

copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All submissions should refer to File No. PCAOB-2003-05 and should be submitted by October 17, 2003.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48506; File No. PCAOB-2003-04]

### Public Company Accounting Oversight Board; Notice of Filing of Proposed Ethics Code

September 22, 2003.

Pursuant to section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on September 23, 2003, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission") the proposed rules described in Items I, II, and III below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

#### I. Board's Statement of the Terms of Substance of the Proposed Rules

On June 30, 2003, the Board adopted an Ethics Code ("Code" or "EC") to govern the conduct of its members, employees, and certain contractors and consultants. The proposed Code consists of 14 sections (EC 1 through 14). The text of the Ethics Code (technical numbering changes in this release made pursuant to authorization from the PCAOB) is as follows:

#### Ethics Code

##### EC1. Application of Code

The provisions of this Ethics Code apply, according to their terms, to—  
 (a) present and former Board members and staff;  
 (b) the spouse, spousal equivalent, and dependents of Board members and staff; and  
 (c) designated contractors and consultants to the Board.

**Note:** Rule 3700(e) requires members of a Board advisory group to comply with certain provisions of the Ethics Code.

##### EC2. Definitions

(a) Reference to Rules of the Board  
 Unless the context requires otherwise, the definitions provided in Section 1001 of the Rules of the Board apply to the words and terms contained in this Ethics Code.

##### (b) Code

The term "Code" means this Ethics Code, as it may be amended from time to time.

##### (c) Dependent

The term "dependent" of a Board member or staff means a person who receives more than half of his or her support for the most recent calendar year from the Board member or staff.

##### (d) Designated Contractors and Consultants

The term "designated contractors and consultants" means certain persons or business organizations—

(1) with which the Board enters into contracts for services, including contracts that provide for both goods and services;

(2) which the Board, or its designate, has determined should be subject to this Code, in whole or in part; and

(3) for which the contract contains a provision expressly incorporating this Code, in whole or in part.

**Note:** The Board will maintain a list of designated contractors and consultants, which will be available to the public. Nothing in this provision will restrict the Board's right to impose additional contractual restrictions and limitations on any contractor or consultant. The Board is committed not to use its contracting authority to convert a person who would ordinarily be an employee to a contractor or consultant, as a means of allowing that person to be excluded from the provisions of this Code.

##### (e) Honoraria

The term "honoraria" means anything with more than a nominal value, whether provided in cash or otherwise, and which is provided in exchange for a speech, panel participation, publication or lecture. Neither the waiver of conference fees nor

acceptance of a modest speakers-only meal constitutes "honoraria."

**Note:** Items, which are provided to all conference participants, including speakers, are not provided "in exchange for" a speech and thus not considered to be "honoraria."

##### (f) Practice

The term "practice" means—

(1) knowingly acting as an agent or attorney for, or otherwise representing any other person in any formal or informal appearance before the Board or Commission with respect to Board-related matters; or

(2) making any oral or written communication on behalf of any other person to, and with the intent to influence, the Board or Commission with respect to Board-related matters.

**Note:** For purposes of this definition, participating in the financial reporting process as the officer or director of an issuer or participating in an audit of an issuer's financial statements does not, in and of itself, constitute practice before the Board or the Commission.

##### (g) Professional Staff or Professional Staff of the Board

The terms "professional staff" or "professional staff of the Board" mean those persons who are employed by the Board and who are exempt, pursuant to Section 13(a)(1) of the Fair Labor Standards Act (29 U.S.C. 201 et seq.), from Sections 6 and 7 (minimum wage and overtime provisions) of that act.

**Note:** These terms may, according to the context, alternatively be used to refer to a single such employee, or to all such employees.

##### (h) Staff or Staff of the Board

The terms "staff" or "staff of the Board" mean those persons who are employed by the Board.

**Note:** These terms may, according to the context, alternatively be used to refer to a single such employee, or to all such employees.

##### EC3. General Principles

(a) The purpose of this Code is to maintain the highest standards of ethical conduct among Board members and staff, and to provide the public with confidence in the objectivity of the Board's decisions by seeking to avoid both actual and perceived conflicts of interest among Board members and staff. The general principles within this section form the basis for the ethics rules and standards of conduct contained in the Code. When a situation is not covered by the Code's specific standards, Board members and staff shall apply the principles set forth in this section in determining whether their conduct is proper.

(1) Board members and staff should at all times be mindful of their responsibilities to the Board, the sensitivity of their positions, and the need for public confidence in the objectivity and deliberative process of the Board.

