

to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest.

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

The CBOE does not believe that the proposed rule change will impose any burden on competition.

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

No written comments were solicited or received with respect to the proposed rule change.

**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 Exchange consents, the Commission will:

(A) By order approve such 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 proposed rule change, as amended, 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 CBOE. All submissions should refer to file number

SR-CBOE-2003-07 and should be submitted by November 18, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-48669; File No. SR-CHX-2003-19]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Incorporated To Amend Certain Provisions of Its Rules Relating to the Governance of Issuers That List Securities on the Exchange**

October 21, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 23, 2003, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. 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 Exchange proposes to amend certain provisions of its rules relating to the governance of issuers that list securities on the CHX. Specifically, the CHX seeks to amend its Tier I and Tier II listing standards to enhance its requirements relating to the roles and responsibilities of independent directors and independent board committees, including audit committees, nominating committees and compensation committees. The Exchange also seeks to amend its maintenance standards to set out a process that would allow an issuer an opportunity to cure a failure to meet the Exchange's maintenance listing standards, including its governance-related standards. The text of the proposed rule change is below.<sup>3</sup> Text in

<sup>7</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> The rule text as set forth herein includes several minor technical revisions that the Exchange has

brackets indicates material to be deleted, and text in italics indicates material to be added.

\* \* \* \* \*

Chicago Stock Exchange Rules

ARTICLE XXVIII

Listed Securities

\* \* \* \* \*

Maintenance Standards Applicable to All Tier I Issues

RULE 17A. The Exchange reserves the right to delist the securities of any corporation, subject to Securities and Exchange Commission Rules, which engages in practices not in the public interest or whose assets have been depleted to the extent that the company can no longer operate as a going concern or whose securities have become so closely held that it is no longer feasible to maintain a reasonable market in the issue. Furthermore, the Exchange reserves the right to delist the securities of any corporation which has drastically changed its corporate structure and/or its type of operation. The Exchange may also make an appraisal of, and determine on an individual basis, the suitability for continued listing of an issue in the light of all pertinent facts whenever it deems such action appropriate, even though a security meets enumerated criteria (including, but not limited to, continued listing on the NYSE, Amex or Nasdaq National Market). Many factors may be considered in this connection, including, but not limited to, abnormally low selling price or volume of trading, or failure to comply with required corporate governance standards.

\* \* \* *Interpretations and Policies*

*If the Exchange identifies a Tier I issue as being below the Exchange's maintenance listing requirements, the Exchange will notify the issuer by letter of its determination and the reasons for that determination. In this letter, the Exchange will provide the issuer with an opportunity to provide the Exchange with a plan (the "Plan") to cure the deficiency. Within 10 business days of the receipt of the Exchange's letter, the issuer must contact the Exchange to confirm its receipt of the letter and to report to the Exchange whether or not the issuer intends to present a Plan. If the issuer notifies the Exchange that it does not intend to present a Plan, the*

committed to correct by filing an amendment. Telephone conversation between Kathleen M. Boege, Vice-President and Associate General Counsel, CHX, and Ira L. Brandriss, Special Counsel, Division of Market Regulation ("Division"), Commission, on October 10, 2003.

Exchange will commence proceedings to suspend and/or delist the issue.

The issuer must present any Plan within 45 days after its receipt of the Exchange's letter. The Plan must describe definitive action that the issuer has taken, or is taking, that would bring it into conformity with the Exchange's maintenance listing requirements within 18 months of receipt of the letter, or within any shorter time period required by the Exchange. (The Exchange will not approve any Plan, under which an issuer is curing a deficiency under SEC Rule 10A-3, which extends beyond the earlier of 12 months or the first annual shareholders' meeting (for circumstances beyond the reasonable control of an issuer) and 6 months (for other circumstances)). The Plan also must set quarterly milestones against which the Exchange will evaluate its progress. Exchange staff will evaluate the Plan and determine whether the issuer has made a reasonable demonstration in the Plan of an ability to come into compliance with the Exchange's maintenance listing requirements. The Exchange will notify the issuer of its determination within 45 days after receipt of the Plan. If the Exchange does not accept the Plan, it will commence proceedings to suspend and/or delist the issue.

If the Exchange accepts the Plan, the Exchange will review the issuer on a quarterly basis to determine the issuer's progress under the Plan. If the issuer fails to meet a material provision of the Plan or one or more of its quarterly milestones, the Exchange will review the facts and circumstances and determine whether to initiate proceedings to suspend and/or delist the issue; provided however, that if an issuer fails to meet a material provision of the Plan that relates to compliance with its obligations under SEC Rule 10A-3, the Exchange will immediately commence proceedings to suspend and/or delist the issue. If, for circumstances that do not involve compliance with SEC Rule 10A-3, the Exchange determines that continued listing is warranted, the Exchange will continue to review the issuer's progress under the Plan on at least a quarterly basis. If the issuer achieves compliance with the Exchange's maintenance listing requirements before the Plan expires under its terms, the Exchange may choose to consider the Plan ended as of that earlier date.

