

Amendment No. 2 to the NYSE's
Corporate Governance Rule Proposals

The following is the principal text of the rule filing submitted by the Exchange to the Securities and Exchange Commission on October 8, 2003. This filing amends and restates the NYSE's amended corporate governance proposals filed with the SEC on April 4, 2003, which reflected the recommendations of the NYSE's Corporate Accountability and Listing Standards Committee.

As we did with the April 4, 2003 filing, we are reproducing here the purpose section of our October 2003 filing, which includes the text of the proposed rules. For your convenience, we have also prepared a comparison version of the proposed rule text to show how the proposed amended rule text differs from the proposed rule text filed in April 2003. This comparison may be found at the following link [[compare](#)].

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The New York Stock Exchange has long pioneered advances in corporate governance. The NYSE has required companies to comply with listing standards for nearly 150 years, and has periodically amended and supplemented those standards when the evolution of our capital markets has demanded enhanced governance standards or disclosure. On February 13, 2002, then SEC Chairman Harvey Pitt asked the Exchange to review its corporate governance listing standards. In conjunction with that request, the NYSE appointed a Corporate Accountability and Listing Standards Committee (the "Committee") to review the NYSE's current listing standards, along with recent proposals for reform, with the goal of enhancing the accountability, integrity and transparency of the Exchange's listed companies.

Following approval of the NYSE Board of Directors, the NYSE filed the NYSE Corporate Governance Proposals with the SEC on August 16, 2002, proposing rule changes to its corporate governance standards which reflected the findings of the Committee and which were designed to further the ability of honest and well-intentioned directors, officers and employees to perform their functions effectively.¹ The NYSE filed

¹ Subsequent to the filing of the Corporate Governance Proposals, the SEC requested that the NYSE file proposed Section 303A(8) (relating to shareholder approval of equity-compensation plans) and proposed NYSE Rule 452 (which prohibits member organizations from giving a proxy to vote on equity-compensation plans absent specific instructions from a beneficial holder) separately from its remaining proposals to facilitate SEC handling. The Exchange made this separate filing with the Commission on October 7, 2002, and it was

Amendment No. 1 to the Corporate Governance Proposals with the Commission on April 4, 2003, which was published for public comment.² The proposals for new corporate governance listing standards for companies listed on the Exchange are codified in a new section 303A of the Exchange's Listed Company Manual (the "Manual").³

Following publication of Amendment No. 1, the Commission received sixty-four comment letters from the public. The Exchange also participated in a number of discussions with the Commission staff regarding the proposed rule text. As a result of these discussions and in response to the comment letters, the Exchange has made a number of changes to the rules as proposed in Amendment No. 1, the most significant of which are outlined below.

approved in June 2003. See Securities Exchange Act Release No. 34-48108 (June 30, 2003); 68 FR 39995 (July 3, 2003) (SR-NYSE-2002-46).

² See Securities Exchange Act Release No. 47672, 68 FR 19051 (April 17, 2003) (SR-NYSE-2002-33) ("Amendment No. 1").

³ In its Report to the NYSE Board the Committee set forth basic principles followed in many cases by explanation and clarification. The Exchange is adopting the recommendations as standards in substantially the form they were made by the Committee and adopted by the NYSE Board. Accordingly, the format used will state a basic principle, with the additional explanation and clarifications included as "commentary". Readers are advised that the words "must" and "should" have been chosen with care when used. The use of the word "must" indicates a standard or practice with which companies are required to comply. The use of the word "should" indicates a standard or practice that the Exchange believes is appropriate for most if not all companies, but failure to employ or comply with such standard or practice will not constitute a violation of NYSE standards.

While many of the requirements set forth in this new rule are relatively specific, the Exchange is articulating a philosophy and approach to corporate governance that companies are expected to carry out as they apply the requirements to the specific facts and circumstances that they confront from time to time. Companies and their boards are expected to apply the requirements carefully and in good faith, making reasonable interpretations as necessary, and disclosing the interpretations that they make.

Significant Amendments from Amendment No. 1 to the Corporate Governance Proposals

General Applicability and Effective Dates

Closed-End Funds

Recognizing the additional regulation to which closed-end funds are subject under the Investment Company Act of 1940,⁴ closed-end funds will be required to comply with the audit committee requirements set out in proposed Sections 303A(6) and (7)(a) and (c), but will not be required to satisfy the NYSE's proposed additional board independence requirements set out in proposed Section 303A(2), or to comply with Section 303A(7)(d) requiring an internal audit function. Closed-end funds will also have relief from the obligation to disclose whether any director serves on more than three audit committees, given the common practice for a fund family to use the same directors to staff a number of boards. However, closed-end funds will be required to comply with proposed Section 303A(12) to provide an annual CEO certification of compliance with listing standards. At the SEC's specific request, closed-end funds will also be required to include procedures in the audit committee charter for confidential submissions by employees of the investment advisor, as well as any employees of the fund itself.

Business Development Companies

At the SEC's request, we have included special provisions for these hybrid companies, that can elect to file periodic reports pursuant to the Exchange Act rather than be subject to the provisions of the Investment Company Act. Due to the fact, however, that all business development companies remain subject to the Investment Company Act requirements relating to "interested directors," business development companies will not be required to comply with the director independence requirements of Section 303A(2).

