

ownership means.¹⁵³ Others requested the ability to have more than one representative if there is more than one controlling shareholder.¹⁵⁴ A few objected to the observer-only status provided by the proposed exemption.¹⁵⁵

In response to commenters' concerns, we are making minor modifications to the exemption. We are expanding the types of controlling persons covered by the exemption, but we continue to believe that it is appropriate that such representatives have only observer status on, and not be a voting member or chair of, the audit committee. Under the final rule, an audit committee member can be a representative of an affiliate of the 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. As revised, this limited exception is designed to address foreign practices, assure independent membership and an independent chair of the audit committee and still exclude management from the committee. As the exemption is designed to provide only a limited accommodation for the practices of some foreign private issuers, we are not extending the exemption to domestic issuers, as requested by some commenters.¹⁵⁶

iv. Foreign Government Representation

Foreign governments may have significant shareholdings in some foreign private issuers or may own special shares that entitle the government to exercise certain rights relating to these issuers. However, due to their shareholdings or other rights, these representatives may not be considered independent under the final rule. To address foreign practices, we believe that foreign governmental representatives should be permitted to sit on audit committees of foreign private issuers. Commenters supported our proposal to exempt one member of the audit committee that is foreign government representative, provided the "no compensation" prong of the independence requirements is met and the member in question is not an executive officer of the issuer.¹⁵⁷ As

with the exemption for controlling shareholder representatives, this limited exception is designed to address foreign practices and still exclude management from the committee. However, some believed the exemption should not be limited to just one foreign government representative if the representatives are otherwise independent and are not executive officers of the issuer. Under the final rule, any audit committee member can be a representative of a foreign government or foreign governmental entity, if the "no compensation" prong of the independence requirement is satisfied and the member in question is not an executive officer of the issuer.

We recognize that foreign governments may have varying arrangements relating to their state holdings. Some governments may hold shares directly, some through various branches or agencies, some through an institution organized under public law, and some by other entities. Several commenters believed the legal form of the entity that holds the governmental shareholdings should not be determinative.¹⁵⁸ We agree. The exemption applies regardless of the manner in which the foreign government owns its interest.

v. Listed Issuers That Are Foreign Governments

Several commenters also requested a specific exemption for listed issuers that are themselves foreign governments, as these issuers most likely would not be able to comply with the requirements. Accordingly, we are exempting in the final rule listed issuers that are foreign governments, as defined in Exchange Act rule 3b-4(a).¹⁵⁹

vi. Boards of Auditors or Similar Bodies

While as noted above there is a continuing trend toward having audit committees in foreign jurisdictions, several foreign jurisdictions require or provide for auditor oversight through a board of auditors or similar body, or groups of statutory auditors, that are in whole or in part separate from the board of directors.¹⁶⁰ We believe that these

boards of auditors or statutory auditors are intended to be independent of management, although their members may not in all cases meet all of the independence requirements set forth in section 10A(m) of the Exchange Act. In addition, while these bodies provide independent oversight of outside auditors, they may not have all of the responsibilities set forth in rule 10A-3. The establishment of an audit committee in addition to these bodies, with duplicative functions, might not only be costly and inefficient, but it also could generate possible conflicts of powers and duties. Accordingly, we proposed an exemption from certain of the requirements for audit committees for boards of auditors or statutory auditors of foreign private issuers that fulfilled the remaining requirements of the rule, if those boards operate under legal or listing provisions intended to provide oversight of outside auditors that is independent of management, membership on the board excludes executive officers of the issuer and certain other requirements were met.

Commenters expressed strong support for the exemption as an appropriate response to address the potential conflicts regarding these alternative structures.¹⁶¹ However, several suggested refinements to the technical wording in the proposed exemption to ensure that it properly covers the appropriate structures in various jurisdictions.¹⁶² Also, many requested removing the proposed requirement that the issuer must be listed on a market outside the U.S., as the board of auditor requirement often is a home country

shareholders. See, e.g., Law for Special Exceptions to the Commercial Code Concerning Audits, etc. of Corporations (Law No. 22, 1974, as amended). Further, we understand that effective April 1, 2003, Japanese corporations will have the option to elect either a governance system with a separate board of directors and board of corporate auditors or a system based on nominating, audit and compensation committees under the board of directors. We also understand that the Italian corporate governance regime provides for an independent board of statutory auditors ("Collegio Sindacale") and the Brazilian corporate governance regime allows a Fiscal Council ("Conselho Fiscal"). See, e.g., the Letters of Assonime; Brazilian Securities Commission. As noted previously, the examples provided in this release are for illustrative purposes only. The exemption provided in the final rule for boards of auditors or similar bodies will be available to any foreign private issuer that meets the exemption's requirements because of the issuer's home country regime.

¹⁶¹ See, e.g., the Letters of ABA; Assonime; Baker & McKenzie; Brazilian Securities Commission; CalPERS; Cleary; FSA; Japan Corporate Auditors Association; Japanese Ministry of Economy, Trade and Industry; Nippon Keidanren; Matsushita; Nomura Holdings, Inc.; NTT DoCoMo, Inc.; NYSE; ORIX Corporation.

¹⁶² See, e.g., the Letters of ABA; Assonime; Baker & McKenzie; Brazilian Securities Commission; Cleary; ORIX Corporation; S&C.

¹⁵³ See, e.g., the Letters of ABA; Cleary; PwC; S&C.

¹⁵⁴ See, e.g., the Letter of AFEP-AGREF.

¹⁵⁵ See, e.g., the Letters of ABA; S&C.

¹⁵⁶ See, e.g., the Letters of Cleary; Duchossois Industries, Inc.; NYSE.

¹⁵⁷ See, e.g., the Letters of ABA; Compania Cervecerias Unidas S.A. ("CCU"); France Telecom SA.

¹⁵⁸ See, e.g., the Letters of Davis Polk & Wardwell; Telekom Austria AG.

¹⁵⁹ 17 CFR 240.3b-4(a). Under that definition, the term "foreign government" means the government of any foreign country or of any political subdivision of a foreign country. The exemption encompasses all registrants that are eligible to register securities under Schedule B of the Securities Act.

¹⁶⁰ For example, under current Japanese law, we understand that large Japanese corporations must maintain a board of corporate statutory auditors, a legally separate and independent body from the corporation's board of directors that is elected by