provisions of 5 U.S.C. § 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549.

Copies of such filing also will be available for inspection and copying at the principal office of NSCC. All submissions should refer to File No. SR–NSCC–99–04 and should be submitted by July 2, 1999.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[10]

Margaret H. McFarland

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41479; File No. SR–NYSE–98–32]

Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1 and 2 Thereto Relating to Shareholder Approval of Stock Option Plans

June 4, 1999.

I. Introduction

On October 13, 1998, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend the Exchange's shareholder approval policy (''Policy'') with respect to stock option and similar plans. The proposed rule change was published for comment in the **Federal Register** on November 19, 1998.[3] The Exchange submitted an amendment to the filing on November 17, 1998.[4] On December 26, 1998, the Commission extended the comment period until January 25, 1999.[5] The Commission received 19 comments on the proposal in response to both the regular and extended comment periods.[6] On March 12, 1999, the Exchange submitted Amendment No. 2.[7] This order approved the proposal, as amended, on a pilot basis until September 30, 2000.

II. Background

The Exchange proposes to amend paragraphs 312.01, 312.03, and 312.04 of the Listed Company Manual (''Manual''). The proposal amends the Exchange's Policy with respect to stock option and similar plans (''Plans'').

The Policy requires, as a prerequisite to listing, shareholder approval of Plans or any other arrangement pursuant to which either officers or directors acquire stock. There are, however, four exemptions from this requirement, one of which is an exemption for Plans that are ''broadly-based.'' Historically, the Exchange had not provided a definition of what constituted a ''broadly-based'' Plan other than to state that such a Plan must include employees other than officers and directors. The only example in the Policy of such a Plan was an employee stock option plan, or ''ESOP.''

In December 1997, the Exchange filed a proposed rule change amending the Policy. The proposal was amended on January 28, 1998 and was then published for public comment by the Commission (''Original Proposal'').[8] The Original Proposal codified, among other things, existing Exchange interpretations regarding ''broadly-based'' Plans. Specifically, the Original Proposal stated that the determination of whether a Plan was ''broadly-based'' required the review of a number of factors, including the number of persons included in the Plan, and the nature of the company's employees, such as whether there were separate compensation arrangements for salaried and hourly employees. The proposal also codified a non-exclusive safe harbor for Plans in which at least 20 percent of a company's employees were eligible, provided that the majority of those eligible were neither officers nor directors.[9] The Commission did not receive any comments on the proposal, and subsequently approved it, as amended, on April 8, 1998.[10]

Following the Commission's approval of the Original Proposal, the Exchange and the Commission received a significant number of inquiries and comments regarding the Original Proposal. Many of these inquiries and comments originated from the institutional investor community and focused on the definition of ''broadly-based.'' Commenters expressed general concern that, without shareholder approval, companies could dilute the value of existing shares by creating new Plans.

[10] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] /Securities Exchange Act Release No. 40679 (November 13, 1998), 63 FR 64304.

[4] Letter from James E. Buck, Senior Vice President and Secretary, NYSE to Richard C. Strasser, Assistant Director, Division of Market Regulation, SEC, dated November 25, 1998 (''Amendment No. 1''). In Amendment No. 1, the Exchange clarified the reason why its proposed ''broadly-based'' definition is limited to ''exempt employees'' under the Fair Labor Standards Act of 1938 in the eligibility part of the definition but not in the participation part.

[5] In response to the solicitation of comments, the Commission received a request to extend the comment period. Letter from Sarah Teslik, Council of Institutional Investors, to Jonathan G. Katz, Secretary, SEC, dated November 20, 1998 (''CII Comment Period Extension Request''). As originally noticed, the comment period expired on December 10, 1998.

[6] Letters from Aldo Del Nou to Commissioner (sic) Arthur Levitt, SEC, dated October 17, 1998; CII Comment Period Extension Request; Kurt N. Schacht, Chief Legal Officer, State of Wisconsin Investment Board to Jonathan G. Katz, Secretary, SEC, dated November 30, 1998; Nell Minow, Lens Investment Management, LLC, to Jonathan G. Katz, Secretary, SEC, dated December 1, 1998; Sarah Teslik, Council of Institutional Investors, to Jonathan G. Katz, Secretary, SEC, dated November 30, 1998 (''CII–I''); Howard D. Sherman, President, Institutional Shareholder Services, to Jonathan G. Katz, Secretary, SEC, dated December 2, 1998; James E. Heard, Chairman and Chief Executive Officer, Proxy Monitor, to Jonathan G. Katz, Secretary, SEC, dated December 4, 1998; Richard Ferlauto, Managing Director, Proxy Voter Services, to Jonathan G. Katz, Secretary, SEC, dated December 8, 1998; Linda S. Selbach, Barclays Gloval Investors, to Jonathan G. Katz, Secretary, SEC, dated December 7, 1998; Lewis A. Sanders, Sanford C. Bernstein & Co., Inc. to Jonathan G. Katz, Secretary, SEC, dated December 9, 1998; Kay R.H. Evans, Executive Director, Maine State Retirement System, to Jonathan G. Katz, Secretary, SEC, dated December 10, 1998; Jack M. Marco, The Marco Consulting Group, to Jonathan G. Katz, Secretary, SEC, dated December 9, 1998; George M. Philip, Executive Director, New York State Teachers' Retirement System, to Jonathan G. Katz, Secretary, SEC, dated December 9, 1998; Kayla J. Gillan, General Counsel, California Public Employees' Retirement System, to Jonathan G. Katz, Secretary, SEC, dated December 9, 1998 (''Cal PERS''); John J. Sweeney, President, American Federation of Labor and Congress of Industrial Organizations, to Jonathan G. Katz, Secretary, SEC, dated December 10, 1998 (''AFL–CIO''); Bart Naylor, Director, Corporate Affairs, International Brotherhood of Teamsters, to Jonathan G. Katz, Secretary, SEC, dated December 10, 1998; Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, SEC, dated December 10, 1998; Michelle Edkins, Corporate Governance Executive, Hermes Investment Management Limited, to Jonathan G. Katz, Secretary, SEC, dated January 18, 1999; Sarah Teslik, Council of Institutional Investors, to Jonathan G. Katz, Secretary, SEC, dated April 14, 1999 (''CII–II'').