Effective Dates

The effective dates and transition periods of the Corporate Governance Proposals have been conformed to those mandated for audit committees by the Sarbanes-Oxley Act of 2002⁵ (the "Sarbanes-Oxley Act") and Rule 10A-3 ("Rule 10A-3")⁶ under the Securities Exchange Act of 1934 (the "Exchange Act"),⁷ that require compliance by the earlier of a company's first annual meeting after January 15, 2004, or no later than October 31, 2004. Companies with classified boards will have an additional year to

⁴ 15 U.S.C. 80a et seq (the "Investment Company Act").

⁵ Pub. L. 107-204, 116 Stat. 745 (2002).

⁶ 17 CFR 240.10A-3 ("Rule 10A-3").

⁷ 15 U.S.C. 78a et seq.

replace a director not scheduled to stand for election in 2004, unless the change would be otherwise required by Rule 10A-3. Foreign private issuers will have until July 31, 2005 to comply with the proposed audit committee requirements that are applicable to them under Section 303A(6).

Companies listing in conjunction with their initial public offerings will be required to phase in their independent nomination and compensation committees on the same schedule as Rule 10A-3 mandates for audit committees, namely, one independent director at the time of listing, a majority within 90 days and fully independent committees within one year. Companies listing in conjunction with an initial public offering will also be required to have a majority independent board within 12 months of listing. The 12-month transition period will also apply to companies that transfer to the NYSE from other markets that do not impose the same requirements.

Proposed Section 303A(2) Regarding Director Independence

“Look-back” Periods

As proposed, the specific independence tests in our standards are applied not only against current circumstances but also “look-back” to prior years. As amended in April, these five year look-back periods were prospective only (*i.e.*, relationships that would disqualify a director as independent under the bright-line tests would not do so if the relationship were ended prior to the effective date of the new standards). The tests built up to a full five-year look-back period only over time.

In response to comments from the SEC that our proposed phased-in approach resulted a long time period before full compliance was required, we have revised the look-back provisions. The independence tests now have a one-year look-back during the first year after these new standards are approved by the SEC, with the full look-back period becoming applicable after the end of that first year. In addition, in response to comments from the public that our five-year look-back was inappropriately long, we have reduced the look-back period from five to three years.

Subsidiary and Parent Corporations

We clarified that references to the “company” includes any parent or subsidiary in a consolidated group with the company.

Section 303A(2)(b)(i) – Employee Relationship

We have clarified that a director who is an employee, or whose immediate family member is an executive officer, of the company is not considered independent until three years after the end of such employment relationship. With respect to the definition of “immediate family member,” we noted in Amendment No. 1 that our proposed definition was broader than that utilized by the SEC in Rule 10A-3 under the Exchange Act. Comment on this point was mixed, and the SEC staff expressed the view that our definition should remain as proposed. Therefore, no change has been made to the definition of immediate family member.

Section 303(A)(2)(b)(ii) - Direct Compensation

As proposed in April, if a director or immediate family member received \$100,000 in direct compensation from the company (other than for service as a director), such director was presumed not to be independent. This presumption could be rebutted, however, and the board could find the director to be independent, as long as no independent director objected and the company disclosed the reason for its determination. In response to a SEC comment, we have amended Section 303A(2)(b)(ii) to be a bright line test, rather than a rebuttable presumption. In addition, we have clarified that immediate family member compensation need only be considered if the family member is an executive officer of the listed company.

Section 303A(2)(b)(v) – Consolidated Gross Revenue Test

In response to public comments, we have amended proposed Section 303A(2)(b)(v) to test all payments (whether to or from the listed company) against the consolidated gross revenues of the director's company, rather than also testing it against the listed company. Commenters pointed out that in the form the provision was proposed in April, it could produce an anomalous result. For example, a small listed company might have on its board an executive of a very large phone company. The small listed company might have phone bills that exceed 2% of its revenues, although the money involved is not significant to the large phone company. Altering the provision to test against the gross revenues of the director's company recognizes that there is no reason to assume that the phone company executive cannot be independent of the small listed company's management.

In addition, we have added commentary to this section to note that, while charitable organizations are not considered "companies" for purposes of this test, listed companies must disclose contributions to a charity of which a director serves as an executive officer, where such contributions exceed the greater of \$1 million or 2% of the charitable organization's annual gross revenues. We also noted that listed company boards are obligated to consider the materiality of these relationships in assessing director independence generally.

Proposed Section 303A(3) – Non-Management Director Sessions

As proposed, Section 303A(3) requires executive sessions between non-management directors, which can include non-management directors who are not independent. At the SEC's request, we have added a suggestion that companies hold an executive session limited solely to independent directors at least once a year.

Independent Board Committees

Section 303A(4) – Compensation Committee

Many commenters expressed concern that as proposed in Section 303A(4), the compensation committee has been given the "sole authority" to determine CEO compensation. We have revised this provision to clarify that all independent directors

may be involved in approving the CEO's compensation. We also clarified that the board in general is not precluded from discussing CEO compensation, as we did not intend this standard to impair communications among all directors.

