SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49998; File No. SR-NSX-2004-10)

July 9, 2004

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by National Stock Exchange Relating to Corporate Governance

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 June 17, 2004, National Stock Exchange ("NSX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On June 29, 2004, the Exchange filed Amendment No. 1 to the proposal.[3] On July 9, 2004, the Exchange filed Amendment No. 2 to the proposal.[4] On July 9, 2004, the Exchange filed Amendment No. 3 to the proposed rule change.[5] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis.

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

2 17 CFR 240. 19b-4.

3 See letter from Jennifer M. Lamie, Assistant General Counsel and Corporate Secretary, NSX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated June 28, 2004 ("Amendment No.1"). In Amendment No. 1, the Exchange clarified the date on which the Exchange's Board of Trustees approved the proposed rule change and made technical changes to the proposed rule text. Amendment No. 1 replaced the original filing in its entirety.

4 See letter from Jennifer M. Lamie, Assistant General Counsel and Corporate Secretary, NSX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated July 8, 2004 ("Amendment No. 2"). The changes made by Amendment No. 2 are incorporated in the proposal as set forth below.

5 See letter from Jennifer M. Lamie, Assistant General Counsel and Corporate Secretary, NSX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated July 9, 2004 ("Amendment No. 3"). Amendment No. 3 was a technical amendment and is not subject to notice and comment.

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

The Exchange is proposing to adopt changes to its listings standards that are aimed to ensure the independence of directors of listed companies and to strengthen corporate governance practices of listed companies.

Below is the text of the proposed rule change, as amended. Proposed new language is in italics; proposed deletions are in brackets.

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RULES

OF

NATIONAL STOCK EXCHANGE

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CHAPTER XIII

Miscellaneous Provisions

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Rule 13.6.

(a) General Application. Companies listed on the Exchange must comply with certain standards regarding corporate governance as codified in this Rule 13.6. Consistent with requirements of the Sarbanes-Oxley Act of 2002, certain provisions of this Rule 13.6 are applicable to some listed companies but not to others.

(1) Equity Listings. Rule 13.6 applies in full to all companies listing common equity securities, with the following exceptions:

(a) 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 Rule 13.6(d)(1), (4) or (5). 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 Commission. Controlled companies must comply with the remaining provisions of Rule 13.6.

(b) Limited Partnerships and Companies in Bankruptcy. Due to their unique attributes, limited partnerships and companies in bankruptcy proceedings need not comply with the requirements of Rule 13.6(d)(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 Rule 13.6.

(c) Closed-End and Open-End Funds. The Exchange considers that many of the significantly expanded standards and requirements provided for in Rule 13.6 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, registered closed-end funds must comply with the requirements of Rule 13.6(d)(6), (7)(a) and (c), and (12). 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 Interpretations and Policies to Rule 13.6(d)(7)(a) which calls for disclosure of the 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.

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 Rule 13.6 applicable to domestic issuers other than Rule 13.6(d)(2) and (7)(b). For purposes of Rule 13.6(d)(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 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 Rule 13.6(d)(6) and (12)(b).

Rule 10A-3(b)(3)(ii) under the 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 investment company, as well as employees of the management

investment company. This responsibility must be addressed in the audit committee charter.

(d) Other Entities. Except as otherwise required by Rule 10A-3 under the Act (for example, with respect to open-end funds), Rule 13.6 does not apply to passive business organizations in the form of trusts (such as royalty trusts) or to derivatives and special purpose securities. 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 Rule 13.6(d)(6) and (12)(b).

(e) Foreign Private Issuers. Listed companies that are foreign private issuers (as such term is defined in Rule 3b-4 under the Act) are permitted to follow home country practice in lieu of the provisions of this Rule 13.6, except that such companies are required to comply with the requirements of Rule 13.6(d)(6), (11) and (12)(b).

(2) Preferred and Debt Listings. Rule 13.6 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 Act, all companies listing only preferred or debt securities on the Exchange are required to comply with the requirements of Rule 13.6(d)(6) and (12)(b).

(3) Dual and Multiple Listings. At any time when an issuer has a class of securities that is listed on a national securities exchange or national securities association subject to requirements substantially similar to those set forth in this Rule 13.6, and that class of security has not been suspended from trading on that market, the issuer shall not be required to separately meet the requirements set forth in this Rule 13.6,

except for the requirements of Rule 13(d)(6) and (7), below (audit committees) and with the notification requirements of Rule 13.6(d)(12)(B), as it relates to their audit committees, with respect to that class of securities or any other class of securities. Governance requirements of other markets will be considered to be substantially similar to the requirements of this Rule 13.6 if they are adopted by the New York Stock Exchange ("NYSE") or the National Association of Securities Dealers (for the Nasdaq National Market or SmallCap Market) or if they otherwise require, subject to exceptions approved by the Commission, that the issuer maintain (a) a board of directors, a majority of whom are independent directors (50% of whom are independent directors, for a small business issuer); (2) a nominating committee or other body, a majority of whom are independent directors; (3) a compensation committee or other body, a majority of whom are independent directors; and (4) a code of business conduct and ethics that complies with the definition of a "code of ethics" set out in Section 406(c) of the Sarbanes-Oxley Act and the rules thereunder (17 C.F.R. 228.406 and 17 C.F.R. 229.406).