[7] Letter from James E. Buck, Senior Vice President and Secretary, NYSE to Jonathan G. Katz, Secretary, SEC, dated March 11, 1999 (''Amendment No. 2''). In Amendment No. 2, the Exchange submitted a sunset provision pursuant to which the proposed rule change will expire on September 30, 2000. Amendment No. 2 also contained the Exchange's response to the comment letters.

[8] Securities Exchange Act Release No. 39659 (February 12, 1998), 63 FR 9036 (February 23, 1998).

[9] According to the NYSE, the 20% test was based upon the ''rule of thumb'' the Exchange had historically used in determining whether a Plan was ''broadly-based.'' *See Request for Comment on NYSE Shareholder Approval Requirement for Broadly-Based Stock Option Plans* at 2 (''Request for Comment'').

[10] Securities Exchange Act Release No. 39839, 63 FR 18481 (April 15, 1998).

In response, the Exchange issued the Request for Comment regarding the definition of ''broadly-based'' Plans. The Exchange received 166 comments in response to that request.[11] According to the NYSE, the listed company community favored retaining the new Policy, while the institutional investor community favored a narrower definition of what constituted a ''broadly-based'' Plan, and suggested that such definition be an exclusive test instead of a non-exclusive safe harbor.

A Stockholder Approval Policy Task Force (''Task Force'') was subsequently established to review the comments and to make recommendations concerning possible changes to the Policy. The Task Force was composed of representatives of the Exchange's Legal Advisory Committee, Individual Investor Committee, Pension Manager Advisory Committee, and Listed Company Advisory Committee. In addition, member of other Exchange constituencies, including the Council of Institutional Investors, were represented on the Task Force.

Following its deliberations, the Task Force recommended that certain changes be made to the definition of a ''broadly-based'' Plan.[12] In addition, the Task Force recommended that the Exchange actively consider setting an overall dilution maximum for all non-tax qualified Plans that otherwise would be exempt from shareholder approval requirements. The Task Force recommended that the Exchange direct it or another appropriate group to immediately consider this issue with a target date of the NYSE's September 1999 Board meeting. The Task Force further stated that the goal should be to complete this study in time for Exchange review prior to the year 2000 proxy statement season.

This proposed rule change implements the first three Task Force recommendations to change the existing rule.[13] The proposed rule change amends the definition of what constitutes a ''broadly-based'' Plan and adds some general language concerning approval of Plans under the Policy. In addition, in its filing, the Exchange stated that it had adopted the Task Force's final recommendation and had convened a new task force (''Dilution Task Force'') to consider a possible listing standard that would include a dilution test.

III. Description of Proposal

The proposed rule change amends the definition of ''broadly-based'' which is used to determine whether a Plan is exempt from shareholder approval. The new definition would classify a Plan as ''broadly-based'' if, pursuant to the terms of the Plan: (a) at least a majority of the issuer's full time, exempt U.S. employees [14] are eligible to participate under the Plan; and (b) at least a majority of the shares awarded under the Plan (or shares of stock underlying options awarded under the Plan) during the shorter of the three-year period commencing on the date the Plan is adopted by the issuer, or the term of the Plan itself, are made to employees [15] who are not officers or directors of the issuer.[16] The new definition is an exclusive test, not a safe harbor as in the current rule.

The proposed rule change also expresses the Exchange's general policy towards Plans. The Exchange recognized the increased use of Plans by companies and expressed its view that companies should consider submitting Plans to shareholders, whether or not required under the Exchange's Policy.

In its filing, the Exchange stated that the proposed changed blend tests based both on Plan eligibility and awards. Furthermore, the Exchange expects that the proposed rule change will provide certainty because it is an exclusive test applicable to all Plans and because it adopts the Commission's definition of ''officer.'' [17]

IV. Summary of Comments

The Commission received 19 comments on the proposed rule change.[18] Of the 19 comment letters, 13 letters opposed the proposed rule change,[19] three comment letters offered qualified support for the proposal,[20] one comment letter supported the proposed rule change,[21] and one comment requested an extension of the comment period.[22] One letter did not address the issues raised in the proposed rule change.[23]

These comment letters raised a number of concerns regarding the amendment to the Policy. The Exchange submitted a written response to the issues raised in the comment letters in Amendment No. 2.[24] The following discussion summarizes the issues raised by the commenters and the Exchange's response.