Sections 303A(6) and (7) – Audit Committees

In response to comments from the public and the SEC, we have restructured Sections 303A(6) and (7) to clearly define the audit committee requirements applicable to listed companies pursuant Rule 10A-3, as opposed to the NYSE's additional requirements that are not applicable to all listed companies. We believe that these changes help clarify the applicability of the proposed audit committee standards for companies such as foreign private issuers and companies that only list debt securities on the NYSE. As amended, these types of companies will be required to comply only with the audit committee requirements of Section 303A(6),⁸ and not Section 303A(7). In adopting the Sarbanes-Oxley audit committee requirements, we have decided to simply incorporate Rule 10A-3 under the Exchange Act by reference, rather than restating that Rule or attempting to paraphrase it.

What follows are the requirements as proposed to be codified in Section 303A of the Manual, other than Section 303A(8), which, as described above, has been filed and approved separately:

303A

General Application

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

Equity Listings

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

Controlled Companies

A company of which more than 50% of the voting power is held by an individual, a group or another company need not comply with the requirements of Sections 303A(1),

⁸ As provided for in Rule 10A-3 under the Exchange Act, listed companies must comply with these provisions by the first annual meeting held after January 15, 2004, but in no event later than October 31, 2004. Foreign private issuers and small business issuers will have until July 31, 2005 to comply.

(4) or (5).⁹ A controlled company that chooses to take advantage of any or all of these exemptions must disclose that choice, that it is a controlled company and the basis for the determination in its annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10-K filed with the SEC. Controlled companies must comply with the remaining provisions of Section 303A.

Limited Partnerships and Companies in Bankruptcy¹⁰

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

Closed-End and Open-End Funds

The Exchange considers the significantly expanded standards and requirements provided for in Section 303A to be unnecessary for closed-end and open-end management investment companies that are registered under the Investment Company Act of 1940, given the pervasive federal regulation applicable to them. However, closed-end funds must comply with the requirements of Sections 303A(6), (7)(a) and (c), and (12).¹¹ Note, however, that in view of the common practice to utilize the same directors for boards in the same fund complex, closed-end funds will not be required to comply with the disclosure requirement in the second paragraph of the Commentary to 303A(7)(a), which calls for disclosure of a board's determination with respect to simultaneous service on more than three public company audit committees. However, the other provisions of that paragraph will apply.

⁹ The Exchange notes that this exemption will affect a small percentage of its listed companies.

¹⁰ Limited partnerships are managed by a general partner rather than by a board of directors. However the Exchange has traditionally required the corporate general partner to comply with its independent audit committee standard, and the Exchange believes that such entities can and should comply with the proposed standards other than the requirement for majority independent boards and independent nominating and compensation committees. Companies in bankruptcy proceedings generally do have a board of directors, but may well have difficulties in retaining independent directors, and in any event are subject to the supervision and control of the bankruptcy court. Accordingly, the Exchange proposes to also exempt them from the requirements for a majority independent board and independent nomination and compensation committees.

¹¹ This is consistent with the Exchange's traditional approach, which has been to require listed closed-end funds to comply with the Exchange's independent audit committee requirement.

Business development companies, which are a type of closed-end management investment company defined in Section 2(a)(48) of the Investment Company Act of 1940 that are not registered under that Act, are required to comply with all of the provisions of Section 303A applicable to domestic issuers other than Sections 303A(2) and (7)(b). For purposes of Sections 303A(1), (3), (4), (5), and (9), a director of a business development company shall be considered to be independent if he or she is not an “interested person” of the company, as defined in Section 2(a)(19) of the Investment Company Act of 1940.

As required by Rule 10A-3 under the Exchange Act, open-end funds (which can be listed as Investment Company Units, more commonly known as Exchange Traded Funds or ETFs) are required to comply with the requirements of Sections 303A(6) and 12(b).

Rule 10A-3(b)(3)(ii) under the Exchange Act requires that each audit committee must establish procedures for the confidential, anonymous submission by employees of the listed issuer of concerns regarding questionable accounting or auditing matters. In view of the external management structure often employed by closed-end and open-end funds, the Exchange also requires the audit committees of such companies to establish such procedures for the confidential, anonymous submission by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the management company, as well as employees of the management company. Such procedures must be set forth in the audit committee charter.

Other Entities

Except as otherwise required by Rule 10A-3 under the Exchange Act (for example, with respect to open-end funds), Section 303A does not apply to passive business organizations in the form of trusts (such as royalty trusts) or to derivatives and special purpose securities (such as those described in Sections 703.16, 703.19, 703.20 and 703.21).¹² To the extent that Rule 10A-3 applies to a passive business organization, listed derivative or special purpose security, such entities are required to comply with Sections 303A(6) and (12)(b).

Foreign Private Issuers

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

Preferred and Debt Listings

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

¹² This is consistent with the Exchange's traditional approach to such listings.

Effective Dates/Transition Periods

Except for Section 303A(8), which became effective June 30, 2003, listed companies will have until the earlier of their first annual meeting after January 15, 2004, or October 31, 2004, to comply with the new standards contained in Section 303A, although if a company with a classified board would be required (other than by virtue of a requirement under Section 303A(6)) to change a director who would not normally stand for election in such annual meeting, the company may continue such director in office until the second annual meeting after such date, but no later than December 31, 2005. In addition, foreign private issuers will have until July 31, 2005, to comply with the new audit committee standards set out in Section 303A(6). As a general matter, the existing audit committee requirements provided for in Section 303 continue to apply to listed companies pending the transition to the new rules.

