

Act<sup>8</sup> which requires, among other things, that the Association's rules to be designed to prevent fraudulent and manipulative acts and practices and, in general, to protect investors and the public interest. As noted above, Nasdaq's proposed rule change is aimed at improving the effectiveness of audit committees of Nasdaq Issuers, which is consistent with these goals. Accordingly, this proposal is properly within the discretion of the Association.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Written comments were neither solicited nor received.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate, up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 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 in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the File No. SR-NASD-99-48 and should be submitted by November 3, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-41980; File No. SR-NYSE-99-39]

#### **Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the New York Stock Exchange, Inc. Amending Audit Committee Requirements of Listed Companies**

October 6, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rules 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 22, 1999, the New York Stock Exchange, Inc. ("Exchange" or "NYSE") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange proposes to amend Paragraph 303 of its *Listed Company Manual* (the "Manual"). The rule change amends the Exchange's policy applicable to audit committee requirements of listed companies. The text of the proposed rule change is as follows.

#### **NYSE Listed Company Manual**

\* \* \* \* \*

<sup>9</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

### **Section 3**

#### **Corporate Responsibility**

[Section 303.00 is being replaced in its entirety with the following (except the parenthetical reference to outside directors)]

#### **303.00 Corporate Governance Standards**

In addition to the numerical listing standards, the Exchange has adopted certain corporate governance listing standards. These standards apply to all companies listing common stock on the Exchange. However, the Exchange does not apply a particular standard to a non-U.S. company if the company provides the Exchange with a written certification from independent counsel of the company's country of domicile stating that the company's corporate governance practices comply with home country law and the rules of the principal securities market for the company's stock outside the United States.

#### **303.01 Audit Committee**

(A) *Audit Committee Policy.* Each company must have a qualified audit committee.

(B) *Requirements for a Qualified Audit Committee.*

(1) *Formal Charter.* Each audit committee must adopt a formal written charter that is approved by the Board of Directors. The audit committee must review and reassess the adequacy of the audit committee charter on an annual basis. The charter must specify the following:

- (a) The scope of the audit committee's responsibilities and how it carries out those responsibilities, including structure, processes and membership requirements;
- (b) That the outside auditor for the company is ultimately accountable to the Board of Directors and audit committee of the company, that the audit committee and Board of Directors have the ultimate authority and responsibility to select, evaluate and, where appropriate, replace the outside auditor (or to nominate the outside auditor to be proposed for shareholder approval in any proxy statement); and
- (c) That the audit committee is responsible for ensuring that the outside auditor submits on a periodic basis to the audit committee a formal written statement delineating all relationships between the auditor and the company and that the audit committee is responsible for actively engaging in a dialogue with the outside auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the outside auditor and for recommending that the Board of Directors take appropriate action to ensure the independence of the outside auditor.

(2) *Composition/Expertise Requirement of Audit Committee Members.*

(a) Each audit committee shall consist of at least three directors, all of whom have no relationship to the company that may interfere with the exercise of their independence from management and the company ("Independent");

(b) Each member of the audit committee shall be financially literate, as such qualification is interpreted by the company's Board of Directors in its business judgment, or must become financially literate within a

<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

reasonable period of time after his or her appointment to the audit committee; and

(c) At least one member of the audit committee must have accounting or related financial management expertise, as the Board of Directors interprets such qualification in its business judgment.

(3) Independence Requirement of Audit Committee Members. In addition to the definition of Independent provided above in (2)(a), the following restrictions shall 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.

(b) Business Relationship. A director (i) who is a partner, controlling shareholder, or executive officer of an organization that has a business relationship with the company, or (ii) who has a direct business relationship with the company (e.g., a consultant) may serve on the audit committee only if the company'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 company, 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 (1) the relationship between the organization with which the director is affiliated and the company, (2) the relationship between the director and his or her partnership status, shareholder interest or executive officer position, or (3) 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. See para. 303.02 for definition of "Immediate Family."

### 303.02 Application of Standards

(A) "Immediate Family" includes a person's spouse, parents, children, siblings, mothers-in-law and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than employees) who shares person's home.

(B) "Affiliate" includes a subsidiary, sibling company, predecessor, parent company, or former parent company.

(C) Written Affirmation. As part of the initial listing process, and with respect to any subsequent changes to the composition of the audit committee, and otherwise approximately once each year, each company should provide the Exchange written confirmation regarding:

(1) Any determination that the company's Board of Directors has made regarding the independence of directors pursuant to any of the subparagraphs above;

(2) The financial literacy of the audit committee members;

(3) The determination that at least one of the audit committee members has accounting or related financial management expertise; and

(4) The annual review and reassessment of the adequacy of the audit committee charter.