A. Dilution

A majority of the comment letters expressed concern over the lack of a dilution test.[25] Dilution refers to the diminished value of a shareholder's investment that can occur when stock options are granted. These commenters believe that the expanded definition of ''broadly-based'' Plans will essentially permit unlimited dilution to occur and

[11] Interested persons are directed to the public file located at the Commission's Public Reference Room, 450 Fifth Street, N.W. Washington, D.C. 20549 to review the comments received by the NYSE. The public file contains: (1) a Summary of Comment Letters (Exhibit B); (2) the NYSE Request for Comment (Exhibit 2A); (3) the Comment Letters in Response to the Request for Comment (Exhibit 2B); and (4) the Report of the NYSE Task Force (Exhibit 2C). The public file may also be inspected at the principal office of the NYSE.

[12] *See Report of the Special Task Force on Stockholder Approval Policy.*

[13] *Id.*

[14] *See* 29 U.S.C. 213(a) for the definition of ''exempt'' employees.

[15] In Amendment No. 1, the Exchange explained that the proposed definition of ''broadly-based'' would be a two-part test. In the first prong, a majority of the company's full-time employees who are ''exempt'' employees must be eligible to receive stock. As a general matter, ''exempt'' employees are salaried employees in an executive, administrative, or professional capacity. According to the NYSE, the Task Force recommended limiting this prong of the definition to ''exempt employees'' because non-exempt employees are often covered by compensation arrangements that do not include stock options.

The second part of the test requires that at least a majority of the shares awarded under the Plan be awarded to employees who are not officers or directors. This part of the test is not limited to ''exempt'' employees, allowing the calculation of the ''majority of shares awarded'' to include both ''exempt'' and non-exempt employees who are not officers or directors. According to the NYSE, the focus of this requirement is to ensure that a company actually implements a Plan in a ''broadly-based'' fashion. In this regard, it does not matter whether the awards to persons other than officers or directors are to ''exempt'' or non-exempt employees.

[16] In this regard, the Exchange proposes to use the definition of ''officer'' contained in Commission Rule 16a–1(f) under the Act, 17 CFR 240.16a–1(f).

[17] *See supra* note 16.

[18] *See supra* note 6.

[19] *See* letters from State of Wisconsin Investment Board; Lens Investment Management; CII–I; Institutional Shareholder Services; Proxy Monitor; Proxy Voter Services; Barclays Global Investors; Maine State Retirement System; Marco Consulting Group; AFL–CIO; Teamsters; Hermes Investment Management; and CII–II.

[20] *See* letters from Sanford C. Bernstein; NY State Teachers' Retirement System; and Cal PERS. Cal PERS, while not specifically addressing the substance of the proposed amendments, suggested that they should only be approved for one year while a dilution test is developed. As discussed below, Cal PERS also supported disclosure.

[21] *See* letter from Investment Company Institute urging adoption of the proposed rule change and stating that the proposed definition addresses many of their previouis concerns with the existing rule.

[22] *See* CII Comment Period Extension Request letter. This letter did not address the proposed rule change's substantive issues.

[23] *See* letter from Mr. Del Nou. Mr. Del Nou's letter requested that shareholders be offered stock options and raised purported constitutional issues regarding shareholder voting rights.

[24] *See supra* note 7.

[25] *See* letters from State of Wisconsin Investment Board; Lens Investment Management; CII–I; Institutional Shareholder Services; Proxy Monitor; Barclays Global Investors; Sanford C. Bernstein; Maine State Retirement System; NY State Teachers' Retirement System; Cal PERS; AFL–CIO; Investment Company Institute Hermes Investment Investment Management; and CII–II.

allow unlimited amounts of equity to be given to Plan participants without share holder approval.[26] Many of these commenters questioned why any Plan that has a dilutive effect on a shareholder's investment should be exempt from a shareholder vote. For example, one commenter observed that shareholders are concerned with the cost of equity-based Plans and not the business decision of who can (or does) receive equity-based compensation.[27] Another commenter suggested that the grant of stock options may also have the effect of a stealth hostile takeover from within the company be diluting shareholders' voting power.[28] Several commenters stated that the definition of ''broadly-based'' Plans should only be adopted in conjunction with adoption of a dilution test and were opposed to the NYSE's decision to consider a dilution test at a later date.[29] Other commenters believe there should be no exemption for ''boardly-based'' Plans and that a dilution commenters believe there should be no exemption for ''broadly-based'' Plans and that a dilution test should be the sole standard.[30]

In Amendment No. 2, the Exchange responded to the comments on dilution. The Exchange stated that while it agrees that it is appropriate to consider a dilution test and is committed to doing so, a dilution test raises numerous policy issues that it was unable to consider in time for the 1999 proxy season. Moreover, the Exchange did not originally seek comment on this issue in the Request for Comment. The Exchange further expressed its commitment to review this issue by amending its proposal to be effective only until September 30, 2000. The Exchange stated that while it expects to propose a dilution test to replace the revised stockholder approval test in advance of the year 2000 proxy season, it proposes to make the current changes to the ''broadly-based'' test effective through the 2000 proxy season in the event there is any unforseen delay in this schedule.

