

### 3. Issuers Affected

#### a. Foreign Issuers

As discussed in the Proposing Release, U.S. investors increasingly have been seeking opportunities to invest in a wide range of securities, including the securities of foreign issuers, and foreign issuers have been seeking opportunities to raise capital and effect equity-based acquisitions in the U.S. using their securities as the "acquisition currency." The Commission has responded to these trends by seeking to facilitate the ability of foreign issuers to access U.S. investors through listings and offerings in the U.S. capital markets. We have long recognized the importance of the globalization of the securities markets both for investors who desire increased diversification and international companies that seek capital in new markets.

Section 10A(m) of the Exchange Act makes no distinction between domestic and foreign issuers. With the growing globalization of the capital markets, the importance of maintaining effective oversight over the financial reporting process is relevant for listed securities of any issuer, regardless of its domicile. Many foreign private issuers already maintain audit committees, and the global trend appears to be toward establishing audit committees.<sup>146</sup> Thus, as proposed, the Commission's direction to the SROs will apply to listings by foreign private issuers as well as domestic issuers.

However, as discussed in the Proposing Release, we are aware that the requirements may conflict with legal requirements, corporate governance standards and the methods for providing auditor oversight in the home jurisdictions of some foreign issuers. Even before we published the Proposing Release, several foreign issuers and their representatives had expressed concerns about the possible application of Exchange Act section 10A(m).<sup>147</sup> The Proposing Release prompted many thoughtful comments from dozens of foreign private issuers and their representatives from around the world. These commenters expressed

overwhelming support for the Commission's approach of providing tailored exemptions and guidance where the requirements of Exchange Act section 10A(m) could result in a direct conflict with home country requirements. In our final rules, we have attempted to address commenters' concerns regarding the specific areas in which foreign corporate governance arrangements differ significantly from general practices among U.S. corporations. In addition to the clarifications discussed in section II.B., we discuss these matters below.

#### i. Employee Representation

We understand that some countries, such as Germany, require that non-management employees, who would not be viewed as "independent" under the requirements, serve on the supervisory board or audit committee.<sup>148</sup> Having such employees serve on the board or audit committee can provide an independent check on management, which itself is one of the purposes of the independence requirements under the Sarbanes-Oxley Act. Accordingly, we are adopting as proposed a limited exemption from the independence requirements to address this concern, so long as the employees are not executive officers, as defined by Exchange Act rule 3b-7.<sup>149</sup>

Commenters expressed support for this exemption.<sup>150</sup> Some commenters, however, recommended extending the exemption to include also non-executive employees that serve on the supervisory board or audit committee as a result of an issuer's governing law or documents or an employee collective bargaining or similar agreement. Under the final rule, non-executive employees can sit on the audit committee of a foreign private issuer if the employee is elected or named to the board of directors or audit committee of the foreign private issuer pursuant to the issuer's governing law or documents, an

employee collective bargaining or similar agreement or other home country legal or listing requirements.

#### ii. Two-Tier Board Systems

Some foreign private issuers have a two-tier board system, with one tier designated as the management board and the other tier designated as the supervisory or non-management board. In this circumstance, we believe that the supervisory or non-management board is the body within the company best equipped to comply with the requirements. Our final rule clarifies that in the case of foreign private issuers with two-tier board systems, the term "board of directors" means the supervisory or non-management board for purposes of Exchange Act rule 10A-3. As such, the supervisory or non-management board can either form a separate audit committee or, if the entire supervisory or non-management board is independent within the provisions and exceptions of the rule, the entire board can be designated as the audit committee.<sup>151</sup> Commenters supported this clarification.<sup>152</sup>

#### iii. Controlling Shareholder Representation

Controlling shareholders or shareholder groups are more prevalent among foreign issuers than in the U.S., and those controlling shareholders have traditionally played a more prominent role in corporate governance. In jurisdictions providing for audit committees, representation of controlling shareholders on these committees is common. As proposed, we believe that a limited exception from the independence requirements can accommodate this practice without undercutting the fundamental purposes of the rule. We proposed that one member of the audit committee can be a shareholder, or representative of a shareholder or group, owning more than 50% of the voting securities of a foreign private issuer, if the "no compensation" prong of the independence requirements is satisfied, the member in question has only observer status on, and is not a voting member or the chair of, the audit committee, and the member in question is not an executive officer of the issuer.

Several commenters requested that the exemption be extended. Some believed the 50% ownership threshold was too high, arguing that a shareholder can exercise control through lower levels of ownership or through non-

<sup>146</sup> See, for example, "Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence," Statement of the IOSCO Technical Committee (Oct. 2002) (available at <http://www.iosco.org>); Egon Zehnder International, Board of Directors Global Study (2000) (available at <http://www.zehnder.com>); and KPMG LLP, Corporate Governance in Europe: KPMG Survey 2001/2002 (2002) (available at <http://www.kpmg.com>).

<sup>147</sup> See, e.g., Petition for Rulemaking submitted by the Organization for International Investment, File No. 4-462 (Aug. 19, 2002).

<sup>148</sup> See, e.g., Co-Determination Act of 1976 (Mitbestimmungsgesetz). The exemptions provided in the final rule are available to any foreign private issuer that meets their individual requirements. Examples provided in this release are meant to be for illustrative purposes only.

<sup>149</sup> Exchange Act rule 3b-7 [17 CFR 240.3b-7] defines the term "executive officer" as an issuer's president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions for the registrant. Executive officers of subsidiaries may be deemed executive officers of the issuer if they perform such policy-making functions for the issuer.

<sup>150</sup> See, e.g., the Letters of Allianz AG; Deutsches Aktieninstitut; German CFOs; NYSE; Alexander Schaub; Telekom Austria AG.

<sup>151</sup> See note above and the accompanying text.

<sup>152</sup> See, e.g., the Letters of AFL-CIO; CalPERS; Deutsches Aktieninstitut; FEE.