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Charles Mierzwa,  
Clearance Officer.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49955; File No. SR-BSE-2004-23]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Boston Stock Exchange, Inc. to Amend Chapter XXVII, Section 10 of the Rules of the Board of Governors By Adding Requirements Concerning Corporate Governance Standards of Exchange-Listed Companies

July 1, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 4, 2004, the Boston Stock Exchange, Inc. ("BSE" or "Exchange") 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 BSE. On June 30, 2004, the BSE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis.

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

The BSE proposes to amend Chapter XXVII, Listed Securities, Section 10, Corporate Governance, of the Rules of the Board of Governors of the Boston

Stock Exchange ("BSE Rules") by adding requirements relating to the corporate governance of Exchange-listed companies. The text of the proposed rule filing is set forth below. Additions are in italics; deletions are in brackets.

\* \* \* \* \*

#### Chapter XXVII—Listed Securities—Requirements

Sec. 1-9. no change  
Sec. 10. Corporate Governance

A. no change

[B. (Reserved for Future Rules Relating to Corporate Governance Standards)]

##### B.1. Definitions

(a) For purposes of this Section 10.B., unless the context requires otherwise:

(1) "Family Member" means a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.

(2) "Independent director" means a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship, which, in the opinion of the company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The following persons shall not be considered independent:

(A) a director who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company;

(B) a director who accepted or who has a Family Member who accepted any payments from the company or any parent or subsidiary of the company in excess of \$60,000 during the current or any of the past three fiscal years, other than the following:

(i) compensation for board or board committee service;

(ii) payments arising solely from investments in the company's securities;

(iii) compensation paid to a Family Member who is a non-executive employee of the company or a parent or subsidiary of the company;

(iv) benefits under a tax-qualified retirement plan, or non-discretionary compensation; or

(v) loans permitted under Section 13(k) of the Act. Provided, however, that audit committee members are subject to additional, more stringent requirements under paragraph 2(c) of this Section 10.B.

(C) a director who is a Family Member of an individual who is, or at any time during the past three years was, employed by the company or by any

parent or subsidiary of the company as an executive officer;

(D) a director who is, or has a Family Member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000 (\$1 million if the listed company is also listed on the New York Stock Exchange), whichever is more, other than the following:

(i) payments arising solely from investments in the company's securities; or

(ii) payments under non-discretionary charitable contribution matching programs.

(E) a director of the listed company who is, or has a Family Member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the listed company serve on the compensation committee of such other entity; or

(F) a director who is, or has a Family Member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during any of the past three years.

(G) In the case of an investment company, in lieu of paragraphs (A)-(F), a director who is an "interested person" of the company as defined in section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee.

#### Interpretive Material

It is important for investors to have confidence that individuals serving as independent directors do not have a relationship with the listed company that would impair their independence. The board has a responsibility to make an affirmative determination that no such relationships exist through the application of Section 10.B.1. Section 10.B.1. also provides a list of certain relationships that preclude a board finding of independence. These objective measures provide transparency to investors and companies, facilitate uniform application of the rules, and ease administration. Because the Exchange does not believe that ownership of company stock by itself would preclude a board finding of independence, it is not included in the aforementioned objective factors. It should be noted that

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

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

<sup>3</sup> See Letter from John Boese, Vice President, Legal and Compliance, BSE, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated June 30, 2004 ("Amendment No. 1"). Amendment No. 1 was a technical amendment and is not subject to notice and comment.

there are additional, more stringent requirements that apply to directors serving on audit committees, as specified in Section 10.B.2 (c).

The rule's reference to a "parent or subsidiary" is intended to cover entities the issuer controls and consolidates with the issuer's financial statements as filed with the U.S. Securities and Exchange Commission (but not if the issuer reflects such entity solely as an investment in its financial statements). The reference to executive officer means those officers covered in Rule 16a-1(f) under the Act. In the context of the definition of Family Member under Section 10.B.1(a)(1), the reference to marriage is intended to capture relationships specified in the rule (parents, children and siblings) that arise as a result of marriage, such as "in-law" relationships.

The three year look-back periods referenced in paragraphs (A), (C), (E) and (F) of the rule commence on the date the relationship ceases. For example, a director employed by the company is not independent until three years after such employment terminates.

Paragraph (B) of the rule is generally intended to capture situations where a payment is made directly to (or for the benefit of) the director or a family member of the director. For example, consulting or personal service contracts with a director or family member of the director or political contributions to the campaign of a director or a family member of the director would be considered under paragraph (B) of the rule.

Paragraph (D) of the rule is generally intended to capture payments to an entity with which the director or Family Member of the director is affiliated by serving as a partner, controlling shareholder or executive officer of such entity. Under exceptional circumstances, such as where a director has direct, significant business holdings, it may be appropriate to apply the corporate measurements in paragraph (D), rather than the individual measurements of paragraph (B). Issuers should contact the Exchange if they wish to apply the rule in this manner. The reference to a partner in paragraph (D) is not intended to include limited partners. It should be noted that the independence requirements of paragraph (D) of the rule are broader than Rule 10A-3(e)(8) under the Act.

