INFORMATION NOTE

Measures Undertaken and Proposals under Discussion to Enhance Corporate Governance of Listed Companies by Regulators of the United Kingdom and the United States of America

1. Background

1.1 On 20 March 2002, the Panel on Financial Affairs (the Panel) requested the Research and Library Services Division (RLSD) to conduct a research on "measures undertaken and proposals under discussion by regulators of overseas jurisdictions" so as to facilitate the Panel to discuss the "enhancement of regulation on listed companies and corporate governance of companies".[1] RLSD has selected the United Kingdom (UK) and the United States of America (US) in this study because both countries have a leading global financial centre (i.e. London and New York) and their experiences may be relevant to Members of the Panel in deliberating this subject.

2. The United Kingdom

Financial Services Authority: the regulator of the London Stock Exchange

2.1 In the UK, under Part VI of the Financial Services and Markets Act (FSMA), the Financial Services Authority[2] (FSA) acts as the regulator of the London Stock Exchange.[3] In particular, FSA should be responsible for:

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1 Related information can be found in the Information Note entitled *Principles of Corporate Governance in Some Overseas Places* published by RLSD on 6 March 2003, IN15/02-03.

2 Under FSMA, FSA is the UK's main financial regulator, and performs the following nine functions: (a) authorizing financial firms which satisfy the necessary conditions (including honesty, competence and financial soundness) by granting permission to carry on regulated activities; (b) setting prudential standards for financial firms; (c) supervising financial firms; (d) overseeing the integrity of investment markets and exchanges; (e) enforcing FSMA for protecting consumers of financial products and services; (f) reducing financial crime; (g) participating in international activities; (h) promoting public understanding of the financial system; and (i) dealing with consumer complaints and compensation.

3 After the enactment of FSMA on 1 May 2000, FSA has undertaken the role of regulating the London Stock Exchange.

(a) admitting securities to listing

— FSA considers applications for listing by examining and approving prospectuses and listing particulars. FSA must be satisfied that an issuer[4] has met all the relevant conditions for listing as set out in the Listing Rules[5] before the company can be listed. However, FSA does not investigate or verify the accuracy or completeness of the information in the submitted documents, nor does it check the sources. The directors of an issuer have the primary responsibility for the accuracy and completeness of these documents.

(b) regulating sponsors

— FSA approves sponsors who are advisers providing certain services to issuers. FSA pledges to ensure that the sponsors have met all relevant requirements of the Listing Rule.

(c) imposing and enforcing ongoing obligations on issuers

— FSA promotes accurate and timely disclosure to the market of all relevant information through the continuing obligations set out in the Listing Rules and referred to in the Guidance Manual[6], and a voluntary code known as the Combined Code[7] setting out the principles of good corporate governance[8]. (The Combined Code is provided in Appendix I.) Additionally, FSA does not investigate or verify the accuracy or completeness of the information given, but it reserves the right to require additional information.

— Under FSMA, FSA is empowered to enforce the Listing Rules. These include the power to impose penalties on issuers for breaches of the Listing Rules and the power to impose penalties on the directors of an issuer who are knowingly involved in a breach of the Listing Rules.

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4 An issuer refers to a company offering (or having already offered) securities for sale to investors.

5 The listing rules are made by FSA for the purposes of Part VI of FSMA and they are published in the book "the Listing Rules", which is amended from time to time.

6 The Guidance Manual has been issued to help users understand the application of the Listing Rules.

7 The Combined Code is attached to the Listing Rules.

8 In the UK, a commonly used definition of corporate governance provided by Sir Cadbury is: "*corporate governance concerns with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society*."

(d) suspending and cancelling listing

— FSA may suspend and cancel the listing of securities if there is not enough information available to ensure an orderly market in the securities. The suspension protects investors from trading without access to full and complete information about the company. FSA may cancel a company's securities if there are special circumstances which prevent normal dealings in them.

2.2 In applying the Listing Rules and carrying out the general functions specified in paragraph 2.1, FSA must have regard to the following principles in accordance with section 73(1) of FSMA:

(a) the need to use its resources in the most efficient and economic way;

(b) the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits, considered in general terms, which are expected to arise from the imposition of that burden or restriction;

(c) the desirability of facilitating innovation in respect of listed securities;

(d) the international character of capital markets and the desirability of maintaining the competitive position of the UK;

(e) the need to minimize the adverse effects on competition of anything done in the discharge of those functions; and

(f) the desirability of facilitating competition in relation to listed securities.

2.3 When carrying out the general functions, FSA considers the following aims:

(a) to provide issuers with ready access to the listed market for their securities while protecting investors;

(b) to promote investors' confidence in the standards of disclosure, the conduct of issuers' affairs and the market as a whole by the listing rules, in particular, the continuing-obligations regime;

(c) to ensure that listed securities are brought to the market in a way that is appropriate to their nature and number, and facilitates an open and efficient market for trading in those listed securities;

(d) to ensure that an issuer makes full and timely disclosure about itself and its listed securities, at the time of listing and subsequently; and

(e) to ensure that holders of listed equity securities are given adequate opportunity to consider in advance and vote upon major changes in the company's business operations and matters of importance concerning the company's management and constitution.

Measures undertaken to enhance corporate governance of listed companies

2.4 To improve the standards of corporate governance of listed companies, FSA has published the Combined Code, which has been incorporated into the Listing Rules, setting out the principles of good governance and the code of best practice.

2.5 The Combined Code consists of 14 principles, each of which is supported by a total of 45 detailed code provisions. These provisions are listed separately as the code of best practice. (Please see Appendix II for the discussion of emergence and evolution of corporate governance in the UK during the 1990s.)

