Section 303(A) applies in full to all companies listing common equity securities, with the following exceptions:

Controlled Companies—

A company of which more than 50% of the voting power is held by an individual, a group or another company need not comply with the requirements of Sections 303A(1), (4) or (5). A controlled company that chooses to take advantage of any or all of these exemptions must disclose in its annual meeting proxy that choice, that it is a controlled company and the basis for the determination. Controlled companies must comply with the remaining provisions of Section 303A.

Limited Partnerships and Companies in Bankruptcy—

Due to their unique attributes, limited partnerships and companies in bankruptcy proceedings need not comply with the requirements of Sections 303A(1), (4) or (5). However, all limited partnerships (at the general partner level) and companies in bankruptcy proceedings must comply with the remaining provisions of Section 303A.

Closed-End Funds—

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 must comply with the requirements set out in Sections 303A(6), (7) and (12)(b).

Other Entities—

Section 303A does not apply to passive business organizations in the form of trusts (such as royalty trusts) or to derivatives and special purpose securities (such as those described in Sections 703.16, 703.19, 703.20 and 703.21).

Foreign Private Issuers—

Listed companies that are foreign private issuers (as such term is defined in Rule 3b–4 under the Exchange Act) are permitted to follow home country practice in lieu of the provisions of this Section 303A, except that such companies are required to comply with the requirements of Sections 303A(6) (including the applicable commentary), (7)(a) and (c), (11) and (12)(b).

Preferred and Debt Listings

Section 303A does not generally apply to companies listing only preferred or debt securities on the Exchange. To the extent required by Rule 10A–3 under the Exchange Act, all companies listing only preferred or debt securities on the NYSE are required to comply with the requirements of Sections 303A(6) (including the applicable commentary), (7)(a) and (c), and (12)(b).

Effective Dates/Transition Periods

Companies that do not already have majority-independent boards will need time to recruit qualified independent directors, and companies with classified boards may need additional time to implement the new standards in a series of director elections. Accordingly, all listed companies will be required to comply with the standards in Sections 303A(1) and (2) no later than eighteen months following publication of SEC approval of these standards in the ***Federal Register****. If a company has a classified board and a change would be required for a director who would not normally stand for election within the 18-month period, the company will have an additional year, or a total of 30 months after publication of SEC approval of Section 303A in the* ***Federal Register****, to effect the change in that director position.*

Companies will have the same 18-month and 30-month periods described above to comply with the new qualification standards applicable to audit, nominating and compensation committee members. As a general matter, the existing audit committee requirements provided for in Section 303 continue to apply to NYSE listed companies pending the transition to the new rules.

Companies listing in conjunction with their initial public offering must comply within 24 months of listing. Companies listing upon transfer from another market have 24 months from the date of transfer in which to comply with any requirement 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 that market's 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.

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. The provision for a public reprimand letter set out in Section 303A(13) is effective upon publication of SEC approval of Section 303A in the ***Federal Register****. The remaining requirements can also be implemented quickly.*

Accordingly, the following standards are effective six months from publication of SEC approval of Section 303A in the ***Federal Register:***

- *Executive sessions of non-management directors (subsection 3);*
- *Nomination and compensation committees with requisite charters (subsections 4 and 5);*
- *Audit committee with requisite charter (subsection 7);*
- *Corporate governance guidelines and code of business conduct and ethics (subsections 9 and 10);*
- *Foreign private issuer statement 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 expect all newly listed companies, both IPOs and transfers, to have provided for these requirements by the time of listing on the Exchange.

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.

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. Of course in no event can any current employee of the listed company be deemed independent of management.

The basis for a board determination that a relationship is not material must be disclosed in the company's annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC. 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. 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 (except where there is a presumption of non-independence, as described in the commentary to Section 303A(2)(b)). 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 in the manner described above. 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) A director who receives, or whose immediate family member receives, more than $100,000 per year in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), is presumed not to be independent until five years after he or she ceases to receive more than $100,000 per year in such compensation.

Commentary: A listed company's board may negate this presumption with respect to a director if the board determines (and no independent director dissents) that, based upon the relevant facts and circumstances, such compensatory relationship is not material. Any affirmative determination of independence made by the board in these circumstances must be specifically explained in the listed company's proxy statement, or, if the company does not file a proxy statement, in the company's annual report filed on Form 10-K with the SEC, and cannot be covered by a categorical standard adopted in accordance with the commentary to Section 303A(2)(a). Compensation received by a director for former service as an interim Chairman or CEO does not need to be considered as a factor by a board in determining independence under this presumption. If a person who received more than $100,000 per year in direct compensation from a listed company dies or becomes incapacitated, the presumption of non-independence applicable to his or her immediate family members will cease immediately upon such death or determination of incapacity.