Similarly, when an issuer has a class of securities that is listed on a national securities exchange or national securities association subject to requirements substantially similar to those set forth in this Rule 13.6, and that class of security has not been suspended from trading on that market, a direct or indirect consolidated subsidiary of the issuer, or an at least 50% beneficially-owned subsidiary of the issuer, shall not be required to separately meet the requirements set forth in this Rule 13.6 with respect to any class of securities it issues, except

classes of equity securities (other than non-convertible, non-participating preferred securities) of such subsidiary.

(b) Effective Dates/Transition Periods. Listed companies will have until the earlier of their first annual meeting after July 31, 2004, or December 31, 2004, to comply with the new standards contained in Rule 13.6, although if a company with a classified board would be required (other than by virtue of a requirement under Rule 13.6(d)(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 Rule 13.6(d)(6). As a general matter, the existing audit committee requirements provided for in Subsection 1.4 of Article IV of the Exchange By-Laws continue to apply to listed companies pending the transition to these 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 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. It should be noted, however, that investment companies are not afforded these exemptions under Rule 10A-3 under the Act. Companies listing in conjunction with their initial public offering will be required to meet the majority independent board requirement within 12 months of listing. For purposes of Rule 13.6 other than Rule 13.6(d)(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 Act. The Exchange will also permit companies that are emerging from

bankruptcy or have ceased to be controlled companies within the meaning of Rule 13.6 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 Rule 13.6(d)(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 Act, namely, that the company was not, immediately prior to the effective date of a registration statement, required to file reports with the Commission pursuant to Section 13(a) or 15(d) of the Act.

Companies listing upon transfer from another market, or that are listing a security that is listed on another market or markets, 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 or that are dually or multiply listing securities will not apply to the requirements of Rule 13.6(d)(6) unless a transition period is available pursuant to Rule 10A-3 under the Act.

(c) References to Form 10-K. There are provisions in this Rule 13.6 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 Commission. For example, for a closed-end fund, the appropriate form would be the annual Form N-CSR.

(d) Listed Company Corporate Governance Requirements.

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

Interpretations and Policies: 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.

Interpretations and Policies: 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 directors who have been determined to be independent 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 Commission. The basis for a board determination that a relationship is not material must also 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 Commission. 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.

Interpretations and Policies: 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.

Interpretations and Policies: 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 (A) $200,000, (B) 5% of such other company's consolidated gross revenues, or (C), for companies whose securities are also listed on the NYSE, the amount permitted under NYSE rules, is not "independent" until three years after falling below such threshold.

Interpretations and Policies: In applying the test in Rule 13.6(d)(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 Rule 13.6(d)(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 Commission, 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 (A) $200,000, (B) 5% of such charitable organization's consolidated gross revenues, or (C), for companies whose securities are also listed on the NYSE, the amount permitted under NYSE

rules. Listed company boards are reminded of their obligations to consider the materiality of any such relationship in accordance with Rule 13.6(d)(2)(a) above.

General Interpretations and Policies to Rule 13.6(d)(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 Rule 13.6(d)(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 Rule 13.6(d)(2)(b) will begin to apply on from and after July 9, 2005.

As an example, until July 8, 2005, a company need look back only one year when testing compensation under Rule 13.6(d)(2)(b)(ii). Beginning July 9, 2005, however, the company would need to look back the full three years provided in Rule 13.6(d)(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.

Interpretations and Policies: 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-a(f) under the Securities Act of 1933), and includes such directors who are not independent by virtue of a material relationship, former status or family membership, or for any other reason.

Regular scheduling of such meetings is important not only to foster better communication among non-management directors, but also to prevent any negative inference from attaching to the calling of executive sessions. There need not be a single presiding director at all executive sessions of the non-management directors. If one director is chosen to preside at these meetings, his or her name must be disclosed in the 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 Commission. 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 Act, as applied to listed companies through Rule 13.6(d)(6).

While this Rule 13.6(d)(3) refers to meetings of non-management directors, if that group includes directors who are not independent under this Rule 13.6, 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.

(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.

Interpretations and Policies: 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 Commission to be included in the company's annual proxy statement or annual report on Form 10-K filed with the Commission;

(ii) an annual performance evaluation of the compensation committee.

Interpretations and Policies: 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.

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.

(6) Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 under the Act and Subsection 1.4 of Article IV of the Exchange By-Laws.