B. Conflict of Interest

Another area of concern for commenters was the apparent conflict of interest of officers and directors.[31] The commenters remarked on the inherent conflict of interest that arises because officers and directors themselves benefit from the Plans they cause a company to establish without shareholder approval and oversight. The comment letters expressed concern over the removal of shareholder oversight and suggested that where officers and directors are allowed to participate in a Plan, the Plan should not be allowed to be considered ''broadly-based.'' [32]

The Exchange contends that ''broadly-based'' Plans have long been exempt from shareholder approval requirements. The Exchange explained that the ''broadly-based'' exemption originally was adopted requirements. The Exchange explained that the ''broadly-based'' exemption originally was adopted because the NYSE believed that any potential concerns regarding preferential treatment of officers or directors would be mitigated if a Plan was boardly available to a company's employees. The Exchange, however, did reiterate its plan to examine whether to continue to rely on the concept of ''broadly-based'' Plans as a basis for exemption from the shareholder approval requirement or whether to abandon that standard in a favor of a dilution test.

C. The Use of an ''Exempt'' Employee Test

Several commenters expressed concerns about the proposed eligibility standard in the proposed rule.[33] As discussed above, the eligibility standard provides that in determining if a Plan is ''broadly-based,'' the Exchange will look at the number of ''exempt'' employees eligible to participate in the Plan. The term ''exempt'' employee is based upon the definition found in the Fair Labor Standards Act of 1934.[34] The commenters believe that limiting the eligibility requirement to require only a majority of a company's full-time ''exempt'' employees could potentially exclude a majority of a company's workforce. Many of the commenters quoted Department of Labor statistics showing that only about 25 percent of the overall U.S. workforce is classified as ''exempt.'' [35] According to these figures, on average, only 12.5 percent of a company's workforce would need to be eligible to participate for a Plan to be considered ''broadly-based'' under the NYSE proposed rule—and thus avoid a shareholder vote.[36] Several of these commenters also expressed concern over excluding low level workers from eligibility because they believed the proposed rule change could be interpreted as a disincentive to grant non-exempt employees stock options, or conversely as an incentive to make stock options available only to a privileged few.[37] Finally, commenters asserted that the NYSE's rationale for excluding non-exempt employees because they are covered by other compensation arrangements is not correct.[38]

In response, the Exchange states that it continues to believe that limiting the proposal to ''exempt'' employees is appropriate. NYSE states that the Task Force, which included representatives of listed companies, leading investor groups, and institutional investors, unanimously proposed the ''exempt'' employee distinction. The Task Force believed that stock options are primarily used to compensate ''exempt'' employees. Moreover, the Task Force expressed its belief that non-exempt employees generally seek other forms of compensation or benefits, such as cash, medical benefits, or retirement packages. The NYSE notes that the Task Force was aware that some parties thought that limiting this prong of the test to ''exempt'' employees was too narrow. Despite these contentions, the Task Force unanimously accepted the ''exempt'' employee distinction.

The Task Force's recommendations were further reviewed and considered by the Exchange's Board. In approving the proposal, the Board accepted the Task Force's recommendation and also

[26] *See* letters from State of Wisconsin Investment Board; Lens Investment Management; Institutional Shareholder Services; Proxy Monitor; Cal PERS; Hermes Investment Investment Management; and CII–II.

[27] *See* letter from Institutional Shareholder Services.

[28] *See* letter from Lens Investment Management.

[29] *See, e.g.,* letters from Lens Investment Management stating that ''under no circumstances should the Exchange be permitted to bifurcate the rulemaking in this way'' and letter from Institutional Shareholder Services stating that ''the proposed listing standard, absent a meaningful ''dilution'' test, is fundamently flawed.'' *See also* letter from State of Wisconsin Investment Board; and CII–II.

[30] *See* letters from State of Wisconsin Investment Board; Barclays Global Investors; Sanford C. Bernstein; Maine State Retirement System; Marco Consulting Group; and Hermes Investment Management.

[31] *See* letters from Lens Investment Management; CII–I; Proxy Voter Services; Sanford C. Bernstein; NY State Teachers' Retirement System; Cal PERS; Teamsters; and Hermes Investment Management. *See also* letter from AFL–CIO, which was concerned about Plans that allow board member participation.

[32] *See* letter from Proxy Voter Services. *See also* letter from Cal PERS stating that ''to the extent those who participate in the decision to approve a plan also may personally benefit from it, and obvious conflict of interest exists.''

[33] *See* letters from Lens Investment Management; CII–I; Institutional Shareholder Services; Proxy Voter Services; AFL–CIO; Marco Consulting Group; and Teamsters.

[34] *See supra* note 14.

[35] *See* letter from CII–I; Institutional Shareholder Services; Proxy Voter Services; AFL–CIO; and Marco Consulting Group.

[36] For example, the AFL–CIO stated that the ''definition effectively assures that ''broadly-based' plans will not be truly 'broadly-based.' ''

[37] *See* letters from Proxy Voter Services; AFL–CIO; and Teamsters.

[38] *See* letters from Proxy Voter Services; and AFL–CIO. In their letter, Proxy Voter Services stated that ''a growing number of companies include grant options and other types of stock awards to 'non-exempt' employees as part of their total compensation packages.''

endorsed limiting the test to ''exempt'' employees. According to the NYSE, the Board expressed its concern that not limiting the test to ''exempt'' employees could result in companies structuring their compensation programs to offer non-exempt employees stock options instead of other benefits that may be preferred by those employees simply to comply with the Exchange's shareholder approval policy, and not because it was an appropriate compensation policy. The Board believed that management should establish compensation policies based on what management believes is best for its company.