If an issuer, within one year after the termination of a Plan, is again determined to have failed to meet the Exchange's maintenance listing requirements, the Exchange will review the facts and circumstances (including

whether the issuer has fallen into non-compliance with the same standards at issue in its earlier Plan) and will take appropriate action, which could include, but is not limited to, shortening the time periods associated with the submission of any new Plan or immediately commencing proceedings to suspend and/or delist the issue.

These procedures do not prevent the Exchange from suspending trading in an issue immediately, whenever it finds that it is necessary to do so for the protection of investors.

\* \* \* \* \*

#### Tier I Corporate Governance and Disclosure Standards

##### Corporate Governance

RULE 19. The following Rule 19 applies [only] to Tier I issuers:

(a) Board of Directors.

(1) General Rule. Each issuer shall maintain a board of directors consisting of a majority of independent directors; however, each small business issuer shall be required only to maintain a board of directors consisting of at least 50% independent directors.

Independent directors must have regularly scheduled meetings at which only independent directors are present.

(2) Exceptions. A controlled company is exempt from the requirements of this paragraph (a).

(b) Audit Committee. Each issuer shall establish and maintain an audit committee, of at least three persons, that meets the following standards.

(1) Audit Committee Composition

(A) Each member of the audit committee: (i) Must be an independent director as defined in subparagraph (o) below; (ii) must meet the criteria for independence set forth in SEC Rule 10A-3; and (iii) must be able to read and understand fundamental financial statements, including a company's balance sheet, income statement and cash flow statement.

(B) Exceptions.

(i) One director who is not independent, but who meets the criteria set forth in SEC Rule 10A-3 and who is not a current officer or employee (or an immediate family member of a current officer or employee) may be appointed to the audit committee, if the issuer's board under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the corporation and its shareholders, and the board discloses, in the next annual proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination. A

member appointed under this exception may not serve on the audit committee for more than two years under this exception (unless he or she ultimately satisfies the definition of an independent director) and may not chair the audit committee.

(ii) If a member of an audit committee ceases to meet the independence criteria set forth in SEC Rule 10A-3 for reasons outside the person's reasonable control, that person may remain a member of the committee until the earlier of the next annual shareholders' meeting or one year from the occurrence of the event that caused the member to no longer meet the independence criteria. The issuer must promptly notify the Exchange if this circumstance occurs.

(iii) A small business issuer is only required to maintain an audit committee of at least two (not three) independent directors, but is otherwise required to comply with the provisions of this paragraph (b)(1).

(2) Audit Committee Responsibilities and Authority. The audit committee must have, at a minimum, (A) the responsibilities and authority set forth in SEC Rule 10A-3; and (B) the obligation to conduct an appropriate review of all related party transactions on an ongoing basis and to review potential conflict of interest situations where appropriate.

(3) Audit Committee Charter. Each issuer must certify that it has adopted a formal written audit committee charter and that the audit committee has reviewed and reassessed the adequacy of the formal written charter on an annual basis. The charter must specify:

(A) the committee's purpose—which, at a minimum, must be to:

(i) assist board oversight of (a) the integrity of the company's financial statements, (b) the company's compliance with legal and regulatory requirements, (c) the independent auditor's qualifications and independence, and (d) the performance of the company's internal auditors and independent auditors; and

(ii) prepare the required report 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; and

(B) the duties and responsibilities of the audit committee, which must, at a minimum, include (i) all duties and responsibilities that are set out in SEC Rule 10A-3 and section 303A(7)(c) and (d) of the Sarbanes-Oxley Act; and (ii) the obligation to conduct an appropriate review of all related party transactions on an ongoing basis and to review

potential conflict of interest situations where appropriate.

(c) Nominating Committee

(1) General Rule. The nomination of the issuer's directors shall be determined either by (A) a majority of the independent directors; or (B) a nominating committee comprised solely of independent directors.

(2) Exceptions.

(A) If the nominating committee is comprised of at least three persons, one director, who is not independent, but who is not a current officer or employee (or an immediate family member of a current officer or employee), may be appointed to the nominating committee if the issuer's board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the next annual meeting proxy statement subsequent to such determination, the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years (unless he or she ultimately satisfies the definition of an independent director).

(B) Alternatively, if the nominating committee is comprised of at least three persons, and if the exception described in paragraph (c)(2) above is not relied upon, one director who owns 20% of more of the company's common stock or voting power outstanding, and is not independent because that director is also an officer, may be appointed to the nominating committee if the issuer's board determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the next annual meeting proxy statement subsequent to such determination, the nature of the relationship, and the reasons for the determination.

(C) A controlled company is exempt from the requirements of this paragraph (c).

(D) 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 those directors need not be subject to the nominating committee process.

(d) Compensation Committee.