Interpretations and Policies: The Exchange will apply the requirements of Rule 10A-3 in a manner consistent with the guidance provided by the Commission in Securities Exchange Act Release No. 34-47654 (April 1, 2003). Without limiting the generality of the foregoing, as provided in Section 1.4(d) of Article IV of the Exchange By-Laws, the Exchange will provide companies the opportunity to cure defects provided in Rule 10A-3(a)(3) under the Act.

(7) (a) In accordance with Subsection 1.4(a)(1) of Article IV of the Exchange By-Laws, the audit committee must have a minimum of three members.

Interpretations and Policies: 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 (h) 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 Commission.

(b) In addition to any requirement of Rule 10A-3(b)(1) of the Act, all audit committee members must satisfy the requirements for independence set out in Rule 13.6(d)(2).

(c) In accordance with Subsection 1.4(a)(2) of Article IV of the Exchange By-Laws, the audit committee must have a written charter. In addition to the requirements of Subsection 1.4(a)(2) of Article IV, the charter must address the following:

(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 Commission 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 Act and in Subsection 1.4 of Article IV of the Exchange By-Laws, as well as include that the committee:

(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;

Interpretations and Policies: 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;

Interpretations and Policies: 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;

Interpretations and Policies: 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;

Interpretations and Policies: 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;

Interpretations and Policies: 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

Interpretations and Policies: 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.

Interpretations and Policies: 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 Interpretations and Policies to Rule 13.6(d)(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 the 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.

Interpretations and Policies: Listed companies must maintain an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management process 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 Interpretations and Policies to Rule 13.6(d)(7): To avoid any confusion, note that the audit committee functions specified in Rule 13.6(d)(7) are the sole responsibility of the audit committee and may not be allocated to a different committee.

(8) Listed companies must satisfy the requirements for shareholder approval of equity compensation plans in accordance with Exchange Rule 13.7.

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

Interpretations and Policies: 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 Commission 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:

(A) Director qualification standards. These standards should, at minimum, reflect the independence requirements set forth in Rule 13.6(d)(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.

(B) 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.

(C) Director access to management and, as necessary and appropriate, independent advisors.

(D) 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.

(E) Director orientation and continuing education.

(F) 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.

(G) 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.

Interpretations and Policies: 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 Commission 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:

(A) 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.

(B) 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.

(C) Confidentially. 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.

(D) 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.

(E) 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.

(F) 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.

(G) 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 the Exchange's listing standards.

Interpretations and Policies: 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 the Exchange's 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 the U.S. shareholders should be aware of the significant ways that the governance of a listed foreign private issuer differs from that of a U.S. listed company. The Exchange underscores that what is required is a brief, general summary of the significant differences, not a cumbersome analysis.

Listed foreign private issuers may provide this disclosure either on their website (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 (again, in the English language). If the disclosure is only made available on the website, 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 Exchange each year that he or she is not aware of any violation by the company of Exchange corporate governance listing standards.

Interpretations and Policies: The CEO's annual certification to the Exchange that, as of the date of certification, he or she is unaware of any violation by the company of the Exchange's corporate governance listing standards will focus the CEO and senior management on the company's compliance with the listing standards. Both this certification to the Exchange, and any CEO/CFO certifications required to be filed with the Commission 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 companies annual report on Form 10-K filed with the Commission.

(b) Each listed company CEO must promptly notify the Exchange in writing after any executive officer of the listed company becomes aware of any material non-compliance with any applicable provisions of this Rule 13.6.

(13) The Exchange may issue a public reprimand letter to any listed company that violates an Exchange listing standard.

Interpretations and Policies: Suspending trading in or delisting a company can be harmful to the very shareholders that the Exchange listing standards seek to protect; the Exchange must therefore use these measures sparingly and judiciously. For this reason it is appropriate for the Exchange to have the ability to apply a lesser sanction to deter companies from violating its corporate governance (or other) listing standards. Accordingly, the Exchange 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 an Exchange listing standard. For companies that repeatedly or flagrantly violate Exchange 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 Article IV of the Exchange By-Laws or that fail to comply with the audit committee standards set out in Subsection 1.4 of Article IV of the Exchange By-Laws or Rule 13.6(d)(6). The process and procedures provided for in those provisions govern the treatment of companies falling below those standards.

Rule [13.6.]13.7. Shareholder Approval of Equity Compensation Plans

No change to text.

[Rule 13.7. Additional Listing Standards Related to Audit Committees

In addition to the requirements set forth in subsection 1.4 of Article IV of the By-laws, audit committees for investment companies must also establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company.]

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

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

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

1. Purpose

The Exchange is proposing to enhance its listing standards in order to further the ability of honest and well-intentioned directors, officers, and employees of listed issuers to perform their functions effectively. NSX believes that the proposal will also allow shareholders to more easily and efficiently monitor the performance of companies and directors in order to reduce instances of lax and unethical behavior.