2.6 Section 1 of the Combined Code contains the corporate governance principles and code provisions applicable to all listed companies. Section 1 mainly covers the following areas:

(a) directors' responsibilities and composition of the board;

(b) levels and make-up of directors' remuneration;

(c) dialogue with institutional shareholders;

(d) constructive use of the annual general meeting; and

(e) accountability and audit function.

2.7 Section 2 contains principles and code provisions applicable to institutional shareholders with regard to their voting, dialogue with companies and evaluation of a company's governance arrangements.

2.8 It is noteworthy that although the Combined Code is not mandatory, a listed company is required to report on corporate governance and explain areas of non-compliance. Under the Listing Rule 12.43A(a) and (b), the listed company is required to include in its annual report and accounts:

(a) a statement of how the listed company has applied the principles set out in Section 1 of the Combined Code, providing sufficient explanation to enable its shareholders to evaluate properly how the principles have been applied.

(b) a statement as to whether or not the listed company has complied throughout the accounting period with the provisions set out in Section 1 of the Combined Code. A listed company, that has not complied with the Code provisions, or complied with only some of the Code provisions or (in the case of provisions whose requirements are of a continuing nature) complied for only part of an accounting period, must specify the Code provisions with which it has not complied, and (where relevant) for what part of the period such non-compliance continued, and give reasons for any non-compliance.

2.9 The Combined Code also calls upon directors of listed companies to conduct, at least annually, a review of the effectiveness of their system of internal controls. Traditionally, the auditor's role has been limited to the review of internal financial controls. The requirement to expand this review to operational and compliance controls and risk management represents a significant change and challenge. As such, the Turnbull Committee was established by the Institute of Chartered Accounts of England and Wales in February 1999 to provide guidance to help companies implement the new requirements.

2.10 The Turnbull Committee published *Internal Control Guidance for Directors on the Combined Code* (the Turnbull report) in September 1999. The objective of the Turnbull report is to provide guidance for directors of listed companies on the implementation of the internal control recommendations set out in the Combined Code. In particular, the report seeks to provide guidance which can be adopted when applying principle D.2[9] of the Combined Code and determining the extent of compliance with the Code provisions D.2.1[10] and D.2.2[11].

2.11 The Turnbull report indicates that a listed company's internal control should:

(a) be embedded within its operations and not be treated as a separate exercise;

(b) be able to respond to changing risks within and outside the company; and

(c) enable the company to apply it in an appropriate manner related to its key risks.

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9 Principle D.2: The Board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

10 Provision D.2.1: The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all controls, including financial, operational, and compliance controls and risk management.

11 Provision D.2.2: Companies which do not have an internal audit function should from time to time review the need for one.

2.12 The report requires companies to evaluate and manage their significant risks and to assess the effectiveness of the related internal control system. Boards of directors are called on to review regularly reports on the effectiveness of the system of internal control in managing key risks, and to undertake an annual assessment for the purpose of making their statements on internal control in the annual report.

Proposals under discussion to enhance corporate governance of listed companies

2.13 FSA is currently undertaking a major review[12] of its Listing Rules in the wake of the incidents of Enron and Worldcom and the demand for high standards of corporate governance and business integrity. The main objective of the review is to ensure that FSA continues to provide a cost-effective regime which facilitates access to capital markets by a broad range of businesses, and to operate that regime so as to maintain market confidence and to protect investors. FSA discharges this role by setting, monitoring and enforcing the Listing Rules.

2.14 FSA published a *Discussion Paper 14: Review of the Listing Regime* in July 2002 to stimulate discussion and solicit views. In the Discussion Paper, FSA spells out that there are five key themes which may deserve further policy development: corporate governance; corporate communication; shareholders' rights and obligations; financial information; and the sponsor regime.

2.15 Under each of the themes, FSA mentions some of the key issues that it intends to consider and what the potential effect of the proposed regulatory changes may be. As FSA develops its policy work in the subsequent consultation papers, it will need to consider, under each individual theme, whether high-level principles or more prescriptive rules provide the most appropriate method of ensuring the protection and clarity demanded by the market.

Discussion on the issues relating to the theme of corporate governance

2.16 Regarding corporate governance, FSA states that corporate governance standards have moved to the centre stage following the collapse of Enron. FSA has been considering the role of the listing regime in setting and applying standards of corporate governance for listed companies.

[12] The review is being carried out by a number of teams comprising FSA staff and market participants overseen by a consultative committee representing stakeholders in the London market.

2.17 According to FSA, its role in setting standards for corporate governance is currently limited. The Listing Rules require the directors and senior management of listed companies to have appropriate expertise and experience to manage their business, but FSA is not empowered to approve the directors of listed companies.[13] Presently, the Articles of a listed company give the company power to make and confirm the appointment of directors at its general meetings.

2.18 There are concerns about the assessment of an issuer's management and its governance arrangements prior to flotation. The Department of Trade and Industry proposed the formulation of a Code of Conduct in relation to flotations and new shares issues in 2001. However, this proposal was met with opposition from a number of leading accountancy firms and was not implemented. FSA would consider this issue in more detail.

2.19 The UK government, in response to the Company Law Review[14], suggests that the Combined Code should remain a non-statutory document. Nonetheless, it also states that it intends to designate a standards board or a similarly designated body to make rules requiring companies to disclose whether they have complied with the Code.

2.20 At present, the Listing Rules do not provide any guidance on how to deal with the conflicts of interest that can arise when directors serve on several different boards and where the demands for such responsibilities can affect their ability to act in the best interests of the companies concerned. Nor do they lay down a limit on the number of directorships that a director can hold in other companies, be they independent or subsidiaries. Therefore, FSA plans to review whether the Listing Rules should provide guidance in this area to avoid such problems occurring in the future. This will also give FSA the opportunity to review the disclosure requirements for such investment entities.

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[13] The appointments of directors and senior management of banks, insurance companies and investment companies are subject to FSA's approval.

