SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–48108; File Nos. SR–NYSE–2002–46 and SR–NASD–2002–140]

Self-Regulatory Organizations; New York Stock Exchange, Inc. and National Association of Securities Dealers, Inc.; Order Approving NYSE and Nasdaq Proposed Rule Changes and Nasdaq Amendment No. 1 and Notice of Filing and Order Granting Accelerated Approval to NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3 Thereto Relating to Equity Compensation Plans

June 30, 2003.

I. Introduction

On October 7, 2002, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposal relating to shareholder approval of equity-compensation plans and the voting of proxies. On October 11, 2002, the NYSE proposal was published for public comment in the **Federal Register**.[3] On November 6, 2002, the NYSE filed NYSE Amendment No. 1 to the proposed rule change.[4] The Commission received a total of 30 comment letters on the NYSE proposal.[5] On June 20, 2003, the NYSE filed NYSE Amendment No. 2 to its proposal.[6]

On October 9, 2002, the National Association of Securities Dealers, Inc. (''NASD''), through its subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq'') filed a similar proposal relating to shareholder approval for stock option plans and other equity compensation arrangements. On October 10, 2002, Nasdaq filed Nasdaq Amendment No. 1 to the proposed rule change.[7] On October 17, 2002, the Nasdaq proposal, as amended, was published for comment in the **Federal Register**.[8] The Commission received a total of 18 comment letters on the Nasdaq proposal.[9] On March 24, 2003, Nasdaq filed Nasdaq Amendment No. 2 to the proposed rule change.[10] On June 23, 2003, Nasdaq filed Nasdaq Amendment No. 3 to its proposal.[11] This order

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 46620 (October 8, 2002), 67 FR 63486 (''Notice of the NYSE Proposal''). The Commission also published a correction to the Notice of the NYSE Proposal to indicate that the word ''less'' in footnote 10 should be changed to ''greater.'' *See* Securities Exchange Act Release No. 44620A (October 21, 2002), 67 FR 65617 (October 25, 2002).

[4] *See* letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated November 5, 2002 (''NYSE Amendment No. 1''). In NYSE Amendment No. 1, the NYSE made technical corrections to its proposed rule language.

[5] *See* letters to Jonathan G. Katz, Secretary, Commission, from Deborah Ackerman, Vice President and General Counsel, Southwest Airlines Co., dated October 15, 2002 (''Southwest Airlines Letter''); Peter C. Clapman, Senior Vice President and Chief Counsel, Corporate Governance, Teacher Insurance and Annuity Association of America College Retirement And Equities Fund (''TIAA CREF''), dated October 24, 2002 (''TIAA CREF Letter''); R. Thomas Buffenbarger, International President, International Association of Machinists and Aerospace Workers (''IAM''), dated October 22, 2002 (''IAM Letter''); Sarah A.B. Teslik, Executive Director, Council of Institutional Investors (''CII''), dated October 24, 2002 (''CII Letter''); Linda S. Selbach, Global Proxy Manager, Barclays Global Investors, dated October 24, 2002 (''Barclays Letter''); Henry I. Morgenbesser *et al.*, Allen & Overy *et al.*, dated October 31, 2002 (''Allen & Overy Letter''); Keith Johnson, Chief Legal Counsel, State of Wisconsin Investment Board (''SWIB''), dated October 31, 2002 (''SWIB Letter''); Peter A. Irwin, Vice President, Legal Services, Consolidated Edison Company of New York, Inc. (''conEdison''), dated October 31, 2002 (''conEdison Letter''); John P. Clarson, Assistant Corporate Secretary and Senior Corporate Attorney, Law Department, RadioShack Corporation, dated October 30, 2002 (''RadioShack Letter''); Paul Lee, Shareholder Engagement Manager, Hermes Investment Management Limited, dated October 29, 2002 (''Hermes Letter''); John Endean, President, American Business Conference (''ABC''), dated October 31, 2002 (''ABC Letter''); James P. Hoffa, General President, International Brotherhood of Teamsters (''IBT''), dated November 1, 2002 (''IBT Letter''); Dorothy M. Donohue, Associate Counsel, Investment Company Institute (''ICI''), dated November 1, 2002 (''ICI Letter''); Damon A. Silvers, Associate General Council, American Federation of Labor and Congress of Industrial Organizations (''AFL–CIO''), dated November 1, 2002 (''AFL–CIO Letter''); Nancy Straus Sundheim, Senior Vice President and General Counsel, Unisys Corporation, dated November 1, 2002 (''Unisys Letter''); Michael R. Fanning, Chief Executive Officer, Central Pension Fund of the International Union of Operating Engineers and Participating Employers (''CPF''), dated October 29, 2002 (''CPF Letter''); Ted White, Director, Corporate Governance, California Public Employees' Retirement System (''CalPERS''), dated October 31, 2002 (''CalPERS Letter''); Sheila W. Beckett, Employees Retirement System of Texas, dated October 30, 2002 (''Employee Retirement System of Texas Letter''); Herbert L. Dryer, Executive Director, State Teachers Retirement System of Ohio (''STRS Ohio''), dated October 30, 2002 (STRS Ohio Letter''); William G. Clark, Deputy Director, New Jersey Division of Investment (''NJ Division''), Department of Treasury, dated October 31, 2002 (''NJ Division Letter''); James E. Heard, Chief Executive Officer and Patrick McGurn, Vice President and Special Counsel, Institutional Shareholder Services (''ISS''), dated October 31, 2002 (''ISS I Letter''); Sullivan & Cromwell, dated November 1, 2002 (''Sullivan & Cromwell Letter''); Mark Heesen, President, National Venture Capital Association (''NVCA''), dated November 1, 2002 (''NVCA I Letter''); Marsha Richter, Chief Executive Officer, Los Angeles County Employees Retirement Association (''LACERA''), dated November 7, 2002 (''LACERA Letter''); Stanley Keller, Chair, Committee on Federal Regulation of Securities, American Bar Association (''ABA''), Section of Business Law, dated November 11, 2002 (''ABA Letter''); Kay R. H. Evans, Executive Director, Maine State Retirement System (''MSRS''), dated October 28, 2002 (''MSRS Letter''); Jerome Pella, dated October 30, 2002 (''Pella Letter''); Michael Ryan, Executive Vice President and General Counsel, American Stock Exchange LLC (''Amex''), dated December 19, 2003 (''Amex I Letter''); Claudia Crowley, Vice President, Listing Qualifications, Amex, dated February 19, 2003 (''Amex II Letter''); and William and Margaret Gillespie, dated May 17, 2003 (Gillespie Letter'').

[6] *See* letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division, Commission, dated June 20, 2003 (''NYSE Amendment No. 2''). In NYSE Amendment No. 2, the NYSE proposed changes to the NYSE proposal based on discussions with Commission staff and in response to the comment letters. As discussed below, NYSE Amendment No. 2, among other things, did the following: (1) Clarified the terms ''equity compensation plan,'' ''material revision,'' and ''repricing'; (2) defined ''evergreen,'' ''formula'' and ''discretionary'' plans; and (3) provided new transition rules. For a more detailed description of NYSE Amendment No. 2, *see* Section II.A., *infra.*

[7] *See* letter from John D. Nachmann, Senior Attorney, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated October 10, 2002 (''Nasdaq Amendment No. 1''). In Amendment No. 1, Nasdaq did the following: (1) Made technical corrections to its proposed rule language; (2) clarified the exceptions to shareholder approval for tax qualified, non-discriminatory employee benefit plans, parallel nonqualified plans, and plans relating to an acquisition or merger; and (3) clarified in the purpose section of its filing that it was proposing to make conforming changes to NASD Rules 4310(c)(17)(A) and 4320(e)(15)(A).

[8] *See* Securities Exchange Act Release No. 46649 (October 11, 2002), 67 FR 64173 (''Notice of the Nasdaq Proposal''). Nasdaq represents that it made a technical error in its reprinting of the original rule text of NASD Rule 4320(e)(15). Nasdaq is not proposing to change this language. Telephone conversation between Sara Nelson Bloom, Associate General Counsel, Nasdaq, and Sapna C. Patel, Attorney, Division, Commission, on June 30, 2003.

[9] *See* letters to Jonathan G. Katz, Secretary, Commission, from James E. Heard, Chief Executive Officer and Patrick McGurn, Vice President and Special Counsel, ISS, dated November 6, 2002 (''ISS II Letter''); and Mark Heesen, President, NVCA, dated November 1, 2002 (''NVCA II Letter''). The Commission notes that 16 of the 18 comment letters received on the Nasdaq proposal are letters commenting jointly on the NYSE and Nasdaq proposals. *See* TIAA CREF Letter; CII Letter; Barclays Letter; Allen & Overy Letter; SWIB Letter; MSRS Letter; Hermes Letter; ICI Letter; AFL–CIO Letter; CPA Letter; CalPERS Letter; STRS Letter; NJ Division Letter; LACERA Letter; ABA Letter; and Pella Letter.

[10] *See* letter from Sara Nelson Bloom, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated March 24, 2003 (''Nasdaq Amendment No. 2''). In Nasdaq Amendment No. 2, Nasdaq clarified the term ''material amendment'' to a stock option plan by providing a non-exclusive list of what Nasdaq would consider to be ''material,'' and proposed an exception to shareholder approval for plans that provide a way to purchase shares on the open market or from the issuer at fair market value. Nasdaq replaced Nasdaq Amendment No. 2 in its entirety with Nasdaq Amendment No. 3. As noted below, some of the proposed changes in Nasdaq Amendment No. 2 were incorporated into Nasdaq Amendment No. 3. *See infra* note 11 and Section II.B.

[11] *See* letter from Sara Nelson Bloom, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated June 23, 2003 (''Nasdaq Amendment No. 3''). In

Continued

approves the NYSE proposal, as amended by NYSE Amendments No. 1 and 2, and the Nasdaq proposal, as amended by Nasdaq Amendments No. 1, 2, and 3. The Commission has found good cause to grant accelerated approval to NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3, as discussed below, and is soliciting comments from interested persons on these amendments.

II. Description of the NYSE and Nasdaq Proposals

A. NYSE Proposal

The NYSE proposes to adopt new section 303A(8) of the NYSE's Listed Company Manual, which would require shareholder approval of all equity-compensation plans and material revisions to such plans, subject to limited exemptions.[12] This new rule, when approved by the Commission, will replace the NYSE's current pilot program relating to amendments to Sections 312.01, 312.03 and 312.04 of the NYSE's Listed Company Manual with respect to the definition of a ''broadly-based'' stock option plan.[13]

Under the NYSE proposal, as amended, an equity compensation plan is defined as a plan or other arrangement that provides for the delivery of equity securities (either newly issued or treasury shares) of the listed company to any employee, director or other service provider as compensation for services, including a compensatory grant of options or other equity securities that is not made under a plan. The NYSE has also proposed changes to clarify certain plans that would not be considered equity compensation plans under its definition.[14] In addition, the NYSE proposal provides for certain types of grants that are exempted from shareholder approval. These limited exemptions include: (1) Inducement awards to person's first becoming an employee of the issuer or any of its subsidiaries; (2) mergers and acquisitions, when conversions, replacements or adjustments of outstanding options or other equity compensation awards are necessary to reflect the transaction, and when shares available under certain plans acquired in corporate acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval; and (3) plans intended to meet the requirements of section 401(a) of the Internal Revenue Code [15] (*e.g.*, ESOPs), plans intended to meet the requirements of section 423 of the Internal Revenue Code,[16] and parallel excess plans. The NYSE also proposes that, in circumstances in which equity compensation plans and amendments to plans are not subject to shareholder approval, the plans and amendments still must be subject to the approval of the company's compensation committee or a majority of the company's independent directors. Finally, in its proposal, the NYSE provides a non-exclusive list of ''material revisions'' to a plan that would require shareholder approval, and also clarifies when plans containing an ''evergreen formula'' and when the ''repricings'' of options in plans would require shareholder approval.[17]

The NYSE also proposes to amend NYSE Rule 452 to prohibit member organizations from voting on equity compensation plans unless the beneficial owner of the shares has given voting instructions. In addition, the NYSE proposes to make conforming changes to current Sections 303.00, 312.03, 312.04, and 402.08 of the NYSE's Listed Company Manual.