D. Participation Test

One commenter supported the participation prong of the proposed rule change.[39] The commenter stated that, by requiring review of awards granted during the first three years of a Plan, the Exchange recognized the importance of implementing a Plan in a truly ''broadly-based'' fashion.

Three commenters argued that the participation prong of the ''broadly-based'' test does not sufficiently prevent companies from granting a majority of options awarded under a Plan to executives after the three-year time period.[40] These commenters pointed out that a company could reserve a majority of shares to be awarded under a Plan and grant them to officers and directors after the three-year time period had elapsed.[41] Moreover, a company could either grant no awards during the initial time period or only a nominal amount and then make the remaining grants to executives after the three-year time period expires. In either of these scenarios, the commenters noted, the company would be in compliance with the proposed rule although shareholders would not have been provided the opportunity to approve the awards to executives. To resolve this, one commenter recommended limiting Plans to three years.[42] Another commenter suggested changing the test so that a majority of the shares must be awarded to nonofficers and directors over the entire life of the Plan or over a rolling three-year period.[43]

The Exchange recognizes that the three-year test could, in theory, allow a company to administer a Plan in a non-broadly-based manner after the initial three years. The Exchange stated, however, that it anticipates that companies will act in good faith, and it has no reason to believe that companies will drastically change their compensation policies in the later years of a Plan.

According to the Exchange, the Task Force specifically considered this issue and determined that if a Plan is to be exempt from shareholder approval, it is critical not only to require a broad group of employee eligibility, but also to require that a company administer a Plan in a ''broadly-based'' manner. However, when considering how to best measure a company's administration of a Plan, the Task Force decided that a three-year period was realistic. The Exchange expressed the Task Force's concern that imposing a one-year test could result in companies structuring their Plans to comply with Exchange rules instead of promoting sound compensation policies. For these reasons, the NYSE determined that the Task Force recommendation was reasonable, recognizing that is was a package of compromises, and that the Exchange needed to consider this recommendation in the context of the full Task Force report. Moreover, the Exchange noted that this issue may well be moot if the Exchange later implements a dilution test.[44]

E. Disclosure

Seven commenters requested that the Commission require full disclosure to shareholders of all Plans implemented without shareholder approval.[45] One commenter observed that shareholders have diminished access to important information regarding issues that are not approved by shareholder votes.[46]

F. Other Issues [47]

Three commenters suggested that the Commission should decide the issues on which shareholders can vote because of the competition between exchanges is gaining listed companies.[48] One commenter suggested that a uniform standard be applied to all exchanges to safeguard shareholder interests in this area.[49] Finally, several commenters argued that all Plans should be subject to shareholder approval.[50]

One commenter supported the proposed rule change as an exclusive test, rather than a non-exclusive safe harbor as under the existing rule.[51] This commenter believed it should ensure shareholder protection and provide greater certainty to the process.

V. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[52] In particular, the Commission believes the proposal is consistent with the requirement of section 6(b)(5) of the Act.[53] Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between issuers.

The Commission has carefully considered the proposed rule change and believes the amended proposed rule change to be consistent with the requirements of the Act. In approving the proposal, the Commission recognizes that the majority of the

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[39] *See* letter from Investment Company Institute.

[40] *See* letters from Institutional Shareholder Services; Marco Consulting Group; and NY State Teachers' Retirement System.

[41] *See, e.g.,* letter from Marco Consulting Group, which stated that most stock option Plans last for 10 years.

[42] *See* letter from NY State Teachers' Retirement System.

[43] *See* letter from Institutional Shareholder Services.

[44] Plans approved under the rules approved today, however, will continue to be subject to the participation test. If a Plan is not administered in a ''broadly-based'' fashion during the first three years, shareholder approval will be required for any shares that the company later seeks to add to the Plan. The Exchange will review all listing applications seeking to add additional shares to any Plan approved under the rules approved today. Telephone call between Steven Walsh, NYSE, Michael Simon, Milbank, Tweed, Hadley & McCloy, and Kelly McCormick, SEC, on March 30, 1999.

[45] *See* letters from State of Wisconsin Investment Board; Lens Investment Management; CII–I; NY State Teachers' Retirement System; Cal PERS; Teamsters; and Hermes Investment Management; and CII–II.

[46] *See* letter from Teamsters.

[47] One comment letter, Sanford C. Bernstein, addressed concerns regarding key employee Plans (*i.e.,* non-broadly-based Plans that (a) provide that no single officer or director may acquire more than 1 percent of the issuer's common stock and (b) together with all non-broadly-based Plans of the issuer, do not authorize the issuance of more than 5 percent of the issuer's common stock at the time the Plan is adopted. The key employee exemptions were at issue in the Original Proposal and were not considered or amended in the current proposed rule change.

[48] *See* letters from CII–I; AFL–CIO and Cal PERS.

[49] *See* letter from Cal PERS, which argues that shareholder voting is a national issue and ''urges the Commission to take steps necessary to ensure that a uniform standard is applied to safeguard shareholders' interests in this area.'' *See also* letter from CII–II.

[50] *See* letters from State of Wisconsin Investment Board; Barclays Global Investors; Sanford C. Bernstein; Maine State Retirement System; Marco Consulting Group; and Hermes Investment Management. In addition, Lens Investment Management asserted that the Exchange had not adequately justified the exemption for ''broadly-based'' Plans.

[51] *See* letter from investment Company Institute.

