



Summary of NASDAQ Corporate Governance Proposals¹ As of February 26, 2003

The following provides a detailed summary of NASDAQ's proposed corporate governance reforms. This summary supersedes the prior document dated November 20, 2002. The primary changes are to: (1) reflect Nasdaq's withdrawal of the proposal to require that each audit committee have a "financial expert," as defined in the Sarbanes-Oxley Act of 2002 (the "Act") and SEC rules promulgated thereunder;² and, (2) clarify that a code of conduct under the proposed Nasdaq rules must have all elements required for a code of ethics under the Act and the rules promulgated thereunder.

NASDAQ proposes that changes requiring a company to modify the composition of its board of directors or the board's committees be effective with a company's first annual meeting occurring after January 1, 2004.³ NASDAQ also proposes that requirements related to codes of conduct, executive sessions of independent directors and audit committee charters be effective six months after SEC approval.

Following is a summary of the proposals:

Stock Options

- Require shareholder approval for the adoption of all stock option plans and for any material modification of such plans. An exemption would permit inducement grants to new employees if such grants are approved by a compensation committee or a majority of the company's independent directors. Exemptions will also be available for certain tax-qualified, non-discriminatory employee benefit plans (e.g., plans that meet the requirements of Section 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. Existing option plans will be unaffected under this proposal, unless there is a material modification made to the plan.

¹ Rule filings reflecting these proposals are 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 have not 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 As noted below, the effect of this change is to retain Nasdaq's existing rule, which requires that one member of the audit committee have financial experience as set forth under the current rule.

³ Please be advised that the SEC has proposed rules that may affect this proposed implementation schedule.

Increase Board Independence

- Require a majority of independent directors on the board.
- 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 family member of the director. An audit committee member may not receive any compensation except for board or committee service, in accordance with the Act.
- Prohibit a director from being deemed independent if any 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 cover not-for-profits 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.
- Prohibit former partners or employees of the outside auditors who worked on a company's audit engagement from being deemed independent for three years.
- Apply a three-year "cooling off" period to directors who are not independent due to: (1) interlocking compensation committees; or (2) the receipt by the director, or a 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 301 of the Act.
 - 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 301 of the Act. In this regard, prohibit audit committee members from owning or controlling 20% or more of the issuer's voting securities, or such lower number as may be established by the SEC in rulemaking under Section 301 of the Act. However, for all other purposes, share ownership would not be a bar from being considered independent.

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 would be permitted to serve on an independent nominating committee: (1) if the individual is an officer who owns or controls more than 20% of the issuer's voting securities, or (2) pursuant to an "exceptional and limited circumstances" exception.⁴
- 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.⁵

Controlled Company Exception

- "Controlled" companies are exempt from the requirements for a majority independent board, executive sessions of the independent directors, 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.

Empower Audit Committees and Harmonize Listing Standards with the Act

- Require that audit committees have the sole authority to appoint, determine funding for, and oversee the outside auditors, as set forth in Section 301 of the Act.
- Require that audit committees approve, in advance, the provision by the auditor of all permissible non-audit services, as set forth in Section 202 of the Act.
- Require that audit committees have the authority to engage and determine funding for independent counsel and other advisors, as set forth in Section 301 of the Act.
- 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 301 of the Act.

⁴ 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.

⁵ *Ibid*

- 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 the Act 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.

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 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.

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 by the SEC pursuant to the Act.

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.

Proposals Under Consideration

Nasdaq previously announced that it would propose certain other rules. At the present time those rules remain under consideration, but rule filings related to those proposals have not been filed.

- Whether to prohibit loans to officers and directors through the adoption of a NASDAQ rule that mirrors Section 402 of the Act.
- Whether to require continuing education for all directors.
- Whether to require accelerated disclosure of insider transactions that would harmonize with, and reinforce, the provisions of the Act and the SEC rules promulgated thereunder.