

Nomination of Directors

The NYSE Corporate Governance Proposal requires each issuer to have a nominating committee that is comprised entirely of independent directors, while the Nasdaq Independent Director Proposal would require the issuer's director nominees to be selected or recommended for the board's selection by a majority of the independent directors or by a nominating committee comprised solely of independent directors. In addition, the NYSE proposal requires that the nominating committee have a written charter that addresses the committee's purpose and responsibilities and an annual performance evaluation of the committee; the Nasdaq proposal requires each issuer to certify that it has adopted a formal written charter or a board resolution addressing the nominations process and such related matters as may be required under the Federal securities laws. With Nasdaq's addition of the written charter requirement, the NYSE and Nasdaq nominating committee proposals are more closely aligned. The commenters who provided their views on independent nominating committees generally supported the NYSE and Nasdaq proposals, although a few of them suggested revisions.

The Commission believes that directors that are independent of management are more likely to support the nomination of qualified, independent directors, and that a written document governing the nominating committee is beneficial in that it would describe the process used to identify board candidates and the criteria for selecting or recommending those candidates. Therefore, the Commission believes that the NYSE and Nasdaq nominating committee provisions are appropriate. In the Commission's view, the NYSE and Nasdaq proposals relating to the definition of "independent director" are a reasonable approach to enable a listed issuer to ascertain whether an individual is truly independent of the issuer. Moreover, the NYSE and Nasdaq proposals requiring a majority of the board to be independent should help to serve shareholders' interests by assuring that key decisions are considered by a board comprised of a majority of individuals without relationships to the issuer that otherwise could impair their judgment.

Compensation of Officers

The NYSE Compensation Committee Provision requires each issuer to have a compensation committee composed

entirely of independent directors that, either as a committee or together with the other independent directors, determines and approves the CEO's compensation, and that makes recommendations to the board with respect to non-CEO compensation. The committee is required to have a written charter addressing the committee's purpose and responsibilities. The Nasdaq Compensation of Executives Provision requires the compensation of the CEO and other executive officers of an issuer to be determined or recommended to the board for determination either by a majority of independent directors or by a compensation committee comprised solely of independent directors. The Nasdaq proposal stipulates that the CEO may not be present during voting or deliberations on the CEO's compensation. In addition, if the committee has at least three members, the Nasdaq proposal permits one director who is not independent and is not a current officer or employee or Family Member of such person to be appointed to the committee for a limited term if the board, under exceptional and limited circumstances, determines that such individual's membership is required and discloses the nature of the relationship and the reasons for the determination.

A number of commenters disapproved of the NYSE's original proposal because it would have given the compensation committee the sole authority to determine CEO compensation. The Commission notes that, in response to these comments, NYSE revised its proposal to state that the committee's responsibility is to determine and approve the CEO's compensation level either as a committee or together with the other independent directors, and made clear that the revised provision does not preclude discussion of CEO compensation with the board generally. Nasdaq also amended its proposal to clarify that an issuer has the flexibility to empower a compensation committee either to take action itself or to recommend that the board take action.

The Commission believes that directors that are independent of management are more likely to evaluate the performance of the CEO and other officers impartially and to award compensation on an objective basis. The Commission believes that the new standards that NYSE and Nasdaq have proposed with respect to how listed companies determine the compensation of their officers are appropriate.

Audit Committee and Compliance With Rule 10A-3

Both NYSE and Nasdaq proposed to strengthen their listing requirements regarding audit committees. Both require listed issuers to comply with the standards set forth in Rule 10A-3, and both elected to adopt the cure period provided in Rule 10A-3(a)(3) for audit committee members who cease to be independent for reasons outside their reasonable control. Both NYSE and Nasdaq retain the requirement that listed issuers have an audit committee that is comprised of at least three directors. Moreover, audit committee members are required to meet the NYSE's or Nasdaq's respective definitions of independence in addition to the independence requirements of Rule 10A-3. The NYSE proposal also requires a special board determination and disclosure in certain instances if an audit committee member simultaneously serves on the audit committee of more than three public companies. The Nasdaq proposal includes a limited exceptional and limited circumstances exception for its non-Rule 10A-3 independence standards and a cure period for certain audit committee vacancies.

Both the NYSE and Nasdaq proposals retain the current provisions that require each member of the audit committee to meet financial literacy requirements and that at least one audit committee member have increased financial sophistication. Regarding the latter requirement, both proposals provide that a director who qualifies as an audit committee financial expert under Commission rules is presumed to qualify for the increased sophistication requirements.

The NYSE and Nasdaq proposals retain the requirement that the audit committee have a written charter that addresses the committee's purpose and responsibilities, and add that the audit committee's responsibilities under Rule 10A-3 must be included. In addition, the NYSE proposal requires that the audit committee charter address an annual performance evaluation of the audit committee.

As with the NYSE and Nasdaq general independence proposals, a number of commenters supported these rule amendments, while a few voiced their concerns. Several commenters, writing before the NYSE and Nasdaq filed amendments to the proposals, requested that the audit committee proposals be reconciled with Rule 10A-3. Others requested clarification of the proposals.

In the Commission's view, an audit committee comprised of independent