[52] In reviewing this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[53] 15 U.S.C. 78f(b)(5).

commenters opposed the proposal and believed a dilution standard would be more appropriate. Nevertheless, the Commission believes that, by including a specific test to ensure that Plans are actually implemented in a ''broadly-based'' fashion, the proposed rule change is an improvement over the existing rule. Moreover, the proposed rule change amends the definition of ''broadly-based'' by making it an exclusive test instead of the current non-exclusive safe harbor. By providing issuers with an exclusive rule, all Plans reviewed by the Exchange will be subject to the same standards. This standardization of review should enable issuers to more easily comply with the Exchange's listing standards and prevent uneven application of the rule. Accordingly, this aspect of the proposed rule will help to ensure that, consistent with the Act, the rule is not designed to permit unfair discrimination among issuers.

The Commission is approving the rule change on a pilot basis until September 30, 2000 in order to give the NYSE time to develop a dilution test. Based on the task force's recommendations, the Exchange has established the Dilution Task Force to study the dilution issue and has stated that it currently expects to propose a dilution test to replace the revised ''broadly-based'' test by the year 2000 proxy season.[54] Accordingly, the Commission is satisfied, for the reasons discussed more fully below, that the proposed rule change should address concerns raised by commenters to the Original Proposal, while also satisfying the requirements of section 6(b)(5) of the Act.[55]

A. Conflict of Interest

A number of the commenters raised concerns about exempting from shareholder approval any Plan in which officers and directors can participate, because of the apparent conflict of interest. Upon careful review, however, the Commission is satisfied that this aspect of the proposed rule change is consistent with the requirements of section 6(b)(5) of the Act for the reasons discussed below.

NYSE current rules and proposed rules will continue to require shareholders to vote on Plans pursuant to which officers and directors may acquire stock unless a Plan meets one of four exemptions set forth in the NYSE Manual.[56] As noted by the Exchange, one of these exemptions, the ''broadly-based'' exemption, has been recognized by the Exchange for many years and was implemented because of the belief that Plans available to a broad group of employees would alleviate concerns that the Plan could give preferential treatment to officers and directors. The Commission believes that it is reasonable for the NYSE to determine that Plans that are ''broad-based'' should be eligible for the exemption even though officers and directors may participate in the Plan because Plans that are truly ''broadly-based'' should provide sufficient protection to shareholders from officer and director conflicts of interest and self-dealing.

While the NYSE could decide to eliminate the ''broadly-based'' exemption, the Act does not dictate how a self-regulatory organization should regulate in this area. Rather, the Commission must find that a self-regulatory organization's proposed rules are consistent with the Act before they can be adopted.[57] The Commission believes that the rationale behind the ''broadly-based'' exemption is sound and will protect investors from self-dealing by officers and directors, consistent with the requirements of section 6(b)(5) of the Act.

B. Definition of ''Broadly-Based''

The proposal defines a ''broadly-based'' Plan as one in which at least a majority of the issuer's full-time ''exempt'' employees are eligible to participate.[58] In contrast, the current definition provides that a Plan would be considered ''broadly-based'' if at least 20 percent of all of a company's employees are eligible to receive stock or options under a Plan and at least half of those eligible are neither officers nor directors. In other words, the proposal limits the eligibility prong of the test to ''exempt'' employees while the current rule does not. Some comment letters suggested that the proposal unfairly limits the number and classification of employees eligible to participate in a Plan. Several commenters also were critical of limiting the eligibility prong to ''exempt'' employees because this excludes a large part of the workforce and could result in companies not offering such Plans to low level workers.

Upon review, however, the Commission notes that the proposal is not a significant change from the current approved standards. The current rule requires that 20 percent of a company's workforce be eligible, but only requires that 10 percent of those eligible be non-officers and directors. The proposed rule change requires that at least half of an issuer's full-time ''exempt'' workforce be eligible to participate. A number of comment letters cited to Department of Labor statistics, which state that 25 percent of the U.S. workforce is exempt. If this number is correct, the majority of employees eligible to participate should be approximately 12.5 percent, on average, which could result in a slight increase in required eligibility over the current rule. Although it is difficult to precisely compare these two measures, on the whole, the number of eligible employees measured to determine if a Plan is ''broadly-based'' under the proposed rule change is not significantly different from the existing approved rule. Accordingly, limiting eligibility to ''exempt'' employees does not appear to significantly alter the number of employees currently being offered participation in a Plan.

Several factors also minimize concerns about the eligibility prong of the proposed test. First, the Commission notes that nothing in the NYSE rules prevents companies from offering a Plan to more than ''exempt'' employees. The eligibility prong is the minimum required for a Plan to be eligible for the ''broadly-based'' exemption. Second, companies currently offering Plans to all employees except officers and directors already are not required to submit these Plans to a shareholder vote. The Commission believes it is unlikely that companies will change these Plans to comply with the minimum requirements of the rules approved today. Finally, the Commission notes that certain companies may need to expand the base of employees eligible for a Plan in order to meet the participation prong of the ''broadly-based'' definition. Thus, the proposed change to the eligibility prong appears to include a reasonable number of employees eligible to participate in Plans which should help to protect investors, pursuant to section 6(b)(5) of the Act.

The participation prong of the ''broadly-based'' definition requires that at least a majority of the shares awarded under a Plan during the shorter of the three-year period commencing on the Plan adoption date or the term of the

[54] Because there may be slippage in its schedule, the Exchange is proposing to extend the pilot through the year 2000 proxy season.