Companies listing in conjunction with their initial public offering will be permitted to phase in their independent nomination and compensation committees on the same schedule as is permitted pursuant to Rule 10A-3 under the Exchange Act for audit committees, that is, one independent member at the time of listing, a majority of independent members within 90 days of listing and fully independent committees within one year. Such companies will be required to meet the majority independent board requirement within 12 months of listing. For purposes of Section 303A other than Sections 303A(6) and 12(b), a company will be considered to be listing in conjunction with an initial public offering if, immediately prior to listing, it does not have a class of common stock registered under the Exchange Act. The Exchange will also permit companies that are emerging from bankruptcy or have ceased to be controlled companies within the meaning of Section 303A to phase in independent nomination and compensation committees and majority independent boards on the same schedule as companies listing in conjunction with an initial public offering. However, for purposes of Sections 303A(6) and 12(b), a company will be considered to be listing in conjunction with an initial public offering only if it meets the conditions of Rule 10A-3(b)(1)(iv)(A) under the Exchange Act, namely, that the company was not, immediately prior to the effective date of a registration statement, required to file reports with the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act.

Companies listing upon transfer from another market have 12 months from the date of transfer in which to comply with any requirement to the extent the market on which they were listed did not have the same requirement. To the extent the other market has a substantially similar requirement but also had a transition period from the effective date of that market's rule, which period had not yet expired, the company will have the same transition period as would have been available to it on the other market. This transition period for companies transferring from another market will not apply to the requirements of Section 303A(6) unless a transition period is available pursuant to Rule 10A-3 under the Exchange Act.

References to Form 10-K

There are provisions in this Section 303A that call for disclosure in a company's Form 10-K under certain circumstances. If a company subject to such a provision is not a

company required to file a Form 10-K, then the provision shall be interpreted to mean the annual periodic disclosure form that the company does file with the SEC. For example, for a closed-end fund, the appropriate form would be the annual Form N-CSR. If a company is not required to file either an annual proxy statement or an annual periodic report with the SEC, the disclosure shall be made in the annual report required under Section 203.01 of the NYSE Listed Company Manual.

1. Listed companies must have a majority of independent directors.

Commentary: Effective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest.

2. In order to tighten the definition of “independent director” for purposes of these standards:

- (a) No director qualifies as “independent” unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). Companies must disclose these determinations.**

Commentary: It is not possible to anticipate, or explicitly to provide for, all circumstances that might signal potential conflicts of interest, or that might bear on the materiality of a director’s relationship to a listed company (references to “company” would include any parent or subsidiary in a consolidated group with the company). Accordingly, it is best that boards making “independence” determinations broadly consider all relevant facts and circumstances. In particular, when assessing the materiality of a director’s relationship with the company, the board should consider the issue not merely from the standpoint of the director, but also from that of persons or organizations with which the director has an affiliation. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others. However, as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding.

The basis for a board determination that a relationship is not material must be disclosed in the company’s annual proxy statement or, if the company does not file an annual proxy statement, in the company’s annual report on Form 10-K filed with the SEC. In this regard, a board may adopt and disclose categorical standards to assist it in making determinations of independence and may make a general disclosure if a director meets these standards. Any determination of independence for a director who does not meet these standards must be specifically explained. A company must disclose any standard it adopts. It may then make the general statement that the independent directors meet the standards

set by the board without detailing particular aspects of the immaterial relationships between individual directors and the company. In the event that a director with a business or other relationship that does not fit within the disclosed standards is determined to be independent, a board must disclose the basis for its determination in the manner described above. This approach provides investors with an adequate means of assessing the quality of a board's independence and its independence determinations while avoiding excessive disclosure of immaterial relationships.

(b) In addition:

- (i) A director who is an employee, or whose immediate family member is an executive officer, of the company is not independent until three years after the end of such employment relationship.**

Commentary: Employment as an interim Chairman or CEO shall not disqualify a director from being considered independent following that employment.

- (ii) A director who receives, or whose immediate family member receives, more than \$100,000 per year in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), is not independent until three years after he or she ceases to receive more than \$100,000 per year in such compensation.**

Commentary: Compensation received by a director for former service as an interim Chairman or CEO need not be considered in determining independence under this test. Compensation received by an immediate family member for service as a non-executive employee of the listed company need not be considered in determining independence under this test.

- (iii) A director who is affiliated with or employed by, or whose immediate family member is affiliated with or employed in a professional capacity by, a present or former internal or external auditor of the company is not "independent" until three years after the end of the affiliation or the employment or auditing relationship.**

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

- (v) A director who is an executive officer or an employee, or whose immediate family member is an executive officer, of a company that makes payments to, or receives payments from, the listed company for property or services in an amount which, in any single fiscal year, exceeds**

the greater of \$1 million, or 2% of such other company’s consolidated gross revenues, is not “independent” until three years after falling below such threshold.

Commentary: In applying the test in Section 303A(2)(b)(v), both the payments and the consolidated gross revenues to be measured shall be those reported in the last completed fiscal year. The look-back provision for this test applies solely to the financial relationship between the listed company and the director or immediate family member’s current employer; a listed company need not consider former employment of the director or immediate family member.