NYSE Amendment No. 2 to the NYSE filing proposes a number of changes to the rules as they were published in the Notice of the NYSE Proposal. According to the NYSE, these changes were made in response to the comment letters and discussions with Commission staff. As a general matter, the changes provide additional guidance as to the scope of the NYSE's proposed rule changes, including the type of material changes to a plan that must be submitted for shareholder approval. The NYSE also proposes to include a new section entitled ''Transition Rules'' to clarify when shareholder approval will be required for plans adopted before the effective date of the proposed amendments. The basic structure of the rule as proposed has remained the same as originally submitted. While the Notice of the NYSE Proposal reflects the original format of the recommendations made by the Committee, stating a basic principle and including additional explanation and commentary, the NYSE states that it intended, through the proposed amendments to the rule text of section 303A(8) in NYSE Amendment No. 2 to write the rule language in a more ''plain-English'' format to enhance understanding of the rule.

1. Significant Changes From the Original Filing of the NYSE Proposal

The NYSE proposes to clarify the description of plans that are not equity compensation plans to expressly exclude plans that do not provide for delivery of equity securities of the issuer (*e.g.*, plans that pay in cash), and deferred compensation plans under which employees pay full current market value for deferred shares.

The NYSE proposes to modify the language of the rule to clarify that shareholder approval is required for pre-existing plans that were not approved by shareholders and that have neither an evergreen formula nor a specific number of shares available under the plan. However, the NYSE proposes to provide a transition period for requiring shareholder approval for such plans.[18] In addition, the NYSE has specified that, during the period prior to approval, the plan may be utilized, but only in a manner consistent with past practice.

In the section entitled ''Material Revisions,'' the NYSE proposes to more specifically define the concept of ''evergreen'' plans (*i.e.*, that contain a formula for automatic increases in the shares available) or ''formula'' plans [19] (*i.e.*, plans that provide for automatic grants pursuant to a formula), and proposes to introduce the concept of ''discretionary plans.'' Generally, a

Nasdaq Amendment No. 3, Nasdaq did the following: (1) Replaced Nasdaq Amendment No. 2 in its entirety; (2) stated that on November 14, 2002, the Nasdaq Board of Directors approved, and that on December 9, 2002, the Board of Governors of the NASD reviewed, all remaining aspects of the Nasdaq proposal; and (3) made clarifying and conforming changes to the Nasdaq proposal in response to discussions with Commission staff and in response to the comment letters. As discussed below, Nasdaq Amendment No. 3, among other things, also clarified the term ''material amendment,'' proposed an exception to shareholder approval for plans that provide a way to purchase shares on the open market or from the issuer at fair market value, and discussed evergreen plans and repricings. For a more detailed description of Nasdaq Amendment No. 3, *see* Section II.B., *infra.*

[12] The NYSE proposal is part of the recommendations made by the NYSE's Corporate Accountability and Listing Standards Committee (''Committee''), a committee appointed by NYSE to review its corporate governance listing standards. The rest of the Committee's recommendations are in a separate rule filing, File No. SR–NYSE–2002–33. *See* Securities Exchange Act Release No. 47672, 68 FR 19051 (April 17, 2003) (published notice of SR–NYSE–2002–33).

[13] *See* Securities Exchange Act Release No. 41479 (June 4, 1999), 64 FR 31667 (June 11, 1999) (notice of filing and order granting accelerated approval, on a pilot basis, to File No. SR–NYSE–98–32). The Pilot was extended several times, most recently until June 30, 2003. *See* Securities Exchange Act Release No. 47409 (February 26, 2003), 68 FR 10560 (March 5, 2003) (File No. SR–NYSE–2003–04).

[14] *See* NYSE Amendment No. 2, *supra* note 6. *See also* Section II.A.1. and 2., *infra.*

[15] 26 U.S.C. 401(a).

[16] 26 U.S.C. 423.

[17] *See* NYSE Amendment No. 2, *supra* note 6. *See also* Section II.A.1. and 2., *infra.*

[18] *See* Section II.A.2., *infra.*

[19] Under the NYSE's rules, an increase or grant pursuant to an evergreen or formula plans would require shareholder approval for each increase or grant unless the plan has a term of not more than 10 years.

discretionary plan is a plan that contains no limit on the number of shares available and is not a formula plan. The NYSE proposes that each grant under such a discretionary plan will require shareholder approval regardless of whether the plan has a term of not more than 10 years. In addition, the NYSE represents that the proposed language under ''Transition Rules'' relating to evergreen plans clarifies that an evergreen plan that was approved by shareholders but that does not have a ten-year term must be: (1) Approved by shareholders before any shares that become available as a result of a formulaic increase are utilized, or (2) amended to include a term of no more than ten years from the date the plan was adopted or last approved by shareholders. If the plan were amended to include such term, shareholder approval would not be required. No action would be required, however, if a plan were frozen at the level of shares available at the time the rule becomes effective. The enumerated list of ''Material Revisions'' has also been revised to change the term ''changes the types of awards'' to ''expansion of the types of awards.'' The NYSE represents that no further substantive amendment to the definition of ''Material Revisions'' have been made.

The NYSE proposal has been amended to clarify that repricings that have commenced prior to the date of effectiveness of the proposal (*i.e.*, exchange offers to optionees) will not be subject to shareholder approval (assuming that such repricing did not require shareholder approval under existing NYSE rules).

The NYSE proposal has also been amended to clarify that inducement awards are available for rehires following a bona fide period of employment interruption. The NYSE further proposes to clarify that inducement awards include grants to new employees in connection with a merger or acquisition. In addition, the NYSE proposes to include a requirement that listed companies must provide prompt public disclosure following the grant of any inducement award in reliance on the exemption.[20]

With respect to the proposed exception for parallel nonqualified plans, the NYSE proposes to redesignate the exception as applying to ''parallel excess plans'' and proposes to add an additional condition relating to employer equity contributions that a plan must satisfy in order to be deemed a parallel excess plan.

[20] *See* Section II.A.2., *infra.*

The NYSE proposes to add a requirement that an issuer must notify the NYSE in writing when it uses any of the exemptions from the shareholder approval requirements.

The NYSE has not made any changes to the proposed amendments to NYSE Rule 452. The NYSE proposes, however, a transition period that will make the amended rule applicable only to shareholder meetings that occur on or after the 90th day following the date of the SEC order approving the amended rule. In addition, the NYSE proposes to make a conforming change to NYSE Rule 452 subsection .11(9) to reflect the amendments that are being proposed to NYSE Rule 452 subsection .11(12), and proposes to reflect the proposed amendments to NYSE Rule 452 in Section 402.08 of the NYSE's Listed Company Manual (''Giving a Proxy to Vote Stock''), which restates NYSE Rule 452 in part.

2. Amended New Section 303A(8) of the NYSE's Listed Company Manual

As amended by NYSE Amendments No. 1 and 2, proposed new section 303A(8) of the NYSE's Listed Company Manual will read as follows:

8. Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exemptions explained below.

Equity-compensation plans can help align shareholder and management interests, and equity-based awards are often very important components of employee compensation. To provide checks and balances on the potential dilution resulting from the process of earmarking shares to be used for equity-based awards, the Exchange requires that all equity-compensation plans, and any material revisions to the terms of such plans, be subject to shareholder approval, with the limited exemptions explained below.

Definition of Equity-Compensation Plan

An ''equity-compensation plan'' is a plan or other arrangement that provides for the delivery of equity securities (either newly issued or treasury shares) of the listed company to any employee, director or other service provider as compensation for services. Even a compensatory grant of options or other equity securities that is not made under a plan is, nonetheless, an ''equity-compensation plan'' for these purposes.

However, the following are not ''equity-compensation plans'' even if the brokerage and other costs of the plan are paid for by the listed company:

- Plans that are made available to shareholders generally, such as a typical dividend reinvestment plan.
- Plans that merely allow employees, directors or other service providers to elect to buy shares on the open market or from the listed company for their current fair market value, regardless of whether:

—The shares are delivered immediately or on a deferred basis; or

—The payments for the shares are made directly or by giving up compensation that is otherwise due (for example, through payroll deductions).

Material Revisions

A ''material revision'' of an equity-compensation plan includes (but is not limited to), the following:

- A material increase in the number of shares available under the plan (other than an increase solely to reflect a reorganization, stock split, merger, spinoff or similar transaction).

—If a plan contains a formula for automatic increases in the shares available (sometimes called an ''evergreen formula'') or for automatic grants pursuant to a formula, each such increase or grant will be considered a revision requiring shareholder approval unless the plan has a term of not more than ten years.

This type of plan (regardless of its term) is referred to below as a ''formula plan.'' Examples of automatic grants pursuant to a formula are (1) annual grants to directors of restricted stock having a certain dollar value, and (2) ''matching contributions,'' whereby stock is credited to a participant's account based upon the amount of compensation the participant elects to defer.

—If a plan contains no limit on the number of shares available and is not a formula plan, then each grant under the plan will require separate shareholder approval regardless of whether the plan has a term of not more than ten years.

This type of plan is referred to below as a ''discretionary plan.'' A requirement that grants be made out of treasury shares or repurchased shares will not, in itself, be considered a limit or pre-established formula so as to prevent a plan from being considered a discretionary plan.

- An expansion of the types of awards available under the plan.
- A material expansion of the class of employees, directors or other service providers eligible to participate in the plan.
- A material extension of the term of the plan.
- A material change to the method of determining the strike price of options under the plan.

—A change in the method of determining ''fair market value'' from

the closing price on the date of grant to the average of the high and low price on the date of grant is an example of a change that the Exchange would not view as material.

• The deletion or limitation of any provision prohibiting repricing of options. See the next section for details. Note that an amendment will not be considered a ''material revision'' if it curtails rather than expands the scope of the plan in question.

Repricings

A plan that does not contain a provision that specifically *permits* repricing of options will be considered for purposes of this listing standard as *prohibiting* repricing. Accordingly any actual repricing of options will be considered a material revision of a plan even if the plan itself is not revised. This consideration will not apply to a repricing through an exchange offer that commenced before the date this listing standard became effective.

''Repricing'' means any of the following or any other action that has the same effect:

• Lowering the strike price of an option after it is granted.

• Any other action that is treated as a repricing under generally accepted accounting principles.