[55] The Commission notes that under Section 19(b)(2) of the Act, the Commission must approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules thereunder. The Commission must disapprove a proposed rule change only if it does not make such a finding. The Commission's standard of review for the proposed rule changes of self-regulatory organizations is determined by, among other things, Section 6(b) of the Act.

[56] *See* NYSE Manual Paragraph 312.03.

[57] *See supra* note 55.

[58] *See supra* notes 14 and 15.

Plan be made to employees who are not officers or directors of the issuer. In contrast, the current rule does not have any requirements regarding actual awards or grants under a Plan. The Commission believes that this portion of the proposal should help to ensure that Plans are ''broadly-based.'' To comply with the participation prong of the test, companies will need to monitor the awards granted to officers and directors under ''broadly-based'' Plans to ensure that officers and directors are not the primary recipients of such awards. Participation under ''broadly-based'' Plans also will be monitored by the Exchange to ensure compliance with the Exchange rules.[59] This should provide protection to investors, consistent with section 6(b)(5) of the Act, by ensuring that companies do not take advantage of the exemption by merely allowing non-executives to be eligible for awards under Plans without actually granting them awards.

While the participation prong is an improvement over the current rule in that it requires that Plans actually be administered in a ''broadly-based'' manner, the Commission recognizes that, as proposed, the participation requirement will only apply for the first three years of a Plan (or the term of the Plan if it is shorter than three years). Accordingly, as some commenters argued, for Plans that are longer than three years, companies could nominally comply with the participation requirement by granting no, or a small amount of, awards during the first three years of the Plan to non-executives and reserve the majority of shares to be awarded to officers and directors after the three years have elapsed.

In response to these concerns, the NYSE stated that it recognized that ''in theory a company could administer a Plan in a non-broadly based manner.'' [60] Nevertheless, the NYSE stated that it expects companies to act in good faith and has no reason to believe that a company will drastically change its compensation policy in later years of a Plan. The Commission agrees with the NYSE but expects the NYSE to monitor whether companies are continuing to administer Plans in a ''broadly-based'' manner after the initial three-year period to determine if changes need to be made to the participation prong of the test. While the Commission recognizes that the NYSE is working on a dilution standard that may replace the ''broadly-based'' standard by the next proxy season, the NYSE should monitor and notify those companies that are subject to this rule if it believes that they are not complying with the spirit of the rule by delaying actual awards under a Plan until the three-year period has expired.

If the NYSE proposes to retain the participation prong of the ''broadly-based'' test long with a dilution standard, the Commission requests further information on actual awards made by issuers to comply with the participation prong. The NYSE also should address whether the development of a rolling three-year period would give companies the flexibility they need to make awards under Plans while at the same time ensuring that Plans are administered in a ''broadly-based'' manner or some other alternative to address the concerns discussed above. In approving the participation prong with the three-year limit, the Commission has considered the need to provide companies with flexibility in administering awards under the Plan. The Commission believes that the sixteenth-month pilot period, along with the NYSE's monitoring of Plans complying with the ''broadly-based'' exemption, should help to ensure that any necessary changes will be made to the rule if companies violate the spirit of the rule by offering a majority of shares to offices and directors after the three-year period has lapsed.

C. Dilution Standard and Pilot

The Exchange has committed to study a dilution standard for determining when shareholder approval is necessary for Plans. As noted above, a substantial majority of comments expressed concern about the potential dilution of shareholder's equity upon the grant of stock options under a Plan. These commenters were generally critical of the NYSE's decision to consider dilution at a later date. While some of these commenters believed that a dilution test should replace the ''broadly-based'' exemption immediately, other believed the definition of ''broadly-based'' Plans should only be adopted along with a dilution test.

While the majority of commenters believe that dilution is a preferable standard over the current proposal, the Commission's standards for reviewing the NYSE's proposal is whether it is consistent with the Act. For the reasons discussed above, the Commission believes that, until such time as a dilution standard is developed, the proposal is a reasonable effort to clarify which Plans are ''broadly-based'' and therefore except from shareholder approval. Accordingly, the adoption of he proposed rule for the pilot period should protect investors in accordance with section 6(b)(5) of the Act by helping to ensure that only ''broadly-based'' Plans will be exempted from shareholder approval. In making this finding, as noted above, the Commission does have some questions about how certain portions of the two prong test will be implemented. The pilot period should provide the NYSE with necessary time to monitor the changes approved today and to address these questions if the NYSE determines that the ''broadly-based'' test should continue to be applied together with a dilution standard.[61]

The pilot period also should provide the NYSE with the necessary time to formulate a dilution standard. We note that one commenter suggested a one-year pilot and another commenter was critical of the proposed sixth-month sunset provisions, suggesting that it would unduly delay the adoption of a dilution standard.

The Commission believes, however, that it is appropriate to approve the proposed rule so that it is effective until September 30, 2000. The NYSE has shown its commitment to be responsive to the comments on dilution by immediately establishing the Dilution Task Force to consider this issue. The NYSE represents that it intends to consider adopting a dilution standard to be place prior to he next proxy season in the year 2000. Because the Commission recognizes that matters involving shareholder voting rights are extremely important and involve a wide variety of interested parties, the Commission believes that adoption of the proposed rule change until September 30, 2000 will ensure that the NYSE is given adequate time to consider and implement and alternative to the proposal. Further this schedule would not prevent the NYSE from replacing the proposal being approved today with a dilution standard prior to the pilot's expiration, assuming Commission approval pursuant to section 19(b) of the Act.[62]

Finally, we note that several commenters stated that disclosure of Plans adopted without shareholder

[59] *See supra* note 44.