Under paragraph (D), a director who is, or who has a Family Member who is, an executive officer of a charitable organization may not be considered independent if the company makes payments to the charity in excess of the greater of the greater of 5% of the

charity's revenues or \$200,000.

However, the Exchange encourages companies to consider other situations where a director or their Family Member and the company each have a relationship with the same charity when assessing director independence.

For purposes of determining whether a lawyer is eligible to serve on an audit committee, Rule 10A-3 under the Act generally provides that any partner in a law firm that receives payments from the issuer is ineligible to serve on that issuer's audit committee. In determining whether a director may be considered independent for purposes other than the audit committee, payments to a law firm would generally be considered under Section 10.B.1(a)(2)(D), which looks to whether the payment exceeds the greater of 5% of the recipients gross revenues or \$200,000; however, if the firm is a sole proprietorship, Section 10.B.1(a)(2)(B), which looks to whether the payment exceeds \$60,000, applies.

Paragraph (G) of the rule provides a different measurement for independence for investment companies in order to harmonize with the Investment Company Act of 1940. In particular, in lieu of paragraphs (A)-(F), a director who is an "interested person" of the company as defined in section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee, would not be considered to be independent.

## 2. Qualitative Listing Requirements for all Exchange Listed Securities.

The Exchange shall review the issuer's past corporate governance activities. This review may include activities taking place while the issuer is listed on the Exchange or an exchange that imposes corporate governance requirements, as well as activities taking place after a formerly listed issuer is no longer listed on the BSE or an exchange that imposes corporate governance requirements. Based on such review, the BSE may take any appropriate action, including placing of restrictions on or additional requirements for listing, or the denial of listing of a security if the Exchange determines that there have been violations or evasions of such corporate governance standards. Such determinations shall be made on a case-by-case basis as necessary to protect investors and the public interest.

### (a) Applicability.

(1) Foreign Private Issuers. The Exchange shall have the ability to provide exemptions from this Section 10.B. to a foreign private issuer when provisions of this Section are contrary to a law, rule or regulation of any public authority exercising jurisdiction over

such issuer or contrary to generally accepted business practices in the issuer's country of domicile, except to the extent that such exemptions would be contrary to the federal securities laws, including without limitation those rules required by Section 10A(m) of the Act and Rule 10A-3 thereunder. A foreign issuer that receives an exemption under this subsection shall disclose in its annual reports filed with the Commission each requirement from which it is exempted and describe the home country practice, if any, followed by the issuer in lieu of such requirements. In addition, a foreign issuer making its initial public offering or first U.S. listing on the BSE shall disclose any such exemptions in its registration statement.

(2) Management Investment Companies. Management investment companies (including business development companies) are subject to all the requirements of this Section 10.B., except that management investment companies registered under the Investment Company Act of 1940 are exempt from the requirements of Section 10.B.2. (b) and (f).

(3) Asset-backed Issuers and Other Passive Issuers. The following are exempt from the requirements of Section 10.B.2(b), (c) and (f): (a) asset-backed issuers; and (b) issuers, such as unit investment trusts, that are organized as trusts or other unincorporated associations that do not have a board of directors or persons acting in a similar capacity and whose activities are limited to passively owning or holding (as well as administering and distributing amounts in respect of) securities, rights, collateral or other assets on behalf of or for the benefit of the holders of the listed securities.

(4) Cooperatives. Cooperative entities, such as agricultural cooperatives, that are structured to comply with relevant state law and federal tax law and that do not have a publicly traded class of common stock are exempt from Section 10. B. 2 (b). However, such entities must comply with all federal securities laws, including without limitation those rules required by Section 10A(m) of the Act and Rule 10A-3 thereunder.

(5) Effective Dates/Transition. In order to allow companies to make necessary adjustments in the course of their regular annual meeting schedule, and consistent with Exchange Act Rule 10A-3, the requirements of this Section 10.B. are effective as set out in this subsection. During the transition period between the date of Commission approval of this Section 10.B and the effective date of Section 10.B.,

companies that have not brought themselves into compliance with Section 10.B. must continue to comply with Section 10.A.

The provisions of Section 10.B.1 and Section 10.B.2(b), (c) and (e) regarding director independence, independent committees, and notification of noncompliance shall be implemented by the following dates:

July 31, 2005 for foreign private issuers and small business issuers (as defined in Rule 12b-2); and

For all other listed issuers, by the earlier of: (1) the listed issuer's first annual shareholders meeting after July 31, 2004; or (2) October 31, 2004.

In the case of an issuer with a staggered board, with the exception of the audit committee requirements, the issuer shall have until their second annual meeting after January 15, 2004, but not later than December 31, 2005, to implement all new requirements relating to board composition, if the issuer would be required to change a director who would not normally stand for election at an earlier annual meeting. Such issuers shall comply with the audit committee requirements pursuant to the implementation schedule bulleted above.

