

INITIAL REPORT
of the
SPECIAL COMMITTEE ON GOVERNANCE OF THE NYSE
June 5, 2003

In a March 26, 2003 letter, Securities and Exchange Commission Chairman William H. Donaldson asked the New York Stock Exchange and the other self-regulatory organizations to review their corporate governance in light of the broad review of governance practices throughout corporate America, to ensure that their governance structures and practices serve the public well.¹ On May 14, 2003, NYSE Chairman Richard A. Grasso informed SEC Chairman Donaldson of the formation of the Special Committee on Governance of the NYSE, which the NYSE Board has charged with reviewing the NYSE's governance with a view to making appropriate reforms that will ensure that the NYSE serves even better the 85 million people who invest, directly or indirectly, through the NYSE.² This is the Committee's Initial Report to the NYSE Board.

The Committee met twice during April and May. In conducting its review, the Committee has decided to reach out to a broad range of individuals and organizations representing investors, listed companies and members ("seat-holders") to hear their views through written submissions and appearances before the Committee over the next several months. This is a process similar to that used successfully by the Corporate Accountability and Listing Standards Committee in the formulation of recommended governance changes for listed companies.

The Committee recommends that the Board take a series of actions now to change or codify and disclose a number of the NYSE's existing governance practices. This Initial Report organizes the changes and codifications into ten recommendations that can take effect upon action by the Board at the NYSE's annual organization meeting on June 5 because they do not require action by the NYSE's members or the SEC.

1. **Revise the charter of the Human Resources and Compensation Committee to provide that only non-industry directors³ may serve as members of the Committee. A proposed revised charter is attached.⁴**
2. **Annually provide the NYSE members, and make publicly available, a report of the Human Resources and Compensation Committee in which the compensation of the directors, the Chairman and the four other most highly compensated executive officers of the NYSE, is disclosed.**
3. **Prohibit service by NYSE employees on the boards of directors of business corporations.⁵**

To minimize disruption to listed companies on which employees of the NYSE currently serve, such employees may continue to serve on the board of directors of listed companies until the listed company's next annual shareholders' meeting.

4. **Separate the Finance and Audit Committee into two standing committees of the Board and provide in the Audit Committee charter that only non-industry directors may serve as members. To the extent feasible, the Audit Committee should also comply with all of the other listing standards prescribed by the NYSE for listed-company audit committees. Proposed revised charters of the Finance Committee and the Audit Committee are attached.**

5. **Establish a standing five-member Governance Committee responsible for reviewing the NYSE's governance-related matters. Three of the members should be non-industry directors (one of whom should chair the Governance Committee), and the other two should be the Vice-Chairs of the NYSE.**

Given the NYSE's unique structure as a member-owned self-regulatory organization, the Committee believes it is essential that, although the Governance Committee will have a majority of non-industry Directors, it should include representation of each of the NYSE's major member organization constituencies.⁶ While nominating functions are often the responsibility of the same board committee that addresses governance functions, at this time the Committee is not recommending specific changes to the Nominating Committee. The composition and the responsibilities of the NYSE Nominating Committee are governed by provisions of the NYSE Constitution. Any change to those provisions requires a vote of the NYSE's members. Accordingly such changes cannot be implemented immediately. For that reason this Committee will consider Nominating Committee matters with the benefit of the input received during the review process.

6. **For matters within the Committee for Review's authority to oversee the NYSE Regulatory Group, require voting members to consist of a majority of non-industry directors. A proposed charter is attached.**

The NYSE's Committee for Review is charged with, among other things, hearing appeals from member firm disciplinary proceedings, conducting listing status and delisting reviews, and reviewing the NYSE's enforcement and disciplinary procedures. The Committee for Review currently consists of 3 industry and 4 non-industry directors. Non-industry members of the Committee for Review rely on industry members to provide relevant industry expertise. This expertise is one of the most effective attributes of the self-regulatory function performed by the NYSE.⁷

Pursuant to an SEC inspection and rule approval, the Committee's current charter requires that, when listing appeals come before the Committee, the voting

members consist of a majority of non-industry directors. However, all members of the Committee who are industry directors may hear the argument and participate in the discussion.

This recommendation would apply that model to the oversight of the programs of the NYSE Regulatory Group. In this context, the Committee for Review will be responsible for monitoring and regularly reviewing all aspects of the structures, policies and procedures of the NYSE's surveillance, examination and enforcement units to better ensure the effectiveness and fairness of the structures, policies and procedures.

