

SROs whether they have been in compliance with the standards. Commenters were more mixed on this point. Several commenters supported periodic confirmation of compliance to SROs.¹⁸³ Others believed it would be redundant to require periodic confirmations in addition to notice of actual breaches, and believed it should be left to the SROs to decide whether periodic confirmations should be included as part of their compliance monitoring procedures.¹⁸⁴ Two national securities exchanges indicated they already require or intend to require such confirmations.¹⁸⁵ We are not adopting a requirement that listed issuers must provide periodic confirmations of compliance to SROs at this time. However, we recognize, as many of the commenters did, that periodic confirmations can be part of an effective overall system for monitoring compliance with listing rules.

5. Opportunity To Cure Defects

Section 10A(m)(1)(B) of the Exchange Act specifies that our rules must provide for appropriate procedures for an issuer to have an opportunity to cure any defects that would be the basis for a prohibition of the issuer's securities as a result of its failure to meet section 10A(m)'s audit committee standards, before imposition of such a prohibition. To effectuate this mandate, our final rule requires SROs to establish such procedures before they prohibit the listing of or delist any security of an issuer.¹⁸⁶ As discussed in the Proposing Release, we believe that existing continued listing or maintenance standards and delisting procedures of the SROs generally will suffice as procedures for an issuer to have an opportunity to cure any defects on an ongoing basis. These procedures already provide issuers with notice and opportunity for a hearing, an opportunity for an appeal and an opportunity to cure any defects before their securities are delisted.¹⁸⁷

We requested comment as to whether the Commission should specify the maximum time limits for an opportunity to cure defects. Commenters were mixed on this point. Some supported having the Commission mandate specific time periods for the SROs, such as 30 days

or 90 days.¹⁸⁸ Others did not support specific time periods, again believing that it should be left to the individual SROs to decide the appropriate time periods given the differences of each market.¹⁸⁹ We are not mandating specific time periods in the final rule. However, as mentioned in the Proposing Release, we expect that the rules of each SRO will provide for definite procedures and time periods for compliance to the extent they do not already do so.

Several commenters expressed concern regarding rare situations that may occur where an audit committee member ceases to be independent for reasons outside the member's reasonable control. For example, an audit committee member could be a partner in a law firm that provides no services to the listed issuer on which the member sits, but the listed issuer could acquire another company that is one of the law firm's clients. Without an opportunity to cure such a defect, the audit committee member would cease to be independent. Additional time may be necessary to cure such defects, such as ceasing the issuer's relationship with the audit committee member's firm or replacing the audit committee member. Accordingly, under our final rule, SRO implementing rules may provide that if a member of an audit committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable national securities exchange or national securities association, may remain an audit committee member of the listed issuer until the earlier of the next annual meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

G. Disclosure Changes Regarding Audit Committees

1. Disclosure Regarding Exemptions

Exchange Act rule 10A-3 provides for certain exemptions. Because these exemptions will distinguish certain issuers from most other listed issuers, we believe that it is important for investors to know if an issuer is availing itself of one of these exemptions. Accordingly, we are adopting as proposed a requirement that these issuers must disclose their reliance on an exemption and their assessment of whether, and if so, how, such reliance will materially adversely affect the ability of their audit committee to act independently and to satisfy the other

requirements of Exchange Act rule 10A-3. Such disclosure will need to appear in, or be incorporated by reference into, annual reports filed with the Commission.¹⁹⁰ The disclosure also will need to appear in proxy statements or information statements of issuers subject to our proxy rules for shareholders' meetings at which elections for directors are held.

While two commenters¹⁹¹ did not believe the proposed disclosure would result in meaningful disclosure to investors, and several others did not support the assessment disclosure,¹⁹² commenters representing investors and investor groups and others uniformly believed the disclosure, including the assessment disclosure, would provide meaningful information to investors.¹⁹³ The purpose of the disclosure is not to single out particular issuers or to imply that a particular listed issuer's home country regime is somehow less effective. Instead, the disclosure is designed to provide additional transparency to investors regarding the listed issuer's audit committee arrangements and the issuer's assessment of the effectiveness of those arrangements.

We proposed that foreign private issuers availing themselves of the exemption for boards of auditors and similar structures would be required to file an exhibit to their annual reports stating that they are doing so. This exhibit would have been in addition to the disclosure required in the body of the report regarding the issuer's use of that exemption. Several commenters did not support the exhibit requirement, arguing that it would be unnecessarily

¹⁹⁰ This disclosure is to be included in Part III of annual reports on Form 10-K [17 CFR 249.310] and 10-KSB (through an addition to Item 401 of Regulations S-K and S-B). Consequently, companies subject to the proxy rules will be able to incorporate the required disclosure from a proxy or information statement that involves the election of directors into the annual report, if the issuer filed such proxy or information statement within 120 days after the end of the fiscal year covered by the report. See General Instruction G.(3) of Form 10-K and General Instruction E.3. of Form 10-KSB.

For foreign private issuers that file their annual reports on Form 20-F, the disclosure requirement will appear in new Item 16D.

For foreign private issuers that file their annual reports on Form 40-F, the disclosure requirement will appear in paragraph (14) to General Instruction B.

For registered investment companies, the disclosure will appear in Item 5(b) of Form N-CSR and Item 22(b)(14) of Schedule 14A.

¹⁹¹ See, e.g., the Letters of ABA; S&C.

¹⁹² See, e.g., the Letters of Cravath; Nippon Keidanren; Matsushita; NTT DoCoMo, Inc.

¹⁹³ See, e.g., the Letters of CalPERS; CII; CSC; Deloitte; E&Y; PwC; Teachers Insurance and Annuity Association "College Retirement Equities Fund" ("TIAA-CREF"); Transparency International-USA.

¹⁸³ See, e.g., the Letters of CalPERS; CII; PwC; Transparency International-USA.

¹⁸⁴ See, e.g., the Letters of CSC; Nasdaq.

¹⁸⁵ See the Letters of Amex; NYSE.

¹⁸⁶ These procedures, of course, cannot include an extended exemption or waiver of the requirements apart from those provided for in Exchange Act Rule 10A-3.

¹⁸⁷ See, e.g., NASD rule 4800 Series and NYSE Listed Company Manual section 804.

¹⁸⁸ See, e.g., the Letters of CalPERS; CSC; PwC.

¹⁸⁹ See, e.g., the Letters of ABA; NYSE.