Issuers that have listed or shall be listed in conjunction with their initial public offering shall be afforded exemptions from all board composition requirements consistent with the exemptions afforded in Rule 10A-3(b)(1)(iv)(A) under the Act. That is, for each committee that the company adopts, the company shall have one independent member at the time of listing, a majority of independent members within 90 days of listing and all independent members within one year.

It should be noted, however, that investment companies are not afforded these exemptions under Rule 10A-3. Issuers may choose not to adopt a compensation or nomination committee and may instead rely upon a majority of the independent directors to discharge responsibilities under the rules. These issuers shall be required to meet the majority independent board requirement within one year of listing.

Companies transferring from other markets with a substantially similar requirement shall be afforded the balance of any grace period afforded by the other market. Companies transferring from other listed markets that do not have a substantially similar requirement shall be afforded one year from the date of listing on the Exchange. This transition period is not intended to supplant any applicable requirements of Rule 10A-3 under the Act.

The limitations on corporate governance exemptions to foreign private issuers shall be effective July 31, 2005. However, the requirement that a foreign issuer disclose the receipt of a corporate governance exemption from the Exchange shall be effective for new listings and filings made after July 31, 2004.

Section 10.B.2(f), requiring issuers to adopt a code of conduct, shall be effective July 31, 2004.

Section 10.B.2(d), requiring audit committee approval of related party transactions, shall be effective July 31, 2004.

The remainder of Section 10.B.2(a) is effective July 31, 2004.

#### (b) Independent Directors

(1) A majority of the board of directors must be comprised of independent directors as defined in this Section 10 (subject to the exception set forth in paragraph (g) with respect to small business issuers). The company must disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) those directors that the board of directors has determined to be independent. If an issuer fails to comply with this requirement due to one vacancy, or one director ceases to be independent due to circumstances beyond their reasonable control, the issuer shall regain compliance with the requirement by the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on this provision shall provide notice to the Exchange immediately upon learning of the event or circumstance that caused the non-compliance.

(2) Independent directors must have regularly scheduled meetings at which only independent directors are present ("executive sessions").

#### (3) Compensation of Officers.

(A) Compensation of the chief executive officer of the company must be determined, or recommended to the Board for determination, either by:

(i) a majority of the independent directors, or

(ii) a compensation committee comprised solely of independent directors.

The chief executive officer may not be present during voting or deliberations.

(B) Compensation of all other executive officers must be determined, or recommended to the Board for determination, either by:

(i) a majority of the independent directors, or

(ii) a compensation committee comprised solely of independent directors.

(C) Notwithstanding paragraphs (3)(A)(ii) and (3)(B)(ii) above, if the compensation committee is comprised of at least three members, one director who is not independent and is not a current officer or employee or a Family Member of an officer or employee, may be appointed to the compensation committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the proxy statement for the next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years.

#### (4) Nomination of Directors.

(A) Director nominees must either be selected, or recommended for the Board's selection, either by:

(i) a majority of the independent directors, or

(ii) a nominations committee comprised solely of independent directors.

(B) Each issuer must certify that it has adopted a formal written charter or board resolution, as applicable, addressing the nominations process and such related matters as may be required under the federal securities laws.

(C) Notwithstanding paragraph (4)(A)(ii) above, if the nominations committee is comprised of at least three members, one director, who is not independent and is not a current officer or employee or a Family Member of an officer or employee, may be appointed to the nominations committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the proxy statement for next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years.

(D) Independent director oversight of director nominations shall not apply in cases where the right to nominate a director legally belongs to a third party. However, this does not relieve a company's obligation to comply with

the committee composition requirements under Section 10.B.2 (b) and (c).

(E) This Section 10.B.2 (b)(4) is not applicable to a company if the company is subject to a binding obligation that requires a director nomination structure inconsistent with this rule and such obligation pre-dates the approval date of this rule.

(5) A Controlled Company is exempt from the requirements of this Section 10.B.2 (b), except for the requirements of subsection (b)(2) which pertain to executive sessions of independent directors. A Controlled Company is a company of which more than 50% of the voting power is held by an individual, a group or another company. A Controlled Company relying upon this exemption must disclose in its annual meeting proxy statement (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) that it is a Controlled Company and the basis for that determination.

#### (c) Audit Committee

##### (1) Audit Committee Charter

Each issuer must certify that it has adopted a formal written audit committee charter and that the audit committee has reviewed and reassessed the adequacy of the formal written charter on an annual basis. The charter must specify:

(A) the scope of the audit committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements;

(B) the audit committee's responsibility for ensuring its receipt from the outside auditors of a formal written statement delineating all relationships between the auditor and the company, consistent with Independence Standards Board Standard 1, and the audit committee's responsibility for actively engaging in a dialogue with the auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor and for taking, or recommending that the full board take, appropriate action to oversee the independence of the outside auditor; and

(C) the committee's purpose of overseeing the accounting and financial reporting processes of the issuer and the audits of the financial statements of the issuer;

(D) the specific audit committee responsibilities and authority set forth in Section 10.B.2(c)(3).