(ii) A director who is affiliated with or employed by, or whose immediate family member is affiliated with or employed in a professional capacity by, a present or former internal or external auditor of the company is not ''independent'' until five years after the end of either the affiliation or the auditing relationship.

(iii) A director who is employed, or whose immediate family member is employed, as an executive officer of another company where any of the listed company's present executives serves on that company's compensation committee is not ''independent'' until five years after the end of such service or the employment relationship.

(iv) A director who is an executive officer or an employee, or whose immediate family member is an executive officer, of another company (A) that accounts for at least 2% or $1 million, whichever is greater, of the listed company's consolidated gross revenues, or (B) for which the listed company accounts for at least 2% or $1 million, whichever is greater, of such other company's consolidated gross revenues, in each case is not ''independent'' until five years after falling below such threshold.

General Commentary to Section 303A(2)(b): 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 domestic employees) who shares such person's home.

Transition Rule. During the five years immediately following [insert the effective date of this listing standard], each five year ''look back'' period referenced in sub-paragraphs (b)(i) through (b)(iv) shall instead be the period since [insert effective date of this listing standard]. For example, if a director received in excess of $100,000 per year in direct compensation from a listed company during the year prior to [insert effective date of this listing standard], there will be no required presumption that the director is not independent unless such compensatory relationship extended past [insert effective date of this listing standard].

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.

Commentary: 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 (as that term is defined in Rule 16a–1(f) under the Securities Act of 1933), 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 or, if the company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC. 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 and confidentially with the presiding director or with the non-management directors as a group. That method can follow the same process established for communications to the audit committee required by Section 303A(7)(c)(ii).*

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; and

(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 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, note that the audit committee functions specified in Section 303A(7) may not be allocated to a different committee, other than as noted in the General Commentary to Section 303A(7).

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, or, if the company does not file a proxy statement, in the company's annual report filed on Form 10–K with the SEC, 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 have sole authority to determine the CEO's compensation level based on this evaluation; and

(B) make recommendations to the board with respect to non-CEO compensation, incentive-compensation plans and equity-based plans; and

(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 or without 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.

Boards may allocate the responsibilities of the compensation committee 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, note that the audit committee functions specified in Section 303A(7) may not be allocated to a different committee, other than as noted in the General Commentary to Section 303A(7).

6. Add to the "independence" requirement for audit committee membership the requirements of Rule 10A–3(b)(1) under the Exchange Act, subject to the exemptions provided for in Rule 10A–3(c).

Commentary Applicable to All Companies: 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'' set out in Section 303A(2), 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 commitment of audit committee members, they may receive reasonable compensation greater than that paid to the other directors (as may other directors for other 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 avoid 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.

Commentary Applicable to All Companies Other than Foreign Private Issuers: 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. A board may presume that a person who satisfies the definition of audit committee financial expert set out in Item 401(e) of Regulation S–K has accounting or related financial management expertise.

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 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 or, if the company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC.

7. (a) Each company is required to have a minimum three person audit committee composed entirely of independent directors that meet the requirements of Section 303A(6).

(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 required by the SEC's proxy rules to be included in the company's annual proxy statement, or, if the company does not file a proxy statement, in the company's annual report filed on Form 10–K with the SEC;

(ii) the duties and responsibilities of the audit committee set out in Section 303A (7)(c) and (d); and

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

(c) As required by Rule 10A–3(b)(2), (3), (4) and (5) of the Securities Exchange Act of 1934, and subject to the exemptions provided for in Rule 10A–3(c), the audit committee must:

(i) directly appoint, retain, compensate, evaluate and terminate the company's independent auditors;

Commentary: 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. In addition, the independent auditor must report directly to the audit committee. This requirement does not preclude the committee from obtaining the input of management, but these responsibilities may not be delegated to management. The audit committee must be directly responsible for oversight of the independent auditors, including resolution of disagreements between management and the independent auditor and pre-approval of all non-audit services.

(ii) establish procedures for the receipt, retention and treatment of complaints from listed company employees on accounting, internal accounting controls or auditing matters, as well as for confidential, anonymous submissions by listed company employees of concerns regarding questionable accounting or auditing matters;

(iii) obtain advice and assistance from outside legal, accounting or other advisors as the audit committee deems necessary to carry out its duties; and

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

(iv) receive appropriate funding, as determined by the audit committee, from the listed company for payment of compensation to the outside legal, accounting or other advisors employed by the audit committee.

(d) In addition to the duties set out in Section 303(A)(7)(c), the duties of the audit committee must be, at a minimum, to:

(i) 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.

(ii) 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;''

(iii) 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.

(iv) 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.

(v) 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 listed companies must have an internal audit function. These separate sessions may be more productive than joint sessions in surfacing issues warranting committee attention.