(1) Compensation of the issuer's chief executive officer shall be determined either by (A) a majority of the independent directors meeting in

executive session or (B) a compensation committee comprised solely of independent directors meeting in executive session.

(2) Compensation of all other officers, as that term is defined in section 16 of the Act, shall be determined either by (A) a majority of the issuer's independent directors or (B) a compensation committee comprised solely of independent directors. The chief executive officer may be present during deliberations regarding compensation of other officers, but may not vote.

(3) Exceptions.

(A) If the compensation committee is comprised of at least three persons, one director who is not independent and is not a current officer or employee (or an immediate family member or a current officer or employee), may be appointed to the compensation committee if the issuer's board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the next annual meeting proxy statement subsequent to such determination, the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years (unless he or she ultimately satisfies the definition of an independent director).

(B) A controlled company is exempt from the requirements of this paragraph (d).

(e) Code of Business Conduct and Ethics. Each issuer shall adopt a code of conduct and ethics applicable to all directors, officers and employees that complies with the requirements of section 406(c) of the Sarbanes-Oxley Act and the rules thereunder. Waivers of the code's provisions for directors and executive officers must be approved by the issuer's board of directors. The issuer must make this code publicly available and must disclose, in its public filings, waivers of the code for directors or executive officers.

(f) Governance-Related Certifications.

(1) Annual Certification. Each issuer's chief executive officer annually must certify to the Exchange that he or she is not aware of any violation by the issuer of the standards set out in paragraphs (a) through (e) of this rule.

(2) Interim Certifications. Each issuer's chief executive officer must promptly notify the Exchange after any executive officer of the issuer becomes aware of any material non-compliance by the issuer with the standards set out

in paragraphs (a) through (e) of this rule.

[(a)] (g) Annual Reports. No change to text.

[(b)] (h) Quarterly Reports. No change to text.

[(c)] (i) Other Reports. No change to text.

[(d)] Each listed company shall establish and maintain an Audit Committee, a majority of the members of which shall be independent directors, as defined below.]

[(e)] Each listed company shall maintain a minimum of two independent directors on its board of directors. For purposes of this section, "independent director" shall mean a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.]

[(f)] (j) Annual Meeting. No change to text.

[(g)] (k) Proxy Solicitations. No change to text.

[(h)] Each issuer shall conduct an appropriate review of all related party transactions on an ongoing basis and shall use the company's audit committee or a comparable body for the review of potential conflict of interest situations where appropriate.]

[(i)] (l) Stock Certificates. No change to text.

[(j)] (m) Shareholder Approval of Employee Stock Option Plans. No change to text.

[(k)] (n) Stock Transfer Facilities. No change to text.

(o) Definitions. For purposes of this Article XXVIII, unless the context requires otherwise:

(1) "Controlled company" means a company of which more than 50% of the voting power is held by an individual, a group or another company.

(2) "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 any person who has the same residence.

(3) "Independent director" means a person other than an officer or employee of the issuer or its subsidiaries or any other individual having a relationship, which, in the opinion of the issuer's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The following persons shall not be considered independent:

(A) A director who is, or during the past three years was, employed by the

issuer or by any parent or subsidiary of the issuer;

(B) A director who accepts or who has an immediate family member who accepts any payments from the issuer or any parent or subsidiary of the issuer in excess of \$60,000 during the current fiscal year or any of the past three fiscal years, other than compensation for board service, payments arising solely from investments in the issuer's securities, compensation paid to an immediate family member who is an employee of the issuer or a parent or subsidiary of the issuer (but not if such person is an executive officer of the company or any parent or subsidiary of the company), benefits under a tax-qualified retirement plan, or non-discretionary compensation;

(C) A director who is an immediate family member of an individual who is, or during the past three years was employed by the issuer or by any parent or subsidiary of the issuer as an executive officer;

(D) A director who is a partner in, or a controlling shareholder or an executive officer of, any organization to which the issuer made, or from which the issuer received, payments (other than those arising solely from investments in the company's securities) that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more, in the current fiscal year or any of the past three fiscal years;

(E) A director of the issuer who is employed as an executive officer of another entity where any of the executive officers of the issuer serve on the compensation committee of such other entity, or if such relationship existed during the past three years; or

(F) A director who is or was a partner or employee of the issuer's outside auditor, and worked on the issuer's audit, during the past three years.

(4) "Sarbanes-Oxley Act" means the Sarbanes-Oxley Act of 2002.

(5) "Small business issuer" means any issuer that meets the definition of that term set out in SEC Rule 12b-2.

\* \* \* Interpretations and Policies

.01 No change to text.

.02 **Controlled Companies.** If an issuer relies on a controlled company exemption from the requirements of paragraphs 19(a), 19(c) or 19(d), above, it must disclose in its annual meeting proxy statement that it is a controlled company and provide the basis for that determination.

.03 **General Exemptions from Governance Rules.** The requirements of this rule do not apply to the following entities, as described below:

(1) Limited partnerships and companies in bankruptcies are not required to comply with sections (a), (c) and (d) above.