[14] The UK government published a White Paper in July 2002, responding to the final report of the Steering Group of the Company Law Review. The White Paper states that the government plans to simplify and modernise company law for all companies. The provisions of the new Companies Bill will also have an impact on the work FSA is undertaking, as there are some areas of overlap between company laws and the Listing Rules, including corporate governance standards, directors' remuneration and financial information disclosure.

Feedback on proposals relating to the theme of corporate governance

2.21 In January 2003, FSA published a separate Discussion Paper entitled *Review of the Listing Regime: Feedback on Discussion Paper 14* which summarised comments on the themes discussed in the Discussion Paper 14 and FSA's responses. According to FSA, the respondents support the Combined Code, considering that it provides an appropriate framework to promote a high level of corporate governance. Respondents generally favour the Combined Code continuing to be non-statutory and to maintain flexibility. In particular, they consider that the "comply or explain" approach required by Rules 12.43A(a) and (b) encourages compliance with the Combined Code, and is therefore valuable.

2.22 FSA responds that it:

(a) agrees that the Combined Code helps strengthen corporate governance.

(b) will work with the government to decide whether there should be a standards board enforcing the "comply or explain" requirement.

Proposed timetable for the review

2.23 FSA intends to publish further consultation papers to consider issues mentioned in *Review of the Listing Regime: Feedback on Discussion Paper 14* and other issues in more detail. These papers are currently scheduled to be published in summer 2003 and spring 2004 respectively. The review is due to be completed by June 2004.

3. The United States of America

Securities and Exchange Commission: the regulator of the stock exchanges

3.1 The Securities and Exchange Commission (SEC) was created by enacting the Securities Exchange Act of 1934 as the authority regulating the securities industry of the US. Under the Securities Exchange Act of 1934, SEC is empowered to:

(a) regulate the country's stock exchanges[15], which include the major exchanges locating in New York City: the New York Stock Exchange[16] (NYSE), the National Association of Securities Dealers Automated Quotation System[17] (NASDAQ) and the American Stock Exchange[18] (AMEX); and other smaller regional exchanges[19] ; and

(b) register, regulate and oversee brokerage firms, transfer agents[20] and clearing agencies.

3.2 In regard to the regulation of the stock exchanges, SEC is responsible for:

(a) reviewing and approving the listing standards of individual stock exchanges

— SEC establishes and maintains a fair, orderly and efficient market by reviewing and approving the listing standards of individual stock exchanges.

(b) protecting investors through information disclosure

— SEC oversees corporate disclosure of important information[21] to the investing public. Corporations are required to comply with regulations pertaining to disclosure that must be made when their stocks are initially sold and then on a continuing and periodic basis. The staff of SEC routinely reviews the disclosure documents filed by companies and provides companies with assistance in interpreting the SEC's rules.

(c) administering securities laws

— SEC administers the securities laws affecting investment companies (including mutual funds) and investment advisers. In applying the federal securities laws to this industry, SEC works to improve disclosure and minimize risk for investors without imposing undue costs on regulated entities.

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15 There are 10 stock exchanges in the US, and they are self-regulatory organizations.

16 NYSE is the world's largest stock exchange in terms of market capitalization and trading volume.

17 NASDAQ is the world's first electronic stock market. It is a screen-based market where transactions are done through a sophisticated computer and telecommunications network.

18 AMEX is the US's second largest floor-based exchange after NYSE. It has a significant presence in common stocks, index shares and equity derivative securities.

19 These regional exchanges are located in Boston, Philadelphia, Cincinnati, Chicago, San Francisco and Los Angeles.

20 Transfer agents refer to parties who maintain records of stock and bond owners.

21 The information includes registration statements for newly-offered securities; annual and quarterly filings; proxy materials sent to shareholders before an annual meeting; annual reports to shareholders; documents concerning tender offers (a tender offer is an offer to buy a large number of shares of a corporation, usually at a premium above the current market price) and filings related to mergers and acquisitions.

(d) enforcing investigations of possible violations

— It is crucial for SEC to have enforcement authority to investigate possible violations of the securities laws. Although SEC has civil enforcement authority only, it works closely with various criminal law enforcement agencies throughout the country to develop and bring forward criminal cases when the misconduct warrants more severe action.

Functions and listing standards of the stock exchanges

3.3 SEC is the ultimate regulator of the securities industry in the US whereas the stock exchanges perform the following major functions:

(a) approving listing application of companies;

(b) de-listing companies from the exchanges when listing standards are violated; and

(c) developing rules and regulations to govern the listed companies' business activities.

3.4 The stock exchanges have their own set of listing standards to:

(a) provide guidelines and procedures for companies applying for listing on the respective exchange; and

(b) set out the circumstances for suspending or de-listing companies from the stock exchange's lists.

3.5 Although, in practice, the listing standards of the stock exchanges generally bear many similarities, the stock exchanges may have a few of their listing standards different in order to attract certain types and sizes of companies. In the cases of NYSE, NASDAQ and AMEX, the major differences of the listing standards promulgated by them are:

(a) companies listed on NYSE should have a market capitalization of at least US$60 million; and

(b) companies listed on NASDAQ and AMEX should have a minimum market capitalization of US$50 million.

3.6 When a company fails to abide by the array of conditions spelled out in the listing standards of a stock exchange, it is exposed to the risk of being de-listed from the respective exchange. Listed below are the primary conditions when the de-listing of a company will be considered by individual stock exchanges:

(a) A NYSE-listed company would run the risk of being de-listed when its average global market capitalization over a consecutive 30 trading-day period of the company is less than US$50 million and total stockholders' equity is less than US$50 million;

(b) A NASDAQ-listed company is required to maintain a minimum bid price of US$1 per share. Failure of compliance is subject to the consideration of removal from the list of NASDAQ; and

(c) An AMEX-listed company would be removed if its stockholders' equity is less than US$2 million and the company has sustained losses from continuing operations and/or net losses in two of its three most recent fiscal years.