(vi) 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.

(vii) set clear hiring policies for employees or former employees of the independent auditors; and

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.

(viii) 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.

General Commentary to Section 303A(7)(d): 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) the type and presentation of information to be included in earnings press releases (paying particular attention to any use of ''pro forma,'' or ''adjusted'' non-GAAP, information), as well as review any financial information and earnings guidance provided to analysts and rating agencies.

General Commentary to Section 303A(7): To avoid any confusion, note that the audit committee functions specified in Section 303A(7) are the sole responsibility of the audit committee and may not be allocated to a different committee.

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

Commentary: Listed companies must maintain an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management processes and system of internal control. A company may choose to outsource this function to a firm other than its independent auditor.

8. Reserved.

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 and the charters *of its most important committees (including at least the audit, and if applicable, compensation and nominating committees). 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 Sections 303A(1) and (2). 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 listed company's website must include its code of business conduct and ethics. 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.

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. Companies may write their codes in a manner that does not alter existing legal rights and obligations of companies and their employees, such as "at will" employment arrangements.*

• *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: 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, 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 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 United States) and/or in their annual report as distributed to shareholders in the United States in accordance with Sections 103.00 and 203.01 of the Listed Company Manual (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. (a) 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, as of the date of certification, 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 or, if the company does not prepare an annual report to shareholders, in the company's annual report on Form 10-K filed with the SEC.

(b) Each listed company CEO must promptly notify the NYSE after any executive officer of the listed company becomes aware of any material non-compliance with any applicable provisions of this Section 303(A).

13. *The NYSE may issue a public reprimand letter to any listed company that violates a 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 a 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 govern the treatment of companies falling below those standards.

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 NYSE included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in item IV below. The NYSE has prepared summaries, set forth in Sections A, B, and C below of the most significant aspects of such statements.

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

1. Purpose

The NYSE represents that it 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 the U.S. 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 believes it has the opportunity—and the responsibility—once again to raise corporate governance and disclosure standards.

On February 13, 2002, then-Commission 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 (''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 Commission, 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. The Exchange states that, 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, it seeks to avoid recommendations that would undermine their energy, autonomy and responsibility.

The NYSE represents that 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 NYSE believes 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.

The NYSE represents that, in preparing the recommendations it made to the NYSE Board of Directors (''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 Commission proposals and legislation introduced in Congress.

On June 6, 2002, the Committee submitted its report and initial recommendations to the NYSE Board.[4] The NYSE states that President Bush, then-Commission 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 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.

Following approval of the NYSE Board of Directors on August 1, 2002, on August 16, 2002, the NYSE filed proposed rule changes to its corporate governance standards with the Commission (the NYSE Corporate Governance Proposals) which reflect the findings of the Committee. The proposals for new corporate governance listing standards for companies listed on the Exchange would be codified in a new Section 303A of the Manual.[5]

Subsequent to the original filing of the NYSE Corporate Governance Proposals, the Commission requested that the NYSE file separately proposed Section 303A(8) (relating to shareholder approval of equity-compensation plans) and the proposed amendment to NYSE Rule 452 (which would prohibit member organizations from giving a proxy to vote on equity-compensation plans absent specific instructions from a beneficial holder). The Exchange made this separate filing with the Commission on October 7, 2002.[6]

Significant Amendments From Original Proposals

In the NYSE Corporate Governance Proposals filed in August 2002, the Exchange proposed to continue its longstanding practice of permitting listed foreign private issuers to follow home country practice in lieu of the standards specified in Section 303A, subject only to the new requirement in proposed Section 303A(11) that such companies must disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards. However, as a result of the Sarbanes-Oxley Act of 2002[7] (''Sarbanes-Oxley Act'') and Rule 10A–3 (''Rule 10A–3'') under the Act,[8] the Exchange must propose standards that require that all listed companies have an independent audit committee and satisfy certain other requirements. For this reason, among others, the Exchanges proposes to add a section entitled ''General Application'' to Section 303A to clarify how the proposed standards would apply to different kinds of listed entities.

The NYSE also proposes to include a subsection entitled ''Effective Date/Transition Period'' in the General Application section of Section 303A. The subsection amends certain of the effective dates originally proposed. NYSE notes, however, that at least certain of those effective dates will require further amendment. Certain of the requirements of proposed Section 303A(6), (7) and (12) reflect the requirements of the Sarbanes-Oxley Act and Rule 10A–3. The Commission's final rules implementing these provisions specify dates by which companies must comply with these requirements.[9] NYSE represents that, of course, listed companies will be required to apply these particular standards in accordance with the transition periods adopted by the Commission, and the rules proposed herein will be amended as necessary to reflect those periods.