Charitable organizations shall not be considered “companies” for purposes of Section 303A(2)(b)(v), provided however that a listed company shall disclose in its annual proxy statement, or if the listed company does not file an annual proxy statement, in the company’s annual report on Form 10-K filed with the SEC, any charitable contributions made by the listed company to any charitable organization in which a director serves as an executive officer if, within the preceding three years, contributions in any single fiscal year exceeded the greater of \$1 million, or 2% of such charitable organization’s consolidated gross revenues. Listed company boards are reminded of their obligations to consider the materiality of any such relationship in accordance with Section 303A(2)(a) above.

General Commentary to Section 303A(2)(b): An “immediate family member” includes a person’s spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person’s home. When applying the look-back provisions in Section 303A(2)(b), listed companies need not consider individuals who are no longer immediate family members as a result of legal separation or divorce, or those who have died or become incapacitated. In addition, references to the “company” would include any parent or subsidiary in a consolidated group with the company.

Transition Rule. Each of the above standards contains a three-year “look-back” provision. In order to facilitate a smooth transition to the new independence standards, the Exchange will phase in the “look-back” provisions by applying only a one-year look-back for the first year after adoption of these new standards. The three-year look-backs provided for in Section 303A(2)(b) will begin to apply only from and after [insert the date which is the first anniversary of the SEC approval date of this listing standard].

As an example, until [insert the date which is the day prior to the first anniversary of the SEC approval date of this listing standard] a company need look back only one year when testing compensation under Section 303A(2)(b)(ii). Beginning [insert date which is the first anniversary of the SEC approval date of this listing standard], however, the company would need to look back the full three years provided in Section 303A(2)(b)(ii).

3. To empower non-management directors to serve as a more effective check on management, the non-management directors of each company must meet at regularly scheduled executive sessions without management.

Commentary: To promote open discussion among the non-management directors, companies must schedule regular executive sessions in which those directors meet without management participation. “Non-management” directors are all those who are not company officers (as that term is defined in Rule 16a-1(f)¹³ under the Securities Act of 1933¹⁴), and includes such directors who are not independent by virtue of a material relationship, former status or family membership, or for any other reason.

Regular scheduling of such meetings is important not only to foster better communication among non-management directors, but also to prevent any negative inference from attaching to the calling of executive sessions. There need not be a single presiding director at all executive sessions of the non-management directors. If one director is chosen to preside at these meetings, his or her name must be disclosed in the company’s annual proxy statement or, if the company does not file an annual proxy statement, in the company’s annual report on Form 10-K filed with the SEC. Alternatively, a company may disclose the procedure by which a presiding director is selected for each executive session. For example, a company may wish to rotate the presiding position among the chairs of board committees.

In order that interested parties may be able to make their concerns known to the non-management directors, a company must disclose a method for such parties to communicate directly with the presiding director or with the non-management directors as a group. Companies may, if they wish, utilize for this purpose the same procedures they have established to comply with the requirement of Rule 10A-3 (b)(3) under the Exchange Act, as applied to listed companies through Section 303A(6).

While this Section 303A(3) refers to meetings of non-management directors, if that group includes directors who are not independent under this Section 303A, listed companies should at least once a year schedule an executive session including only independent directors.

4. (a) Listed companies must have a nominating/corporate governance committee composed entirely of independent directors.

¹³ 17 CFR 240.16a-1(f). This same definition is found in Section 303.02(E) of the current Manual.

¹⁴ 15 U.S.C. 77a et seq.

(b) The nominating/corporate governance committee must have a written charter that addresses:

(i) the committee's purpose and responsibilities – which, at minimum, must be to: identify individuals qualified to become board members, consistent with criteria approved by the board, and to select, or to recommend that the board select, the director nominees for the next annual meeting of shareholders; develop and recommend to the board a set of corporate governance principles applicable to the corporation; and oversee the evaluation of the board and management; and

(ii) an annual performance evaluation of the committee.

Commentary: A nominating/corporate governance committee is central to the effective functioning of the board. New director and board committee nominations are among a board's most important functions. Placing this responsibility in the hands of an independent nominating/corporate governance committee can enhance the independence and quality of nominees. The committee is also responsible for taking a leadership role in shaping the corporate governance of a corporation.

If a company is legally required by contract or otherwise to provide third parties with the ability to nominate directors (for example, preferred stock rights to elect directors upon a dividend default, shareholder agreements, and management agreements), the selection and nomination of such directors need not be subject to the nominating committee process.

The nominating/corporate governance committee charter should also address the following items: committee member qualifications; committee member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board. In addition, the charter should give the nominating/corporate governance committee sole authority to retain and terminate any search firm to be used to identify director candidates, including sole authority to approve the search firm's fees and other retention terms.

Boards may allocate the responsibilities of the nominating/corporate governance committee to committees of their own denomination, provided that the committees are composed entirely of independent directors. Any such committee must have a published committee charter.

5. (a) Listed companies must have a compensation committee composed entirely of independent directors.