(2) Closed-end management companies are not required to comply with any provision of this rule other than section (b) above and are only required to comply with that provision to the extent required by SEC Rule 10A-3.

(3) Passive business organizations (such as royalty trusts) or derivatives and special purpose entities that are exempt from the requirements of SEC Rule 10A-3 are not subject to any requirement under this rule.

(4) Foreign issuers will be permitted to comply with their home country practices with respect to corporate governance (and thus are exempt from the requirements of sections (a)-(f), above), except to the extent that SEC Rule 10A-3 requires compliance with specific audit committee requirements.

(5) Issuers listing only preferred or debt securities on the Exchange typically will not be required to adhere to the requirements set out in sections (a)-(f) because they will be subject to the multiple listing exception described in Interpretation .04, below. To the extent required by SEC Rule 10A-3, these issuers will only be required to comply with section (b) above.

.04 **Dual and Multiple Listings.** At any time when an issuer has a class of securities that is listed on a national securities exchange or national securities association subject to requirements substantially similar to those set forth in sections (a)-(d) above, and that class of security has not been suspended from trading on that market, the issuer shall not be required to separately meet the requirements set forth in sections (a)-(d) above with respect to that class of securities or any other class of securities. Governance requirements of other markets will be considered to be substantially similar to the requirements of sections (a)-(d) above if they are adopted by the New York Stock Exchange, the American Stock Exchange or the National Association of Securities Dealers (for the Nasdaq National Market or Small Cap Market) or if they otherwise require, subject to exceptions approved by the Commission, that the issuer maintain (1) a board of directors, a majority of whom are independent directors (50% of whom are independent directors, for a small business issuer); (2) an audit committee, consisting of at least three persons (two persons, for a small business issuer), all of whom are independent directors who meet the

requirements of SEC Rule 10A-3; (3) a written audit committee charter that provides information about the committee's duties and responsibilities; (4) a nominating committee or other body, a majority of whom are independent directors; and (5) a compensation committee or other body, a majority of whom are independent directors.

Similarly, when an issuer has a class of securities that is listed on a national securities exchange or national securities association subject to requirements substantially similar to those set forth in sections (a)-(d) above, and that class of security has not been suspended from trading on that market, a direct or indirect consolidated subsidiary of the issuer, or an at least 50% beneficially-owned subsidiary of the issuer, shall not be required to separately meet the requirements set forth in sections (a)-(d) above with respect to any class of securities it issues, except classes of equity securities (other than non-convertible, non-participating preferred securities) of such subsidiary.

.05 **Transition Periods and Compliance Dates.** Sections (a)-(f) will become effective pursuant to the following schedule:

(1) The audit committee requirements mandated by SEC Rule 10A-3 (and the exception set out in section (b)(1)(B)(ii) in this rule) will become effective as set out in Rule 10A-3.

(2) The other requirements of sections (a)-(f) will become effective two years after the date that they are approved by the Commission. If an issuer has a board with staggered terms, and a change is required with respect to a director whose term does not apply within this two-year period, the issuer will have an additional year to comply with the requirements of section (a).

(3) Except as otherwise required by SEC Rule 10A-3, an issuer listing securities on the Exchange in connection with an initial public offering or transferring from another marketplace that does not have governance standards substantially similar to the standards set out in sections (a)-(f), above, will be required to comply with sections (a)-(f) within two years after listing on the Exchange. An issuer transferring from a market that does have governance standards substantially similar to those set out in sections (a)-(f) above must comply with those provisions at the time that they list; provided, however, that an issuer that transfers during another market's transition period to new governance standards will be allowed to comply with the Exchange's requirements

within any transition period that had been provided by the other marketplace.

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Tier II Corporate Governance, Disclosure, and Miscellaneous Requirements

RULE 21. The following Rule 21 applies only to Tier II issuers:

(a) Each issuer shall comply with the governance requirements set out in Rule 19 (a)–(f) of this Article and is subject to Interpretations .02–.05 of that rule.

[(1) Each listed company shall establish and maintain an Audit Committee, a majority of the members of which shall be independent directors.]

[(2) Each listed company shall maintain a minimum of two independent directors on its board of directors. For purposes of this section, “independent director” shall mean a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.]

[(3)b) *Stock Certificates*. No change to text.

[(4)c) *Changes to Listing Standards*. No change to text.

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Tier II Maintenance Standards

RULE 22. (a) The Exchange reserves the right to delist the securities of any corporation, subject to Securities and Exchange Commission Rules, which engages in practices not in the public interest or whose assets have been depleted to the extent that the company can no longer operate as a going concern or whose securities have become so closely held that it is no longer feasible to maintain a reasonable market in the issue. Furthermore, the Exchange reserves the right to delist the securities of any corporation which has drastically changed its corporate structure and/or its type of operation. The Exchange may also make an appraisal of, and determine on an individual basis, the suitability for continued listing of an issue in the light of all pertinent facts whenever it deems such action appropriate, even though a security meets enumerated criteria (including, but not limited to, continued listing on the NYSE, Amex or Nasdaq National Market). Many factors may be considered in this connection, including, but not limited to, abnormally low selling price or volume of trading, or failure to comply with required corporate governance standards.