##### (2) Audit Committee Composition

(A) Each issuer must have, and certify that it has and will continue to have, an audit committee of at least three members (subject to the exception set forth in paragraph (g) with respect to small business issuers), each of whom must: (i) Be independent; (ii) meet the criteria for independence set forth in Rule 10A-3(b)(1) under the Act (subject to the exemptions provided in Rule 10A-3(c)); (iii) not have participated in the preparation of the financial statements of the company or any current subsidiary of the company at any time during the past three years; and (iv) be able to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flow statement. Additionally, each issuer must certify that it has, and will continue to have, at least one member of the audit committee who has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

(B) Notwithstanding paragraph (2)(A)(i), one director who: (i) Is not independent; (ii) meets the criteria set forth in Section 10A(m)(3) under the Act and the rules thereunder; and (iii) is not a current officer or employee or a Family Member of such officer or employee, may be appointed to the audit committee, if the board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the company and its shareholders, and the board discloses, in the next annual proxy statement subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for that determination. A member appointed under this exception may not serve longer than two years and may not chair the audit committee.

##### (3) Audit Committee Responsibilities and Authority

The audit committee must have the specific audit committee responsibilities and authority necessary to comply with Rule 10A-3(b)(2), (3), (4) and (5) under the Act (subject to the exemptions provided in Rule 10A-3(c)), concerning responsibilities relating to: (i) Registered public accounting firms, (ii) complaints

relating to accounting, internal accounting controls or auditing matters, (iii) authority to engage advisors, and (iv) funding as determined by the audit committee. Audit committees for investment companies must also establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company.

##### (4) Cure Periods

(A) If an issuer fails to comply with the audit committee composition requirement under Rule 10A-3(b)(1) under the Act and Section 10.B.2 (c)(2) because an audit committee member ceases to be independent for reasons outside the member's reasonable control, the audit committee member may remain on the audit committee until the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on this provision must provide notice to the Exchange immediately upon learning of the event or circumstance that caused the non-compliance.

(B) If an issuer fails to comply with the audit committee composition requirement under Section 10.B.2 (c)(2)(A) due to one vacancy on the audit committee, and the cure period in paragraph (A) is not otherwise being relied upon for another member, the issuer will have until the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on this provision must provide notice to the Exchange immediately upon learning of the event or circumstance that caused the non-compliance.

##### (d) Conflicts of Interest

Each issuer shall conduct an appropriate review of all related party transactions for potential conflict of interest situations on an ongoing basis and all such transactions must be approved by the company's audit committee or another independent body of the board of directors. For purposes of this rule, the term "related party transaction" shall refer to transactions required to be disclosed pursuant to SEC Regulation S-K, Item 404.

**(e) Notification of Material Noncompliance**

An issuer must provide the Exchange with prompt notification after an executive officer of the issuer becomes aware of any material noncompliance by the issuer with the requirements of Section 10.B.2.

**(f) Code of Conduct**

Each issuer shall adopt a code of conduct applicable to all directors, officers and employees, which shall be publicly available. A code of conduct satisfying this rule must comply with the definition of a "code of ethics" set out in Section 406(c) of the Sarbanes-Oxley Act of 2002 ("the Sarbanes-Oxley Act") and any regulations promulgated thereunder by the Commission. See 17 CFR 228.406 and 17 CFR 229.406. In addition, the code must provide for an enforcement mechanism. Any waivers of the code for directors or executive officers must be approved by the Board. Domestic issuers shall disclose such waivers in a Form 8-K within five business days. Foreign private issuers shall disclose such waivers either in a Form 6-K or in the next Form 20-F.

(g) **Small Business Issuers** "Small business issuers (as defined in Rule 12b-2 under the Securities Exchange Act of 1934) are subject to all requirements specified in this Section, except that such issuers are only required to maintain a Board of Directors comprised of at least 50% independent directors, and an Audit Committee of at least two members, comprised solely of independent directors who also meet the requirements of Rule 10A-3 under the Securities Exchange Act of 1934.

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**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 III below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.<sup>4</sup>

<sup>4</sup> The Commission has revised and clarified some aspects of these statements with the Exchange's consent. Telephone conversation between John Boese, Vice President, Legal and Compliance, BSE, and Ira Brandriss, Assistant Director, Division, Commission, on June 23, 2004.

**A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change****1. Purpose**

The BSE proposes to amend Chapter XXVII, Listed Securities, Section 10, Corporate Governance, of the BSE Rules by adding requirements relating to the corporate governance of Exchange-listed companies. Under the proposal, a majority of the directors on the board of a BSE-listed company would be required to be independent directors,<sup>5</sup> defined in the proposed rule as "a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship, which, in the opinion of the company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director." The Exchange also proposes to require each listed company to disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) those directors that the board has determined to be independent.