(D) Independence Requirement of Audit Committee Members. Notwithstanding the requirements of subparagraphs (3)(a) and (3)(d) of para. 303.01, one director who is no longer an employee or who is an Immediate Family member of a former executive officer of the company or its affiliates, but is not considered independent pursuant to these provisions due to the three-year restriction period, may be appointed, under exceptional and limited circumstances, to the audit committee if the company's board of directors determines in its business judgment that membership on the committee by the individual is required by the best interests of the corporation and its shareholders, and the company discloses, in the next annual proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination.

### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

### A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

In September 1998, the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees ("BRC") was formed. The BRC solicited public comments on possible recommendations in November of the same year. The comment period expired December 1, 1998, and earlier this year the BRC compiled and published a report that contained ten specific recommendations ("Recommendations") to the Exchange, the National Association of Securities Dealers ("NASD"), the Commission, and the accounting profession.

The Exchange distributed to its listed companies copies of the report issued by the BRC. For several months, NYSE staff worked with listed companies and constituent committees on their comments and views on the Recommendations. Most of the issues raised during this working period addressed the four Recommendations made to the Commission and the accounting profession.

On June 3, 1998, the Exchange Board reviewed the suggested rule changes and authorized the Exchange staff to distribute to its listed companies the Exchange staff's suggestions for rule changes in response to the Recommendations. The comments from the Exchange's listed companies were generally supportive of the suggestions put forth by the Exchange, with limited concerns addressing the concept of "financial literacy." Furthermore, during that time period, the Exchange staff met with staff at the Commission and the NASD regarding uniformity among the markets in standards governing issuer audit committees.

As a result of comments from the issuers and conversations with staff at the Commission and the NASD, the Exchange slightly modified the proposed audit committee requirements and obtained Board approval on September 2, 1999 to file the proposed rule change with the Commission. The Exchange proposes to revise Paragraph 303 of the Manual. The proposed rule change specifies four requirements for a qualified audit committee and defines the terms "Immediate Family" and "Affiliate" for purposes of the proposed audit committee requirements.

#### • Audit Committee Requirements:

1. *Formal Charter:* The Exchange proposes to adopt the Recommendations to require audit committees to adopt a formal written charter that is approved

by the company's board and to review and reassess annually the adequacy of the charter. In addition, the charter must specify: (a) The scope of the audit committee's responsibilities and how they are being carried out, (b) the ultimate accountability of the outside auditor to the board and audit committee, (c) the responsibility of the audit committee and board for selection, evaluation and replacement of the outside auditor, and (d) the responsibility of the audit committee for ensuring the independence of the outside auditor by reviewing, and discussing with the board if necessary, any relationships between the auditor and the company or any other relationships that may adversely affect the independence of the auditor.

**2. Composition/Expertise Requirement of Audit Committee Members:** Three requirements suggested by the BRC, with one slight modification from the Recommendations as noted below, are part of the proposed rule change:

(a) Each audit committee must have at least three Independent directors, as described in item 3 below, subject to a board "override" for one director. The "override" may be exercised by the board in the event that it determines in its business judgment that a director who is no longer an Employee of the company or its affiliates, or who is an Immediate Family member of a former executive officer of the company or its affiliates, but is otherwise not eligible due to the three-year bar, should serve on the audit committee because such service is required in the best interests of the corporation and its shareholders. In exercising such discretion, the company would be required to disclose in its next annual proxy statement the nature of the relationship and the reasons for that determination. The Exchange notes that the BRC suggested that the "override" provision apply to all four restrictions regarding Independence; however, the Exchange proposes to limit it to the two instances referenced above, and to codify its existing interpretations and policies with respect to analysis of business relationships between organizations and directors. The Exchange further believes that the potential conflicts presented by the cross-compensation committee link are such that it should not be a subject of board override.

(b) Each audit committee member must be financially literate, as such qualification is interpreted by the company's board in its business judgment, or must shortly attain such status.

(c) At least one member of each audit committee must have accounting or related financial management expertise, as the company's board interprets such qualification in its business judgment.

**3. Independence:** In keeping with the spirit of the Recommendations, the following restrictions will apply to each audit committee member for the purpose of determining such member's Independence:

(a) **Employees.** Employees (including non-employee executive officers) of the company or its affiliates may not serve on the audit committee until three years following the termination of such employment. However, if such relationship is with a former parent or predecessor of the company (see definition of Affiliate described in item 4 below), the three-year bar applies to the time period following the severance of the relationship between the company and the former parent or predecessor.

(b) **Business Relationship.** A director (i) who is a partner, controlling shareholder, or executive officer of an organization that has a business relationship with the company, or (ii) who has a direct business relationship with the company (e.g., a consultant), may serve on the audit committee only if the company's board determines in its business judgment that the relationship does not interfere with the director's exercise of independent judgment. "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 determination after three years following the termination of, as applicable, either (1) the relationship between the organization with which the director is affiliated and the company, (2) the relationship between the director and his or her partnership status, shareholder interest or executive officer position, or (3) 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.