Last year, the Commission approved changes to NSX's listing standards that were primarily designed to comply with the provisions of Section 10A(m) of the Act[6] and Rule 10A-3 thereunder,[7] and to incorporate requirements related to shareholder approval of equity compensation plans.[8] The remaining provisions that the Exchange proposes, which are set out in this submission, include additional enhancements to the Exchange's governance requirements for listed companies. In most respects, the proposed changes are substantially similar to changes in governance requirements made by the New York Stock Exchange ("NYSE").[9]

The NSX governance standards would apply generally to companies listing securities on the Exchange, with particular exemptions for certain issuers[10] as delineated below. Specific exemptions are included for dual and multiple listings, where the same or another class of security of the company is already listed on another national securities exchange or national securities association that has substantially similar governance-related requirements.[11]

Summarized below are significant provisions of the proposal.

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6 15 U.S.C. 78j-1(m).

7 17 CFR 240.10A-3.

8 See Securities Exchange Act Release Nos. 48832 (November 25, 2003), 68 FR 67715 (December 3, 2003)(SR-CSE-2003-06) and 48738 (October 31, 2003), 68 FR 63166 (November 7, 2003)(SR-CSE-2003-11).

9 See Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (approving changes to the corporate governance listing standards of the Nasdaq Stock Market, Inc. and the NYSE).

10 See infra Section II.A.1.l.

11 See NSX Rule 13.6(a)(3). Specifically, such company listing on another market would not be required to separately meet the NSX governance requirements, except certain requirements relating to audit committees. The NSX has represented that it will have surveillance procedures sufficient to allow the Exchange to confirm that an issuer relying on this provision is in compliance with the requirements of the other market.

a. Independence of Majority of Board Members

Proposed Rule 13.6(d)(1)[12] of the Exchange Rules would require the board of directors of each listed company to consist of a majority of independent directors, whose names would be required to be disclosed.[13] Pursuant to proposed Exchange Rule 13.6(d)(2), no director would qualify as "independent" unless the board affirmatively determines that the director has no material relationship with the company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). The company would be required to disclose 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 Commission, the directors who have been determined to be independent and the basis of such determination.[14] In complying with this requirement, a board would be permitted to adopt and disclose standards to assist it in making determinations of independence, disclose those standards, and then make the general statement that the independent directors meet those standards.[15]

b. Definition of Independent Director

In addition, NSX proposes a definition of independent director that would require the following: First, a director who is an employee, or whose immediate family member is an executive officer, of the company would not be independent until three years after the end of

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12 Existing Exchange Rule 13.6 would be re-numbered to Rule 13.7 and existing Exchange Rule 13.7 would be moved to paragraph (a)(1)(c) of proposed Exchange Rule 13.6.

13 See NSX Rule 13.6(d)(1). See infra Section II.A.1.l. concerning entities that would be exempt from this requirement.

14 NSX proposes that for all provisions of Proposed Exchange Rule 13.6 that call for disclosure in a company's Form 10-K, if a company subject to such a provision is not a company required to file a Form 10-K, then the provision would be interpreted to mean the annual periodic disclosure form that the company files with the Commission.

15 See Proposed Exchange Rule 13.6(d)(2)(a).

such employment relationship.[16] Employment as an interim Chairman or CEO would not disqualify a director from being considered independent following that employment.[17] Second, a director who receives, or whose immediate family member receives, more than $100,000 per year in direct compensation from the listed company, except for certain permitted payments,[18] would not be independent until three years after he or she ceases to receive more than $100,000 per year in such compensation.

Third, 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 would not be independent until three years after the end of the affiliation or the employment or auditing relationship.[19]

Fourth, a director who is employed, or whose immediate family member is employed, as an executive officer of another company where any of the company's present executives serve on that company's compensation committee would not be independent until three years after the end

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16 See Proposed Exchange Rule 13.6(d)(2)(b)(i).

17 See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(2)(b)(i).

18 Permitted payments would include 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. See Proposed Exchange Rule 13.6(d)(2)(b)(ii). In addition, compensation received by a director for former service as an interim Chairman or CEO would not be required to be considered. See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(2)(b)(ii). Compensation received by an immediate family member for service as a non-executive employee of the listed company would also not be required to be considered. Id.