(b)–(d) No change to text.

\* \* \* Interpretations and Policies

If the Exchange identifies a Tier II issue as being below the Exchange’s maintenance listing requirements, the Exchange will notify the issuer by letter of its determination and the reasons for that determination. In this letter, the Exchange will provide the issuer with an opportunity to provide the Exchange with a plan (the “Plan”) to cure the deficiency. Within 10 business days of the receipt of the Exchange’s letter, the issuer must contact the Exchange to confirm its receipt of the letter and to report to the Exchange whether or not the issuer intends to present a Plan. If the issuer notifies the Exchange that it does not intend to present a Plan, the Exchange will commence proceedings to suspend and/or delist the issue.

The issuer must present any Plan within 45 days after its receipt of the Exchange’s letter. The Plan must describe definitive action that the issuer has taken, or is taking, that would bring it into conformity with the Exchange’s maintenance listing requirements within 18 months of receipt of the letter, or within any shorter time period required by the Exchange. (The Exchange will not approve any Plan, under which an issuer is curing a deficiency under SEC Rule 10A–3, which extends beyond the earlier of 12 months or the first annual shareholders’ meeting (for circumstances beyond the reasonable control of an issuer) and 6 months (for other circumstances)). The Plan also must set quarterly milestones against which the Exchange will evaluate its progress. Exchange staff will evaluate the Plan and determine whether the issuer has made a reasonable demonstration in the Plan of an ability to come into compliance with the Exchange’s maintenance listing requirements. The Exchange will notify the issuer of its determination within 45 days after receipt of the Plan. If the Exchange does not accept the Plan, it will commence proceedings to suspend and/or delist the issue.

If the Exchange accepts the Plan, the Exchange will review the issuer on a quarterly basis to determine the issuer’s progress under the Plan. If the issuer fails to meet a material provision of the Plan or one or more of its quarterly milestones, the Exchange will review the facts and circumstances and determine whether to initiate proceedings to suspend and/or delist the issue; provided however, that if an issuer fails to meet a material provision of the Plan that relates to compliance with its obligations under SEC Rule 10A–3, the Exchange will immediately commence

proceedings to suspend and/or delist the issue. If, for circumstances that do not involve compliance with SEC Rule 10A–3, the Exchange determines that continued listing is warranted, the Exchange will continue to review the issuer’s progress under the Plan on at least a quarterly basis. If the issuer achieves compliance with the Exchange’s maintenance listing requirements before the Plan expires under its terms, the Exchange may choose to consider the Plan ended as of that earlier date.

If an issuer, within one year after the termination of a Plan, is again determined to have failed to meet the Exchange’s maintenance listing requirements, the Exchange will review the facts and circumstances (including whether the issuer has fallen into non-compliance with the same standards at issue in its earlier Plan) and will take appropriate action, which could include, but its not limited to, shortening the time periods associated with the submission of any new Plan or immediately commencing proceedings to suspend and/or delist the issue.

These procedures do not prevent the Exchange from suspending trading in an issue immediately, whenever it finds that it is necessary to do so for the protection of investors.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change 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 Exchange 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 CHX states that the purpose of the proposed rule change is to amend certain provisions of its rules relating to the governance of issuers that list securities on the Exchange. Specifically, the CHX seeks to amend its listing standards to enhance its requirements relating to the roles and responsibilities of independent directors and independent board committees

(including audit committees, nominating committees and compensation committees), which are set forth in CHX Article XXVIII, Rules 19 and 21 (collectively, the "CHX Governance Standards"). The proposed amendments to the CHX Governance Standards constitute a comprehensive group of significant changes to the Exchange's listing standards and are intended to enhance investor confidence by helping to ensure the independence of corporate directors and strengthening corporate governance practices. The Exchange believes that the additional proposed changes to the Exchange's maintenance listing standards, which are found in CHX Article XXVIII, Rules 17A and 22, will ensure continued compliance with the CHX Governance Standards, while also providing issuers an opportunity to cure failures to meet those (and other) on-going requirements.<sup>4</sup>

These changes to the CHX Governance Standards and to the CHX's maintenance listing standards are designed to comply with the provisions of Section 10A(m) under the Act<sup>5</sup> and SEC Rule 10A-3 thereunder;<sup>6</sup> they also include additional enhancements to the Exchange's governance requirements for listed companies.<sup>7</sup> In most respects, the Exchange believes that proposed changes are substantially similar to governance changes proposed by the National Association of Securities Dealers, Inc. and the American Stock Exchange LLC.<sup>8</sup> The Exchange also states that a few of the proposed changes—particularly those made to the CHX maintenance standards or incorporated within at least one new definition—mirror existing rules or proposals of the New York Stock Exchange, Inc. ("NYSE").<sup>9</sup>

<sup>4</sup> A few additional clerical changes are also made; these changes re-number the paragraphs within affected rules and add new headings for certain paragraphs.

