



Summary of NASDAQ Corporate Governance Proposals¹ As of September 10, 2003

The following provides a detailed summary of NASDAQ's proposed corporate governance reforms. This summary supersedes the prior document dated February 26, 2003. The primary changes are to: (1) reflect the Security and Exchange Commission's ("SEC") approval of NASDAQ's proposal requiring shareholder approval for stock option plans and other equity compensation, and (2) note certain changes in other proposals based on comments received during the rule-making process. In particular, NASDAQ has withdrawn its proposal to expand the definition of "family member" but has proposed that all of NASDAQ's bright-line independence determinations apply both to the director and any immediate family member of the director. NASDAQ has also proposed to conform to SEC's Rule 10A-3 and, in particular, has proposed to determine eligibility for the audit committee based on share ownership consistent with the "safe harbor" approach of Rule 10A-3. Further, NASDAQ has proposed to require the independent directors of a controlled company to meet in executive sessions.

NASDAQ's proposed rules will generally take effect with a company's first annual meeting occurring after January 15, 2004, but not later than October 31, 2004.² NASDAQ's proposal with respect to codes of conduct would be effective six months after SEC approval.

Following is a summary of the proposals:

Stock Options

- Effective June 30, 2003, shareholder approval is required for the adoption of all stock option plans and for any material modification of such plans. An exemption permits inducement grants to new employees if such grants are approved by a compensation committee or a majority of the company's independent directors. Exemptions are also available for certain tax-qualified, non-discriminatory employee benefit plans (e.g., plans that meet the requirements of Sections 401(a) or 423 of the Internal Revenue Code) or parallel nonqualified plans, provided such plans are approved by the issuer's compensation committee or a majority of the issuer's independent directors, and for plans relating to an acquisition or merger. Pre-existing option plans are unaffected by this change, unless a material modification is made to the plan.

Increase Board Independence

- Require a majority of independent directors on the board.

¹ Rule filings reflecting these proposals will be posted on the [Legal and Compliance](#) section of www.nasdaq.com. To the extent that these proposals are not in the form of a Federal Register Notice, they may not have received the benefit of input from SEC staff. NASDAQ may amend these proposals prior to publication by the SEC, based upon input from the SEC or otherwise. Once the rule proposals are published in the Federal Register, they will be subject to public comment, and may be further amended in response to such comment, before approval by the SEC.

² Issuers having staggered boards would be provided an additional year to achieve compliance, except with respect to the audit committee requirements. Foreign issuers and SB filers would be provided until July 31, 2005 to achieve compliance.

- Require regularly convened executive sessions of the independent directors.
- Require that a company's audit committee or a comparable body of the board of directors review and approve all related-party transactions.
- Prohibit an independent director from receiving any payments (including political contributions) in excess of \$60,000 other than for board service and extend such prohibition to the receipt of payments by a non-employee who is an immediate family member of the director. An audit committee member may not receive any compensation except for board or committee service, in accordance with Section 10A(m) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10A-3 thereunder.
- Prohibit a director from being deemed independent if an immediate family member of the director is employed as an executive officer of the issuer or a parent or subsidiary of the issuer, or has been so employed within the past three years.
- Expand to include not-for-profit entities under the current rule prohibiting a director from being considered independent if the company makes payments to an entity where the director is an executive officer and such payments exceed the greater of \$200,000 or five percent of the recipient's gross revenues. Also expand rule to cover situations where an immediate family member of the director is an executive officer of the entity.
- Prohibit current partners and any former partner or employee of the outside auditor who worked on a company's audit engagement, and any immediate family member of such people, from being deemed independent for three years.
- Prohibit a director from being independent if, during the past three years, the director or an immediate family member of the director was employed as an executive of another entity where any of the company's executives serve on that entity's compensation committee.
- Apply a three-year "cooling off" period to directors who are not independent due to the receipt by the director, or an immediate family member of the director who is not an employee of the issuer, of any payments in excess of \$60,000 other than for board service.

Heightened Standards of Independence for Audit Committee Members

- Audit committee members will be required to meet the NASDAQ independence definition set forth in Rule 4200(a)(14), as amended by the proposals described above. In addition, the proposals:
 - Prohibit audit committee members from receiving any payment other than payment for board or committee service, consistent with Section 10A(m) of the Exchange Act and Rule 10A-3 thereunder.
 - Prohibit directors from serving on the audit committee in the event they are deemed an affiliated person of the issuer or any subsidiary, consistent with Section 10A(m) of the Exchange Act and Rule 10A-3 thereunder.

Strengthen the role of independent directors in compensation and nomination decisions

- Require independent director approval of director nominations, either by an independent nominating committee or by a majority of the independent directors. A single non-independent director, who is not an officer, would be permitted to serve, for up to two years, on an independent nominating committee pursuant to an “exceptional and limited circumstances” exception.³ Issuers whose nominating committees are constituted pursuant to a pre-existing binding agreement that is inconsistent with this rule would not be required to meet this rule until such agreement expires.
- Require a charter for the nominating committee, or alternatively the independent directors in the nominations process.
- Require independent director approval of CEO compensation, either by an independent compensation committee or by a majority of the independent directors meeting in executive session. Require independent director approval of other executive officer compensation, either by an independent compensation committee or by a majority of the independent directors in a meeting at which the CEO may be present. A single non-independent director, who is not an officer, would be permitted to serve, for up to two years, on the independent compensation committee pursuant to an “exceptional and limited circumstances” exception.⁴

Controlled Company Exception

- “Controlled” companies are exempt from the requirements for a majority independent board and independent compensation and nominating committees. A controlled company is a company of which more than 50% of the voting power is held by an individual, group or another company. A controlled company relying upon this exemption must disclose in its annual meeting proxy that it is a controlled company and the basis for that determination. Such companies, however, remain subject to each of the audit committee requirements and to the requirement that independent directors meet in executive session.