(b) The compensation committee must have a written charter that addresses:

(i) the committee's purpose and responsibilities – which, at minimum, must be to have direct responsibility to:

- (A) review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO’s performance in light of those goals and objectives, and, either as a committee or together with the other independent directors (as directed by the board), determine and approve the CEO’s compensation level based on this evaluation; and**
 - (B) make recommendations to the board with respect to non-CEO compensation, incentive-compensation plans and equity-based plans; and**
 - (C) produce a compensation committee report on executive compensation as required by the SEC to be included in the company’s annual proxy statement or annual report on Form 10-K filed with the SEC;**
- (ii) an annual performance evaluation of the compensation committee.**

Commentary: In determining the long-term incentive component of CEO compensation, the committee should consider the company’s performance and relative shareholder return, the value of similar incentive awards to CEOs at comparable companies, and the awards given to the listed company’s CEO in past years. To avoid confusion, note that the compensation committee is not precluded from approving awards (with or without ratification of the board) as may be required to comply with applicable tax laws (i.e., Rule 162(m)¹⁵).

The compensation committee charter should also address the following items: committee member qualifications; committee member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board.

Additionally, if a compensation consultant is to assist in the evaluation of director, CEO or senior executive compensation, the compensation committee charter should give that committee sole authority to retain and terminate the consulting firm, including sole authority to approve the firm’s fees and other retention terms.

Boards may allocate the responsibilities of the compensation committee to committees of their own denomination, provided that the committees are composed entirely of independent directors. Any such committee must have a published committee charter.

Nothing in this provision should be construed as precluding discussion of CEO compensation with the board generally, as it is not the intent of this standard to impair communication among members of the board.

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26 U.S.C. §162(m) (2002).

6. Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 under the Exchange Act.

Commentary: The Exchange will apply the requirements of Rule 10A-3 in a manner consistent with the guidance provided by the Securities and Exchange Commission in SEC Release No. 34-47654 (April 1, 2003). Without limiting the generality of the foregoing, the Exchange will provide companies the opportunity to cure defects provided in Rule 10A-3(a)(3) under the Exchange Act.

7. (a) The audit committee must have a minimum of three members.

Commentary: Each member of the audit committee must be financially literate, as such qualification is interpreted by the company's board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee. In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the company's board interprets such qualification in its business judgment. While the Exchange does not require that a listed company's audit committee include a person who satisfies the definition of audit committee financial expert set out in Item 401(e) of Regulation S-K, a board may presume that such a person has accounting or related financial management expertise.

Because of the audit committee's demanding role and responsibilities, and the time commitment attendant to committee membership, each prospective audit committee member should evaluate carefully the existing demands on his or her time before accepting this important assignment. Additionally, if an audit committee member simultaneously serves on the audit committees of more than three public companies, and the listed company does not limit the number of audit committees on which its audit committee members serve, then in each case, the board must determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee and disclose such determination in the company's annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10-K filed with the SEC.

(b) In addition to any requirement of Rule 10A-3(b)(1), all audit committee members must satisfy the requirements for independence set out in Section 303A(2).

(c) The audit committee must have a written charter that addresses:

(i) the committee's purpose – which, at minimum, must be to:

(A) assist board oversight of (1) the integrity of the company's financial statements, (2) the company's compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence, and (4) the performance of the company's internal audit function and independent auditors; and

- (B) prepare an audit committee report as required by the SEC to be included in the company’s annual proxy statement;**
- (ii) an annual performance evaluation of the audit committee; and**
- (iii) the duties and responsibilities of the audit committee – which, at a minimum, must include those set out in Rule 10A-3(b)(2), (3), (4) and (5) of the Exchange Act , as well as to:**
 - (A) at least annually, obtain and review a report by the independent auditor describing: the firm’s internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor’s independence) all relationships between the independent auditor and the company;**

Commentary: After reviewing the foregoing report and the independent auditor’s work throughout the year, the audit committee will be in a position to evaluate the auditor’s qualifications, performance and independence. This evaluation should include the review and evaluation of the lead partner of the independent auditor. In making its evaluation, the audit committee should take into account the opinions of management and the company’s internal auditors (or other personnel responsible for the internal audit function). In addition to assuring the regular rotation of the lead audit partner as required by law, the audit committee should further consider whether, in order to assure continuing auditor independence, there should be regular rotation of the audit firm itself. The audit committee should present its conclusions with respect to the independent auditor to the full board.

- (B) discuss the company’s annual audited financial statements and quarterly financial statements with management and the independent auditor, including the company’s disclosures under “Management’s Discussion and Analysis of Financial Condition and Results of Operations”;**
- (C) discuss the company’s earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies;**

Commentary: The audit committee’s responsibility to discuss earnings releases, as well as financial information and earnings guidance, may be done generally (i.e., discussion of the types of information to be disclosed and the type of presentation to be made). The audit committee need not discuss in advance each

earnings release or each instance in which a company may provide earnings guidance.

(D) discuss policies with respect to risk assessment and risk management;

Commentary: While it is the job of the CEO and senior management to assess and manage the company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled. The audit committee should discuss the company's major financial risk exposures and the steps management has taken to monitor and control such exposures. The audit committee is not required to be the sole body responsible for risk assessment and management, but, as stated above, the committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken. Many companies, particularly financial companies, manage and assess their risk through mechanisms other than the audit committee. The processes these companies have in place should be reviewed in a general manner by the audit committee, but they need not be replaced by the audit committee.

(E) meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors;

Commentary: To perform its oversight functions most effectively, the audit committee must have the benefit of separate sessions with management, the independent auditors and those responsible for the internal audit function. As noted herein, all listed companies must have an internal audit function. These separate sessions may be more productive than joint sessions in surfacing issues warranting committee attention.