Measures undertaken to enhance corporate governance of listed companies

3.7 In 1998, NYSE and NASDAQ sponsored the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (the "Blue Ribbon Committee") to study the effectiveness of audit committees. In its 1999 report, the Blue Ribbon Committee recognized the importance of audit committees and issued 10 recommendations to improve their effectiveness. In response to these recommendations, NYSE and the NASDAQ, among others, revised their listing standards relating to audit committees.

3.8 In light of several high-profile corporate failures in the first half of 2002[22], SEC requested NYSE and NASDAQ to review their corporate governance[23] standards and proposed changes to their rules to provide more demanding standards for listed companies. At the same time, Congress passed and the President signed into law on 30 July 2002, the Sarbanes-Oxley Act of 2002 (the Act), with the aim of regaining public confidence towards the securities market.

3.9 The Act mandates sweeping corporate disclosure and financial reporting reform among the stock exchanges in the US to improve the responsibility of public companies for their financial disclosures.

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[22] Examples included the collapse of Enron and the bankruptcies of major telecommunications companies, including Global Crossing and WorldCom.

[23] Corporate governance refers to the practices of companies in maintaining appropriate standards of corporate responsibility, integrity and accountability to shareholders.

3.10 The Act contains 11 titles with 69 sections, and signals the most intense scrutiny of corporate behaviour affecting the securities market since the enactment of the Securities Exchange Act of 1934. The requirements of the Act apply not only to US listed companies, but also to investment companies and all foreign companies that have securities publicly traded in a national securities exchange. The key themes of the Act are as follows:

(a) setting corporate governance standards for directors and executive officers.

— The Act requires two separate certification of the Chief Executive Officer (CEO)/Chief Financial Officer (CFO). In the first certification, the CEO and CFO must certify in writing as to each periodic report containing financial statements filed with SEC that:

(i) the report complies with the applicable reporting requirements of the Securities Exchange Act of 1934; and

(ii) the information contained in the report fairly presents, in all material respects, the financial conditions and results of operations of the reporting company.

— In the second certification, the CEO and CFO must state in each annual and quarterly report filed with SEC that:

(i) the officer has reviewed the report;

(ii) the report does not contain an untrue statement of material fact or omit to state a material fact so that the statements made are not misleading;

(iii) the CEO/CFO have established internal controls adequate to insure that material information relating to the companies covered by the report is made known to them;

(iv) they have disclosed to the company's independent auditor and audit committee all significant deficiencies in the design and implementation of the controls; and

(v) whether or not there have been any significant changes in internal controls or corrective actions taken with regard to significant deficiencies or material weaknesses in controls.

(b) establishing public company accounting oversight board

— A portion of the Act is taken up with the establishment of an SEC-supervised non-governmental Public Company Accounting Oversight Board (PCAOB). PCAOB has the authority to conduct investigations and disciplinary proceedings and to impose sanctions[24] on registered public accounting firms and their employees.

(c) formulating auditor independence standards

— The Act specifically prohibits registered public accounting firms from providing audit clients with non-auditing services including:

(i) financial information systems design and implementation;

(ii) appraisal or valuation services, fairness opinions;

(iii) actuarial services;

(iv) internal audit outsourcing services;

(v) management of human resources functions;

(vi) investment banking services; and

(vii) legal services.

(d) creating new standards for corporate responsibility

— The Act amends Section 10A of the Securities Exchange Act of 1934, adding a provision relating to corporate audit committee standards. The new provision:

(i) makes the audit committee responsible for the appointment, compensation and oversight of the work of any registered public accounting firm employed by the issuer;

(ii) requires that each member of the audit committee be a member of the Board of Directors of the issuer or otherwise independent; and

[24] The power of sanction of the Public Company Accounting Oversight Board includes the right to suspend the registration of firms or the participation of individuals in a registered firm.

(iii) requires each audit committee to establish procedures for the receipt, retention and treatment of complaints received by the issuer concerning accounting, internal accounting controls or auditing matters as well as the confidential anonymous submission by employees concerning questionable accounting or auditing matters.

(e) enhancing financial disclosure

— SEC is required to adopt rules addressing the following concerns:

(i) disclosure of all material off balance sheet transactions and relationships that may have a material effect on the financial condition of the issuer; and

(ii) the presentation of pro forma financial information in a manner that is not misleading, and is reconcilable with the financial condition of the issuer under generally accepted accounting principles (GAAP).

— Issuers are obliged to disclose their code of ethics for senior financial officers, and if they do not have one, the reason for not doing so. SEC is also mandated to come up with rules by 1 November 2002, requiring issuers to disclose whether or not they have at least one financial expert on their audit committee, and if not, the reason for not having one.

(f) requiring disclosure of analysts' conflicts of interest

— SEC has the responsibility for adopting rules designed to address conflicts of interest that may arise when securities analysts recommend equity securities in research reports and public appearances.

(g) ordering further studies and reports

— Congress has ordered the Comptroller General[25] to conduct a study to identify the factors that have led to the consolidation of public accounting firms and the impact on the capital formation and the securities market.

[25] The Comptroller General is the head of the General Accounting Office, which is the audit, evaluation, and investigative arm of Congress.

(h) penalties increasing and enforcement

— The Act imposes fines or imprisonment of a maximum of 20 years, or both, for whoever knowingly alters, destroys, mutilates or conceals a record, document or other object with the intent to impair the object's integrity or availability for use in an official proceeding. There is also statutory protection against employers taking discriminatory action against "whistleblowers" who follow the provisions of the Act.

— SEC is granted the authority to petition the courts for an escrow of extraordinary payments that may be made to any director, officer, employee, partner, controlling person or agent during the course of an investigation involving potential violations of federal securities laws.