Within the proposed rule, the Exchange proposes to provide a list of relationships that would preclude a board finding of independence. First, a director who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company, would not be deemed independent. Second, a director who accepts or has a family member (as defined within the proposed rule) who accepts any payments from the company, or any parent or subsidiary of the company, in excess of \$60,000 during the current fiscal year or any of the past three fiscal years, other than certain permitted payments, would not be deemed independent. Permitted payments would include compensation for board or board committee service; payments arising solely from investments in the company's securities; compensation paid to a family member who is a non-executive employee of the company or a parent or subsidiary of the company; benefits under a tax-qualified retirement plan, or non-discretionary compensation; and loans permitted under Section 13(k) of the Act.

Furthermore, the proposed rule would set forth that a director who is a family member of an individual who is, or at any time during the past three years was, employed by the company or by

<sup>5</sup> See *infra* note and accompanying text regarding small business issuers. See also proposed BSE Rule 10.B.2(a) regarding entities excepted from these requirements.

any parent or subsidiary of the company as an executive officer, would not be deemed independent. Also, a director who is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000 (\$1 million if the listed company is also listed on the New York Stock Exchange), whichever is more, other than certain permitted payments, would not be deemed independent. Permitted payments would include payments arising solely from investments in the company's securities, and payments under non-discretionary charitable contribution matching programs.

Moreover, a director of the listed company who is, or has a family member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the listed company served on the compensation committee of such other entity, would not be deemed independent. Also, a director who is, or has a family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor, and worked on the company's audit, at any time during the past three years, would not be deemed independent. Finally, the Exchange proposes that, in the case of an investment company, a director would not be considered independent if the director is an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act, other than in his or her capacity as a member of the board of directors or any board committee. This provision would be in lieu of the other tests for independence specified in the rule.

The Exchange further proposes to require the compensation of the chief executive officer of a listed company to be determined or recommended to the board for determination either by a majority of the independent directors, or by a compensation committee comprised solely of independent directors.<sup>6</sup> In addition, the compensation of all other officers would be required to be determined or recommended to the board for determination either by a majority of the independent directors, or a

<sup>6</sup> See proposed BSE Rule 10.B.2(a) regarding entities excepted from the requirements relating to compensation.

compensation committee comprised solely of independent directors. Under the proposal, if the compensation committee was comprised of at least three members, one director who is not independent and is not a current officer or employee or a family member of such person would be permitted to be appointed to the committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the next annual meeting proxy statement subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under such exception would not be permitted to serve longer than two years.

The Exchange also proposes to require director nominees to either be selected or recommended for the board's selection either by a majority of independent directors, or by a nominations committee comprised solely of independent directors.<sup>7</sup> If the nominations committee is comprised of at least three members, one director, who is not independent and is not a current officer or employee or a family member of such person, would be permitted to be appointed to the committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the next annual meeting proxy statement subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under such exception would not be permitted to serve longer than two years.

Further, the Exchange proposes to require each issuer to certify that it has adopted a formal written charter or board resolution, as applicable, addressing the nominations process and such related matters as may be required under the federal securities laws. The BSE also proposes that the nomination provision would not apply in cases where either the right to nominate a director legally belongs to a third party, or the company is subject to a binding obligation that requires a director nomination structure inconsistent with

this provision, and such obligation pre-dates the date the provision is approved.

Moreover, the Exchange proposes generally to exempt controlled companies from the requirement to have a majority of independent directors and from the compensation and nomination committee requirements discussed above. However, the independent directors would still be required to have regularly scheduled meetings at which only independent directors are present. A controlled company would be defined as a company of which more than 50% of the voting power is held by an individual, a group, or another company. A company relying upon the exemption would be required to disclose in its annual proxy statement (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) that it is a controlled company and the basis for that determination.

In its proposed rules, the BSE would retain the requirement, set forth in Chapter XXVII, Section 10.A of the BSE Rules, to establish an independent audit committee that complies with the standards required by Rule 10A-3 under the Act. The proposal would further require each issuer to certify that it has adopted a formal audit committee charter with specified responsibilities and authority, and that the audit committee has reviewed and reassessed the adequacy of the charter on an annual basis. The proposal also would require that each listed issuer have, and certify that it has, an audit committee composed of at least three members,<sup>8</sup> each of whom would be required to: (1) Be independent as defined in the BSE's rules; (2) meet the criteria for independence set forth in Rule 10A-3 under the Act (subject to the exceptions provided in Rule 10A-3(c)); and (3) not have participated in the preparation of the financial statements of the company or any current subsidiary of the company at any time during the past three years, in addition to satisfying a requirement that the member be able to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flow statement. In addition, the Exchange would require that at least one member of the audit committee have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior

officer with financial oversight responsibilities.

One director who is not independent and meets the criteria set forth in Section 10A(m)(3) of the Act and the rules thereunder, and is not a current officer or employee of the company or a family member of such person, would be able to be appointed to the audit committee if the board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the company and its shareholders, and the board discloses, in the next annual proxy statement subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for that determination. A member appointed under this exception would not be permitted to serve longer than two years and would not be permitted to chair the audit committee.