(F) review with the independent auditor any audit problems or difficulties and management's response;

Commentary: The audit committee must regularly review with the independent auditor any difficulties the auditor encountered in the course of the audit work, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management. Among the items the audit committee may want to review with the auditor are: any accounting adjustments that were noted or proposed by the auditor but were "passed" (as immaterial or otherwise); any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any "management" or "internal control" letter issued, or proposed to be issued, by the audit firm to the company. The review should also include discussion of the responsibilities, budget and staffing of the company's internal audit function.

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

Commentary: Employees or former employees of the independent auditor are often valuable additions to corporate management. Such individuals' familiarity with the business, and personal rapport with the employees, may be attractive qualities when filling a key opening. However, the audit committee should set hiring policies taking into account the pressures that may exist for auditors consciously or subconsciously seeking a job with the company they audit.

(H) report regularly to the board of directors.

Commentary: The audit committee should review with the full board any issues that arise with respect to the quality or integrity of the company's financial statements, the company's compliance with legal or regulatory requirements, the performance and independence of the company's independent auditors, or the performance of the internal audit function.

General Commentary to Section 303A(7)(c): While the fundamental responsibility for the company's financial statements and disclosures rests with management and the independent auditor, the audit committee must review: (A) major issues regarding accounting principles and financial statement presentations, including any significant changes in the company's selection or application of accounting principles, and major issues as to the adequacy of the company's internal controls and any special audit steps adopted in light of material control deficiencies; (B) analyses prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements; (C) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the company; and (D) the type and presentation of information to be included in earnings press releases (paying particular attention to any use of "pro forma," or "adjusted" non-GAAP, information), as well as review any financial information and earnings guidance provided to analysts and rating agencies.

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

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

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

8. Reserved.

9. Listed companies must adopt and disclose corporate governance guidelines.

Commentary: No single set of guidelines would be appropriate for every company, but certain key areas of universal importance include director qualifications and responsibilities, responsibilities of key board committees, and director compensation. Given the importance of corporate governance, each listed company's website must include its corporate governance guidelines and the charters of its most important committees (including at least the audit, and if applicable, compensation and nominating committees). Each company's annual report on Form 10-K filed with the SEC must state that the foregoing information is available on its website, and that the information is available in print to any shareholder who requests it. Making this information publicly available should promote better investor understanding of the company's policies and procedures, as well as more conscientious adherence to them by directors and management.

The following subjects must be addressed in the corporate governance guidelines:

- **Director qualification standards.** These standards should, at minimum, reflect the independence requirements set forth in Sections 303A(1) and (2). Companies may also address other substantive qualification requirements, including policies limiting the number of boards on which a director may sit, and director tenure, retirement and succession.
- **Director responsibilities.** These responsibilities should clearly articulate what is expected from a director, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.
- **Director access to management and, as necessary and appropriate, independent advisors.**
- **Director compensation.** Director compensation guidelines should include general principles for determining the form and amount of director compensation (and for reviewing those principles, as appropriate). The board should be aware that questions as to directors' independence may be raised when directors' fees and emoluments exceed what is customary. Similar concerns may be raised when the company makes substantial charitable contributions to organizations in which a director is affiliated, or enters into consulting contracts with (or provides other indirect forms of compensation to) a director. The board should critically evaluate each of these matters when determining the form and amount of director compensation, and the independence of a director.
- **Director orientation and continuing education.**
- **Management succession.** Succession planning should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO.

- **Annual performance evaluation of the board.** The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively.

10. Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.

Commentary: No code of business conduct and ethics can replace the thoughtful behavior of an ethical director, officer or employee. However, such a code can focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability.

Each code of business conduct and ethics must require that any waiver of the code for executive officers or directors may be made only by the board or a board committee and must be promptly disclosed to shareholders. This disclosure requirement should inhibit casual and perhaps questionable waivers, and should help assure that, when warranted, a waiver is accompanied by appropriate controls designed to protect the company. It will also give shareholders the opportunity to evaluate the board's performance in granting waivers.

Each code of business conduct and ethics must also contain compliance standards and procedures that will facilitate the effective operation of the code. These standards should ensure the prompt and consistent action against violations of the code. Each listed company's website must include its code of business conduct and ethics. Each company's annual report on Form 10-K filed with the SEC must state that the foregoing information is available on its website and that the information is available in print to any shareholder who requests it.

Each company may determine its own policies, but all listed companies should address the most important topics, including the following:

- **Conflicts of interest.** A "conflict of interest" occurs when an individual's private interest interferes in any way – or even appears to interfere – with the interests of the corporation as a whole. A conflict situation can arise when an employee, officer or director takes actions or has interests that may make it difficult to perform his or her company work objectively and effectively. Conflicts of interest also arise when an employee, officer or director, or a member of his or her family, receives improper personal benefits as a result of his or her position in the company. Loans to, or guarantees of obligations of, such persons are of special concern. The company should have a policy prohibiting such conflicts of interest, and providing a means for employees, officers and directors to communicate potential conflicts to the company.