— A CEO or CFO found to have knowingly certified non-complying financial statements can be fined up to US$1 million and/or imprisoned for 10 years. For wilful violations of the Act, the penalties can be up to US$5 million or imprisonment of not more than 20 years.

Proposals under discussion to enhance corporate governance of listed companies

3.11 With a view to enhancing the corporate governance standards to comply with the Act, the three leading stock exchanges have proposed changes to their listing standards. These proposed changes are fairly similar to each other, and their core considerations cover the following issues:

(a) establishment of standards for independent directors

— The board should comprise a majority of (or at least three) independent directors. It is mandated to gain the approval of independent directors regarding CEO compensation and director nominations. For a director to be deemed independent, it is necessary for the board to determine that the director has no material relationship with the company. The determination includes a "cooling off" period (five years for NYSE-listed companies, three years for NASDAQ-listed companies and AMEX-listed companies) for all non-independent directors before they can be considered independent.

(b) specification of audit committee composition and functions

— All members of the audit committee must be financially literate at the time of appointment. Audit committees must have the sole responsibility for hiring and firing the company's independent auditors and for approving any significant non-audit work by the auditors. Moreover, audit committees are granted the authority and funding to engage independent counsel.

(c) requirement of listed companies to adopt a code of conduct and maintain an internal audit function

— It is necessary for listed companies to adopt and publish a code of business conduct and ethics and disclose any waivers for directors and executive officers. Besides, listed companies have the obligation to maintain an internal audit function.

(d) requirement of director continuing education

— Both NYSE and NASDAQ require directors to receive continuing education. NYSE urges for every listed company to establish an orientation programme for new board members. In addition, NYSE also calls for the establishment of a Directors Institute that would offer continuing education forums across the US for both current and newly-elected directors.

(e) consequences of violation of proposed governance standards

— Upon finding a violation of a corporate governance standard, both NYSE and AMEX will issue a letter to warn the listed company of the non-compliance and NYSE would consider a de-listing if necessary.

3.12 At the same time, there are also some differences in the corporate governance standards proposed by the three stock exchanges, which are summarized as follows:

(a) Requirement of CEO certification

— NYSE is proposing that each listed company's CEO is accountable for certifying annually that he or she is not aware of any violation by the company of NYSE corporate-governance standards. The CEO needs to further certify that he or she has reviewed with the board those procedures and the company's compliance with them. Although NASDAQ and AMEX do not have similar requirement, NASDAQ states that material misrepresentation or omission by an issuer to the stock exchange may form the basis for de-listing.

(b) restrictions of financial benefits of officers and directors

— NYSE requires that audit committee members can only get director's fees as the sole remuneration from the listed company. As for NASDAQ, it states the prohibition of giving loans to officers and directors.

(c) establishment of independent relationships between auditors and their clients

— NYSE proposes the prohibition of relationships between auditors and their clients that would affect the fairness and objectivity of audits.

Proposed timetable for implementing the recommendations

3.13 There is no exact date for implementing the new standards as the effective date is subject to SEC's approval. Upon the approval of SEC, the new standards will be implemented in stages.

4. Overall Comparison

4.1 The following table compares the measures undertaken and proposals under discussion to enhance corporate governance of listed companies in the UK and the US.

Table - Comparison of the Measures Undertaken and Proposals under Discussion to Enhance Corporate Governance of Listed Companies in the United Kingdom and the United States of America

	The United Kingdom	**The United States of America**
Regulatory Environment		
Regulator of stock exchanges	• The Financial Services Authority (FSA)	• The Securities and Exchange Commission (SEC)
Major functions of the regulator	• Admitting securities to listing; • Regulating sponsors; • Imposing and enforcing obligations on issuers; and • Suspending and cancelling listing.	• Reviewing and approving the listing standards of stock exchanges; • Regulating sponsors; • Imposing and enforcing obligations on issuers; and • Protecting investors through information disclosure.
Roles of the stock exchanges	• Serving as a market place for trading.	• Approving listing application of companies; • De-listing of companies from the exchanges when listing standards are violated; and • Developing rules and regulations to govern the listed companies' business activities.

Table - Comparison of the Measures Undertaken and Proposals under Discussion to Enhance Corporate Governance of Listed Companies in the United Kingdom and the United States of America (cont'd)

	The United Kingdom	The United States of America
Measures Undertaken to Enhance Corporate Governance of Listed Companies		
Measures undertaken	• By incorporating the Combined Code (the Code) into the Listing Rules.	• After reviewing the listing standards of the stock exchanges, the Sarbanes-Oxley Act of 2002 (the Act) was enacted.
Major issues under the principles of corporate governance	• Directors' responsibilities and the composition of the board; • Levels and make-up of directors' remuneration; • Dialogue with institutional shareholders; • Constructive use of the annual general meeting; and • Accountability and audit function.	• Governance standards for directors and executive officers; • Auditor independence standards; • Corporate responsibility standards; • Enhanced financial disclosure; and • Penalties and enforcement.
Reporting system	• The Code is not mandatory, however, listed companies are required to report on corporate governance and explain areas of non-compliance in their annual report and accounts.	• The CEO and CFO are required to certify with respect to each annual or quarterly report of the issuer to SEC.
Penal provisions	• FSA may suspend and cancel the listing of securities if a listed company has not met the requirements of the Listing Rules.	• A CEO or CFO found to have knowingly certified non-complying financial statements can be fined up to US$1 million and/or imprisoned for 10 years; and • For wilful violations of the Act, penalties can be up to US$5 million or imprisonment of not more than 20 years.