• Canceling an option at a time when its strike price exceeds the fair market value of the underlying stock, in exchange for another option, restricted stock, or other equity, unless the cancellation and exchange occurs in connection with a merger, acquisition, spin-off or other similar corporate transaction.

Exemptions

This listing standard does not require shareholder approval of employment inducement awards, certain grants, plans and amendments in the context of mergers and acquisitions, and certain specific types of plans, all as described below. However, these exempt grants, plans and amendments may be made only with the approval of the company's independent compensation committee or the approval of a majority of the company's independent directors. Companies must also notify the Exchange in writing when they use one of these exemptions.

Employment Inducement Awards

An employment inducement award is a grant of options or other equity-based compensation as a material inducement to a person or persons being hired by the listed company or any of its subsidiaries, or being rehired following a bona fide period of interruption of employment. Inducement awards include grants to new employees in connection with a merger or acquisition. Promptly following a grant of any inducement award in reliance on this exemption, the listed company must disclose in a press release the material terms of the award, including the recipient(s) of the award and the number of shares involved.

Mergers and Acquisitions

Two exemptions apply in the context of corporate acquisitions and mergers.

First, shareholder approval will not be required to convert, replace or adjust outstanding options or other equity-compensation awards to reflect the transaction.

Second, shares available under certain plans acquired in corporate acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval. This exemption applies to situations where a party that is not a listed company following the transaction has shares available for grant under pre-existing plans that were previously approved by shareholders. A plan adopted in contemplation of the merger or acquisition transaction would not be considered ''pre-existing'' for purposes of this exemption.

Shares available under such a pre-existing plan may be used for post-transaction grants of options and other awards with respect to equity of the entity that is the listed company after the transaction, either under the pre-existing plan or another plan, without further shareholder approval, so long as:

• The number of shares available for grants is appropriately adjusted to reflect the transaction;

• The time during which those shares are available is not extended beyond the period when they would have been available under the pre-existing plan, absent the transaction; and

• The options and other awards are not granted to individuals who were employed, immediately before the transaction, by the post-transaction listed company or entities that were its subsidiaries immediately before the transaction.

Any shares reserved for listing in connection with a transaction pursuant to either of these exemptions would be counted by the Exchange in determining whether the transaction involved the issuance of 20% or more of the company's outstanding common stock and thus required shareholder approval under Listed Company Manual Section 312.03(c).

These merger-related exemptions will not result in any increase in the aggregate potential dilution of the combined enterprise. Further, mergers or acquisitions are not routine occurrences, and are not likely to be abused. Therefore, the Exchange considers both of these exemptions to be consistent with the fundamental policy involved in this standard.

Qualified Plans, Parallel Excess Plans and Section 423 Plans

The following types of plans (and material revisions thereto) are exempt from the shareholder approval requirement:

• Plans intended to meet the requirements of Section 401(a) of the Internal Revenue Code [21] (*e.g.*, ESOPs);

• Plans intended to meet the requirements of Section 423 of the Internal Revenue Code;[22] and

• ''Parallel excess plans'' as defined below.

Section 401(a) plans and section 423 plans are already regulated under the Internal Revenue Code and Treasury regulations. Section 423 plans, which are stock purchase plans under which an employee can purchase no more than $25,000 worth of stock per year at a plan-specified discount capped at 15%, are also required by the Internal Revenue Code to receive shareholder approval. While section 401(a) plans and parallel excess plans are not required to be approved by shareholders, U.S. GAAP requires that the shares issued under these plans be ''expensed'' (*i.e.*, treated as a compensation expense on the income statement) by the company issuing the shares.

An equity-compensation plan that provides non-U.S. employees with substantially the same benefits as a comparable Section 401(a) plan, Section 423 plan or parallel excess plan that the listed company provides to its U.S. employees, but for features necessary to comply with applicable foreign tax law, are also exempt from shareholder approval under this section.

The term ''parallel excess plan'' means a plan that is a ''pension plan'' within the meaning of the Employee Retirement Income Security Act (''ERISA'') [23] that is designed to work in parallel with a plan intended to be qualified under Internal Revenue Code Section 401(a) to provide benefits that exceed the limits set forth in Internal Revenue Code Section 402(g) (the section that limits an employee's annual pre-tax contributions to a 401(k) plan), Internal Revenue Code Section 401(a)(17) (the section that limits the

[21] 26 U.S.C. 401(a) (1988).

[22] 26 U.S.C. 423 (1988).

[23] 29 U.S.C. 1002 (1999).

amount of an employee's compensation that can be taken into account for plan purposes) and/or Internal Revenue Code Section 415 (the section that limits the contributions and benefits under qualified plans) and/or any successor or similar limitations that may hereafter be enacted. A plan will not be considered a parallel excess plan unless (1) it covers all or substantially all employees of an employer who are participants in the related qualified plan whose annual compensation is in excess of the limit of Code Section 401(a)(17) (or any successor or similar limits that may hereafter be enacted); (2) its terms are substantially the same as the qualified plan that it parallels except for the elimination of the limits described in the preceding sentence and the limitation described in clause (3); and (3) no participant receives employer equity contributions under the plan in excess of 25% of the participant's cash compensation.

Transition Rules

Except as provided below, a plan that was adopted before the date of the Securities and Exchange Commission order approving this listing standard will not be subject to shareholder approval under this section unless and until it is materially revised.

In the case of a discretionary plan (as defined in ''Material Revisions'' above), whether or not previously approved by shareholders, additional grants may be made after the effective date of this listing standard without further shareholder approval only for a limited transition period, defined below, and then only in a manner consistent with past practice. See also ''Material Revisions'' above. In applying this rule, if a plan can be separated into a discretionary plan portion and a portion that is not discretionary, the non-discretionary portion of the plan can continue to be used separately, under the appropriate transition rule. For example, if a shareholder-approved plan permits both grants pursuant to a provision that makes available a specific number of shares, and grants pursuant to a provision authorizing the use of treasury shares without regard to the specific share limit, the former provision (but not the latter) may continue to be used after the transition period, under the general rule above.

Similarly, in the case of a formula plan (as defined in ''Material Revisions'' above) that either (1) has not previously been approved by shareholders or (2) does not have a term of ten years or less, additional grants may be made after the effective date of this listing standard without further shareholder approval only for a limited transition period, defined below.

The limited transition period described in the preceding two paragraphs will end upon the first to occur of:

- the listed company's next annual meeting at which directors are elected that occurs more than 180 days after the effective date of this listing standard;
- the first anniversary of the effective date of this listing standard; and
- the expiration of the plan.

A shareholder-approved formula plan may continue to be used after the end of this transition period if it is amended to provide for a term of ten years or less from the date of its original adoption or, if later, the date of its most recent shareholder approval. Such an amendment may be made before or after the effective date of this listing standard, and would not itself be considered a ''material revision'' requiring shareholder approval.

In addition, a formula plan may continue to be used, without shareholder approval, if the grants after the effective date of this listing standard are made only from the shares available immediately before the effective date, in other words, based on formulaic increases that occurred prior to such effective date.

Broker Voting

In addition, the Exchange will preclude its member organizations from giving a proxy to vote on equity-compensation plans unless the beneficial owner of the shares has given voting instructions. This is codified in NYSE Rule 452. Amended Rule 452 will be effective for any meeting of shareholders that occurs on or after the 90th day following the date of the Securities and Exchange Commission order approving the rule change.

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

B. Nasdaq Proposal

Nasdaq proposes to amend NASD Rule 4350(i) to require shareholder approval for stock option plans or other equity compensation arrangements (subject to exceptions specified in the rule), adopt ''Interpretative Material'' pertaining to shareholder approval for stock option plans or other equity compensation arrangements, and to make related conforming changes to NASD Rules 4310(c)(17)(A) and 4320(e)(15)(A).

Nasdaq Amendments No. 2 and 3 to the Nasdaq filing proposes a number of changes to the rules as they were published in the Notice of the Nasdaq Proposal. According to Nasdaq, these changes were made in response to the comment letters and discussions with Commission staff. The Nasdaq proposal, as amended by Nasdaq Amendments No. 2 and 3, is described below.

1. Nasdaq Proposal Amended by Nasdaq Amendments No. 2 and 3

Specifically, Nasdaq proposes to eliminate the exception for broadly-based plans, and also proposes to eliminate the *de minimis* exception to NASD Rule 4350(i)(1)(A), which allows for the grant of the lesser of 1% of the number of shares of common stock or 25,000 shares, without shareholder approval. Nasdaq believes that this exception is not in accord with the concept of restricting the use of unapproved options.

Nasdaq proposes to retain its current exception for warrants or rights offered generally to all shareholders. In Nasdaq Amendment No. 3, Nasdaq proposed an amendment to this exception to exclude stock purchase plans available on equal terms to all security holders of the company (such as a dividend reinvestment plan) from shareholder approval. In addition, the Nasdaq proposal would not require shareholder approval for tax qualified, non-discriminatory benefit plans as these plans are regulated under the Internal Revenue Code and Treasury Department regulations. Along with tax qualified, non-discriminatory employee benefit plans, the Nasdaq proposal also provides an exception for parallel nonqualified plans. Nasdaq represents that the proposed amendments to NASD Rule 4350(i) would not have any effect on any shareholder approval or other requirements under the Internal Revenue Code or other applicable laws or requirements for such plans.

Furthermore, Nasdaq proposes to retain its current exception for inducement grants to new employees because Nasdaq believes that, in these cases, a company has an arm's length relationship with the new employees, and its interests are directly aligned with the shareholders. In Nasdaq Amendment No. 3, Nasdaq amended its proposal to apply this exception to persons previously employed by the issuer following a bona fide period of non-employment. In addition, Nasdaq states that, for these purposes, inducement grants would include grants

of options or stock to new employees in connection with a merger or acquisition.

In addition, the proposed amendments to NASD Rule 4350(i) would clarify that plans involving a merger or acquisition would not require shareholder approval in two situations. First, Nasdaq will not require shareholder approval to convert, replace or adjust outstanding options or other equity compensation awards to reflect the transaction. Second, Nasdaq represents that shares available under certain plans acquired in corporate acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval. Nasdaq clarifies that this exception applies to situations where the target/acquired company, which is no longer a listed company following the transaction, has shares available for grant under its pre-existing plans that were previously approved by its shareholders. Nasdaq represents that these shares may be used for post-transaction grants of options and other equity awards by the acquiring/listed company (after appropriate adjustment of the number of shares to reflect the transaction), either under the pre-existing plan or another plan, without further shareholder approval, so long as: (1) The time during which those shares are available for grants is not extended beyond the period when they would have been available under the pre-existing plan, absent the transaction, and (2) such options and other awards are only granted to individuals who were employed by the target/acquired company at the time the merger or acquisition was consummated. Nasdaq would view a plan adopted in contemplation of the merger or acquisition transaction as not pre-existing for purposes of this exception. Nasdaq believes that this exception is appropriate because it believes that it will not result in any increase in the aggregate potential dilution of the combined enterprise.

Nasdaq states that, under the proposed amendments to the NASD Rule 4350(i), inducement grants, tax qualified, non-discriminatory benefit plans, and parallel nonqualified plans are subject to approval by either the issuer's compensation committee, or a majority of the issuer's independent directors. Nasdaq also notes that a company would not be permitted to use repurchased shares to fund options without prior shareholder approval. Nasdaq represents, however, that plans that merely provide a convenient way to purchase shares on the open market or from the issuer at fair market value would not require shareholder approval.