19 See Proposed Exchange Rule 13.6(d)(2)(b)(iii).

of such service or the employment relationship.[20]

Fifth, 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 (a) $200,000, (b) 5% of such other company's consolidated gross revenues, or (c), for companies whose securities are listed on NSX and NYSE, the amount permitted under NYSE rules, would not be independent until three years after falling below such threshold ("Business Relationship Provision").[21] NSX proposes to clarify this proposal with respect to charitable organizations by adding a provision noting that charitable organizations would not be considered "companies" for purposes of the Business Relationship Provision, provided that the listed company discloses in its annual proxy statement, or if the listed company does not file an annual proxy statement, in its annual report on Form 10-K filed with the Commission, 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, such contributions in any single year exceeded the greater of $200,000 or 5% of the organization's consolidated gross revenues, or, for companies whose securities are also listed on

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20 See Proposed Exchange Rule 13.6(d)(2)(b)(iv).

21 See Proposed Exchange Rule 13.6(d)(2)(b)(v). The NYSE Business Relationship Provision currently provides that a director that 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, exceed the greater of $1 million, or 2% of such other company's consolidated gross revenues, would not be independent until three years after falling below such threshold. See NYSE section 303A(b)(2)(v). See also Securities Exchange Act Release No. 48745, supra note 9, 68 FR at 64157.

the NYSE, the amount permitted under NYSE rules.[22]

NSX also proposes to add a provision explaining that both the payments and the consolidated gross revenues to be measured for the Business Relationship Provision would be those reported in the last completed fiscal year, and that the look-back provisions would apply solely to the financial relationship between the listed company and the director or immediate family member's current employer. A listed company would not need to consider former employment of the director or immediate family member.[23]

NSX proposes to define "immediate family member" to include person's spouse, parents, children, siblings, mothers- and fathers-in-law, daughters- and sons-in-law, sisters- and brothers-in-law, and anyone (other than domestic employees) who shares such person's home.[24] NSX also proposes that references to "company" include any parent or subsidiary in a consolidated group with the company.[25]

NSX further proposes to apply a one-year look-back for the first year after adoption of these new standards.[26] The three-year look back would begin to apply from the date that is the first anniversary of Commission approval of the proposed rule change.[27]

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22 See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(2)(b)(v).

23 Id.

24 See General Interpretations and Policies to Proposed Exchange Rule 13.6(d)(2)(b). NSX proposes that when applying the look-back provisions in Rule 13.6(d)(2)(b), listed companies would not need to 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. Id.

25 See General Interpretations and Policies to Proposed Exchange Rule 13.6(d)(2)(b).

26 See Transition Rule to Proposed Exchange Rule 13.6(d)(2)(b).

27 Id.

c. Separate Meetings for Board Members

NSX proposes to require the non-management directors of each NSX-listed company to meet at regularly scheduled executive sessions without management.[28] In addition, NSX proposes to require listed companies to disclose a method for interested parties to communicate directly with the presiding director of such executive sessions, or with the non-management directors as a group.[29] Companies may use the same procedures they have established to comply with Rule 10A-3(b)(3) of the Act.[30]

d. Nominating/Corporate Governance Committee

NSX proposes to require each listed company to have a nominating/corporate governance committee composed entirely of independent directors.[31] NSX also proposes such committee to have a written charter that addresses, among other items, the committee's purpose and responsibilities, and an annual performance evaluation of the nominating/corporate governance committee.[32] NSX further proposes to clarify that the committee would be required to identify individuals qualified to become board members, consistent with the criteria approved by the board.[33]

e. Compensation Committee

NSX proposes to require each listed company to have a compensation committee

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28 See Proposed Exchange Rule 13.6(d)(3).

29 See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(3).

30 Id. See also infra Section II.A.1.l concerning entities that would be exempt from these requirements.

31 See Proposed Exchange Rule 13.6(d)(4)(a). See infra Section II.A.1.l. concerning controlled companies and other entities that would be exempt from this requirement.

32 See Proposed Exchange Rule 13.6(d)(4)(b).

33 Id.

composed entirely of independent directors.[34] NSX also proposes to require the compensation committee to have a written charter that addresses, among other items, the committee's purpose and responsibilities, and an annual performance evaluation of the compensation committee.[35] The compensation committee also would be required to produce a compensation committee report on executive compensation, as required by Commission rules to be included in the company's annual proxy statement or annual report on Form 10-K filed with the Commission.[36] Further, NSX proposes to (1) provide that either as a committee or together with the other independent directors (as directed by the board), the committee would determine and approve the CEO's compensation level based on the committee's evaluation of the CEO's performance;[37] and (2) provide that discussion of CEO compensation with the board generally is not precluded.[38]

f. Audit Committee

i. Composition

Article IV, Subsection 1.4 of the Exchange By-Laws sets forth provisions on audit committee requirements for listed companies. Currently, Subsection 1.4 requires each NSX-listed company to have a minimum three-person audit committee composed entirely of directors that meet the independence standards of Rule 10A-3.[39] Subsection 1.4 also requires that each member of the audit committee be financially literate and that at least one member have

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34 See Proposed Exchange Rule 13.6(d)(5)(a). See infra Section II.A.1.l. concerning controlled companies and other entities that would be exempt from this requirement.