Table - Comparison of the Measures Undertaken and Proposals under Discussion to Enhance Corporate Governance of Listed Companies in the United Kingdom and the United States of America (cont'd)

	The United Kingdom	The United States of America
Proposals under Discussion to Enhance Corporate Governance of Listed Companies		
Review undertaken	• FSA is currently undertaking a major review of its Listing Rules.	• SEC is reviewing the proposed changes on corporate governance standards submitted by the stock exchanges.
Major issues raised regarding corporate governance	• Approval of directors of listed companies by FSA; • Assessment of an issuer's management and its governance arrangements prior to flotation; • Designation of a standards board to make rules requiring companies to disclose whether they have complied with the Code; and • Plans for providing guidance on how to deal with conflicts of interest of directors who serve on several boards.	• Establishment of standards for independent directors; • Specification of audit committee composition and functions; • Requirement of listed companies to adopt a code of conduct and maintain an internal audit function; • Requirement of director continuing education; • Consequences of violation of proposed governance standards; • Requirement of CEO certification; • Restrictions of financial benefits of officers and directors; and • Establishment of independent relationships between auditors and their clients.
Proposed timetable for the review/ implementation	• FSA intends to publish further consultation papers in summer 2003 and spring 2004; and • The review is due to be completed by June 2004.	• No exact date for implementing the new standards as the effective date is subject to SEC's approval.

Appendix I

The Combined Code

Principles of Good Governance and Code of Best Practice

Derived by the Committee on Corporate Governance from the Committee's Final Report and from the Cadbury and Greenbury Reports.

Part 1 - Principles of Good Governance

Section 1 - Companies

A. Directors

The Board

1. Every listed company should be headed by an effective board which should lead and control the company.

Chairman and Chief Executive Officer

2. There are two key tasks at the top of every public company — the running of the board and the executive responsibility for the running of the company's business. There should be a clear division of responsibilities at the head of the company which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.

Board Balance

3. The board should include a balance of executive and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision making.

Supply of Information

4. The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

Appointments to the Board

5. There should be a formal and transparent procedure for the appointment of new directors to the board.

Appendix I (cont'd)

Re-election

6. All directors should be required to submit themselves for re-election at regular intervals and at least every three years.

B. Directors' Remuneration

The Level and Make-up of Remuneration

1. Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose. A proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

Procedure

2. Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

3. Disclosure

The company's annual report should contain a statement of remuneration policy and details of the remuneration of each director.

C. Relations with Shareholders

Dialogue with Institutional Shareholders

1. Companies should be ready, where practicable, to enter into a dialogue with institutional shareholders based on the mutual understanding of objectives.

Constructive Use of the Annual General Meeting

2. Boards should use the Annual General Meeting (AGM) to communicate with private investors and encourage their participation.

D. Accountability and Audit

Financial Reporting

1. The board should present a balanced and understandable assessment of the company's position and prospects.

Appendix I (cont'd)

Internal Control

2. The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

Audit Committee and Auditors

3. The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Section 2 - Institutional Shareholders

E. Institutional Investors

Shareholder Voting

1. Institutional shareholders have a responsibility to make considered use of their votes.

Dialogue with Companies

2. Institutional shareholders should be ready, where practicable, to enter into a dialogue with companies based on the mutual understanding of objectives.

Evaluation of Governance Disclosures

3. When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional investors should give due weight to all relevant factors drawn to their attention.

Appendix I (cont'd)

Part 2 - Code of Best Practice

Section 1 - Companies

A. Directors

A.1 The Board

Principle Every listed company should be headed by an effective board which should lead and control the company.

Code Provisions

A.1.1 The board should meet regularly.

A.1.2 The board should have a formal schedule of matters specifically reserved to it for decision.

A.1.3 There should be a procedure agreed by the board for directors in the furtherance of their duties to take independent professional advice if necessary, at the company's expense.

A.1.4 All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are followed and that applicable rules and regulations are complied with. Any question of the removal of the company secretary should be a matter for the board as a whole.

A.1.5 All directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments and standards of conduct.

A.1.6 Every director should receive appropriate training on the first occasion that he or she is appointed to the board of a listed company, and subsequently as necessary.

A.2 Chairman and CEO

Principle There are two key tasks at the top of every public company - the running of the board and the executive responsibility for the running of the company's business. There should be a clear division of responsibilities at the head of the company which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.

Appendix I (cont'd)

Code Provision

A.2.1 A decision to combine the posts of chairman and chief executive officer in one person should be publicly justified. Whether the posts are held by different people or by the same person, there should be a strong and independent non-executive element on the board, with a recognised senior member other than the chairman to whom concerns can be conveyed. The chairman, chief executive and senior independent director should be identified in the annual report.

A.3 Board Balance

Principle The board should include a balance of executive and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision taking.

Code Provisions

A.3.1 The board should include non-executive directors of sufficient calibre and number for their views to carry significant weight in the board's decisions. Non-executive directors should comprise not less than one third of the board.

A.3.2 The majority of non-executive directors should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Non-executive directors considered by the board to be independent in this sense should be identified in the annual report.

A.4 Supply of Information

Principle The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

Code Provision

A.4.1 Management has an obligation to provide the board with appropriate and timely information, but information volunteered by management is unlikely to be enough in all circumstances and directors should make further enquiries where necessary. The chairman should ensure that all directors are properly briefed on issues arising at board meetings.

A.5 Appointments to the Board

Principle There should be a formal and transparent procedure for the appointment of new directors to the board.

Appendix I (cont'd)

Code Provision

A.5.1 Unless the board is small, a nomination committee should be established to make recommendations to the board on all new board appointments. A majority of the members of this committee should be non-executive directors, and the chairman should be either the chairman of the board or a non-executive director. The chairman and members of the nomination committee should be identified in the annual report.

A.6 Re-election

Principle All directors should be required to submit themselves for re-election at regular intervals and at least every three years.

Code Provisions

A.6.1 Non-executive directors should be appointed for specified terms subject to re-election and to Companies Act provisions relating to the removal of a director, and reappointment should not be automatic.