Furthermore, the BSE proposes to add a cure period provision, as follows: (1) if a listed issuer fails to comply with the audit committee composition requirement under Rule 10A-3 under the Act and the BSE Rule 10.B.2(c)(2) because an audit committee member ceases to be independent for reasons outside the member's reasonable control, the audit committee member could remain on the committee until the earlier of the issuer's next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with the requirement; and (2) if an issuer fails to comply with the audit committee composition requirement of BSE Rule 10.B.2(c)(2)(A) due to one vacancy on the audit committee, and the aforementioned cure period is not otherwise being relied upon for another audit committee member, the issuer would have until the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on either of these provisions would be required to provide notice to the Exchange immediately upon learning of the event or circumstance that caused the non-compliance.

The proposal would also include, among the specified responsibilities of audit committees, a requirement that audit committees of investment companies must establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of

<sup>7</sup> See *id.* regarding entities that would be exempted from the requirements relating to nominations.

<sup>8</sup> See *infra* note, regarding small business issuers.

accounting related services for the investment company, as well as employees of the investment company.

The Exchange further proposes to require that an issuer provide the Exchange with prompt notification after an executive officer of the issuer becomes aware of any material noncompliance by the issuer with the requirements of the BSE Rules relating to corporate governance.

The Exchange also proposes to require each listed company to adopt a code of conduct applicable to all directors, officers, and employees, and to make such code publicly available.<sup>9</sup> The code of conduct would be required to comply with the definition of a "code of ethics" set forth in Section 406(c) of the Sarbanes-Oxley Act and any regulations thereunder. In addition, the code would have to provide for an enforcement mechanism, which the Exchange states, would need to ensure prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations. Moreover, any waivers of the code for directors or executive officers would have to be approved by the board and disclosed in a Form 8-K within five days for domestic issuers, or in a Form 6-K or the next Form 20-F for foreign private issuers.

Furthermore, the BSE proposes to specify that each issuer shall conduct an appropriate review of all related party transactions for potential conflict of interest situations on an ongoing basis. All such transactions would be required to be approved by the listed company's audit committee or another independent body of the board of directors. For purposes of the rule, "related party transactions" would refer to transactions required to be disclosed pursuant to SEC Regulation S-K, Item 404.

The proposal would also provide that small business issuers are subject to all the proposed new requirements, except that such issuers would only be required to maintain a board of directors comprised of at least 50% independent directors, and an audit committee of at least two members, comprised solely of independent directors who also meet the requirements of Rule 10A-3 under the Act.<sup>10</sup>

The BSE also proposes to provide that the Exchange would have the ability to grant exemptions to a foreign private issuer from the corporate governance

standards when the provisions of these standards are contrary to a law, rule, or regulation of any public authority exercising jurisdiction over such issuer or are contrary to generally accepted business practices in the issuer's country of domicile, except to the extent that such exemptions would be contrary to the federal securities laws, including Section 10A(m) of the Act and Rule 10A-3 thereunder. The BSE also proposes to provide that a foreign issuer that receives an exemption from any of the corporate governance requirements would be required to disclose in its annual reports filed with the Commission each requirement from which it is exempted and to describe the home country practice, if any, followed by the issuer in lieu of these requirements. In addition, a foreign issuer making its initial public offering or first U.S. listing on the BSE would be required to disclose any such exemptions in its registration statement.

In addition, the Exchange proposes that management investment companies (including business development companies) would be subject to all of the requirements of the BSE Rules, except that management investment companies registered under the Investment Company Act would be exempt from the requirements which pertain to the number of independent directors on the board and the requirement that they meet in executive sessions, the role of independent directors in determining compensation of officers and nomination of directors, and codes of conduct. The Exchange proposes these exemptions in light of the fact that registered management investment companies are already subject to a pervasive system of federal regulation.

Finally, the Exchange proposes that cooperative entities, such as agricultural cooperatives that are structured to comply with relevant state law and federal tax law and that do not have a publicly traded class of common stock, would be exempt from the requirements of the BSE Rules regarding the number of independent directors on the board and the role of independent directors in determining compensation of officers and nomination of directors. However, such entities would be required to comply with all federal securities laws, including Section 10A(m) of the Act and Rule 10A-3 thereunder.

The Exchange proposes to establish the deadlines for compliance as listed below. During the transition period between the date of approval of the rule filing by the Commission and the deadline indicated for each rule change, companies that have not brought

themselves into compliance with the new rules would be required to comply with the previously existing rules, as applicable.

Companies would be required to be in compliance with the new rules by the following dates:

The provisions regarding director independence, independent committees, and notification of noncompliance would be required to be implemented by July 31, 2005, for foreign private issuers and small business issuers; and for all other listed issuers, by the earlier of: (1) The listed issuer's first annual shareholders meeting after July 31, 2004; or (2) October 31, 2004.