<sup>5</sup> 15 U.S.C. 78j-1(m).

<sup>6</sup> 17 CFR 10A-3. The Commission notes that the CHX intends to amend the proposed rule change to fully conform with SEC Rule 10A-3. Telephone conversation between Kathleen M. Boege, Vice-President and Associate General Counsel, CHX, and Ira L. Brandriss, Special Counsel, Division, Commission, on October 10, 2003.

<sup>7</sup> The Commission notes that the CHX will consider amendments to the proposed rule change once the Commission approves proposals on corporate governance matters filed by other exchanges. Telephone conversation between Kathleen M. Boege, Vice-President and Associate General Counsel, CHX, and Ira L. Brandriss, Special Counsel, Division, Commission, on October 10, 2003.

<sup>8</sup> See Securities Exchange Act Release No. 47516 (March 17, 2003), 68 FR 14451 (March 25, 2003) (SR-NASD-2002-141) and SR-Amex-2003-65.

<sup>9</sup> See Securities Exchange Act Release No. 47672 (April 11, 2003), 68 FR 19051 (April 17, 2003) (SR-

The CHX Governance Standards will apply to all companies listing common stock on the Exchange, with particular exemptions for controlled companies, limited partnerships, companies in bankruptcy, closed-end management companies and foreign issuers. Under proposed Article XXVIII, Rule 19, Interpretation and Policy .03, passive business organizations (such as royalty trusts) will not be subject to these standards, nor will the standards apply to derivatives or special purpose securities, if those entities and securities are exempt from the requirements of Rule 10A-3 under the Act.<sup>10</sup> Under proposed Article XXVIII, Rule 19, Interpretation and Policy .04, additional exemptions will exist for dual and multiple listings, where the same or another class of security of the company is already listed on another national securities exchange or national securities association that has similar governance-related requirements. The proposed CHX Governance Standards will apply to companies that list securities under Tier I or Tier II of the CHX's listing standards.

Summarized below are the principal categories of change to the CHX Governance Standards.

#### Definition of "Independence"

The Exchange believes that it is critical for investors to have confidence that an individual serving as an independent director does not have any relationship with the issuer (or its officers) that would impair the director's independence. Accordingly, in addition to the existing CHX rule language, which generally precludes any relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director, the proposed amendments specifically identify six categories of persons who shall not be considered independent under proposed CHX Article XXVIII, Rule 19(o)(3).

In general, persons who shall not be considered independent include: (i) A director employed by the issuer or its parent or subsidiary during the previous three years; (ii) a director who accepts (or who has immediate family members who accept) any payments from the issuer in excess of \$60,000 during the current year or any of the past three fiscal years (other than compensation for board service, payments from investments in the issuer's securities, compensation to non-executive family members, tax-qualified retirement

benefits or non-discretionary compensation); (iii) a director who is an immediate family member of an individual who is, or who served during the previous three years, as an executive officer of the issuer or its parent or subsidiary; (iv) a director who is a principal (*i.e.*, a partner, controlling shareholder or executive officer) in any organization that received payments from the issuer, or that made payments to the issuer, exceeding 5% of the recipient's consolidated gross revenues for the year or \$200,000, whichever is greater; (v) a director who is an executive officer of another entity, if there is compensation committee overlap between the issuer and such entity currently or during the past three years; and (vi) a director who was a partner or employee of the issuer's outside auditor, and worked on the issuer's audit, during any of the past three years.

Under proposed CHX Article XXVIII, Rule 19(o)(2), the proposed amendments define an immediate family member as a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law and any person who has the same residence as the director in question.

#### Independent Board and Board Committees

Through the exercise of independent judgment, independent directors act on behalf of investors to maximize shareholder value and guard against conflicts of interest. Accordingly, under proposed Article XXVIII, Rule 19(a), the proposed amendments require most issuers to maintain a majority of independent directors on their boards; small business issuers will be required to have boards consisting of at least 50% independent directors. The proposed rule also requires regularly convened executive sessions of the independent directors. The Exchange states that regularly scheduled executive sessions will encourage and enhance communication among independent directors. A controlled company would be exempt from this requirement.<sup>11</sup>

Under proposed CHX Article XXVIII, Rule 19(c), the nomination of the issuer's directors will be determined by independent directors. Independent director oversight of the director nomination process should enhance investor confidence in the selection of well-qualified director nominees. This

<sup>11</sup> Under the definition in proposed in CHX Article XXVIII, Rule 19(o)(1), a "controlled company" would mean a company of which more than 50% of the voting power is held by an individual, group or other company.

NYSE-2002-33) and NYSE Listed Company Manual Section 802.

