

composition requirements, audit committee approval of related party transactions, and revisions to the Exchange's delisting rule are also proposed.<sup>5</sup>

Below is the text of the proposed rule change. Proposed new language is italicized; deletions are in brackets.

#### Rule 849. Audit Committee/Conflicts of Interest

##### Rule 849

(a) A listed company shall establish and maintain an audit committee, a majority of the members of which shall be independent directors, as defined in Rule 851. [The audit committee shall conduct an appropriate review of all related party transactions on an ongoing basis in order to review for potential conflict of interest situations]. *The requirements set forth in this Rule 849(a) shall continue to apply pending the implementation of the new requirements set forth in 849(b)-(j) and Commentary Sections (1)-(4). Listed issuers must be in compliance with such new requirements, subject to any applicable exemptions set forth therein, by the following dates: (A) July 31, 2005 for foreign private issuers and small business issuers as defined in Commission Rule 12b-2 under the Securities Exchange Act of 1934 (the "Act"); and (B) for all other listed issuers, the earlier of the listed issuer's first annual shareholders meeting after January 15, 2004, or October 31, 2004.*

(b) *Listing Standards Relating to Audit Committees. Each issuer of securities listed on the Exchange must*

*have, and certify that it has and will continue to have, an audit committee, as defined in Section 3(a)(58) of the Securities Exchange Act of 1934, of at least three members each of whom meet the following criteria.*

(1) *Independence.*

(i) *Each member of the audit committee must be a member of the board of directors of the listed issuer, and must otherwise be independent; provided that, where a listed issuer is one of two dual holding companies, those companies may designate one audit committee for both companies so long as each member of the audit committee is a member of the board of directors of at least one of such dual holding companies. The following restrictions apply to every audit committee member:*

(A) *Employees. A director who is an employee (including non-employee executive officers) of the company or any of its affiliates may not serve on the audit committee until three years following the termination of his or her employment. In the event the employment relationship is with a former parent or predecessor of the company, the director could serve on the audit committee after three years following the termination of the relationship between the company and the former parent or predecessor. "Affiliate" for purposes of this subsection (A) includes a subsidiary, sibling company, predecessor, parent company, or former parent company.*

(B) *Business Relationship. A director (a) who is a partner, controlling shareholder, or executive officer of an organization that has a business relationship with the company, or (b) who has a direct business relationship with the company (e.g., as a consultant), may serve on the audit committee only if the issuer's board of directors determines in its business judgment that the relationship does not interfere with the director's exercise of independent judgment. In making a determination regarding the independence of a director pursuant to this paragraph, the board of directors should consider, among other things, the materiality of the relationship to the issuer, to the director, and, if applicable, to the organization with which the director is affiliated.*

*"Business relationships" can include commercial, industrial, banking, consulting, legal, accounting and other relationships. A director can have this relationship directly with the company, or the director can be a partner, officer or employee of an organization that has such a relationship. The director may serve on the audit committee without*

*the above-referenced board of directors' determination after three years following the termination of, as applicable, either (a) the relationship between the organization with which the director is affiliated and the company, (b) the relationship between the director and his or her partnership status, shareholder interest or executive officer position, or (c) the direct business relationship between the director and the company.*

(C) *Cross Compensation Committee Link. A director who is employed as an executive of another corporation where any of the company's executives serves on that corporation's compensation committee may not serve on the audit committee.*

(D) *Immediate Family. A director who is an Immediate Family member of an individual who is an executive officer of the company or any of its affiliates cannot serve on the audit committee until three years following the termination of such employment relationship. "Immediate Family" includes a person's spouse, parents, children, siblings, mothers-in-law and fathers-in-law, sons and daughters-in-law, and anyone (other than employees) who shares such person's home.*

(ii) *Independence requirements for non-investment company issuers. In order to be considered to be independent for purposes of this paragraph (b)(1), a member of an audit committee of a listed issuer that is not an investment company may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee:*

(A) *Accept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof, provided that compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the listed issuer (provided that such compensation is not contingent in any way on continued service); or*

(B) *Be an affiliated person of the issuer or any subsidiary thereof.*

(iii) *Independence requirements for investment company issuers. In order to be considered to be independent for purposes of this paragraph (b)(1), a member of an audit committee of a listed issuer that is an investment company may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee:*

(A) *Accept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer or any*

<sup>5</sup> The Exchange intends to file additional proposed rule changes relating to other corporate governance listing standards, including board independence and independent committees, issuers' codes of conduct, and announcement of going concern qualification in the near future. The New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD") have proposed a number of rule changes in these areas. See, e.g., Securities Exchange Act Release Nos. 47516 (March 17, 2003), 68 FR 14451 (March 25, 2003) (SR-NASD-2002-141, a proposed rule change relating to board independence and independent committees); 48123 (July 2, 2003), 68 FR 41191 (July 10, 2003) (SR-NASD-2002-77, disclosure of audit opinions with going concern qualifications); 48125 (July 2, 2003), 68 FR 41194 (July 10, 2003) (SR-NASD-2002-139 and Amendment No. 1 thereto, requiring listed companies to adopt a code of conduct for all directors, officers, and employees); and 47672 (April 11, 2003), 68 FR 19051 (April 17, 2003) (SR-NYSE-2002-33 and Amendment No. 1 thereto, proposing corporate governance rule changes). The Commission has recently approved NYSE and Nasdaq proposals relating to shareholder approval of equity compensation plans. See Securities Exchange Act Release No. 48108 (June 30, 2003), 68 FR 39995 (July 3, 2003) (approving SR-NYSE-2002-46 and SR-NASD-2002-140). The Exchange filed a proposed rule change relating to equity compensation on September 30, 2003 (File No. SR-Phlx-2003-67).