Proposed Section 303A(2) Regarding Director Independence

The Exchange has made a number of changes to its originally proposed definition of independence for board membership as a result of comments from the Commission, although not to the general rule that charges the board of directors to affirmatively determine independence.

In addition, the Exchange wishes to point out a matter that arises as a result of the enactment of the Sarbanes-Oxley Act and the Commission's implementing rules thereunder.

Immediate Family

Certain close family relationships preclude independence under the NYSE's proposed rule. The definition of ''immediate family'' is unchanged from that proposed in the NYSE's original filing, which in turn is the same as that employed in the NYSE's current rule regarding the independent audit committee.[10]

When the Commission proposed its rules implementing Section 301 of the Sarbanes-Oxley Act, it proposed to use a more limited concept of family. The Exchange defines ''immediate family'' as including ''a person's spouse, parents, children, siblings, mothers-in-law and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than

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

[5] In its Report to the NYSE Board, the Committee set forth basic principles followed in many cases by explanation and clarification. The Exchange is proposing to adopt the recommendations as standards in substantially the form they were made by the Committee and adopted by the NYSE Board. Accordingly, the format used states a basic principle, with the additional explanation and clarifications included as ''commentary''. The NYSE advises readers 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 would be 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 would not constitute a violation of NYSE standards.

While many of the requirements set forth in this new rule are relatively specific, the Exchange notes that it is articulating a philosophy and approach to corporate governance that companies would be 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 would be expected to apply the requirements carefully and in good faith, making reasonable interpretations as necessary, and disclosing the interpretations that they make.

[6] *See* Securities Exchange Act Release No. 46620 (October 8, 2002), 67 FR 63486 (October 11, 2002) (SR–NYSE–2002–46).

[7] Pub. L. 107–204, 116 Stat. 745 (2002).

[8] *See* Securities Exchange Act Release No. 47654 (April 9, 2003).

[9] Companies must comply with these provisions by the first annual meeting held after January 15, 2004, but in no event later than October 31, 2004. Foreign private issuers and small business issuers will have until July 31, 2005 to comply.

[10] Section 303.02(A) of the Manual.

employees) who shares such person's home.'' The Commission's proposal includes only a person's spouse, minor children or stepchildren or children or stepchildren sharing the director's home.

2. Statutory Basis

The Exchange believes that the basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)[11] that an exchange have rules that are designed 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, in general, to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others [12]

Overview

Widespread Support for the Recommendations. The Exchange indicates that 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 would 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 would make it more difficult for companies to find quality independent directors because of the increased responsibilities and time commitment that the rules would 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.

Tighter ''Independent Director'' Definition

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

[11] 15 U.S.C. 78f(b)(5).

[12] For a discussion of comments received with respect to NYSE's proposal regarding shareholder approval of equity-compensation plans which was filed as a separate proposal, *see* Securities Exchange Act Release No. 46620 (October 8, 2002), 67 FR 63486 (October 11, 2002) (SR-NYSE–2002–46).

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 would 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 cited the competing demands on the board's time and attention; the likelihood that the ''no material relationship'' requirement would unduly shrink the pool of qualified directorship candidates; and the possibility that the fact-specific inquiry required would 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 would not negate independence.

Numerous companies and organizations argued 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 suggested 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 would end by examining the present and past relationships at companies where directors are currently employed, or if one would be required to 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.

Non-Management Executive Sessions

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 would 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 could 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 would unduly limit the number of candidates available to chair the audit committee and unnecessarily dictate 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.

Audit Committee Charter

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 would be 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.

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 or her 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.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve the proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the amended proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549–0609. 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR–NYSE–2002–33 and should be submitted by May 8, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[13]

Margaret H. McFarland,

Deputy Secretary.

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[13] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47667; File No. SR–NYSE–2003–09]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc. Relating to Elimination of the Exception to Rule 123(e) for Exchange-Traded Funds

April 11, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the ''Exchange Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on April 9, 2003, 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 self-regulatory organization. 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 NYSE proposes to eliminate the exception to NYSE Rule 123(e), which provided that orders in Exchange-Traded Funds (''ETFs'') must be entered into an electronic data base (front end systemic capture, or ''FESC'') on the Floor within 90 seconds of execution. This amendment originally became effective on a pilot basis for one year.[3] Thereafter the pilot was extended for an additional year, and is set to expire on January 5, 2004.[4]

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 NYSE 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. The NYSE has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 45246 (January 7, 2002), 67 FR 1527 (January 11, 2002) (SR–NYSE–2001–52), adopting Supplementary Material .23 of NYSE Rule 123(e).

[4] *See* Securities Exchange Act Release No. 46713 (October 23, 2002), 67 FR 66033 (October 29, 2002) (SR–NYSE–2002–48).