A.6.2 All directors should be subject to election by shareholders at the first opportunity after their appointment, and to re-election thereafter at intervals of no more than three years. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details to enable shareholders to take an informed decision on their election.

B. Directors' Remuneration

B.1 The Level and Make-up of Remuneration

Principle Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose. A proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

Code Provisions

Remuneration policy

B.1.1 The remuneration committee should provide the packages needed to attract, retain and motivate executive directors of the quality required but should avoid paying more than is necessary for this purpose.

Appendix I (cont'd)

B.1.2 Remuneration committees should judge where to position their company relative to other companies. They should be aware what comparable companies are paying and should take account of relative performance. But they should use such comparisons with caution, in view of the risk that they can result in an upward ratchet of remuneration levels with no corresponding improvement in performance.

B.1.3 Remuneration committees should be sensitive to the wider scene, including pay and employment conditions elsewhere in the group, especially when determining annual salary increases.

B.1.4 The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels.

B.1.5 Executive share options should not be offered at a discount save as permitted by paragraphs 13.30 and 13.31 of the Listing Rules.

B.1.6 In designing schemes of performance related remuneration, remuneration committees should follow the provisions in Schedule A to this code.

Service Contracts and Compensation

B.1.7 There is a strong case for setting notice or contract periods at, or reducing them to, one year or less. Boards should set this as an objective; but they should recognise that it may not be possible to achieve it immediately.

B.1.8 If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should be reduced after the initial period.

B.1.9 Remuneration committees should consider what compensation commitments (including pension contributions) their directors' contracts of service, if any, would entail in the event of early termination. They should, in particular, consider the advantages of providing explicitly in the initial contract for such compensation commitments except in the case of removal for misconduct.

B.1.10 Where the initial contract does not explicitly provide for compensation commitments, remuneration committees should, within legal constraints, tailor their approach in individual early termination cases to the wide variety of circumstances. The broad aim should be to avoid rewarding poor performance while dealing fairly with cases where departure is not due to poor performance and to take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.

Appendix I (cont'd)

B.2 Procedure

Principle Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Code Provisions

B.2.1 To avoid potential conflicts of interest, boards of directors should set up remuneration committees of independent non-executive directors to make recommendations to the board, within agreed terms of reference, on the company's framework of executive remuneration and its cost; and to determine on their behalf specific remuneration packages for each of the executive directors, including pension rights and any compensation payments.

B.2.2 Remuneration committees should consist exclusively of non-executive directors who are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.

B.2.3 The members of the remuneration committee should be listed each year in the board's remuneration report to shareholders (B.3.1 below).

B.2.4 The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors, including members of the remuneration committee, within the limits set in the Articles of Association. Where permitted by the Articles, the board may, however, delegate this responsibility to a small sub-committee, which might include the chief executive officer.

B.2.5 Remuneration committees should consult the chairman and/or chief executive officer about their proposals relating to the remuneration of other executive directors and have access to professional advice inside and outside the company.

B.2.6 The chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration in the same way as for other matters.

B.3 Disclosure

Principle The company's annual report should contain a statement of remuneration policy and details of the remuneration of each director.

Appendix I (cont'd)

Code Provisions

B.3.1 The board should report to the shareholders each year on remuneration. The report should form part of, or be annexed to, the company's annual report and accounts. It should be the main vehicle through which the company reports to shareholders on directors' remuneration.

B.3.2 The report should set out the company's policy on executive directors' remuneration. It should draw attention to factors specific to the company.

B.3.3 In preparing the remuneration report, the board should follow the provisions in Schedule B to this code.

B.3.4 Shareholders should be invited specifically to approve all new long term incentive schemes (as defined in the Listing Rules) save in the circumstances permitted by paragraph 13.13A of the Listing Rules.

B.3.5 The board's annual remuneration report to shareholders need not be a standard item of agenda for AGMs. But the board should consider each year whether the circumstances are such that the AGM should be invited to approve the policy set out in the report and should minute their conclusions.

C. Relations with Shareholders

C.1 Dialogue with Institutional Shareholders

Principle Companies should be ready, where practicable, to enter into a dialogue with institutional shareholders based on the mutual understanding of objectives.

C.2 Constructive Use of the AGM

Principle Boards should use the AGM to communicate with private investors and encourage their participation.

Code Provisions

C.2.1 Companies should count all proxy votes and, except where a poll is called, should indicate the level of proxies lodged on each resolution, and the balance for and against the resolution, after it has been dealt with on a show of hands.

C.2.2 Companies should propose a separate resolution at the AGM on each substantially separate issue, and should, in particular, propose a resolution at the AGM relating to the report and accounts.

Appendix I (cont'd)

C.2.3 The chairman of the board should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM.

C.2.4 Companies should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

D. Accountability and Audit

D.1 Financial Reporting

Principle The board should present a balanced and understandable assessment of the company's position and prospects.

Code Provisions

D.1.1 The directors should explain their responsibility for preparing the accounts, and there should be a statement by the auditors about their reporting responsibilities.

D.1.2 The board's responsibility to present a balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

D.1.3 The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

D.2 Internal Control

Principle The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

Code Provisions

D.2.1 The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control and should report to shareholders that they have done so. The review should cover all controls, including financial, operational and compliance controls and risk management.

D.2.2 Companies which do not have an internal audit function should from time to time review the need for one.

Appendix I (cont'd)

D.3 Audit Committee and Auditors

Principle The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Code Provisions

D.3.1 The board should establish an audit committee of at least three directors, all non-executive, with written terms of reference which deal clearly with its authority and duties. The members of the committee, a majority of whom should be independent non-executive directors, should be named in the report and accounts.

D.3.2 The duties of the audit committee should include keeping under review the scope and results of the audit and its cost effectiveness and the independence and objectivity of the auditors. Where the auditors also supply a substantial volume of non-audit services to the company, the committee should keep the nature and extent of such services under review, seeking to balance the maintenance of objectivity and value for money.