- **Corporate opportunities.** Employees, officers and directors should be prohibited from (a) taking for themselves personally opportunities that are discovered through the use of corporate property, information or position; (b) using corporate property, information, or position for personal gain; and (c) competing with the company. Employees, officers and directors owe a duty to the company to advance its legitimate interests when the opportunity to do so arises.
- **Confidentiality.** Employees, officers and directors should maintain the confidentiality of information entrusted to them by the company or its customers, except when disclosure is authorized or legally mandated. Confidential information includes all non-public information that might be of use to competitors, or harmful to the company or its customers, if disclosed.
- **Fair dealing.** Each employee, officer and director should endeavor to deal fairly with the company's customers, suppliers, competitors and employees. None should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair-dealing practice. Companies may write their codes in a manner that does not alter existing legal rights and obligations of companies and their employees, such as "at will" employment arrangements.
- **Protection and proper use of company assets.** All employees, officers and directors should protect the company's assets and ensure their efficient use. Theft, carelessness and waste have a direct impact on the company's profitability. All company assets should be used for legitimate business purposes.
- **Compliance with laws, rules and regulations (including insider trading laws).** The company should proactively promote compliance with laws, rules and regulations, including insider trading laws. Insider trading is both unethical and illegal, and should be dealt with decisively.
- **Encouraging the reporting of any illegal or unethical behavior.** The company should proactively promote ethical behavior. The company should encourage employees to talk to supervisors, managers or other appropriate personnel when in doubt about the best course of action in a particular situation. Additionally, employees should report violations of laws, rules, regulations or the code of business conduct to appropriate personnel. To encourage employees to report such violations, the company must ensure that employees know that the company will not allow retaliation for reports made in good faith.

11. Listed foreign private issuers must disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards.

Commentary: Foreign private issuers must make their U.S. investors aware of the significant ways in which their home-country practices differ from those followed by domestic companies under NYSE listing standards. However, foreign private

issuers are not required to present a detailed, item-by-item analysis of these differences. Such a disclosure would be long and unnecessarily complicated. Moreover, this requirement is not intended to suggest that one country's corporate governance practices are better or more effective than another. The Exchange believes that U.S. shareholders should be aware of the significant ways that the governance of a listed foreign private issuer differs from that of a U.S. listed company. The Exchange underscores that what is required is a brief, general summary of the significant differences, not a cumbersome analysis.¹⁶

Listed foreign private issuers may provide this disclosure either on their web site (provided it is in the English language and accessible from the United States) and/or in their annual report as distributed to shareholders in the United States in accordance with Sections 103.00 and 203.01 of the Listed Company Manual (again, in the English language). If the disclosure is only made available on the web site, the annual report shall so state and provide the web address at which the information may be obtained.

12. (a) Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards.

Commentary: The CEO's annual certification to the NYSE that, as of the date of certification, he or she is unaware of any violation by the company of the NYSE's corporate governance listing standards will focus the CEO and senior management on the company's compliance with the listing standards.¹⁷ Both this

¹⁶ The NYSE will work with its counterparts throughout the world to strive for harmony in corporate governance principles, with the goal of establishing global principles to be implemented by global companies no matter where those companies are based.

¹⁷ The Committee's original recommendations to the NYSE Board included a CEO certification that the company had established procedures for verifying the accuracy and completeness of the information provided to investors, that those procedures had been carried out, that the CEO had no reasonable cause to believe that the information provided to investors is not accurate and complete in all material respects, and that the CEO had reviewed with the company's board those procedures and the company's compliance with them. Given the SEC's August 2002 emergency order and the provisions of the Sarbanes-Oxley Act regarding CEO certifications relating to the quality of financial disclosure, the Committee recommended, and the NYSE agreed, that there was no purpose to requiring under NYSE rules a similar but separate certification regarding a company's public disclosure. See File No. 4-460: Order Requiring the Filing of Sworn Statements Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934 (June 27, 2002) and Sections 302 and 906 of the Sarbanes-Oxley Act. The Committee noted to the NYSE Board that there has been a great deal of concern expressed by commentators regarding the additional potential liability created by the various certification proposals and the Committee recommended, and the

certification to the NYSE, and any CEO/CFO certifications required to be filed with the SEC regarding the quality of the company's public disclosure, must be disclosed in the company's annual report to shareholders or, if the company does not prepare an annual report to shareholders, in the company's annual report on Form 10-K filed with the SEC.

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

13. The NYSE may issue a public reprimand letter to any listed company that violates a NYSE listing standard.

Commentary: Suspending trading in or delisting a company can be harmful to the very shareholders that the NYSE listing standards seek to protect; the NYSE must therefore use these measures sparingly and judiciously. For this reason it is appropriate for the NYSE to have the ability to apply a lesser sanction to deter companies from violating its corporate governance (or other) listing standards. Accordingly, the NYSE may issue a public reprimand letter to any listed company, regardless of type of security listed or country of incorporation, that it determines has violated a NYSE listing standard. For companies that repeatedly or flagrantly violate NYSE listing standards, suspension and delisting remain the ultimate penalties. For clarification, this lesser sanction is not intended for use in the case of companies that fall below the financial and other continued listing standards provided in Chapter 8 of the Listed Company Manual or that fail to comply with the audit committee standards set out in Section 303A(6). The processes and procedures provided for in Chapter 8 govern the treatment of companies falling below those standards.

NYSE agreed, that the SEC should have exclusive authority to enforce the requirement of a CEO and CFO certification and that no certification should give rise to private rights of action.