Empower Audit Committees and Harmonize Listing Standards with the Exchange Act

- Require that audit committees have the sole authority to appoint, determine funding for, and oversee the outside auditors, as set forth in Section 10A(m)(2) of the Exchange Act.
- Require that audit committees approve, in advance, the provision by the auditor of all permissible non-audit services, as set forth in Section 10A(h) of the Exchange Act.
- Require that audit committees have the authority to engage and determine funding for independent counsel and other advisors, as set forth in Sections 10A(m)(5) and (6)(B) of the Exchange Act.

³ An “exceptional and limited circumstances” exception would be available for an individual who is not an officer or current employee or a family member of such a person. Additionally, such an exception may only be implemented following a determination by the board that the individual’s service on the committee is in the best interests of the company and its shareholders. The issuer is also required to disclose the use of such an exception in the next annual proxy statement, as well as the nature of the individual’s relationship to the company and the basis for the board’s determination.

⁴ *Ibid*

- Require that the audit committee establish procedures for the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls or auditing matters. Additionally, the audit committee is required to ensure that such complaints are treated confidentially and anonymously, as set forth in Section 10A(m)(4) of the Exchange Act.
- Require that all audit committee members be able to read and understand financial statements at the time of their appointment rather than “within a reasonable period of time” thereafter.
- Limit the time that a non-independent director may serve on the audit committee pursuant to the “exceptional and limited circumstances” exception set forth in Rule 4350(d)(2)(B) to two years and prohibit that person from serving as the chair of the audit committee. Those directors not satisfying the audit committee independence requirements of Section 10A(m) of the Exchange Act and Rule 10A-3 thereunder are not eligible for this exception.
- Eliminate exceptions for the audit committee requirements for Small Business issuers.
- Issuers will still be required to have at least one member on the audit committee that 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. NASDAQ has withdrawn a previous proposal to require one member of the audit committee to meet the SEC’s definition of a “financial expert.”

Provide Transparency With Respect to Non-U.S. Companies

- Require that non-U.S. issuers disclose any exemptions to NASDAQ’s corporate governance requirements, permissible under the Exchange Act or rules promulgated by the SEC thereunder, at the time of their first U.S. listing and annually, as well as any alternative measures taken in lieu of the waived requirements. This disclosure will take effect for new listings and filings made on or after January 1, 2004.
- Consistent with Rule 10A-3, limit exemptions from NASDAQ’s corporate governance requirements to foreign private issuers, instead of all non-U.S. issuers.

Codes of Conduct

- Require a code of conduct for all directors and employees, which must be publicly available. Waivers to the code of conduct for executive officers and directors can only be granted by the issuer’s board and must be disclosed. The code of conduct must include those elements necessary to meet the “code of ethics” requirements, as defined in SEC Regulation S-K, Item 406.

Other Rule Proposals

- Harmonize the NASDAQ rule on the disclosure of material information with SEC Regulation FD, so that issuers may use Regulation FD compliant methods such as conference calls, press conferences and web casts, so long as the public is provided adequate notice (generally by press release) and granted access. This proposal has been approved by the SEC and is currently effective.

- Require that a going concern qualification in an audit opinion be disclosed through the issuance of a press release.
- Clarify that NASDAQ will presume that a change of control will occur, for purposes of the shareholder approval rules, once an investor acquires 20% of an issuer's outstanding voting power, unless a larger ownership and/or voting position is held on a post-transaction basis by: (1) a shareholder, or an identified group of shareholders, unaffiliated with the investor, or (2) the issuer's directors and officers that are unaffiliated with the investor.
- Clarify the authority of NASDAQ to deny re-listing to an issuer based upon a corporate governance violation that occurred while that issuer's appeal of the delisting was pending.
- Clarify that a material misrepresentation or omission by an issuer to NASDAQ may form the basis for delisting. This proposal has been approved by the SEC and is currently effective.
- Clarify when shareholder approval is required in connection with a stock issuance to an officer or director of the company in a private placement.

Director Education

- NASDAQ is committed to helping board members understand their governance responsibilities. In that regard, we are partnering with experts to provide opportunities for directors to receive relevant continuing education. One such initiative is an alliance with the National Association of Corporate Directors (NACD) to provide corporate governance educational services to NASDAQ listed companies. The resources provided are practical, nationally recognized programs designed to define director roles and responsibilities, hone board members' financial oversight skills, provide guidance on audit committee structure and processes, and provide strategies for risk oversight. In addition, NASDAQ sponsors the Board Governance Series of webcasts, produced in conjunction with *Corporate Board Member* magazine, which is available free of charge at <http://www.nasdaqnews.com>.