The Nasdaq proposal further clarifies that material amendments to plans would require shareholder approval. The accompanying proposed ''Interpretative Material'' also provides a non-exclusive list of plan amendments that are considered material, and clarifies that while general authority to amend a plan would not obviate the need for shareholder approval, if a plan permits a specific action without further shareholder approval, then no such approval would be required.[24] Certain provisions in a plan, however, cannot be amended without shareholder approval. For example, plans that contains a formula for automatic increases in the shares available or for automatic grants pursuant to a dollar-based formula cannot have a term in excess of ten years unless shareholder approval is obtained every ten years. In addition, plans that impose no limit on the number of shares available for grant would require shareholder approval of each grant under the plan. A requirement that grants be made out of treasury shares or repurchased shares will not alleviate these additional shareholder approval requirements. The proposed ''Interpretative Material'' also provides that as a general matter, when preparing plans and presenting them for shareholder approval, issuers should strive to make plan terms easy to understand. In that regard, Nasdaq recommends that plans meant to permit repricing use explicit terminology to make this clear.

With respect to implementation of the proposed amendments to NASD Rule 4350(i), Nasdaq proposes that amended NASD Rule 4350(i) become effective upon SEC approval, and that existing plans be grandfathered.[25] Nasdaq represents that any material modification to plans in place or adopted after the effective date of NASD Rule 4350(i) would require shareholder approval.

Separately, Nasdaq represents that Nasdaq staff intends to consider further changes to provide greater transparency to investors, including a possible disclosure requirement with respect to situations where an issuer relies upon an exception to the shareholder approval requirements of NASD Rule 4350(i)(1)(A).

Lastly, Nasdaq proposes to make conforming changes to NASD Rules 4310(c)(17)(A) and 4320(e)(15)(A). These proposed changes will require issuers to notify Nasdaq on the appropriate form no later than 15 calendar days prior to establishing or materially amending a stock option plan, purchase plan or other equity compensation arrangement pursuant to which stock may be acquired by officers, directors, employees, or consultants without shareholder approval.

2. Amended NASD Rule 4350(i) and IM–4350–5

As amended by Nasdaq Amendments No. 2 and 3, NASD Rule 4350(i)(1)(A) and proposed new ''Interpretive Material,'' IM–4320–5, will read as follows:

(i) Shareholder Approval

(1) Each issuer shall require shareholder approval prior to the issuance of designated securities under subparagraph (A), (B), (C), or (D) below:

(A) when a stock option or purchase plan is to be established or materially amended or other equity compensation arrangement made or materially amended pursuant to which options or stock may be acquired by officers, directors, employees, or consultants, except for:

(i) warrants or rights issued generally to all security holders of the company or stock purchase plans available on equal terms to all security holders of the company (such as a dividend reinvestment plan); or

(ii) tax qualified, non-discriminatory employee benefit plans (*e.g.*, plans that meet the requirements of Section 401(a) or 423 of the Internal Revenue Code) or parallel nonqualified plans, provided such plans are approved by the issuer's compensation committee or a majority of the issuer's independent directors; or plans that merely provide a convenient way to purchase shares on the open market or from the issuer at fair market value; or

(iii) plans or arrangements relating to an acquisition or merger as permitted under IM–4350–5; or

(iv) issuances to a person not previously an employee or director of the company, or following a bonafide period of non-employment, as an inducement material to the individual's entering into employment with the company, provided such issuances are approved by either the issuer's compensation committee comprised of a majority of independent directors or a

[24] The Commission notes that if a plan permits a specific action without further shareholder approval, it must be clear and specific enough to provide meaningful shareholder approval of those provisions.

[25] The Commission notes that the Nasdaq proposal does not address broker-dealer discretionary voting because NASD rules currently prohibit discretionary voting by broker-dealers without explicit instructions from the beneficial owner. In addition, the Commission notes that the Nasdaq proposal does not eliminate the ''treasury share exception'' because Nasdaq does not have such an exception under current NASD rules.

majority of the issuer's independent directors.

* * * * *

IM–4350–5. Shareholder Approval for Stock Option Plans or Other Equity Compensation Arrangements

Employee ownership of company stock can be an effective tool to align employee interests with those of other shareholders. Stock option plans or other equity compensation arrangements can also assist in the recruitment and retention of employees, which is especially critical to young, growing companies, or companies with insufficient cash resources to attract and retain highly qualified employees. However, these plans can potentially dilute shareholder interests. As such, Rule 4350(i)(1)(A) ensures that shareholders have a voice in these situations, given this potential for dilution.

Rule 4350(i)(1)(A) requires shareholder approval when a plan or other equity compensation arrangement is established or materially amended. For these purposes, a material amendment would include, but not be limited to, the following:

(1) Any material increase in the number of shares to be issued under the plan (other than to reflect a reorganization, stock split, merger, spinoff or similar transaction);

(2) Any material increase in benefits to participants, including any material change to: (i) permit a repricing (or decrease in exercise price) of outstanding options, (ii) reduce the price at which shares or options to purchase shares may be offered, or (iii) extend the duration of a plan;

(3) Any material expansion of the class of participants eligible to participate in the plan; and

(4) Any expansion in the types of options or awards provided under the plan.

While general authority to amend a plan would not obviate the need for shareholder approval, if a plan permits a specific action without further shareholder approval, then no such approval would generally be required. However, if a plan contains a formula for automatic increases in the shares available (sometimes called an ''evergreen formula''), or for automatic grants pursuant to a dollar-based formula (such as annual grants based on a certain dollar value, or matching contributions based upon the amount of compensation the participant elects to defer), such plans cannot have a term in excess of ten years unless shareholder approval is obtained every ten years. However, plans that impose no limit on the number of shares available for grant would require shareholder approval of each grant under the plan. A requirement that grants be made out of treasury shares or repurchased shares will not alleviate these additional shareholder approval requirements.

As a general matter, when preparing plans and presenting them for shareholder approval, issuers should strive to make plan terms easy to understand. In that regard, it is recommended that plans meant to permit repricing use explicit terminology to make this clear.

Rule 4350(i)(1)(A) provides an exception to the requirement for shareholder approval for warrants or rights offered generally to all shareholders. In addition, an exception is provided for tax qualified, non-discriminatory employee benefit plans as well as parallel nonqualified plans [26] as these plans are regulated under the Internal Revenue Code and Treasury Department regulations.

Further, there is an exception for inducement grants to new employees because in these cases a company has an arm's length relationship with the new employees. Inducement grants for these purposes include grants of options or stock to new employees in connection with a merger or acquisition. The rule requires that such issuances must be approved by the issuer's compensation committee or a majority of the issuer's independent directors.

In addition, plans or arrangements involving a merger or acquisition do not require shareholder approval in two situations. First, shareholder approval will not be required to convert, replace or adjust outstanding options or other equity compensation awards to reflect the transaction. Second, shares available under certain plans acquired in acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval. This exception applies to situations where the party which is not a listed company following the transaction has shares available for grant under pre-existing plans that meet the requirements of this Rule 4350(i)(1)(A). These shares may be used for post-transaction grants of options and other equity awards by the listed company (after appropriate adjustment of the number of shares to reflect the transaction), either under the pre-existing plan or arrangement or another plan or arrangement, without further shareholder approval, provided: (1) The time during which those shares are available for grants is not extended beyond the period when they would have been available under the pre-existing plan, absent the transaction, and (2) such options and other awards are not granted to individuals who were employed by the granting company or its subsidiaries at the time the merger or acquisition was consummated. Nasdaq would view a plan or arrangement adopted in contemplation of the merger or acquisition transaction as not pre-existing for purposes of this exception. This exception is appropriate because it will not result in any increase in the aggregate potential dilution of the combined enterprise. In this regard, any additional shares available for issuance under a plan or arrangement acquired in a connection with a merger or acquisition would be counted by Nasdaq in determining whether the transaction involved the issuance of 20% or more of the company's outstanding common stock, thus triggering the shareholder approval requirements under Rule 4350(i)(1)(C).

Inducement grants, tax qualified non-discriminatory benefit plans, and parallel nonqualified plans are subject to approval by either the issuer's compensation committee comprised of a majority of independent directors, or a majority of the issuer's independent directors. It should also be noted that a company would not be permitted to use repurchased shares to fund option plans or grants without prior shareholder approval.

III. Summary of Comments

The Commission received a total of 32 comment letters on the NYSE and Nasdaq proposals.[27] Sixteen comment

[26] The term ''parallel nonqualified plan'' means a plan that is a ''pension plan'' within the meaning of the Employee Retirement Income Security Act (''ERISA''), 29 U.S.C. 1002 (1999), that is designed to work in parallel with a plan intended to be qualified under Internal Revenue Code Section 401(a), to provide benefits that exceed the limits set forth in Internal Revenue Code Section 402(g) (the section that limits an employee's annual pre-tax contributions to a 401(k) plan), Internal Revenue Code Section 401(a)(17) (the section that limits the amount of an employee's compensation that can be taken into account for plan purposes) and/or Internal Revenue Code Section 415 (the section that limits the contributions and benefits under qualified plans) and/or any successor or similar limitations that may thereafter be enacted. However, a plan will not be considered a parallel nonqualified plan unless: (i) It covers all or substantially all employees of an employer who are participants in the related qualified plan whose annual compensation is in excess of the limit of Code Section 401(a)(17) (or any successor or similar limitation that may hereafter be enacted); (ii) its terms are substantially the same as the qualified plan that it parallels except for the elimination of the limitations described in the preceding sentence; and, (iii) no participant receives employer equity contributions under the plan in excess of 25% of the participant's cash compensation.

