

The Commission has long encouraged exchanges to adopt and strengthen their corporate governance listing standards in order to, among other things, enhance investor confidence in the securities markets. The Commission believes that, with these proposals, NYSE and Nasdaq have made significant strides in strengthening their corporate governance listing standards. The Commission notes that many commenters generally supported the NYSE's and Nasdaq's initiatives, although some commenters offered suggestions to clarify, improve, or reconcile various provisions of the proposals. Accordingly, NYSE and Nasdaq amended their proposals to respond to specific issues raised by the commenters; and to harmonize their respective rule proposals in certain areas. The Commission discusses below significant aspects of the NYSE and Nasdaq corporate governance proposals.

Definition of "Independent Director" and Composition of Board of Directors

Both NYSE and Nasdaq propose to require listed issuers to have a majority of independent directors on their boards; require the boards of listed issuers to make an affirmative determination of independence and provide information to investors about their determinations; and identify certain relationships that automatically preclude a board finding of independence.

A number of commenters supported these rule amendments, although a few commenters voiced their objections. The Commission believes that requiring boards to have a majority of independent directors should increase the likelihood that boards will make decisions in the best interests of shareholders. The Commission further believes that requiring boards to make an affirmative determination of independence, and to disclose these determinations, will increase the accountability of boards to shareholders and give shareholders the ability to evaluate the quality of a board's independence and its independence determinations.

The Commission also believes that, by tightening the definition of "independent director," the NYSE and Nasdaq rule revisions appropriately prohibit many relationships that otherwise could impair the independence of directors, such as employment, business, financial, and family relationships. The Commission believes that the listing standards as proposed by the NYSE and Nasdaq provide objective and clear guidance for evaluating a director's independence.

Accordingly, these new listing standards will establish criteria for independence that can be consistently and fairly applied by companies. The Commission also notes that, in addition to incorporating specific factors that preclude a director from being considered independent, the NYSE and Nasdaq provisions require a board to further exercise appropriate discretion to identify any additional material relationship that the director may have with the listed issuer that could interfere with the director's ability to exercise independent judgment.

The Commission also believes that requiring an issuer to disclose in its annual proxy (or annual report on Form 10-K for an issuer that does not file a proxy) its determination regarding those directors it has deemed to be independent will provide greater transparency to the governance process. In addition, the Commission believes it is appropriate for NYSE to require that non-management directors meet at regularly scheduled executive sessions, and for Nasdaq to impose a similar requirement with respect to independent directors meeting in regularly-scheduled executive sessions.

The Commission notes that the NYSE and Nasdaq amended their proposals regarding the independence of directors to respond to concerns or suggestions raised by the commenters or to harmonize more closely various provisions of their proposals to reduce the possibility of differing regulatory treatment. In this regard, the NYSE tightened the definition of "independent director" to state that an employee of the company (or an individual whose immediate family member is an executive officer) is not independent until a specified period after the end of such employment relationship, which is similar to a provision that was proposed by Nasdaq. The NYSE also revised language of the NYSE Business Relationship Proposal by adding language to indicate that the term "company" included parents and subsidiaries. As a result of these changes, the NYSE and Nasdaq provisions are more closely aligned.

In addition, the NYSE revised its provision regarding a director or immediate family member's receipt of \$100,000 in direct compensation from a rebuttable presumption to a bright-line test, which aligns this provision more closely with the test proposed by Nasdaq. The NYSE also amended the length of its look-back periods from five years to three years and revised the phase-in of its look-back proposal so that the full three-year look-back period would be implemented one year after

the Commission's approval of the proposed rule change. As a result of the revisions to the look-back periods, the NYSE narrowed differences in how the NYSE and Nasdaq rules would be applied. Similar to Nasdaq's proposal, the NYSE added a presumption of financial expertise for directors who satisfy the definition of audit committee financial expert set out in Item 401(h) of Regulation S-K.

The Commission notes that Nasdaq also has revised the Nasdaq Independent Director Proposal to take into account the concerns or suggestions of commenters and to bring its proposal into greater harmony with the NYSE Corporate Governance Proposal. In response to commenters' concerns about the clarity of the Nasdaq Independent Director Proposal, Nasdaq set forth more clearly how the terms "subsidiary," and "executive officer" would be defined; indicated that the three-year look-back would apply to relationships that existed at any time within the three-year period; and noted that an independent director who serves on the boards of both a holding company and a subsidiary would not be considered an affiliate of either entity merely as a result of such service. Nasdaq also revised the Nasdaq Independent Director Proposal to provide that loans permitted by section 13(k) of the Exchange Act and compensation for service on board committees were permissible payments. Nasdaq also has extended certain prohibitions to the family members of directors under the amended definition. For example, a director would not be considered independent if a family member of a director is a controlling shareholder or executive officer of any organization to which the company made or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year or \$200,000, whichever is more. In addition, Nasdaq expanded the scope of relationships with the company's outside auditor that would preclude a finding of independence. A director would not be considered independent if he or she is a partner of the company's outside audit firm or if one of his or her family members is a partner of the outside audit firm. Finally, Nasdaq narrowed the definition of "Family Member" and required the issuer to disclose those directors that it has determined to be independent; both of these changes conform the Nasdaq and NYSE proposals more closely.