In the case of an issuer with a staggered board, with the exception of the audit committee requirements, the issuer would have until its second annual meeting after January 15, 2004, but not later than December 31, 2005, to implement all new requirements relating to board composition, if the issuer would be required to change a director who would not normally stand for election at an earlier annual meeting. Such issuers would be required to comply with the audit committee requirements pursuant to the implementation schedule noted above.

Issuers that have listed or will be listed in conjunction with their initial public offering would be afforded exemptions from all board composition requirements consistent with the exemptions afforded in Rule 10A-3(b)(1)(iv)(A) under the Act. That is, for each committee that the company adopts, the company would be required to have one independent member at the time of listing, a majority of independent members within 90 days of listing, and all independent members within one year. However, the rule would note that investment companies would not be afforded the aforementioned exemptions in Rule 10A-3 of the Act. Issuers could choose not to adopt a compensation or nomination committee and could instead rely upon a majority of the independent directors to discharge responsibilities under the rules. These issuers would be required to meet the majority independent board requirement within one year of listing.

Companies transferring from other markets with a substantially similar requirement would be afforded the balance of any grace period afforded by the other market. Companies transferring from other listed markets that do not have a substantially similar requirement would be afforded one year from the date of listing on the Exchange. The rule would stipulate that this

<sup>9</sup> See proposed BSE Rule 10.B.2(a) regarding entities exempted from these requirements.

<sup>10</sup> See proposed BSE Rule 10.B.2(g).

transition period is not intended to supplant any applicable requirements of Rule 10A-3 under the Act.

The limitations on corporate governance exemptions to foreign private issuers would be effective by July 31, 2005. However, the requirement that a foreign issuer disclose the receipt of a corporate governance exemption from the Exchange would apply to new listings and filings made after July 31, 2004.

Compliance with the rules requiring issuers to adopt a code of conduct would be effective by July 31, 2004. The rules requiring audit committee approval of related party transactions would be effective on July 31, 2004. The remainder of the proposed rules would be effective on July 31, 2004.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act<sup>11</sup> in general, and furthers the objectives of Section 6(b)(5)<sup>12</sup> in particular, in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, protect investors and the public interest.

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

The proposed rule change will impose no 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

No written comments were solicited or received with respect to the proposed rule change.

## III. 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. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File

Number SR-BSE-2004-23 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-BSE-2004-23. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the BSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BSE-2004-23 and should be submitted on or before July 30, 2004.

## IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>13</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act<sup>14</sup> in that it is designed, among other things, to facilitate transactions in securities, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove

<sup>13</sup> 15 U.S.C. 78f(b). In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and does not permit unfair discrimination among issuers.

In the Commission's view, the proposed rule change will foster greater transparency, accountability, and objectivity in the oversight by, and decision-making processes of, the boards and key committees of BSE-listed issuers. The proposal also will promote compliance with high standards of conduct by the issuers' directors and management. The Commission notes that the BSE has designed its proposal to harmonize it with rule changes recently approved by the Commission for other self-regulatory organizations ("SROs").<sup>15</sup>

The BSE has requested that the Commission grant accelerated approval to the proposed rule change. The Commission believes that the revisions proposed by the Exchange will significantly align the corporate governance standards proposed for companies listed on the BSE with the standards approved by the Commission for companies listed on other SROs. The Commission believes it is appropriate to accelerate approval of the proposed rule change so that the comprehensive set of strengthened corporate governance standards for companies listed on the BSE may be implemented on generally the same timetable (with some modification of certain deadlines) as that for similar standards adopted for issuers listed on other SROs. The Commission therefore finds good cause, consistent with Section 19(b)(2) of the Act,<sup>16</sup> to approve the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**.

## V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>17</sup> that the proposed rule change (SR-BSE-2004-23) be, and hereby is, approved on an accelerated basis.

<sup>15</sup> See, e.g., Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (approving changes to the corporate governance listing standards of the Nasdaq Stock Market, Inc. and the New York Stock Exchange, Inc.).

<sup>16</sup> 15 U.S.C. 78s(b)(2).

<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).



For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

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

[FR Doc. 04-15586 Filed 7-8-04; 8:45 am]

**BILLING CODE 8010-01-P**

**SMALL BUSINESS ADMINISTRATION**

**[Declaration of Disaster #P040]**

**State of Arkansas**

As a result of the President's major disaster declaration for Public Assistance on June 30, 2004, the U.S. Small Business Administration is activating its disaster loan program only for private non-profit organizations that provide essential services of a governmental nature. I find that Bradley, Calhoun, Clark, Columbia, Hempstead, Howard, Lafayette, Little River, Nevada, Ouachita, Pike, and Sevier Counties in the State of Arkansas constitute a disaster area due to damages caused by severe storms and flooding occurring on May 30, 2004, and continuing. Applications for loans for physical damage as a result of this disaster may be filed until the close of business on August 30, 2004, at the address listed below or other locally announced locations: U.S. Small Business Administration, Disaster Area 3 Office, 14925 Kingsport Road, Fort Worth, TX 76155-2243.