As is currently the case for all matters coming before the Committee for Review, if a programmatic matter came before the Committee that raised a conflict of interest for a particular industry member of the Committee, that member would recuse himself or herself.

The work of this Committee, which will report regularly to the Board, will assure a high degree of Board-level focus on the critical self-regulatory aspects of the NYSE's operations.

7. **For purposes of allocating Board committee assignments, the Board should not consider any director who is the CEO of a bank holding company, one of the subsidiaries of which is a broker or dealer that does business with the public, to be a non-industry director.**

Provisions in the NYSE Constitution that predate the repeal of the Glass-Steagall Act make it impossible for a CEO of a bank holding company with a broker-dealer subsidiary that is not its principal subsidiary to be designated as an industry director. However, the NYSE Constitution permits such a CEO to serve as a non-industry director if the broker-dealer subsidiary contributes 20 percent or less of the revenue of the bank holding company.⁸

This Committee intends to consider in connection with its review process, the size and composition of the Board, including the Constitutional definitions of "industry director" and "public director". As noted, Constitutional changes will require member approval and accordingly cannot be implemented immediately. Nonetheless, the Board has the authority now, as a matter of policy in allocating committee assignments, to ensure that no non-industry position on any Board committee is occupied by a director who is the CEO of a bank holding company with *any* broker or dealer subsidiary that does business with the public.

8. **Adopt and post on the NYSE's web-site written Governance Principles in the form annexed at Tab B to formalize and establish the practices described herein and including, among others, (a) the regular convening of executive sessions of the Board at which the non-management directors meet without the management directors and (b) designating the Chairman of the newly-formed Governance Committee to preside over these executive sessions.**

9. **Collect and augment the NYSE's current ethics requirements for NYSE directors in the form of an ethics code for directors annexed at Tab B. Post the directors ethics code on the NYSE's web-site, and promptly disclose any waivers of the ethics codes for directors or executive officers of the NYSE.**

10. **Require that the committee charters and the membership of each committee be disclosed on the NYSE's web-site. This policy is included in the proposed Interim Governance Principles.**

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The NYSE's governance system has evolved over two centuries into a mechanism that melds the views of its various constituencies with the goal of serving the interests of the American investor. But just as corporate America is re-examining and improving its own corporate governance in the context of a changing environment, so too must the NYSE.⁹ This Committee is only beginning the review process, but believes that the immediate adoption by the Board of the ten recommendations contained in this Initial Report will demonstrate not only the seriousness with which the NYSE takes this task, but the public-minded purpose of the endeavor.

Respectfully submitted,

SPECIAL COMMITTEE ON GOVERNANCE OF THE NYSE

H. Carl McCall, *Co-Chair*
Leon E. Panetta, *Co-Chair*
Kenneth G. Langone
Peter N. Larson
Gerald M. Levin
Robert M. Murphy
Henry M. Paulson, Jr.
Lawrence W. Sonsini

¹ Chairman Donaldson's letter is attached.

² Chairman Grasso's letter is attached hereto. Chairman Grasso's letter encloses a summary of the Governance of the New York Stock Exchange, Inc. ("White Paper") describing the NYSE's existing governance and should be read in conjunction with this Initial Report.

³ The NYSE's Constitution designates non-industry directors as "public" directors. The Constitution coined this term in 1938 when it first included three non-industry directors on the Board. In today's parlance of corporate governance, "public" has come to have quite a different meaning. Accordingly, this Initial Report uses the term "non-industry".

⁴ While the Committee intends that all of the NYSE's corporate governance documents be reviewed and updated regularly, the word "Interim" as used in the title of many of the Annexes, reflects the Committee's view that such documents will be of particular focus in the continuation of its review process.

⁵ The NYSE's Officers' and Employees' Statement of Business Conduct and Ethics ("Ethics Code") already prohibits such service but authorizes the Board to waive the provisions (subject to firewalls). Waivers are currently in effect with respect to the service of Messrs. Grasso and Britz and Ms. Kinney on the Home Depot, Stanley Works and Met-Life boards, respectively.

⁶ For more on the unique structure of the NYSE, please see the White Paper.

⁷ For more on the self-regulatory function of the NYSE please see the White Paper.

⁸ For a more detailed description of this issue, please see the White Paper.

⁹ In most instances, the governance practices the Committee recommends are consistent with those included in the NYSE's proposed corporate governance listing standards. However, given the unique member-owned, self-regulatory structure of the NYSE, there are certain areas where the practices recommended necessarily differ from those of an NYSE-listed company.

ATTACHMENTS