

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 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 SEC. 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 and confidentially with the presiding director or with the non-management directors as a group. That method can follow the same process established for communications to the audit committee required by Section 303A(7)(c)(ii).

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—which, at minimum, must be to: identify individuals qualified to become board members, and to select, or to recommend that the board select, the director nominees for the next annual meeting of shareholders; and develop and recommend to the board a set of corporate governance principles applicable to the corporation;

(ii) the committee's goals and responsibilities—which must reflect, at minimum, the board's criteria for selecting new directors, and oversight of the evaluation of the board and management; and

(iii) an annual performance evaluation of the committee.

*Commentary:* 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. To avoid any confusion, note that the audit committee functions specified in Section 303A(7) may not be allocated to a different committee, other than as noted in the General Commentary to Section 303A(7).

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—which, at minimum, must be to discharge the board's responsibilities relating to compensation of the company's executives, and to produce an annual report on executive compensation for inclusion in the company's proxy statement, or, if the company does not file a proxy statement, in the company's annual report filed on Form 10-K with the SEC, in accordance with applicable rules and regulations;

(ii) the committee's duties and responsibilities—which, at minimum, must be 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 have sole authority to determine 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

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

*Commentary:* 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 (i.e., Rule 162(m)).

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. To avoid any confusion, note that the audit committee functions specified in Section 303A(7) may not be allocated to a different committee, other than as noted in the General Commentary to Section 303A(7).

6. Add to the "independence" requirement for audit committee membership the requirements of Rule 10A-3(b)(1) under the Exchange Act, subject to the exemptions provided for in Rule 10A-3(c).

*Commentary Applicable to All Companies:* While it is not the audit committee's responsibility to certify the company's financial statements or to guarantee the auditor's report, the committee stands at the crucial intersection of management, independent auditors, internal auditors and the board of directors. The Exchange supports additional directors' fees to compensate audit committee members for the significant time and effort they expend to fulfill their duties as audit committee members, but does not believe that any member of the audit committee should receive any compensation other than such director's fees from the company. If a director satisfies the definition of "independent