

the proposed exemption for controlling shareholder representatives, this limited exception is designed to accommodate foreign practices and still exclude management from the committee.

Finally, while as noted above there is a 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 separate from the board of directors.⁸⁸ 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 our proposals.

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 propose an exemption from certain of the requirements for audit committees for boards of auditors or statutory auditors of foreign private issuers that fulfill the remaining requirements of the rule, if those boards operate under legal or listing provisions that are 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 are met. Specifically, foreign private issuers with boards of auditors or similar bodies or statutory auditors meeting these requirements would be exempt from the requirements regarding the independence of audit committee members and the audit committee's responsibility to oversee the work of the outside auditor. The remaining proposed requirements regarding procedures for handling complaints, access to advisors and funding for advisors would apply to these issuers, with the requirements being applicable

to the board of auditors or statutory auditors instead of an audit committee. Also, such board or body would need to be, to the extent permitted by law, responsible for the appointment and retention of any registered public accounting firm engaged by the listed issuer.⁸⁹

A foreign private issuer availing itself of any of these exemptions would be subject to specific disclosure requirements discussed in Section II.G.1 below. In proposing these exemptions, we recognize that some foreign jurisdictions continue to have historical structures that may conflict with maintaining audit committees meeting the requirements of Section 10A(m) of the Exchange Act. We encourage foreign issuers that access the U.S. capital markets to continue to move toward internationally accepted best practices in corporate governance.⁹⁰

As mentioned below, we request comment on whether there are other areas, in either one country or in many countries, in which the rules we are proposing are inconsistent or inappropriate in a significant way with foreign corporate governance arrangements. If there are other areas, do those arrangements adequately address the problems to be addressed under Exchange Act Section 10A(m)? As proposed, there would be no other ability for an SRO to exempt or waive foreign issuers from the proposed requirements.

b. Small Businesses

Section 10A(m) of the Exchange Act makes no distinction based on an issuer's size. We think that improvements in the financial reporting process for companies of all sizes are important for promoting investor confidence in our markets. In this regard, because we have seen instances of financial fraud at small companies as well as at large companies, we think that improving the effectiveness of audit committees of small and large companies is important.⁹¹ The proposed rule, therefore, would apply to listed issuers of all sizes.

⁸⁸ Such responsibility could be vested in such board or body, or statutory auditors, in any manner, including without limitation by law or listing requirement or delegation.

⁹⁰ See, e.g., IOSCO Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence (2002); OECD Principles of Corporate Governance (1999).

⁹¹ See Beasley, Carcello and Hermanson, *Fraudulent Financial Reporting: 1987–1997, An Analysis of U.S. Public Companies* (Mar. 1999) (study commissioned by the Committee of Sponsoring Organizations of the Treadway Commission).

We recognize that because the proposals apply only to listed issuers, quantitative listing standards applicable to listed securities, such as minimum revenue, market capitalization and shareholder equity requirements, will limit the size of issuers that will be affected by the requirements.⁹² However, we are sensitive to the possible implication for smaller issuers and for SROs that would like to specialize in securities of these issuers. We request comment below on these topics.

c. Issuers of Asset-Backed Securities

In several of our releases implementing provisions of the Sarbanes-Oxley Act,⁹³ we have noted the special nature of asset-backed issuers.⁹⁴ Because of the nature of these entities, such issuers are subject to substantially different reporting requirements. Most significantly, asset-backed issuers are generally not required to file the financial statements that other companies must file. Also, such entities typically are passive pools of assets, without an audit committee or board of directors or persons acting in a similar capacity. Accordingly, we propose to exclude asset-backed issuers from the proposed requirements.

d. Investment Companies

There are essentially two categories of investment companies that have shares listed for trading on exchanges: closed-end investment companies and so-called "exchange-traded funds" ("ETFs"). Closed-end investment companies are actively managed investment companies, which do not issue redeemable securities. ETFs are investment companies that are registered under the Investment Company Act as open-end investment companies or unit investment trusts ("UITs"). Unlike typical open-end funds or UITs, ETFs do not sell or redeem their individual shares ("ETF shares") at net asset value ("NAV"). Instead, ETFs sell and redeem ETF shares at NAV only in large blocks (such as 50,000 ETF shares). In addition, national securities exchanges list ETF shares for trading, which allows investors to purchase and sell individual ETF shares among themselves at market prices throughout the day. Unlike open-end ETFs or closed-end investment companies, UITs, including those that operate as ETFs, are

⁹² Examples of the types of quantitative standards necessary for initial and continued listings on the NYSE, Nasdaq and AMEX are available on their respective websites.

⁹³ See note 30 above.

⁹⁴ The term "Asset-Backed Issuer" is defined in 17 CFR 240.13a–14(g) and 240.15d–14(g).