The interest rates are:

	Percent
<i>For Physical Damage:</i> Non-Profit Organizations Without Credit Available Elsewhere .....	2.750
Non-Profit Organizations With Credit Available Elsewhere	4.875

The number assigned to this disaster for physical damage is P04006.

(Catalog of Federal Domestic Assistance Program Nos. 59008)

Dated: July 2, 2004.

**Cheri L. Cannon,**

*Acting Associate Administrator for Disaster Assistance.*

[FR Doc. 04-15632 Filed 7-8-04; 8:45 am]

**BILLING CODE 8025-01-P**

**SMALL BUSINESS ADMINISTRATION**

**[Declaration of Disaster #P041]**

**State of California**

As a result of the President's major disaster declaration for Public Assistance on June 30, 2004, the U.S. Small Business Administration is activating its disaster loan program only for private non-profit organizations that provide essential services of a governmental nature. I find that San Joaquin County in the State of California constitutes a disaster area due to damages caused by flooding as a result of a levee break occurring on June 3, 2004, and continuing. Applications for loans for physical damage as a result of this disaster may be filed until the close of business on August 30, 2004, at the address listed below or other locally announced locations: U.S. Small Business Administration, Disaster Area 4 Office, P.O. Box 419004, Sacramento, CA 95841-9004.

The interest rates are:

	Percent
<i>For Physical Damage:</i> Non-profit organizations without credit available elsewhere .....	2.750
Non-profit organizations with credit available elsewhere ...	4.875

The number assigned to this disaster for physical damage is P04106.

(Catalog of Federal Domestic Assistance Program Nos. 59008).

Dated: July 2, 2004.

**Cheri L. Cannon,**

*Acting Associate Administrator for Disaster Assistance.*

[FR Doc. 04-15633 Filed 7-8-04; 8:45 am]

**BILLING CODE 8025-01-P**

**SMALL BUSINESS ADMINISTRATION**

**[Declaration of Disaster #3595]**

**State of Michigan**

As a result of the President's major disaster declaration on June 30, 2004, I find that Barry, Berrien, Cass, Genesee, Gladwin, Ingham, Ionia, Jackson, Kent, Livingston, Macomb, Mecosta, Oakland, Ottawa, Sanilac, Shiawassee, St. Clair, St. Joseph and Wayne Counties in the State of Michigan constitute a disaster area due to damages caused by severe storms, tornadoes, and flooding occurring on May 20 and continuing through May 24, 2004. Applications for loans for physical damage as a result of this disaster may be filed until the close of business on August 30, 2004, and for

economic injury until the close of business on March 30, 2005, at the address listed below or other locally announced locations: U.S. Small Business Administration, Disaster Area 2 Office, One Baltimore Place, Suite 300, Atlanta, GA 30308.

In addition, applications for economic injury loans from small businesses located in the following contiguous counties may be filed until the specified date at the above location: Allegan, Arenac, Bay, Branch, Calhoun, Clare, Clinton, Eaton, Gratiot, Hillsdale, Huron, Isabella, Kalamazoo, Lake, Lenawee, Lapeer, Midland, Monroe, Montcalm, Muskegon, Newaygo, Ogemaw, Osceola, Roscommon, Saginaw, Tuscola, Van Buren and Washtenaw in the State of Michigan; and Elkhart, La Grange, La Porte and St. Joseph counties in the State of Indiana.

The interest rates are:

	Percent
<i>For Physical Damage:</i> Homeowners With Credit Available Elsewhere .....	5.750
Homeowners Without Credit Available Elsewhere .....	2.875
Businesses With Credit Available Elsewhere .....	5.500
Businesses and Non-Profit Organizations Without Credit Available Elsewhere .....	2.750
Others (Including Non-Profit Organizations) With Credit Available Elsewhere .....	4.875
<i>For Economic Injury:</i> Businesses and Small Agricultural Cooperatives Without Credit Available Elsewhere ...	2.750

The number assigned to this disaster for physical damage is 359512. For economic injury the number is 9ZK400 for Michigan; and 9ZK500 for Indiana.

(Catalog of Federal Domestic Assistance Program Nos. 59002 and 59008)

Dated: July 1, 2004.

**Herbert L. Mitchell,**

*Associate Administrator for Disaster Assistance.*

[FR Doc. 04-15572 Filed 7-8-04; 8:45 am]

**BILLING CODE 8025-01-P**

**SOCIAL SECURITY ADMINISTRATION**

**Finding Regarding Foreign Social Insurance or Pension System of the Republic of Lithuania**

**AGENCY:** Social Security Administration.

**ACTION:** Notice of finding regarding foreign social insurance or pension system of the Republic of Lithuania.

*Finding:* Section 202(t)(1) of the Social Security Act (42 U.S.C. 402(t)(1))

<sup>18</sup> 17 CFR 200.30-3(a)(12).