<sup>10</sup> 17 CFR 240.10A-3.

rule would not apply in cases where the right to nominate a director legally belongs to a third party.<sup>12</sup>

The proposal under proposed CHX Article XXVIII, Rule 19(d) also contemplates independent director approval of the compensation of an issuer's officers.<sup>13</sup> The Exchange believes this oversight will help ensure that appropriate executive incentives are in place, consistent with the board's responsibility to maximize shareholder value.

#### Audit Committee Requirements

Under proposed CHX Article XXVIII, Rule 19(b), the proposed amendments would expand existing CHX requirements relating to audit committee composition and would include new requirements relating to that committee's role and authority. With very limited exceptions set forth in the proposed rule, each member of an issuer's audit committee: (i) Must be an independent director; (ii) must meet the criteria for independence set forth in SEC Rule 10A-3; and (iii) must be able to read and understand fundamental financial statements, including a company's balance sheet, income statement and cash flow statement.<sup>14</sup>

The proposed amendment would require each issuer's audit committee to have the responsibilities and authority set out in SEC Rule 10A-3 (and to act in accordance with those provisions) and to have a written charter to specify the audit committee's minimum purposes, duties and responsibilities, including those that are required by the SEC Rule and by the Sarbanes-Oxley Act.<sup>15</sup> The written charter must be reviewed, and its adequacy must be reassessed on an annual basis by the audit committee.

#### Code of Business Conduct and Ethics

Under the proposed rules, each issuer would be required to adopt a code of

conduct and ethics that applies to its directors, officers and employees and that meets the requirements of section 406(c) of the Sarbanes-Oxley Act. Under proposed CHX Article XXVIII, Rule 19(e), waivers of the code for directors and officers would need to be approved by the issuer's board of directors and be made publicly available.

#### Governance-Related Certifications

Given the importance of the requirements set forth in the CHX Governance Standards, the proposed amendments contain a requirement that each issuer's chief executive officer certify, on an annual basis, that he or she is not aware of any violation by the issuer of any standard set forth in CHX Article XXVIII, Rules 19(a)-(e). Further, under proposed CHX Article XXVIII, Rule 19(f), such chief executive officer is required to promptly notify the Exchange if any executive officer of the issuer becomes aware of any material non-compliance by the issuer with those standards.

#### Changes to CHX Maintenance Standards

For both Tier I and Tier II issuers under proposed CHX Article XVIII, Rules 17A and 22, the proposed amendments contemplate a process whereby the Exchange would provide non-compliant issuers with notice and an opportunity to cure the stated deficiency. These provisions would apply to situations in which an issuer fails to meet governance-related standards, as well as those in which an issuer fails to meet other maintenance standards.

In general, the proposed rule amendments would require the Exchange to notify a non-compliant issuer in writing of the Exchange's determination and the reasons for such determination. The issuer would then be required to respond within 10 business days to confirm its receipt of the letter and to advise the Exchange whether or not the issuer intends to submit a plan for curing the deficiency. Any plan must describe definitive action that the issuer has taken or is taking that would bring it into conformity with the Exchange's standards within 18 months, or within any shorter period of time required by the Exchange.<sup>16</sup> The plan must be submitted within 45 days after receiving

the Exchange's determination of deficiency. If the Exchange accepts the plan, the Exchange would assess the issuer's progress on a quarterly basis. If the Exchange does not accept the plan, the Exchange would initiate proceedings to suspend and/or delist the issue. While the plan is in effect, the Exchange could initiate proceedings to suspend and/or delist the issue if the issuer fails to meet a material provision of the plan or fails to meet quarterly milestones.

The foregoing procedures would not preclude the Exchange from taking immediate action to suspend trading in an issue, if such action is necessary for the protection of investors.

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

Because the majority of the Exchange's issuers have securities that are also listed on one or more other markets, the Exchange has included a provision in its proposed rule amendments under proposed CHX Article XVIII, Rule 19, Interpretation and Policy .04 that would exempt such issuers from the CHX Governance Standards if the issuer is listed on a national securities exchange or national securities association with listing standards substantially similar to the CHX Corporate Governance Standards. The proposed rule text contains specific criteria that must be considered when determining whether another market's governance standards are "substantially similar."

#### Schedule for Effectiveness of Proposed Rule Changes

The CHX anticipates that the proposed rule changes to CHX Governance Standards will become effective in accordance with the timetable set forth in proposed CHX Article XXVIII, Rule 19, Interpretation and Policy .05. In general, following Commission approval of the proposed rule changes: (i) The audit committee requirements mandated by Rule 10A-3 under the Act (and the exception set out in CHX Article XXVIII, Rule 19(b)(1)(B)(ii)) will become effective as set out in Rule 10A-3 for all issuers; (ii) the other CHX Governance Standards will become effective two years after they are approved by the Commission, with a one-year "grace period" for issuers with staggered term boards; and (iii) issuers listing on the Exchange in connection with an initial public offering or transferring from another marketplace with different governance standards will be required to comply with CHX Governance Standards within

<sup>12</sup> The rule incorporates other limited exceptions that would permit certain persons to serve on the nominating committee, if the issuer's board determines that a person's membership on the committee is required by the best interests of the company and its shareholders and the board discloses the nature of the relationship and the basis for its determination in the next annual meeting proxy statement following that determination. An issuer's chief executive officer would be permitted to participate in the deliberations relating to the compensation of other officers, but would not be allowed to vote.

