

coverage of the proposed rule, we request comment on the propriety of either a complete or partial exemption from the requirements for other types of securities? For example, should the rule apply only to classes of voting common equity of an issuer? What would be the basis for such an exclusion, and how would it be consistent with the purposes of the Sarbanes-Oxley Act? In responding to this request, commenters should specifically address how such an exemption would be consistent with investor protection.

### 3. Issuers Affected

#### a. Foreign Issuers

For many years, 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 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<sup>82</sup> already maintain audit committees, and the global trend appears to be toward establishing audit committees.<sup>83</sup> The proposed rule, therefore, would apply to

foreign private issuers as well as domestic issuers.

However, we are aware that the proposed requirements may conflict with legal requirements, corporate governance standards and the methods for providing auditor oversight in the home jurisdictions of some foreign issuers. Several foreign issuers and their representatives have expressed concerns about the possible application of Exchange Act Section 10A(m).<sup>84</sup> In our proposal, we attempt to address these concerns in specific areas in which foreign corporate governance arrangements differ significantly from general practices among U.S. corporations.

For example, we understand that some countries, such as Germany, require that non-management employees, who would not be viewed as “independent” under the proposed requirements, serve on the supervisory board or audit committee.<sup>85</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 proposing a limited exemption from the independence requirements to address this concern. We would provide that non-management employees could 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 home country legal or listing requirements.

We also note that certain foreign private issuers have a two-tier board, 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 would be the body within the company best equipped to comply with the proposed requirements. We propose to clarify that in the case of foreign private issuers with two-tier boards of directors, the term “board of directors” means the supervisory or non-management board. As such, the supervisory or non-management board could either form a separate audit committee or, if the entire supervisory or non-management board was independent within the provisions and exceptions of the proposed rule, the

entire board could be designated as the audit committee.<sup>86</sup>

Controlling shareholders or shareholder groups are more prevalent among foreign issuers than in the United States, 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. We believe that a limited exception from the independence requirements can accommodate this practice without undercutting the fundamental purposes of the proposed rule. In particular, we would propose that one member of the audit committee could 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.<sup>87</sup> This limited exception is designed to accommodate foreign practices, would assure independent membership and an independent chair of the audit committee and would still exclude management from the committee.

Similarly, 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 our proposals. To accommodate foreign practices, we believe that foreign governmental representatives should be permitted to sit on audit committees of foreign private issuers. As a result, we propose a limited exception that one member of the audit committee could 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. As with

<sup>82</sup> The term “foreign private issuer” is defined in Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer is a non-government foreign issuer, except for a company that (1) has more than 50% of its outstanding voting securities owned by U.S. investors and (2) has either a majority of its officers and directors residing in or being citizens of the U.S., a majority of its assets located in the U.S., or its business principally administered in the U.S.

<sup>83</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 [www.iosco.org](http://www.iosco.org)); Egon Zehnder International, Board of Directors Global Study (2000) (available at [www.zehnder.com](http://www.zehnder.com)); and KPMG LLP, Corporate Governance in Europe: KPMG Survey 2001/2002 (2002) (available at [www.kpmg.com](http://www.kpmg.com)).

<sup>84</sup> See, e.g., Petition for Rulemaking submitted by the Organization for International Investment, File No. 4-462 (Aug. 19, 2002).

<sup>85</sup> See, e.g., Co-Determination Act of 1976 (Mitbestimmungsgesetz).

<sup>86</sup> See note 37 above and the accompanying text.

<sup>87</sup> Exchange Act Rule 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.