Section 2 - Institutional Shareholders

E. Institutional Investors

E.1 Shareholder Voting

Principle Institutional shareholders have a responsibility to make considered use of their votes.

Code Provisions

E.1.1 Institutional shareholders should endeavour to eliminate unnecessary variations in the criteria which each applies to the corporate governance arrangements and performance of the companies in which they invest.

E.1.2 Institutional shareholders should, on request, make available to their clients information on the proportion of resolutions on which votes were cast and non-discretionary proxies lodged.

E.1.3 Institutional shareholders should take steps to ensure that their voting intentions are being translated into practice.

Appendix I (cont'd)

E.2 Dialogue with Companies

Principle Institutional shareholders should be ready, where practicable, to enter into a dialogue with companies based on the mutual understanding of objectives.

E.3 Evaluation of Governance Disclosures

Principle When evaluating companies' governance arrangements, particularly those relating to board structure and composition, institutional investors should give due weight to all relevant factors drawn to their attention.

Schedule A: Provisions on the Design of Performance Related Remuneration.

1. Remuneration committees should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to enhance the business. Upper limits should always be considered. There may be a case for part payment in shares to be held for a significant period.

2. Remuneration committees should consider whether the directors should be eligible for benefits under long-term incentive schemes. Traditional share option schemes should be weighed against other kinds of long-term incentive scheme. In normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in under three years. Directors should be encouraged to hold their shares for a further period after vesting or exercise, subject to the need to finance any costs of acquisition and associated tax liability.

3. Any new long term incentive schemes which are proposed should be approved by shareholders and should preferably replace existing schemes or at least form part of a well considered overall plan, incorporating existing schemes. The total rewards potentially available should not be excessive.

4. Payouts or grants under all incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria reflecting the company's objectives. Consideration should be given to criteria which reflect the company's performance relative to a group of comparator companies in some key variables such as total shareholder return.

5. Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block.

6. Remuneration committees should consider the pension consequences and associated costs to the company of basic salary increases and other changes in remuneration, especially for directors close to retirement.

7. In general, neither annual bonuses nor benefits in kind should be pensionable.

Appendix I (cont'd)

Schedule B: Provisions on what should be Included in the Remuneration Report.

1. The report should include full details of all elements in the remuneration package of each individual director by name, such as basic salary, benefits in kind, annual bonuses and long term incentive schemes including share options.

2. Information on share options, including SAYE options, should be given for each director in accordance with the recommendations of the Accounting Standards Board's Urgent Issues Task Force Abstract 10 and its successors.

3. If grants under executive share option or other long-term incentive schemes are awarded in one large block rather than phased, the report should explain and justify.

4. Also included in the report should be pension entitlements earned by each individual director during the year, disclosed on one of the alternative bases recommended by the Faculty of Actuaries and the Institute of Actuaries and included in the UK Listing Authority's Listing Rules. Companies may wish to make clear that the transfer value represents a liability of the company, not a sum paid or due to the individual.

5. If annual bonuses or benefits in kind are pensionable, the report should explain and justify.

6. The amounts received by, and commitments made to, each director under 1, 2 and 4 above should be subject to audit.

7. Any service contracts which provide for, or imply, notice periods in excess of one year (or any provisions for predetermined compensation on termination which exceed one year's salary and benefits) should be disclosed and the reasons for the longer notice periods explained.

Appendix II

The Emergence and Evolution of Corporate Governance in the United Kingdom during the 1990s

I. In the United Kingdom (UK), the concern of corporate governance during the 1990s focused on the roles of directors and the standards expected of them. The establishment of the Committee on the Financial Aspects of Corporate Governance (commonly known as the Cadbury Committee) was the first major review of corporate governance practices in the UK.

II. In December 1992, the Cadbury Committee published a set of codes which provided a pragmatic approach to corporate governance.[26] In 1995, the Greenbury Study Group on Directors' Remuneration provided further guidance, together with the 1992 codes, on the issue of board remuneration.[27] In 1998, the Hampel Committee on Corporate Governance adopted and refined both the Cadbury and Greenbury codes.[28]

III. In addition to this review, the remit of the committee included a further review of the roles of directors, shareholders and auditors in corporate governance. The findings of the Hampel Report resulted in the issue, by the London Stock Exchange, of the Combined Code.

IV. With the implementation of the Combined Code, a working party was set up by the Institute of Chartered Accountants in England and Wales to provide further guidance on section D2 of the Code — the requirement of internal control procedures. The final report (also known as the Turnbull Report) was released in September 1999.

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[26] The report laid out a code of best practice, which discussed the merits of strengthening the legal responsibilities and duties of directors, the audit function and the relationships between the board, the company's auditors and shareholders.

[27] This report addressed the pay packages at privatized utilities, which were perceived as excessive.

[28] This committee was established as a result of the recommendations of Cadbury and Greenbury Committees that a new committee should review the implementations of their findings. The remit was to ensure that the original purpose of the previous committee recommendations was being achieved. In addition, the committee was to look afresh at the roles of directors, shareholders and auditors in corporate governance.

Appendix III

NYSE

Listed Company Manual

Last Modified: 12/20/1999

Section 3 Corporate Responsibility

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-US company if the company provides the Exchange with 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.

Appendix III (cont'd)

NYSE Listed Company Manual

Last Modified: 12/20/1999

303.00 Corporate Governance Standards

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. The Board of Directors must adopt and approve a formal written charter for the audit committee. 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 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 in response to the outside auditors' report to satisfy itself of the outside auditors' independence.

Appendix III (cont'd)

(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 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 that 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.

Appendix III (cont'd)

"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.

(Since 1956 the Exchange has required all domestic companies listing on the Exchange to have at least two outside directors on their boards.)

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