**4. Written Affirmation.** To monitor compliance with the proposed rule change, the Exchange proposes to incorporate an ongoing written affirmation requirement. In this regard, as part of the initial listing process, and with respect to any subsequent changes to the composition of the audit committee, and otherwise approximately once each year, each company should provide the Exchange written confirmation regarding:

(a) Any determination that the company's board has made regarding the independence of directors described above;

(b) The financial literacy of the audit committee members;

(c) The determination that at least one of the audit committee members has accounting or related financial management expertise; and

(d) The annual review and reassessment of the adequacy of the audit committee charter.

• **Definitions:** The Exchange proposes to codify two long-standing interpretations under the current audit committee requirements as follows:

1. "Immediate Family" includes a person's spouse, parents, children, siblings, mothers-in-law and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than employees) who shares such person's home.

2. "Affiliate" includes a subsidiary, sibling company, predecessor, parent company, or former parent company.

Finally, the Exchange proposes to implement a transition period in order to provide its issuers with sufficient time to come into compliance with the proposed rule change. Specifically, the Exchange proposes (1) to "grandfather" all public company audit committee members qualified under current NYSE rules until they are re-elected or replaced and (2) give companies that have less than three members on their audit committees eighteen months from the date of SEC approval of this rule filing to recruit the requisite members.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>3</sup> which requires, among other things, the Exchange's rules to be designed to prevent fraudulent and manipulative

<sup>3</sup> 15 U.S.C. 78f(b)(5).

acts and practices and, in general, to protect investors and the public interest.

*B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

*C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

The Exchange circulated the report issued by the BRC and the Exchange staff's proposed responses to it to its issuers. As a general matter, those responding agreed with the proposed rule change. The relevant comments were focused in three general areas. The primary issue raised was the element of "financial literacy," with a small proportion of responses suggesting that only a majority of members need be financially literate. In addition, issuers were concerned that the proposed concept of a "financial literacy" requirement for all audit committee members was not adequately defined and is potentially limiting with regard to the expertise of an audit committee member. Second, some issuers felt the definition of independence was too restrictive and that the board should be given more authority over the determination of the independence of a director. Finally, a number of companies thought the recommendations put forth by the BRC, which are substantially analogous to the proposed rule change, will not meaningfully help to prevent fundamental problems such as fraud and financial reporting failures. In addition to the foregoing, some companies thought the thrust of the Recommendations is to transfer some of the traditional responsibilities of the outside auditors to the board and audit committee, possibly increasing litigation exposure for issuers.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is 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 in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to the File No. SR-NYSE-99-39 and should be submitted by November 3, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>4</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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**SOCIAL SECURITY ADMINISTRATION**

**Privacy Act of 1974, as Amended; Computer Matching Program (SSA/Internal Revenue Service (IRS)—Match Number 1009)**

**AGENCY:** Social Security Administration (SSA).

**ACTION:** Notice of Computer Matching Program.

**SUMMARY:** In accordance with the provisions of the Privacy Act, as amended, this notice announces a computer matching program that SSA plans to conduct with IRS.

**DATES:** SSA will file a report of the subject matching program with the Committee on Governmental Affairs of the Senate; the Committee on Government Reform and Oversight of the House of Representatives; and the Office of Information and Regulatory

Affairs, Office of Management and Budget (OMB). The matching program will be effective as indicated below.

**ADDRESSES:** Interested parties may comment on this notice by either telefax to (410) 966-2935 or writing to the Associate Commissioner for Program Support, 4400 West High Rise Building, 6401 Security Boulevard, Baltimore, MD 21235. All comments received will be available for public inspection at this address.

**FOR FURTHER INFORMATION CONTACT:** The Associate Commissioner for Program Support as shown above.

**SUPPLEMENTARY INFORMATION:**

**A. General**

The Computer Matching and Privacy Protection Act of 1988 (Public Law (Pub. L.) 100-503), amended the Privacy Act (5 U.S.C. 552a) by establishing the conditions under which computer matching involving the Federal Government could be performed and adding certain protections for individuals applying for and receiving Federal benefits. Section 7201 of the Omnibus Budget Reconciliation Act of 1990 (Pub. L. 101-508) further amended the Privacy Act regarding protections for such individuals. The Privacy Act, as amended, regulates the use of computer matching by Federal agencies when records in a system of records are matched with other Federal, State, or local government records. It requires Federal agencies involved in computer matching programs to:

(1) Negotiate written agreements with the other agency or agencies participating in the matching programs;

(2) Obtain the Data Integrity Boards' approval of the match agreements;

(3) Furnish detailed reports about matching programs to Congress and OMB;

(4) Notify applicants and beneficiaries that their records are subject to matching; and

(5) Verify match findings before reducing, suspending, terminating or denying an individual's benefits or payments.

**B. SSA Computer Matches Subject to the Privacy Act**

We have taken action to ensure that all of SSA's computer matching programs comply with the requirements of the Privacy Act, as amended.

<sup>4</sup> 17 CFR 200.30-3(a)(12).