[60] *See* Amendment No. 2, *supra* note 7.

[61] We note that nay extension of the current proposal would have to be approved by the Commission pursuant to Section 19(b)(2) of the Act. Of course, as detailed above, NYSE has indicated its intention to submit a proposal, pursuant to Section 19(b)(2) of the Act, to replace or supplement the pilot with a dilution standard. *See infra* note 62.

[62] We note that the Commission would expeditiously publish for comment and review any proposal submitted by the NYSE to adopt a dilution standard so that such a standard could be put in place as soon as possible.

approval should be required. The Division of Corporation Finance is presently reviewing Commission rules requiring disclosure of executive and director compensation (Item 402 of Regulations S–K; Item 10 of Schedule 14A) and director and director nominee qualifications and relationships (Items 401 and 404 of Regulation S–K), with a view toward determining whether to recommend changes to the Commission. One of the issues to be examined is the extent to which additional disclosure should be provided in registrant filings about non-shareholder approved Plans.

D. Conclusion

In summary, the Commission believes that the current proposal helps to address some of the earlier concerns raised by the NYSE's Original Proposal for determining when a Plan including officers and directors is ''broadly-based'' enough to be exempt from the shareholder approval requirements. The Original Proposal merely intended to codify the NYSE's existing policy interpreting the ''broadly-based'' exemption, which it had used for many years. While the Original Proposal was submitted to a full notice and comment period, no comments were received on the rule prior to its approval. Nevertheless, after Commission approval of the NYSE's rule, several commenters, particularly those representing institutional investors, raised concerns over the Commission's approval process as well as the NYSE's role in developing its definition of a ''broadly-based'' Plan.

Both the NYSE and the Commission have taken these concerns seriously. While the Original Proposal provided the NYSE with more flexibility in determining when a Plan was ''broadly-based'' and entitled to the exemption, the current proposal has the benefit of providing a clear bright line test. This should provide benefits to both investors and issuers consistent with section 6(b)(5) of the Act.

The NYSE has indicated its strong commitment to develop a dilution standard that potentially could replace the current proposal by the next proxy season. The Commission requests that any proposal by the NYSE to adopt a dilution standard be submitted to the Commission by October 15, 1999. This should provide the Commission with sufficient time to review and solicit comment on the proposal prior to the beginning of the proxy season in 2000. If the NYSE is unable to submit a proposal by this date, the Exchange must submit a status report by October 15, 1999 on the NYSE's progress in developing a dilution standard.[63]

The Commission finds good cause to approve Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Exchange submitted Amendment No. 1 to clarify the use of the ''exempt'' employee definition in the eligibility prong of the test and not in the participation prong of the test. As discussed earlier, the Commission is satisfied that the use of ''exempt'' employees in determining the level of eligibility does not unfairly exclude a large number of employees. Because the amendment only serves to clarify and does not change the meaning or intent of the proposed rule, it does not raise any new regulatory issues. Therefore, the Commission believes good cause exists, consistent with section 6(b)(5) [64] and section 19(b) [65] of the Act, to approve Amendment No. 1 to the proposed rule change on an accelerated basis.

The Commission also finds good cause for approving Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Amendment No. 2 amends the proposal so that it would be effective for a pilot period until September 30, 2000. As discussed above, this pilot period seems reasonable and should provide the NYSE with adequate time to monitor the rule as well as provide the NYSE with time to develop a dilution test. Amendment No. 2 does not substantially change the meaning or intent of the proposed rule change. Because Amendment No. 2 further explains the Exchange's commitment regarding the development of a dilution test and raises no new issues or regulatory concern regarding the proposed rule change, the Commission believes that good cause exists, consistent with section 6(b)(5) [66] and section 19(b) [67] of the Act, to approve the amendment on an accelerated basis.

VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1 and 2, including whether they are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filings also will be available for inspection and copying at the principal office of the NYSE. All submissions should refer to File No. SR–NYSE–98–32 and should be submitted by July 2, 1999.

VII. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[68] that the amended proposed rule change (SR–NYSE–98–32) is approved on a pilot basis until September 30, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[69]

Margaret H. McFarland,

Deputy Secretary.

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[63] The Commission recognizes that the NYSE could decide, as some commenters suggested, to keep the ''broadly-based'' exemption in its rules and adopt a dilution standard as part of the test. Any request by the NYSE to change or extend the standard being adopted in this order must be submitted to the Commission no later than May 18, 2000 along with a monitoring report about the Plans utilizing the revised ''broadly-based'' exemption. Any new proposal containing the new definition approved today should also address the questions noted above about the three-year limit in the participation prong. Further, the monitoring report should include, at a minimum, information on the types and number of employees who are eligible to participate under a Plan, as well as information concerning actual awards being made under the Plans.

[64] 15 U.S.C. 78f(b)(5).

[65] 15 U.S.C. 78s(b).

[66] 15 U.S.C. 78f(b)(5).

[67] 15 U.S.C. 78s(b).

[68] 15 U.S.C. 78s(b)(2).

[69] 17 CFR 200.30–3(a)(12).