[27] *See supra* notes 5 and 9.

letters generally supported the proposals requiring shareholder approval of all equity compensation plans based on the general premise that these proposals would improve corporate governance standards overall and would help restore investor confidence in the marketplace.[28] Several other commenters were supportive of certain aspects of the proposals, but expressed concerns about some or all of the exceptions in the proposed rules.[29] Five comment letters commented only on specific aspects of the NYSE and Nasdaq proposals.[30] Four comment letters stated that there should be a collective bargaining agreement exception.[31] Another comment letter supported shareholder approval solely for plans including senior executives and directors.[32] One comment letter stated that companies' compensation practices should not be micro-managed and that shareholder approval should be required only for plans that ''dilute (shareholder) ownership over a certain threshold (*e.g.*, 1% to 2%) or on plans where a potential for self dealing exists (*e.g.*, for top management and directors).'' [33] One comment letter found the proposals to be too complicated and stated that ''the better solution may be to eliminate stock options from a company's source of funds for employees.'' [34]

Thirteen comment letters supported the NYSE proposed rule change to preclude broker-dealers from casting proxy votes on equity compensation plans without instructions from the beneficial owner,[35] while three commenters opposed this provision.[36] Eleven of these commenters, supporting the elimination of broker voting on equity compensation plans, suggested precluding broker-dealers from voting proxies without instructions on all other matters as well.[37] In addition, several commenters also supported the NYSE proposed rule change that would eliminate the ''treasury share exception.'' [38]

A. Exceptions to Shareholder Approval of Equity Compensation Plans

Several commenters, while agreeing with the general concept of shareholder approval for all equity compensation plans, had concerns with various exceptions for the general requirement [39] and some believed that the exceptions should be removed from the proposed rules.[40]

1. Exception for Inducements Grants

Several commenters were critical of the exception from the shareholder approval requirement for inducement options offered in an arms-length transaction.[41] One commenter, who commented separately on the NYSE and Nasdaq proposals, stated that this exception could have the effect of encouraging the use of inducement grants simply to avoid having to acquire shareholder approval to issue shares, and that this exception should therefore be limited.[42] Another commenter stated that such an exception invites companies to offer huge one-time awards of options to incoming executives.[43] One commenter, stated that there should not be an exception for inducement awards from shareholder approval, but noted that companies should anticipate the hiring of new executives and have a ''cushion of shares available for awards under existing shareholder-approved plans.'' [44] This commenter was concerned that an exception for inducement awards would provide an incentive for management to move between companies to take advantage of the exception in obtaining larger option awards.[45] Another commenter suggested that the exception should also be made available to individuals who are rehired by an issuer or one of its subsidiaries after a bona fide interruption of employment.'' [46] One commenter suggested that Nasdaq conform its proposal to the NYSE proposal and permit the issuance of inducement awards to persons who were previously employees of or served on the board of directors of the issuer.[47]

2. Exception for Mergers and Acquisitions

Several commenters were generally critical of the exception from the shareholder approval requirement for plans acquired in an acquisition or merger.[48] These commenters specifically opposed the exception for shares available to employees of the acquired or targeted company, stating that such additional issuances could be dilutive to the shareholders of the acquiring company. Two commenters suggested that this exception could have ''the unintended consequence of making the availability of shares authorized under assumed plans dependent on the transaction structure.'' [49] Another commenter argued that the exception could allow management to ''use a merger or acquisition to 'adopt' a plan that otherwise would not be approved by their shareholders.'' [50]

[28] *See* TIAA-CREF Letter; Barclays Letter; Allen & Overy Letter; SWIB Letter; Hermes Letter; ICI Letter; NJ Division Letter; ISS I Letter; ISS II Letter; NVCA I Letter; NVCA II Letter; LACERA Letter; conEdison Letter; Unisys Letter; Employees Retirement System of Texas Letter; and Gillespie Letter. As discussed below, some of these commenters, while supporting the overall proposals, recommended eliminating or changing some of the exceptions to shareholder approval or requested clarification.

[29] *See* CII Letter; SWIB Letter; CPF Letter; IBT Letter; STRS Letter; MSRS Letter; and Employees Retirement System of Texas Letter.

[30] *See* CalPERS Letter; Sullivan & Cromwell Letter; ABA Letter; Radioshack Letter; and ABC Letter.

[31] *See* Southwest Airlines Letter; IAM Letter; AFL-CIO Letter; and IBT Letter. For example, see Southwest Airlines Letter, stating that the NYSE shareholder approval proposal is overly broad as currently drafted and that it would be ''unwise'' and ''unfair'' to approve unless a collective bargaining exception is added to the exceptions.

[32] *See* AFL–CIO Letter.

[33] *See* Employees Retirement System of Texas Letter.

[34] *See* Pella Letter.

[35] *See* TIAA–CREF Letter; CII Letter; Barclays Letter; SWIB Letter; Hermes Letter; AFL-CIO Letter; CPF Letter; STRS Letter; NJ Division Letter; ISS I Letter; IBT letter; MSRS Letter; and Employees Retirement System of Texas Letter. As noted above, NASD rules already prohibit broker-dealer discretionary voting on such matters. *See supra* note .

[36] *See* ABC Letter; Pella Letter; Amex I Letter; and Amex II Letter. The Commission considers the Amex I Letter and Amex II Letter to be from the same commenter.

[37] *See* CII Letter; SWIB Letter; Hermes Letter; AFL-CIO Letter; CPF Letter; STRS Letter; NJ Division Letter; ISS I Letter; IBT Letter; MSRS Letter; and Employees Retirement System of Texas Letter.

[38] *See* CII Letter; Barclays Letter; SWIB Letter; Hermes Letter; CPF Letter; STRS Letter; NJ Division Letter; Unisys Letter; and Employees Retirement System of Texas Letter.

[39] *See* CII Letter; Barclays Letter; SWIB Letter; Hermes Letter; AFL–CIO Letter; CPF Letter; STRS Letter; LACERA Letter; Unisys Letter; and Employees Retirement System of Texas Letter.

[40] *See* Barclays Letter; SWIB Letter; Hermes Letter; and LACERA Letter.

[41] *See* CII Letter; Barclays Letter; SWIB Letter; Hermes Letter; CalPERS Letter; STRS Letter; NJ Division Letter; ISS I Letter; ISS II Letter; Unisys Letter; and Employees Retirement System of Texas Letter.

[42] *See* ISS I Letter and ISS II Letter.

[43] *See* Hermes Letter. See also AFL-CIO Letter, which refers to inducement grants as ''golden handshake'' compensation packages for newly recruited executives.

[44] *See* CalPERS Letter. Two other commenters recommended that companies plan in advance for these situations and set aside shares of stock for this specific purpose with shareholder approval. *See* IBT Letter and Employees Retirement System of Texas Letter.

[45] *See* CalPERS Letter.

[46] *See* Allen & Overy Letter. This commenter stated that Nasdaq should be also permit inducement grants to an independent director who is hired as an employee of an issuer or one of its subsidiaries.

[47] *See* ABA Letter.

[48] *See* CII Letter; Barclays Letter; SWIB Letter; AFL-CIO Letter; CalPERS Letter; STRS Letter; NJ Division Letter; ISS I Letter; ISS II Letter; Unisys Letter; and Employees Retirement System of Texas Letter.

[49] *See* Allen & Overy Letter and NJ Division Letter.

[50] *See* Employees Retirement System of Texas Letter.

3. Exception for Tax Qualified and Parallel Nonqualified Plans

Several commenters were generally critical of the exception from the shareholder approval requirement for tax qualified and parallel nonqualified plans.[51] These commenters stated that shareholder oversight was necessary for tax qualified and parallel non-qualified plans. In addition, commenters noted that the exception for parallel nonqualified plans may result in a potential for abuse because participants in these plans could defer up to 100 percent of their compensation into stock if the plan allowed such deferrals before the application of tax limits.[52] Commenters further noted that parallel nonqualified plans are structured solely to benefit highly compensated employees and, therefore, should be subject to shareholder approval.[53] One commenter stated that ''the fact that such plans are expensed is not a valid reason to exempt them from the shareholder approval process.'' [54] Two commenters stated that the definition of parallel nonqualified plan should be similar to the definition of ''excess benefit plan'' under Rule 16b-3 of the Act.[55] Another commenter stated that requiring non-parallel plans to be substantially similar to tax qualified plans is too narrow and restrictive a standard.[56] One commenter suggested the use of ''stock purchase plans'' as defined in Rule 16b-3(b)(5) under the Act, stating that this definition should replace the reference to Section 423 plans under this exception.[57] One commenter suggested that the exception for tax qualified and parallel nonqualified plans should be extended to cover employee stock option purchase plans that would qualify as noncompensatory plans under APB Opinion 25 of the Financial Accounting Standards Board.[58]

4. Material Revisions to Plans

Several commenters suggested that the NYSE and Nasdaq define ''material'' for purposes of defining major changes to an equity compensation plan.[59] One commenter stated that Nasdaq should adopt the NYSE's list of what is considered a ''material revision.'' [60] Another commenter suggested that the NYSE follow Nasdaq's approach by defining ''materiality'' ''by reference to former Rule 16b-3 under the Act.'' [61] One commenter suggested adopting a ''global standard'' and providing a ''transparent definition of materiality'' to ensure that issues regarding materiality are handled similarly by the NYSE and Nasdaq.[62] Another commenter, while supporting a uniform definition, objected to the use of ''materiality,'' stating that the concept is too vague and subjective.[63] Another commenter suggested that the definition of ''material'' should be more specific to ensure that companies have a practical and enforceable standard that they can apply.[64] One commenter, separately commenting on both of the NYSE and Nasdaq proposals, suggested that, because it is difficult to determine what types of changes qualify as material, the Commission should require the NYSE and Nasdaq to separately publish, on a website in real time, determinations of all their staff determinations on requests for exemptions from the their rules and listing standards.[65] One commenter stated that the definition of ''material revision'' of an equity compensation plan should be clarified so as not to include any decreases in any benefits under the plan, and thereby subject only material increases, to any benefits under a plan, to shareholder approval.[66]

5. Repricing of Plans

Several commenters suggested that Nasdaq should address the issue of repricing, and that it should adopt the NYSE's approach for such repricing provisions in equity compensation plans.[67] Under the NYSE proposal, unless a plan explicitly contains a repricing provision, shareholder approval would be required for any revisions deleting or limiting the repricing provisions; a plan that is silent on repricing would also require shareholder approval in these instances. One commenter, commenting solely on the NYSE proposal, stated that shareholder approval should not be required for plans that are silent on repricing.[68] Another commenter suggested that repricing should only be considered a ''material revision'' of a plan for newly adopted plans or for plans that were materially revised after the effective date of the NYSE proposal.[69]

6. Foreign Exemption

Two commenters suggested that the exemption for plans covering employees residing in non-U.S. jurisdictions should also apply to plans that are designed to comply with local foreign tax laws and under which all full-time employees of the sponsoring entity are, in general, eligible to participate subject to certain service, age or other requirements permitted under the foreign jurisdiction's law.[70] Both commenters stated that Nasdaq should adopt a similar exemption.[71] One commenter stated that a transition period should be provided for plans of listed domestic issuers and their affiliates covering employees residing in a non-U.S. jurisdiction.[72]

B. Collective Bargaining Agreements

Four commenters suggested that there be an exception for the shareholder requirement for equity compensation plans for plans entered into pursuant to a collective bargaining agreement.[73] Two of the commenters limited this suggestion to collective bargaining agreements that do not permit participation by officers and directors.[74] Three of the commenters argued that proposed rules are overly-broad, would significantly impact the collective bargaining process, and provide disincentives for parties on both sides of the bargaining table to negotiate equity compensation plans.[75] One commenter stated that a shareholder approval requirement would deny employees, who have given up pay raises for a number of years over the term of the collective bargaining agreement in order to receive stock options, the opportunity to participate fully in the growth and success of their companies.[76]

[51] *See* CII Letter; Barclays Letter; SWIB Letter; CalPERS Letter; STRS Letter; ISS I Letter; ISS II Letter; Unisys Letter; and Employees Retirement System of Texas Letter.

[52] *See* CII Letter; AFL–CIO Letter; CalPERS Letter; STRS Letter; and Unisys Letter.

[53] *See* CII Letter; SWIB Letter; CalPERS Letter; STRS Letter; and Unisys Letter.

[54] *See* Employees Retirement System of Texas Letter.

[55] *See* Sullivan & Cromwell Letter and ABA Letter.

[56] *See* RadioShack Letter.

[57] *See* ABA Letter.

[58] *See* Allen & Overy Letter.

[59] *See* CII Letter; STRS Letter; Sullivan & Cromwell Letter; ABA Letter; and Unisys Letter.

[60] *See* ISS II Letter.

[61] *See* Sullivan & Cromwell Letter.