35 Id.

36 See Proposed Exchange Rule 13.6(d)(5)(b)(i)(C).

37 See Proposed Exchange Rule 13.6(d)(5)(a).

38 See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(5).

39 See Article IV, Subsection 1.4(a) of the Exchange By-Laws.

accounting or related financial management expertise.[40] With respect to independence, proposed Exchange Rule 13.6(d)(7) would also require the members of the audit committee of each NSX-listed company to meet the independence standards set out in proposed paragraph (d)(2) of the Rule.[41] With respect to accounting or related financial management expertise, proposed Exchange Rule 13.6(d)(7) would clarify that 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 forth in Item 401(h) of Regulation S-K, a board may presume that such a person has accounting or related financial management experience.[42]

If an audit committee member simultaneously serves on the audit committee of more than three public companies, and the listed company does not limit the number of audit committees on which its audit committee members serve, each board would be required to determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee and to disclose such determination.[43]

ii. Audit Committee Charter and Responsibilities

Exchange Rule 13.6(d)(7)(c) would expand on the provisions of Subsection 1.4(a)(2) of Article IV of the Exchange By-Laws and require the audit committee of each listed company to have a written charter that addresses: (i) the committee's purpose; (ii) an annual performance evaluation of the audit committee; and (iii) the duties and responsibilities of the audit committee (the "Audit Committee Charter Provision"). The Audit Committee Charter Provision provides

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40 See Article IV, Subsection 1.4(a)(1) of the Exchange By-Laws.

41 See Proposed Exchange Rule 13.6(d)(7)(b). See also infra Section II.A.1.l concerning the applicability of certain of this requirement.

42 See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(7)(a).

43 Id.

details as to the duties and responsibilities of the audit committee that would be required to be addressed. These would include, at a minimum, those set out in Rule 10A-3(b)(2), (3), (4) and (5),[44] as well as the responsibility to annual obtain and review a report by the independent auditor; discuss the company's annual audited financial statement and quarterly financial statements with management and the independent auditor; discuss the company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies; discuss policies with respect to risk assessment and risk management; meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function), and with independent auditors; review with the independent auditors any audit problems or difficulties and management's response; set clear hiring policies for employees or former employees of the independent auditors; and report regularly to the board.[45]

g. Internal Audit Functions

Exchange Rule 13.6(d)(7)(d) would require each listed company to have an internal audit function.[46]

h. Corporate Governance Guidelines

Exchange Rule 13.6(d)(9) would require each listed company to adopt and disclose corporate governance guidelines.[47] The following topics would be required to be addressed: director qualification standards; director responsibilities; director access to management and, as necessary and appropriate, independent advisors; director compensation; director orientation and

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44 See Proposed Exchange Rule 13.6(d)(7)(c).

45 See Proposed Exchange Rule 13.6(d)(7)(c)(iii). See also infra Section II.A.1.l concerning the applicability of these requirements.

46 See infra Section II.A.1.l concerning the applicability of this requirement.

47 See id.

continuing education; management succession; and annul performance evaluation of the board.[48] Each company's website would be required to include its corporate governance guidelines and the charters of its most important committees, and the availability of this information on the website or in print to shareholders would need to be referenced in the company's annual report on Form 10-K filed with the Commission.[49]

i. Code of Business Conduct and Ethics

Exchange Rule 13.6(d)(10) would require each listed company to adopt and disclose a code of business conduct and ethics for directors, officers, and employees, and to promptly disclose any waivers of the code for directors or executive officers.[50] The interpretations and policies to this provision would set forth the most important topics that should be addressed, including conflicts of interest; corporate opportunities; confidentiality of information; fair dealing; protection and proper use of company assets; compliance with laws, rules, and regulations (including insider trading laws); and encouraging the reporting of any illegal or unethical behavior. Each code would be required to contain compliance standards and procedures to facilitate the effective operation of the code. Each listed company's website would be required to include its code of business conduct and ethics, and the availability of the code on the website or in print to shareholders would need to be referenced in the company's annual report on Form 10-K filed with the Commission.[51]

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48 See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(9).

49 Id.

50 See also infra Section II.A.1.l concerning applicability of this requirement.

51 See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(10).

j. CEO Certification

Exchange Rule 13.6(d)(12)(a) would require the CEO of each listed company to certify to NSX each year that he or she is not aware of any violation by the company of NSX's corporate governance listing standards.[52] This certification would be required to be disclosed in the company's annual report 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 Commission.