<sup>13</sup> Controlled companies would be exempt from this requirement, and a specific exception would exist to allow certain persons to serve on the compensation committee in exceptional and limited circumstances.

<sup>14</sup> Nothing in the rule exempts an issuer from the requirements of section 10A(m) under the Act, 15 U.S.C. 78j-1(m), and Rule 10A-3 thereunder.

<sup>15</sup> Pub. L. 107-204, 116 Stat. 745 (2002).

<sup>16</sup> The proposed rule confirms that the Exchange would not accept a plan that is designed to cure a deficiency under SEC Rule 10A-3 if the plan extends beyond the earlier of 12 months or the first annual shareholders' meeting (for circumstances beyond the reasonable control of an issuer) and 6 months (for other circumstances).

two years after listing on the CHX.<sup>17</sup> Changes to CHX Maintenance Standards will become effective upon Commission approval.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act<sup>18</sup> in general, and furthers the objectives of section 6(b)(5) of the Act<sup>19</sup> in particular, because it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were solicited or received. The Exchange, however, did notify its issuers of the types of proposed rule changes that it was contemplating and has not received any objections to those proposals. One issuer's verbal comments "seeking flexibility in the effective dates of, or the scope of the exceptions from, the proposals for the new independence requirements" have been incorporated into the Exchange's rule proposal.

## 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 Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or

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

<sup>17</sup> An issuer transferring to the CHX from another market with substantially similar governance standards must comply with such governance standards at the time the issuer lists with the CHX, or within any transition period that was provided by the other marketplace.

<sup>18</sup> 15 U.S.C. 78f(b).

<sup>19</sup> 15 U.S.C. 78f(b)(5).

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change 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, as amended, that are filed with the Commission, and all written communications relating to the proposed rule change, as amended, 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 CHX. All submissions should refer to file number SR-CHX-2003-19 and should be submitted by November 18, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>20</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 03-27135 Filed 10-27-03; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48678; File No. SR-GSCC-2002-04]

### **Self-Regulatory Organizations; Government Securities Clearing Corporation; Order Approving Proposed Rule Change to Institute Informal Hearing Procedures for Fine Disputes**

October 22, 2003.

#### **I. Introduction**

On June 28, 2002, the Government Securities Clearing Corporation ("GSCC") filed with the Securities and Exchange Commission ("Commission") and on August 19, 2003, amended proposed rule change SR-GSCC-2002-04 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the **Federal Register** on

<sup>20</sup> 17 CFR 200.30-3(a)(12).

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

September 2, 2003.<sup>2</sup> For the reasons discussed below, the Commission is approving the proposed rule change.

#### **II. Description**

Since 1998, GSCC has had the authority to impose fines in order to promote greater compliance with its funds settlement debit and clearing fund deposit deficiency call deadlines.<sup>3</sup> GSCC Rule 37 contains procedures whereby a member can dispute any fine assessment through a formal hearing process. Rule 37 also permits GSCC to establish procedures for a hearing not otherwise provided for in the rules.<sup>4</sup> GSCC seeks authority to specifically incorporate into its rules informal hearing procedures with respect to disputed fines.

Pursuant to GSCC's new procedures, if a member disputes a fine and asks for a formal hearing in the manner already specified in the rules, GSCC's management will automatically conduct a review of the disputed fine. Based on the documentation already required in the rules and/or a meeting arranged with the member, management may determine that the fine should be waived. If management determines that the fine should be waived, it must inform the Membership and Risk Management Committee of its determination and the reasons for that determination. The Committee has the ability to accept or reject management's determination. If the Committee accepts management's determination, the fine will be waived. However, if the Committee chooses not to accept management's determination or if management had not determined in its review that the fine should be waived, the member has the right to the formal hearing already provided for in Rule 37.

In addition, GSCC's rules are being amended to require that if a fine is assessed, the member must pay the fine within 30 calendar days (currently 90 days) after it receives the fine imposition letter. If the member requests a hearing in accordance with GSCC's rules to dispute the fine, the fine will not be owing while the hearing is pending.

#### **III. Discussion**

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to perfect the mechanism of a national system for the

<sup>2</sup> Securities Exchange Act Release No. 48411 (August 26, 2003), 68 FR 52256.

<sup>3</sup> Securities Exchange Act Release No. 39746 (March 12, 1998), 63 FR 13439 (March 19, 1998) [File No. SR-GSCC-97-04].

<sup>4</sup> Government Securities Clearing Corporation Rule 37, Section 7.