[62] *See* AFL–CIO Letter.

[63] *See* CalPERS Letter.

[64] *See* IBT Letter.

[65] *See* ISS I Letter and ISS II Letter.

[66] *See* RadioShack Letter.

[67] *See* CII Letter; SWIB Letter; Hermes Letter; ICI Letter; CalPERS Letter; STRS Letter; NJ Division Letter; and Unisys Letter.

[68] *See* Sullivan & Cromwell Letter.

[69] *See* ABA Letter.

[70] *See* Allen & Overy Letter and ABA Letter.

[71] *See* Allen & Overy Letter and ABA Letter.

[72] *See* ABA Letter.

[73] *See* Southwest Airlines Letter; IAM Letter; AFL–CIO Letter; and IBT Letter.

[74] *See* Southwest Airlines Letter and IBT Letter.

[75] *See* Southwest Airlines Letter; IAM Letter and AFL–CIO Letter.

[76] *See* Southwest Airlines Letter.

C. Evergreen Plans

One commenter stated that ''evergreen plans'' can be dilutive to shareholders because ''there can be no termination date for the plans and the number of shares issued can increase annually depending on the number of shares outstanding.'' [77] The commenter urged the NYSE and Nasdaq to view increases in the shares available under an evergreen plan to be a material revision requiring shareholder approval.[78] One commenter, commenting solely on the NYSE proposal, requested clarification on whether, for evergreen plans, the 10-year maximum term for the plan runs from the effective date of the proposed rule, the date of the addition of the 10-year term, or the date of the original adoption or shareholder approval of the plan.[79] Two commenters stated that a transition period—not requiring shareholder approval until the next annual shareholder meeting—should apply to existing evergreen plans.[80] One commenter stated that there should be a ''specific transition period for plans adopted before the effective date that do not limit the number of shares available for grant, since these plans will never be required to be amended to increase the number of authorized share.'' [81] Another commenter suggested that evergreen increases should not be considered ''material revisions'' until the earliest of: (1) A subsequent material revision to the plan; (2) the expiration of the term of the plan; (3) the later of ten years from the date the plan was adopted or five years from the effective date of the NYSE proposal.[82] The same commenter recommended that Nasdaq conform its proposal to the NYSE proposal with respect to provisions on the treatment of evergreen plans.[83] One commenter stated that a ''retroactive shareholder approval requirement'' should not be applied to existing evergreen plans.[84] Another commenter requested clarification on whether an evergreen plan that was previously approved by a company's shareholders must again be approved by the shareholders if it is for an unlimited term and has been in existence for more than ten years.[85]

[77] *See* ICI Letter.

[78] *See* ICI Letter.

[79] *See* Sullivan & Cromwell Letter.

[80] *See* Sullivan & Cromwell Letter and conEdsion Letter.

[81] *See* Allen & Overy Letter.

[82] *See* ABA Letter.

[83] *See* ABA Letter.

[84] *See* RadioShack Letter.

[85] *See* Unisys Letter. This commenter suggested a transition period until the next annual shareholder meeting to obtain shareholder approval if it is required in these circumstances.

D. Conformity and Clarity

A few commenters stated that the NYSE and Nasdaq proposals should be consistent with one another.[86] One commenter recommended specific changes to clarify and conform the NYSE and Nasdaq proposals.[87] Another commenter suggested that the NYSE and Nasdaq clarify the proposed rules to indicate that cash-only plans and benefits would not be subject to shareholder approval.[88] One commenter stated that the NYSE and Nasdaq should harmonize their proposals on the ''repricing'' issue; the commenter did not take a position on which approach it believed was more appropriate.[89] The same commenter suggested that ''the NYSE proposal, like the Nasdaq proposal, should specify the significant and substantive components of its (proposed) rule in the rule's text'' rather than in a commentary or footnotes.[90] One commenter praised the NYSE and Nasdaq for proposing similar rules requiring shareholder approval of equity compensation plans, stating that this ''coordinated approach ensures that the NYSE and Nasdaq do not compete on the basis of differences in their rules, encouraging a ''race to the bottom'' to attract new listings, to the detriment of investors.'' [91]

E. Elimination of Broker-Dealer Voting on Equity Compensation Plans

Several commenters also supported the NYSE proposed rule change to preclude broker-dealers from voting on equity compensation plans without instructions from the beneficial owner.[92] Some of these commenters stated that broker-dealers should be precluded from voting proxies without instructions on all other matters as well.[93] Some of these commenters stated that votes should be cast by the beneficial owners—the real parties in interest—and not broker-dealers who tend to side with management and override their clients' interests.[94] Other commenters pointed out that, because companies now routinely receive votes from more than 50 percent of their beneficial owners, broker-dealer votes are no longer necessary to meet quorum requirements.[95] One commenter stated that ''this rule is unnecessary in an age where shareholders can vote electronically by telephone, Internet, and facsimile, in addition to the traditional means of written proxy or participation in shareholder meetings.'' [96] One commenter stated that the NYSE should specify when the proposed new rule eliminating broker voting of equity compensation plans will become effective and stated that a transition period should be provided.[97]

[86] *See* AFL–CIO Letter; Allen & Overy Letter; ICI Letter; and ABA Letter.

[87] *See* ABA Letter.

[88] *See* Allen & Overy Letter.

[89] *See* ABA Letter.

[90] *See* ABA Letter.

[91] *See* ICI Letter.

[92] *See* TIAA–CREF Letter; CII Letter; Barclays Letter; SWIB Letter; Hermes Letter; AFL–CIO Letter; CPF Letter; STRS Letter; NJ Division Letter; ISS I Letter; IBT letter; MSRS Letter; and Employees Retirement System of Texas Letter.

[93] *See* CII Letter; SWIB Letter; Hermes Letter; AFL–CIO Letter; CPF Letter; STRS Letter; NJ Division Letter; ISS I Letter; IBT Letter; MSRS Letter; and Employees Retirement System of Texas Letter.

[94] *See* TIAA–CREF Letter; CII Letter; SWIB Letter; Hermes Letter; AFL-CIO Letter; CPF Letter; STRS Letter; ISS I Letter; IBT Letter; MSRS Letter; and Employees Retirement System of Texas Letter.

[95] *See* CII Letter; SWIB Letter; CPF Letter; STRS Letter; IBT Letter; and MSRS Letter. One commenter stated that, if uninstructed broker-dealer votes are needed to meet a quorum, broker voting should be limited solely to quorum votes. *See* ISS I Letter.

[96] *See* AFL–CIO Letter.

[97] *See* ABA Letter.

Three commenters opposed the NYSE proposal to eliminate broker-dealer proxy voting on equity compensation plans.[98] Two of these commenters stated that the elimination of broker voting would harm smaller issuers and result in a significant increase in cost and administrative burden.[99] In addition, one commenter stated that elimination of broker-dealer voting on equity compensation plans, and thereby designating such plans as ''non-routine'' for proxy voting purposes, would result in uncertainty of whether there will be a quorum and, instead suggested as an alternative that unvoted broker held shares be deemed voted in proportion to the votes actually cast (*i.e.*, ''echo'' voting).[100] The commenter further stated that, while the issue of broker-dealer voting should be addresses on an industry-wide basis, it wanted clarification that the NYSE's elimination of broker-dealer voting on equity compensation plans only applied to NYSE listed issuers '' and not to Amex listed issuers '' in case of a conflict in proxy voting rules of the two exchanges.[101] One commenter stated that the average beneficial owner would not understand or know how to vote on his or her own.[102]

F. Miscellaneous Comments

A few commenters suggested that the Commission urge the American Stock

[98] *See* ABC Letter; Pella Letter; Amex I Letter; and Amex II Letter.

[99] *See* ABC Letter and Amex I Letter.

[100] *See* Amex I Letter.

[101] *See* Amex I Letter and Amex II Letter.

[102] *See* Pella Letter.

Exchange, LLC (''Amex'') to propose and adopt listing standards similar to the NYSE and Nasdaq proposals.[103] One commenter, commenting solely on the NYSE proposal, stated that the shareholder approval requirement should apply only to companies listing common stock on the NYSE.[104] The same commenter stated that NYSE should state that the requirement of shareholder approval would not apply to ''cash-only'' plans and other plans where securities are not deliverable.[105] The commenter also stated that plans adopted after the effective date of the proposed rule but before the company's stock is listed on the NYSE should also be grandfathered.'' [106] The commenter further stated that compensation committee pre-approval of certain exceptions to shareholder approval, such as for inducement grants and tax qualified plans, is unnecessary and impractical.[107] One commenter stated that NYSE should define ''equity compensation plan.'' [108] The same commenter stated that the NYSE should specify when the proposed amendments to the NYSE Rule 452 eliminating broker voting on plans would become effective and suggested that there be a transition period.[109] One commenter, commenting solely on the NYSE proposal, stated that there should be an implementation period for obtaining shareholder approval for plans that are not pre-existing plans that will become ''grandfathered'' upon approval of the NYSE proposal.[110] One commenter stated that ''compensatory discount stock purchase plans'' should not be subject to shareholder approval because this requirement would unduly restrict the management's design of long-standing compensation plans for a broad base of employees, while providing minimal benefit to shareholders.[111] Some commenters stated that the 21-day comment period was inadequate to obtain public comment on these and other proposals.[112]

[103] *See* CII Letter; SWIB Letter; STRS Letter; NJ Division Letter; and Unisys Letter. In response to a Commission request, the Amex filed a proposed rule change on May 6, 2003, which proposes to require shareholder approval of stock option and equity compensation plans. *See* File No. SR–Amex–2003–42.

[104] *See* Sullivan & Cromwell Letter.

[105] *See* Sullivan & Cromwell Letter.

[106] *See* Sullivan & Cromwell Letter.

[107] *See* Sullivan & Cromwell Letter.

[108] *See* ABA Letter.

[109] *See* ABA Letter.

[110] *See* conEdison Letter.

[111] *See* RadioShack Letter.

[112] *See* CII Letter; CPF Letter; CalPERS Letter; STRS Letter; IBT Letter; and MSRS Letter.

IV. Discussion

After careful review, the Commission finds that the NYSE proposal, as amended, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a national securities exchange and, in particular, with the requirements of section 6(b) of the Act.[113] Specifically, the Commission finds that approval of the NYSE proposal, as amended, is consistent with section 6(b)(5) of the Act [114] in that it is designed to, among other things, facilitate transactions in securities; to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and in general, to protect investors and the public interest, and does not permit unfair discrimination among issuers.

In addition, after careful review, the Commission finds that the Nasdaq proposal, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.[115] The Commission finds that the Nasdaq proposal, as amended, is consistent with provisions of section 15A of the Act,[116] in general, and with section 15A(b)(6) of the Act,[117] in particular, in that it is designed to, among other things, facilitate transactions in securities; to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and in general, to protect investors and the public interest, and does not permit unfair discrimination among issuers.

The Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, restore investor confidence in the national marketplace. The Commission believes that the NYSE proposal and the Nasdaq proposal, which require shareholder approval of equity compensation plans, are the first step under this directive because they should have the effect of safeguarding the interests of shareholders, while placing certain restrictions on their listed companies. The Commission notes that many commenters generally supported the NYSE and Nasdaq's proposals to require shareholder approval of all equity compensation plans mainly based on the premise that such a requirement would protect shareholders and overall improve the marketplace. The Commission further notes that several commenters, while supporting the general shareholder approval requirement, voiced concerns regarding certain or all of the exemptions to, and certain aspects of, the shareholder approval requirement. Accordingly, the NYSE and Nasdaq amended their proposals to: (1) Respond to specific concerns raised by the commenters and suggestions made by Commission staff; (2) clarify terms and language used in their respective proposals; and (3) harmonize and conform their respective rule proposals, in response to certain comments, so that they are more consistent with one another.

[113] 15 U.S.C. 78f(b). In approving the NYSE proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

[114] 15 U.S.C. 78f(b)(5).

[115] In approving the Nasdaq proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[116] 15 U.S.C. 78*o*–3.

[117] 15 U.S.C. 78*o*–3(b)(6).

A. Exemption From Shareholder Approval for Inducement Grants

The Commission notes that several commenters were critical of the exemption from shareholder approval for inducement grants that could be made to recruit new employees. These commenters were generally concerned that the exemption could potentially lead to abuse and could be used to avoid shareholder approval. The commenters suggested either eliminating or limiting the exemption for inducement grants.

The Commission believes that the requirement that the issuance of all inducement grants be subject to review by either the issuer's independent compensation committee or a majority of the board's independent directors, in both proposals, should prevent abuse of this exemption. The Commission notes that the NYSE has also amended its proposal to include a requirement that, following the grant of any inducement award, companies must disclose in a press release the material terms of the award, including the recipient(s) of the award and the number of shares involved.[118] In addition, the

[118] This disclosure would, of course, be in addition to any information that is required to be disclosed in annual reports filed with the Commission. For example, Item 201(d) of Regulation S–K (17 CFR 229.201(d)) and Item 201(d) of Regulation S–B (17 CFR 228.201(d)) require issuers to present—in their annual reports on Form 10–K or Form 10–KSB—separate, tabular disclosure concerning equity compensation plans that have been approved by shareholders and equity compensation plans that have not been approved by shareholders.

Commission notes that the NYSE proposes an additional requirement that an issuer must notify it in writing when it uses this exemption from the shareholder approval requirement. Nasdaq has also committed to considering similar disclosure requirements. The Commission believes that such disclosure requirements would provide transparency to investors and reduce the potential for abuse of this exemption for inducement grants.[119]

In addition, one commenter pointed out an inconsistency between the NYSE and Nasdaq proposals—that the exemption for inducement grants as proposed in the Notice of the Nasdaq Proposal would exclude grants to previous employees and directors of the company, while the exemption for inducement grants as proposed in the Notice of the NYSE Proposal would allow grants to all new employees. In response to these concerns, the NYSE and Nasdaq clarified their respective exemptions for inducement grants and limited the exemptions to new employees or to previous employees being rehired after a bona fide period of interruption of employment, and to new employees in connection with an acquisition or merger. The Commission believes that these amendments to the exemption for inducement grants in the NYSE and Nasdaq proposals are consistent with the original intent of the exemption. The language requiring a bone fide period of interruption of employment for previous employees should help to prevent the inducement exemption from being used inappropriately. Furthermore, the proposed changes should address the commenters' concerns about consistency between the NYSE and Nasdaq proposals.

B. Exemption From Shareholder Approval for Mergers and Acquisitions

The Commission notes that several commenters objected to an exemption from shareholder approval for plans acquired in a merger or acquisition. These commenters stated that additional issuances under plans to shareholders of the acquired or targeted company could be dilutive to shareholders of the acquiring company. The commenters were also concerned that companies could use a merger or acquisition to acquire a plan that would otherwise not be approved by their shareholders.

While the Commission understands these concerns, it notes that both the NYSE and Nasdaq exemptions contain safeguards that should prevent abuse in this area. First, only pre-existing plans that were previously approved by the acquired company's shareholders would be available to the listed company for post-transactional grants. In addition, shares under those previously approved plans could not be granted to individuals who were employed, immediately before the transaction, by the post-transaction listed company or its subsidiaries. The Commission also notes that, under both the NYSE and Nasdaq proposals, any shares reserved for listing in connection with a merger or acquisition pursuant to this exemption would be counted by the NYSE and Nasdaq in determining whether the transaction involved the issuance of 20% or more of the company's outstanding common stock, thereby requiring shareholder approval under the appropriate NYSE and Nasdaq rules. Finally, the Commission notes that the NYSE proposes an additional requirement that an issuer must notify it in writing when it uses this exemption from the shareholder approval requirement. Based on the above, the Commission believes that the NYSE and Nasdaq have provided measures to ensure that the exemption for mergers and acquisitions is only used in limited circumstances, which should help reduce the potential for dilution of shareholder interests.

C. Exemption From Shareholder Approval for Tax Qualified and Parallel Nonqualified Plans

Several commenters were critical of the exemption from shareholder approval for tax qualified and parallel nonqualified plans[120] and stated that these plans should be subject to shareholder approval. Many of these commenters were concerned that these types of plans are structured in a way to benefit only highly compensated employees and that participants in such plans could defer up to 100% of their compensation in stock under these plans.

The Commission believes that, given the extensive government regulation—the Internal Revenue Code and Treasury regulations—for qualified plans and the general limitations associated with parallel nonqualified plans, shareholders should not experience significant dilution as a result of this exemption. In addition, the Commission notes that NYSE and Nasdaq are proposing to add an additional limitation under this exemption that a plan would not be considered a nonqualified parallel under the Nasdaq proposal or parallel excess plan under the NYSE proposal if employees who are participants in such plans receive employer contributions under the plans in excess of 25% of the participants' cash contributions. The Commission further notes that the NYSE proposes an additional requirement that an issuer must notify it in writing when it uses this exemption from the shareholder approval requirement. The Commission believes that, taken together, these limitations should reduce concerns regarding abuse of this exemption.

D. Material Amendments to Plans

The Commission notes that several commenters urged the NYSE and Nasdaq to adopt a similar definition for what constitutes a material amendment or revision to a plan requiring shareholder approval. Specifically, these commenters stated that the NYSE and Nasdaq should adopt a more uniform and enforceable definition. One commenter suggested that material revisions to plans should only include any increases in benefits, not decreases in benefits, under a plan.

In response to these concerns, the NYSE and Nasdaq have proposed amendments to their respective proposals and provided similar definitions of a material amendment or revision. A material amendment or revision under both proposals would now basically include: A material increase in the number of shares to be issued under the plan (other than to reflect a reorganization, stock split, merger, spinoff or similar transaction); an expansion of the type of awards available under the plan; a material expansion of the class of participants eligible to participate in the plan; a material extension of the term of the plan; a material change to limit or delete any provisions prohibiting repricing of options in a plan or for determining the strike or exercise price of options under a plan. In addition, the NYSE amended its proposal under ''Material Revisions'' to define ''evergreen'' and ''formula'' plans and introduced the new concept of ''discretionary plan.'' The NYSE further described what would constitute a material revision to such plans and require shareholder approval. Nasdaq also amended its proposal to clarify when plans containing a formula for automatic increases (such as evergreen plans) and automatic grants would require shareholder approval.

The Commission believes that the NYSE and Nasdaq's non-exclusive lists

---

[119] The Commission urges Nasdaq to consider adopting a disclosure requirement similar to the NYSE's requirement.

[120] The Commission notes that the NYSE has replaced the term ''parallel nonqualified plan'' in its proposal with the term ''parallel excess plan.'' Nasdaq has retained the term ''parallel nonqualified plan'' to describe such plans.

of what would constitute a material amendment or revision to a plan provides companies with clarity and guidance for when certain amendments to plans would require shareholder approval. The Commission also believes that the NYSE and Nasdaq proposed amendments in this area should help to ensure that the concept of material amendments or revisions between their respective proposals is consistent with each other so that differences between the markets cannot be abused.

E. Repricing of Plans

A minority of commenters suggested that Nasdaq should address the issue of the repricing of options in plans and adopt the NYSE's approach to this issue. The NYSE proposal provides that, if a plan explicitly contains a repricing provision, shareholder approval would be required to delete or limit the repricing provisions. In addition, the NYSE proposal provides that, if a plan is silent on repricing, it will be considered as prohibiting repricing and shareholder approval would be required to permit repricing under the plan. In response to the commenters' concerns on this issue, Nasdaq proposed amendments to its proposal to state that it would be considered a material amendment to a plan requiring shareholder approval if the plan was amended to permit repricing. In addition, Nasdaq recommended in its proposed amendments that plans meant to permit repricing should explicitly and clearly state that repricing is permitted. The NYSE proposed an amendment to its proposal to clarify that repricings that have commenced prior to the date of effectiveness of its proposal would not be subject to shareholder approval, provided that such repricing does not require shareholder approval under the NYSE's existing shareholder approval rules.

The NYSE and Nasdaq proposals, as amended, should benefit shareholders by ensuring that companies cannot do a repricing of options, which can have a dilutive effect on shares, without explicit shareholder approval of such provisions and their terms. The Commission also believes that NYSE and Nasdaq proposals now provide similar views in the area of repricing and should offer companies clarity and guidance as to when a change in a plan regarding the repricing of options would trigger a shareholder approval requirement and addresses commenters' concerns in this area.

F. Evergreen or Formula Plans and Discretionary Plans

A minority of commenters raised concerns about plans containing evergreen formulas, which would allow for automatic increases in the number of shares available or for automatic grants pursuant to a formula in the plans. These commenters were generally concerned about evergreen/formula plans that provided no termination date and that did not place a limit on the number of shares that could be issued. The commenters wanted the NYSE and Nasdaq to consider increases in the number of shares under such plans as material revisions to the plans requiring shareholder approval. In addition, some of these commenters suggested that the NYSE and Nasdaq provide a transition period for existing evergreen/formula plans to comply with the new shareholder approval requirements. Some commenters wanted more clarity as to when shareholder approval would be required for evergreen/formula plans that were adopted prior to the effective date of the NYSE and Nasdaq proposals, and one commenter suggested that Nasdaq adopt NYSE's approach to evergreen/formula plans.

The Commission notes that both the NYSE and Nasdaq have proposed amendments to the respective proposals in response to commenters' concerns and are proposing similar approaches as to the treatment of evergreen/formula plans. More specifically, under both the NYSE and Nasdaq proposals, if a plan contains a formula for automatic increases in the shares available or for automatic grants pursuant to a formula, each increase or grant will require shareholder approval unless the plan has a term of not more than ten years. In addition, under both the NYSE and Nasdaq proposals, if a plan contains no limit on the number of shares available and is not a formula plan (the NYSE amended its proposal to refer to such plans as ''discretionary plans''), then each grant under the plan will require separate shareholder approval. Furthermore, both the NYSE and Nasdaq proposals provide that a requirement that grants be made out of treasury or repurchased shares will not alleviate the need for shareholder approval for additional grants.

The Commission believes that these provisions should help to ensure that certain terms of a plan cannot be drafted so broad as to avoid shareholder scrutiny and approval. The Commission also notes that the NYSE and Nasdaq's conforming rules relating to the treatment of evergreen/formula and discretionary plans should provide more clarity and transparency to issuers as to when shareholder approval would be required for such plans.