In addition, Exchange Rule 13.6(d)(12)(b) would require the CEO of each listed company to promptly notify the Exchange in writing after any executive officer of the listed company becomes aware of any material non-compliance with any applicable provisions of the new requirements.

k. Public Reprimand

Exchange Rule 13.6(d)(13) would allow NSX to issue a public reprimand letter to any listed company that violates an NSX listing standard.[53]

l. Exceptions to Corporate Governance Proposals

NSX proposes to exempt any listed company of which more than 50% of the voting power is held by an individual, a group or other company ("controlled company") from the requirements that its board have a majority of independent directors, and that the company have nominating/corporate governance and compensation committees composed entirely of independent directors. A company that chose to take advantage of any or all of these exemptions

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52 See also infra Section II.A.1.l concerning the applicability of these requirements.

53 This lesser sanction is not intended for use in the case of companies that fail to comply with the requirements of Rule 10A-3. See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(13).

would be required to disclose the 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 Commission.[54] Limited partnerships and companies in bankruptcy proceedings also would be exempt from the requirements that the board have a majority of independent directors and that the issuer have nominating/corporate governance and compensation committees composed entirely of independent directors.[55]

NSX considers many of the requirements of proposed Exchange Rule 13.6 to be unnecessary for closed-end and open-end management investment companies that are registered under the Investment Company Act of 1940 ("Investment Company Act")[56], given the pervasive federal regulation applicable to them. However, NSX proposes that registered closed-end management investment companies ("closed-end funds") would be required to: (1) have a minimum three-member audit committee that satisfies the requirements of Rule 10A-3 and meets additional composition requirements of proposed Rule 13.6(d)(7)(a) and the requirements of Subsection 1.4 of Article IV of the Exchange By-Laws; (2) comply with the requirements of the Audit Committee Charter Provision; and (3) comply with the certification and notification

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54 See Proposed Exchange Rule 13.6(a)(1)(a).

55 See Proposed Exchange Rule 13.6(a)(1)(b).

56 15 U.S.C. 80a-1 et seq.

provisions regarding non-compliance.[57] Closed-end funds would be excluded from the disclosure requirement related to an audit committee member's simultaneous service on more than three audit committees, but would be subject to the requirement for the board to determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee.[58]

NSX also proposes to require business development companies, which are a type of closed-end management investment company defined in Section 2(a)(48) of the Investment Company Act[59] that are not registered under that act, to comply with all of the provisions of Exchange Rule 13.6 applicable to domestic issuers, except that the directors of such companies, including audit committee members, would not be required to satisfy the independence requirements set forth in proposed Exchange Rule 13.6(d)(2) and (d)(7)(b).[60] For purposes of proposed Exchange Rule 13.6(d)(1), (3), (4), (5), and (9), a director of a business development company would 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.[61]

Open-end management investment companies ("open-end funds"), which can be listed as Investment Company Units, and are more commonly known as Exchange Traded Funds or ETFs, would be required to: (1) have an audit committee that satisfies the requirements of Rule 10A-3 and Subsection 1.4 of Article IV of the Exchange By-Laws, and (2) notify the Exchange

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57 See Proposed Exchange Rule 13.6(a)(1)(c).

58 Id.

59 15 U.S.C. 80a-2(a)(48).

60 See Proposed Exchange Rule 13.6(a)(1)(c).

61 15 U.S.C. 80a-2(a)(19).

in writing of any material non-compliance.[62]

In addition, NSX proposes also to require the audit committees of closed-end and open-end funds to establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment advisor, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company.[63] This responsibility would be required to be addressed in the audit committee charter.[64]

NSX proposes that, except as otherwise required by Rule 10A-3, the new requirements would also not apply to passive business organizations in the form of trusts (such as royalty trusts) or to derivatives and special purpose securities. To the extent that Rule 10A-3 applies to a passive business organization, listed derivative, or special purpose security, the requirement to have an audit committee that satisfies the requirements of Rule 10A-3, and the requirements to notify NSX in writing of any material non-compliance, also would apply.[65]

The new requirements generally would not apply to companies listing only preferred or debt securities on NSX. To the extent required to Rule 10A-3, however, all companies listing only preferred or debt securities on NSX would be required to: (1) have an audit committee that satisfies the requirements of Rule 10A-3, and (2) notify the Exchange in writing of any material non-compliance.[66]

Because the majority of the Exchange's issuers have securities that are also listed on one

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62 See Proposed Exchange Rule 13.6(a)(1)(c).

