

effectively if one director has historical knowledge and experience with the company. Accordingly, we propose to exempt one member of a non-investment company issuer's audit committee from the independence requirements for 90 days from the effective date of an issuer's initial registration statement under Section 12 of the Exchange Act or a registration statement under the Securities Act covering an initial public offering of securities of the issuer.<sup>56</sup>

Further, many companies, particularly financial institutions and other entities with a holding company structure, operate through subsidiaries. For these companies, the composition of the boards of the parent company and the subsidiary are sometimes similar given the control structure between the parent and the subsidiary. If an audit committee member of the parent is otherwise independent, merely serving also on the board of a controlled subsidiary should not adversely affect the board member's independence, assuming that the board member also would be considered independent of the subsidiary except for the member's seat on the parent's board. Accordingly, we propose to exempt from the "affiliated person" requirement a committee member that sits on the board of directors of both a parent and a direct or indirect consolidated majority-owned subsidiary, if the committee member otherwise meets the independence requirements for both the parent and the subsidiary, including the receipt of only ordinary-course compensation for serving as a member of the board of directors, audit committee or any other board committee of the parent or subsidiary.<sup>57</sup>

As discussed in Section II.G.1 below, any issuer availing itself of any of these exceptions would have to disclose that fact. Apart from the two limited exemptions discussed above, and the exemptions for controlling shareholders, foreign governmental board representatives and non-management employee members of foreign private issuers discussed in Section II.F.3.a below, we do not propose to exempt any other particular relationships from the independence requirements at this time. In this regard, we note that Section 10A(m) of the Exchange Act does not, and therefore our proposed rule does not, contain any exemptions based on exceptional and limited circumstances similar to those that exist currently

under several SRO rules.<sup>58</sup> Also, given the policy and purposes behind the Sarbanes-Oxley Act, as well as to maintain consistency and to ease administration of the requirements by the SROs, we do not currently propose to entertain exemptions or waivers for particular relationships on a case-by-case basis.<sup>59</sup>

*Questions regarding the proposed independence requirements:*

- Is additional clarification necessary regarding the consulting, advisory or other compensatory fee prohibition? For example, should we clarify whether "compensatory fees" would include compensation under a retirement or similar plan in which a former officer or employee of the issuer participates? Should there be an exception for a *de minimis* amount of payments? If so, what amount would be appropriate? How would such an exception be consistent with the purposes of the prohibition?

- Is the proposed extension of the compensatory prohibition to spouses, minor children or stepchildren or children or stepchildren sharing a home with the member appropriate? Should it be expanded or narrowed? For example, should there be an exception for non-executive family members employed by the issuer? Is the extension to payments accepted by an entity in which an audit committee member is a partner, member or principal or occupies a similar position and which provides accounting, consulting, legal, investment banking, financial or other advisory services or any similar services to the issuer appropriate? Should we extend the prohibition further, such as to ordinary course business relationships?

- Is the proposed definition of "affiliated person" for non-investment companies appropriate? Is the proposed safe harbor from the definition of affiliated person appropriate? Should it include fewer or more persons? In responding to these questions, please keep in mind that, by its very nature, it would be difficult to create a safe harbor covering all individuals who are non-affiliates without inadvertently covering affiliates as well. The safe harbor would not create a presumption that those outside the safe harbor are affiliates. Rather, the safe harbor is designed to

cover only those individuals whom we reasonably believe would not be affiliates. Is this assumption accurate? Can we reliably assume that people who own less than 10% of a company and are not officers or directors are not in control of the company? Should this threshold be higher (e.g., 20%) or lower (e.g., 5%)? Should the exclusion from the definition of affiliate include an express presumption that those persons not so excluded are affiliates, unless rebutted by a majority of independent directors?

- Should we rely exclusively on retaining a subjective test for determining affiliate status, given the varied contractual arrangements with a control feature entered into by issuers, particularly smaller companies? A person might employ specified thresholds to conceal a control relationship. Should a facts and circumstances test be retained in order to reflect the different ways a control relationship can be established with an issuer?

- Should the board of directors be required to determine whether an audit committee member is independent?<sup>60</sup> Should the board be required to disclose this determination? If so, when? If the board should not make the determination, who should?

- The proposed independence requirements relate to current relationships with the audit committee member and related persons. Should the prohibition also extend to a "look back" period before the appointment of the member to the audit committee? If so, what period (e.g., three years or five years) would be appropriate? Should there be different look-back periods for different relationships or different parties? If so, which ones?

- Should there be additional criteria for independence apart from the two proposed criteria? For example, in addition to the proposed prohibitions, should there be a prohibition on any transactions or relationships with the audit committee member or an affiliate of the audit committee member apart from the committee member's capacity as a member of the board and any board committee?

- Should additional relationships be exempted from the independence requirements at this time? If so, which relationships should be exempted, why should they be exempted, and how would such an exemption be consistent with maintaining the independence of the audit committee?

- Is the proposed exemption for new public companies appropriate? Should

<sup>58</sup> See, for example, Section 303.01 of the NYSE's listing standards; Rule 4350(d) of the NASD's listing standards and Section 121B of the AMEX's listing standards. The rules of the NYSE, NASD and AMEX are available on their Web sites at [www.nyse.com](http://www.nyse.com), [www.nasd.com](http://www.nasd.com) and [www.amex.com](http://www.amex.com), respectively.

<sup>59</sup> Similarly, Commission staff would not entertain no-action letter or exemption requests in this area.

<sup>60</sup> See, e.g., note 26 above.

<sup>56</sup> See proposed Exchange Act Rule 10A-3(b)(1)(iv)(A).

<sup>57</sup> See proposed Exchange Act Rule 10A-3(b)(1)(iv)(B).