The Commission further notes that the NYSE has proposed amendments to its proposal to provide for a transition period for evergreen/formula plans and discretionary plans. The limited transition period would end on the first to occur of the following: (1) The listed company's next annual meeting at which directors are elected that occurs more than 180 days after the date of the effective date of the NYSE proposal; (2) the first anniversary of the effective date of the NYSE proposal; or (3) the expiration of the plan. The Commission believes that the NYSE's proposed transition period for evergreen/formula and discretionary plans should provide companies with additional clarity and guidance as to when shareholder approval would be required for such plans while in the transition period, and should provide companies with more time to comply with the new NYSE shareholder approval requirements for evergreen/formula type plans. The Commission believes that this period is not so long as to permit abuse of the shareholder approval requirement, and at most, will last one year from the date of this Commission approval order.

G. Miscellaneous Concerns

Some commenters had suggested that there should be an exemption from shareholder approval for plans entered into pursuant to a collective bargaining agreement mainly because they believed that a shareholder approval requirement would hinder negotiations regarding equity compensation plans by both parties in the collective bargaining process. The Commission believes, however, that such an exemption could expose shareholders to significant dilution because of the lack of shareholders oversight in the collective-bargaining process. Accordingly, the Commission agrees with the NYSE and Nasdaq decisions not to provide such an exemption to their respective shareholder approval requirements.

The Commission notes that commenters requested clarification as to what type of plans would be considered ''equity compensation plans'' and what type of plans would not be considered ''equity compensation plans.'' In response to commenters'' concerns, the NYSE proposed amendments to its proposal to better define ''equity compensation plans'' and clarified that such plans would expressly exclude plans that do not provide delivery of equity securities of the issuer—for example, ''cash plans''—and deferred compensation plans under which

employees pay full market value for deferred shares. The Commission notes that Nasdaq also amended its proposal to incorporate the term ''equity compensation'' and proposes to adopt a similar concept as the NYSE as to this term so that plans that merely provide a convenient way to purchase shares in the open market or from the issuer at fair market price would not require shareholder approval. The Commission believes that the proposed amendments should make the NYSE and Nasdaq proposals more consistent and provide greater clarity with respect to which plans would and would not require shareholder approval.

Finally, many commenters wanted clarification as to how the new NYSE and Nasdaq shareholder approval requirements would apply to pre-existing plans. The NYSE and Nasdaq have proposed amendments to their proposals to clarify the applicability and transition period for their shareholder approval requirements. In particular, the NYSE and Nasdaq have provided that pre-existing plans, which were adopted prior to the SEC's approval of the NYSE and Nasdaq proposals, would essentially be ''grandfathered'' and would not require shareholder approval unless the plans were materially revised or amended. The NYSE provides further clarification that shareholder approval is required for pre-existing plans that were not approved by shareholders and that do not have an evergreen formula or a specific number of shares available under the plan. The Commission believes that this clarification should provide companies with guidance as to which plans would be subject to the new NYSE and Nasdaq shareholder approval requirements.

H. Elimination of Broker-Dealer Voting on Equity Compensation Plans

The Commission notes that several commenters supported the NYSE's proposed rule change to prohibit broker-dealers from voting proxies on equity compensation plans without the beneficial owner's explicit consent. These commenters urged the NYSE to adopt a prohibition for broker voting without instructions on all matters, not just with respect to equity compensation plans. Some of these commenters were concerned that broker-dealers tend to side with management and do not always vote in their client's best interest. One commenter requested clarification on the effective date for eliminating broker voting on equity compensation plans and suggested that the NYSE consider a transition period for the effective of the new rule.

The Commission further notes that three commenters opposed the elimination of broker voting on equity compensation plans, stating that such elimination would harm smaller issuers and provide uncertainty as to whether there will be a quorum at the next meeting. These commenters suggested that the NYSE consider an alternative to the elimination of broker voting—''mirror'' or ''echo'' voting—where unvoted shares held by a broker-dealer would be deemed as being voted proportionally to votes that were actually cast. One commenter requested clarification that the NYSE's proposed elimination of broker voting on equity compensation plans would only apply to NYSE listed issuers and not to Amex listed issuers.

The Commission believes that the NYSE's provision precluding broker voting on equity compensation plans is consistent with the Act. The Commission notes that equity compensation plans have become an important issue for shareholders. Because of the potential for dilution from such issuances, shareholders should be making the determination rather than brokers on their behalf. The Commission further notes that, generally under NYSE rules, only matters that are considered routine are allowed to be voted on by a broker on behalf of a beneficial owner. Because of the recent significance and concern about equity compensation plans, the Commission believes that it is appropriate for the NYSE to decide that shareholder approval of equity compensation plans is not a routine matter and must be voted on by the beneficial owner. As noted above, NASD rules do not provide for broker voting on any matters, so the NYSE's rule is now consistent for equity compensation plans. The Commission has considered the impact on smaller issuers, such as those listed on Nasdaq and the Amex, in response to the comments on this issue. The Commission believes that the benefit of ensuring that the votes reflect the views of beneficial shareholders on equity compensation plans outweighs the potential difficulties in obtaining the vote.

The Commission notes that, in its original filing, the NYSE committed to establishing a working group to advise on how to facilitate the implementation of this new rule prohibiting brokers from voting on equity compensation plans without voting instructions from the beneficial owner of the shares. The Commission also notes that the NYSE, in response to a commenter's concerns, has implemented a transition period that would make the new rule eliminating broker voting on equity compensation plans applicable only to shareholder meetings that occur on or after the 90th day from the effective date of the NYSE proposal.

I. Summary

Overall, the Commission believes that the proposed amendments to the NYSE and Nasdaq proposals should alleviate many of the concerns raised by the commenters and should provide for more clear and uniform standards for shareholder approval of equity compensation plans under both NYSE and NASD rules. The Commission notes that, even with the availability of the proposed limited exemptions to shareholder approval under the NYSE and Nasdaq proposals, shareholder approval under the new standards would be required in more circumstances than under existing NYSE and NASD rules. The Commission further notes that the NYSE proposes to add a requirement that an issuer must notify it in writing when it uses one of the exemptions from the shareholder approval requirements and that Nasdaq has committed to considering such a requirement. The Commission believes that this disclosure requirement should reduce the potential for abuse of any of the exemptions.[121] In addition, the NYSE's proposed amendment to NYSE Rule 452, which would preclude broker-dealers from voting on equity compensation plans without explicit instructions from the beneficial owner, is consistent with the standard under current NASD rules.

The Commission notes that the NYSE and Nasdaq proposals, while not identical, set a consistent, minimum standard for shareholder approval of equity compensation plans. These proposals should help to ensure that companies will not make listing decisions simply to avoid shareholder approval requirements for equity compensation plans. As noted above, many of the commentators expressed concerns over the differences between the proposals, as well as over issues of scope and clarity. The Commission believes the proposed amendments have addressed these concerns. Thus, the Commission believes that the NYSE and Nasdaq proposals should provide shareholders with greater protection from the potential dilutive effect of equity compensation plans. Based on the above, the Commission finds that the NYSE and Nasdaq proposals should help to protect investors, are in the

[121] *See also* supra note 118.

public interest, and do not unfairly discriminate among issuers, consistent with sections 6(b) and 15A(b) of the Act.[122] The Commission therefore finds the proposals, as amended, to be consistent with the Act and the rules and regulations thereunder.

V. Accelerated Approval of NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3

The Commission finds good cause for approving NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3 to the NYSE and Nasdaq proposed rule changes prior to the thirtieth day after the amendments are published for comment in the **Federal Register** pursuant to section 19(b)(2) of the Act.[123] NYSE Amendment No. 1 proposes technical corrections to the proposed rule language of the NYSE proposal. NYSE Amendment No. 2 proposes changes to the NYSE proposal based on discussions with Commission staff and in response to the comment letters. As discussed more fully above, NYSE Amendment No. 2, among other things, does the following: (1) Clarifies the terms ''equity compensation plan,'' ''material revision,'' and ''repricing''; (2) defines ''evergreen,'' ''formula'' and ''discretionary'' plans; and (3) provides new transition rules. Nasdaq Amendment No. 3, which replaces Nasdaq Amendment No. 2 in its entirety, also does the following: (1) States that the Nasdaq Board of Directors approved the Nasdaq proposed rule changes for filing with the Commission; and (2) proposes clarifying and conforming changes to the Nasdaq proposal based on recommendations from Commission staff and in response to the comment letters. As discussed more fully above, Nasdaq Amendment No. 3, among other things, also clarifies the term ''material amendment,'' proposes an exception to shareholder approval for plans that provide a way to purchase shares on the open market or from the issuer at fair market value, and discusses evergreen plans and repricings.

The Commission believes that the proposed changes in NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3 not only address many concerns raised in the comment letters, but are necessary to the conformity and proper application of the NYSE and Nasdaq listing standards relating to shareholder approval of equity compensation plans. The Commission therefore believes that accelerated approval of NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3 is appropriate. The Commission also notes that the amendments provide further clarification to portions of the NYSE and Nasdaq proposals that have already been noticed for comment and do not separately raise any new regulatory issues. Based on the above, the Commission finds, consistent with sections 6(b)(5),[124] 15A(b)(6),[125] and 19(b)[126] of the Act, that good cause exists to accelerate approval of NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3 to the NYSE and Nasdaq proposed rule changes, including whether NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3 are 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 offices of the NYSE and Nasdaq. All submissions should refer to File No. SR–NYSE–2002–46 and SR–NASD–2002–140 and should be submitted by July 24, 2003.

VII. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule changes, SR–NYSE–2002–46 and SR–NASD–2002–140, as amended, are consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange and a national securities association, respectively, and, in particular, with section 6(b)(5) of the Act[127] and with section 15A(b)(6) of the Act,[128] respectively.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[129] that the proposed rule changes, SR–NYSE–2002–46 and SR–NASD–2002–140, and Nasdaq Amendment No. 1 are approved, and that NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3 are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[130]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 03–16883 Filed 7–2–03; 8:45 am]

BILLING CODE 8010–01–P

122 15 U.S.C. 78f(b)(5) and 15 U.S.C. 78*o*–3(b)(6).

123 15 U.S.C. 78s(b)(2).

124 15 U.S.C. 78f(b)(5).

125 15 U.S.C. 78*o*–3(b)(6).

126 15 U.S.C. 78s(b).

127 15 U.S.C. 78f(b)(5).

128 15 U.S.C. 78*o*–3(6).

129 15 U.S.C. 78s(b)(2).

130 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–48100; File No. SR–PCX–2003–23]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. and Amendment No. 1 Thereto To Reduce Archipelago Exchange Facility Fees and Charges for the Execution and Routing of Odd-Lot Orders and To Clarify the Application of Market Data Revenue Sharing Credit

June 26, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on May 30, 2003, the Pacific Exchange, Inc. (''PCX'' or ''Exchange'') submitted to the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the PCX. On June 26, 2003, the PCX filed Amendment No. 1 to the proposed rule change.[3] 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 PCX, through its wholly-owned subsidiary PCX Equities, Inc. (''PCXE''),

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

2 17 CFR 240.19b–4.

3 In Amendment No. 1, the PCX made a technical correction to the proposal, the substance of which has been incorporated into this notice. *See* letter from Peter D. Bloom, Acting Managing Director, Regulatory Policy, PCX to Tim Fox, Attorney, Division of Market Regulation, Commission, dated June 25, 2003.