63 Id.

64 Id.

65 See Proposed Exchange Rule 13.6(a)(1)(d).

66 See Proposed Exchange Rule 13.6(a)(2).

or more other markets, the Exchange has included a provision in its proposed rule amendments that would exempt such issuers from certain of NSX's governance standards if the issuer is listed on a national securities exchange or national securities association with listing standards substantially similar to the NSX governance standards. Specifically, such company listing on another market would not be required to separately meet the NSX governance requirements.[67] The propose rule text contains specific criteria that would be required to be considered when determining whether another market's governance standards are "substantially similar."

m. Applications to Foreign Private Issuers

Exchange Rule 13.6 would permit NSX-listed companies that are foreign private issuers, such as that term is defined in Rule 3b-4 of the Act,[68] to follow home country practice in lieu of the new requirements, except that such companies would be required to: (1) have an audit committee that satisfies the requirements of Rule 10A-3; (2) notify NSX in writing after any executive officer becomes aware of any non-compliance with any applicable provision; and (3) provide a brief, general summary of the significant ways in which its governance practices differ from those followed by domestic companies under NSX listing standards.[69] Listed foreign private issuers would be permitted to provide this disclosure either on their website (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.[70] If the disclosure is made available only on the

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67 The exemption would not apply to the Exchange's requirements relating to audit committees or to an issuer's obligation to notify the Exchange if there is material non-compliance with the audit committee requirements. See Proposed Exchange Rule 13.6(a)(3). See also supra note 11.

68 17 CFR 240.3b-4.

69 See Proposed Exchange Rule 13.6(a)(1)(e) and (d)(11).

70 See Interpretations and Policies to Proposed Exchange Rule 13.6(d)(11).

website, the annual report would be required to state this and provide the web address at which the information may be obtained.[71]

n. Proposed Implementation of New Provisions

Pursuant to the proposed schedule, listed companies would have until the earlier of their first annual meeting after July 31, 2004, or December 31, 2004 to comply with the new standards. However, if a company with a classified board is required to change a director who would not normally stand for election in an annual meeting, the company would be permitted to continue such director in office until the second annual meeting after such date, but no later than December 31, 2005. Notwithstanding the foregoing, foreign private issuers would have until July 31, 2005 to comply with any Rule 10A-3 audit committee requirements.[72]

Companies listing in conjunction with their initial public offering[73] would be required to have 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. They would be required to

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71 Id.

72 See Proposed Exchange Rule 13.6(b).

73 For purposes of proposed Exchange Rule 13.6, a company would 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 Act. NSX also proposes to permit companies that are emerging from bankruptcy or have ceased to be controlled companies within the meaning of proposed Exchange Rule 13.6 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 the requirement that a company have an audit committee that complies with the requirements of Rule 10A-3, and the requirement that a company notify the Exchange in writing of any material non-compliance, 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). Investment companies are not subject to this exemption under Rule 10A-3(b)(1)(iv)(A), however. See Proposed Exchange Rule 13.6(b).

meet the majority of independent board requirement within 12 months of listing.[74]

Companies listing upon transfer from another market, or that are listing a security on the Exchange that will remain listed on another market or markets, would have 12 months from the date of transfer in which to comply with any requirement to the extent that the market on which they had/have been listed does not have the same requirement. To the extent that 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 would have the same transition period as would have been available to it on the other market. This transition period for companies transferring from other markets or that are dually or multiply listing securities would not apply to the audit committee requirements of Rule 10A-3 unless a transition period is available under Rule 10A-3.[75]

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6 of the Act[76] in general and furthers the objectives of Section 6(b)(5)[77] in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and to remove impediments to and perfect the mechanism of a free and open market and a national market system and, generally, in that it protects investors and the public interest.

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

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74 Id.

75 Id.

76 15 U.S.C. 78f(b).

77 15 U.S.C. 78f(b)(5).

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

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

No written comments were solicited or received in connection with the proposed rule change.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NSX-2004-10 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-NSX-2004-10. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the NSX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NSX-2004-10 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[78] In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act[79] in that it is designed, among other things, to 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 the Commission's view, the proposed rule change will foster greater transparency,

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

79 15 U.S.C. 78f(b)(5).

accountability, and objectivity in the oversight by, and decision-making processes of, the boards and key committees of NSX-listed issuers. The proposal also will promote compliance with high standards of conduct by the issuers' directors and management. The Commission notes that the NSX's proposal is similar to proposals of other self-regulatory organizations ("SROs") recently approved by the Commission.[80]

The NSX has requested that the Commission grant accelerated approval to the proposed rule change. The Commission believes that the proposed rule change will significantly align the corporate governance standards proposed for companies listed on the NSX with the standards approved by the Commission for companies listed on other SROs. The Commission believes it is appropriate to accelerate approval of the proposed rule change so that the comprehensive set of strengthened corporate governance standards for companies listed on the NSX may be implemented on generally the same timetable (with some modification of certain deadlines) as that for similar standards adopted for issuers listed on other SROs. The Commission therefore finds good cause, consistent with Section 19(b)(2) of the Act,[81] to approve the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register.

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80 See, e.g., Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (approving changes to the corporate governance listing standards of the Nasdaq Stock Market, Inc. and the NYSE).

81 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[82] that the proposed rule change (SR-NSX-2004-10), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[83]

Margaret H. McFarland
Deputy Secretary

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82 15 U.S.C. 78s(b)(2).

83 17 CFR.200.30-3(a)(12).