

clarification.<sup>98</sup> However, several commenters recommended extending the instruction to include other requirements in the rule, such as auditor compensation and termination, to address foreign requirements that vest these responsibilities with shareholders.<sup>99</sup> We agree with these commenters that the same reasons that justify the clarification regarding auditor selection justify an extension to these other responsibilities. We also agree with those commenters that noted that the clarification should apply even if shareholders are not required to vote on the responsibilities, but voluntarily elect to do so.<sup>100</sup>

Accordingly, we are expanding the instruction. The revised instruction clarifies that none of the audit committee requirements in the final rule conflicts with, nor do they affect the application of, any requirement or ability under an issuer's governing law or documents or other home country legal or listing provisions that requires or permits shareholders to ultimately vote on, approve or ratify such requirements. In addition, we are adopting as proposed the further clarification that if such responsibilities are vested with shareholders, and the issuer provides a recommendation or nomination regarding such matters to its shareholders, the audit committee of the issuer, or body performing similar functions, must be responsible for making the recommendation or nomination.

The proposed instruction also included a clarification that the requirement that the audit committee select auditors does not conflict with any requirement in a company's home jurisdiction that prohibits the full board of directors from delegating such responsibility to a committee. In that case, the audit committee would need to be granted advisory and other powers with respect to such matters to the extent permitted by law, including submitting nominations or proposals to the full board. Several commenters noted that this instruction should be expanded to address other responsibilities in the final rule for the same reasons as those relating to shareholder approval.<sup>101</sup> In some jurisdictions, boards may be prohibited

from delegating such responsibilities to a committee, including the ability to submit nominations or recommendations to shareholders as called for in the instruction regarding shareholder approval of such matters.

Accordingly, we are expanding the instruction to cover other situations where the board of directors may be prohibited from delegating responsibility to the audit committee, including the ability to submit nominations or recommendations to shareholders. The revised instruction clarifies that none of the audit committee requirements in the final rule, including the requirement that the audit committee provide recommendations to shareholders where such responsibilities are vested with shareholders, conflicts with any legal or listing requirement in an issuer's home jurisdiction that prohibits the full board of directors from delegating such responsibilities to the audit committee or limits the degree of such delegation. However, we continue to believe that in such an instance, the audit committee, or body performing similar functions, must be granted such responsibilities, which can include advisory powers, with respect to such matters to the extent permitted by law, including submitting nominations or recommendations to the full board of directors.

Finally, some commenters noted that in some jurisdictions, the outside auditor can only be removed by court order upon specified circumstances.<sup>102</sup> Other commenters noted that the government is required to select the outside auditor for some foreign private issuers. Similar to the previous instructions, we are providing an additional instruction to clarify that the requirements in the final rule do not conflict with any legal or listing requirement in an issuer's home jurisdiction vesting such responsibilities with a government entity or tribunal. Similar to the other instructions, in such an instance we believe the audit committee should be granted such responsibilities, which can include advisory powers, with respect to such matters to the extent permitted by law.

Some commenters requested that we provide for these clarifications as explicit exemptions from the final rule. As noted previously, however, we believe that the rule's requirements relate to the assignment of such responsibilities as between the audit committee and management. They do not conflict with, and otherwise have no

bearing on, the vesting of such responsibilities in other bodies such as shareholders or government entities. Accordingly, we believe it is more appropriate to clarify what the requirements do not apply to or conflict with in the form of an instruction rather than an exemption.

### 3. Application to Investment Companies

We proposed to exempt investment companies from the requirement that the audit committee be responsible for the selection of the independent auditor. We proposed the exemption in light of section 32(a) of the Investment Company Act,<sup>103</sup> which requires that independent auditors of registered investment companies be selected by majority vote of the disinterested directors.<sup>104</sup>

On January 28, 2003, we adopted amendments to our existing requirements regarding auditor independence.<sup>105</sup> Those amendments require that the audit committee of a registered investment company pre-approve all audit, review, or attest engagements required under the securities laws, a requirement that was supported by the commenters.<sup>106</sup> In order to conform the rules that we are adopting today to the auditor independence rules, we are removing the proposed exemption for investment companies from the requirements regarding selection of the auditor. As a result, the audit committee will be required to select the independent

<sup>103</sup> 15 U.S.C. 80a-31(a).

<sup>104</sup> Section 32(a) applies to management investment companies and face-amount certificate companies. It does not apply to unit investment trusts, which do not have boards of directors and which we are excluding entirely from the requirements that we are adopting today. See section II.F.3.d. concerning unit investment trusts.

There are three types of investment companies: face-amount certificate companies, unit investment trusts and management companies. See section 4 of the Investment Company Act [15 U.S.C. 80a-4]. The Investment Company Act divides management companies into two sub-categories, defining an open-end company as a management company that offers for sale or has outstanding any redeemable securities of which it is the issuer and a closed-end company as any management company other than an open-end company. See section 5(a) of the Investment Company Act [15 U.S.C. 80a-5(a)]. A unit investment trust is an investment company that is organized under a trust indenture, contract of custodianship or agency, or similar instrument; does not have a board of directors; and issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities, but does not include a voting trust. See section 4(2) of the Investment Company Act of 1940 [15 U.S.C. 80a-4(2)].

<sup>105</sup> See Release No. 33-8183 (Jan. 28, 2003).

<sup>106</sup> See, e.g., Letter of Investment Company Institute dated January 13, 2003, in response to Release No. 33-8154 (Dec. 2, 2002) [67 FR 76780], proposing auditor independence rules adopted in Release No. 33-8183 (Jan. 28, 2003).

<sup>98</sup> See, e.g., the Letters of AICPA; The Treasury of the Government of Australia; CalPERS; Deloitte; Financial Services Agency of Japan ("FSA"); German CFOs; NYSE; PwC; Alexander Schaub; Telekom Austria AG.

<sup>99</sup> See, e.g., the Letters of Assonime; Canadian Bankers Association; Cleary; PwC; S&C.

<sup>100</sup> See, e.g., the Letter of Cleary.

<sup>101</sup> See, e.g., the Letters of Brazilian Securities Commission; Cleary; S&C.

<sup>102</sup> See, e.g., the Letters of Aventis SA; Deloitte; France Telecom SA.