(2) Board members and staff should take great care to conduct themselves and all of their activities in such a manner so that their personal investments or other personal activities will not affect their professional independence or objectivity, or otherwise hinder the interests or reputation of the Board.

(3) Board members and staff should recognize that the degree of public confidence in the function and activities of the Board depends heavily upon the observance of both the letter and spirit of this Code.

(b) No Board member or staff shall act in a manner, regardless of whether specifically prohibited by this Code, which might reasonably result in or reasonably create the appearance that the employee is—

(1) using his or her official position with the Board, or confidential information obtained through service for the Board, for the private gain of any person;

(2) giving preferential treatment to any person with respect to the Board member or employee's work for the Board;

(3) losing independence or objectivity with respect to his or her work for the Board;

(4) adversely affecting the public confidence in, or the integrity, independence or objectivity of the Board; or

(5) otherwise hindering the interests or reputation of the Board.

#### EC4. Financial and Employment Interests

(a) While employed by the Board, no Board member or professional staff shall—

(1) be owed, directly or indirectly, any financial or other obligation by any former employer, business partner, client, or publisher except—

(A) routine banking and other routine commercial relationships;

(B) securities and other investments permitted by this Code;

(C) benefits under a bona fide pension, retirement, group life, health or accident insurance, or other employee welfare or benefit plan maintained by a former employer and related to prior services for the former employer, business partner or client;

(D) profit-sharing, stock bonus or other payments related to prior services

for the former employer, business partner or client;

(E) royalties or other like payments with respect to writings and recordings completed prior to commencement of employment with the Board; or

(F) such other obligations permitted by this Code, or as may be specifically and expressly approved by the Board;

(2) owe, directly or indirectly, any financial or other obligation to any former employer, business partner or client, except—

(A) routine banking and other routine commercial relationships;

(B) covenants not to compete;

(C) non-disclosure agreements; or

(D) such other obligations permitted by this Code, or as may be specifically and expressly approved by the Board.

(b) Notwithstanding any other provision of this Code, no member of the Board or his or her spouse, spousal equivalent, or dependents may share in any of the profits of, or receive payments from, a public accounting firm, other than fixed continuing payments under standard arrangements for retirement from public accounting firms.

#### EC5. Investments

(a) Except as provided in this Section, nothing in this Code prohibits Board members and staff, or their spouses, spousal equivalents, or dependents, from owning and holding securities (including futures), real estate, commodities (including futures), exchange-traded options and other investments held for personal investment purposes, except that no Board member or staff may have any financial interest in a public accounting firm.

(b) Board members and staff should at all times be mindful of their responsibilities to the Board and shall avoid personal financial activities which might affect or reasonably create the appearance of affecting their independence or objectivity.

(c) Board members and staff should at all times be mindful that, in the course and scope of their employment activities, they may obtain knowledge of confidential, non-public information which, if disclosed, might affect the value of particular securities or investments. Accordingly, Board members and staff may not—

(1) disseminate or otherwise disclose any confidential, non-public information obtained by virtue of their position with the Board, regardless of whether that information may be considered to be "material" under the securities laws; or

(2) use such information for the financial gain of themselves or others.

**Note:** Concurrent restrictions on disclosure of non-public information are provided in EC9.

(d) Board members and professional staff shall annually disclose their holdings, and the holdings of their spouses, spousal equivalents, and dependents, in securities of issuers (including exchange-traded options and futures).

(1) For initial disclosures, statements shall be filed with the Ethics Officer within the first 60 days of commencement of service with the Board, or 60 days from the effective date of this Code, whichever is later.

(2) Subsequent disclosures shall be filed with the Ethics Officer on May 1, commencing the first year following the initial disclosure.

(3) Disclosure statements by Board Members shall be made available to the public.

(4) Disclosure statements by professional staff shall remain confidential.

**Note:** The form and content of this disclosure statement shall be included in the Board's ethics manual.

#### EC6. Outside Activities

(a) No member of the Board may undertake any employment or other activity for compensation outside of service to the Board.

(b) Staff of the Board may only undertake other employment or other activity for compensation with the express and specific approval of the Board or such person to whom the Board may delegate such approval authority.

(c) No Board member or staff of the Board shall engage in any outside activity, whether or not for compensation, which—

(1) affects or reasonably creates the appearance of affecting his or her independence or objectivity;

(2) interferes with his or her responsibilities to the Board; or

(3) otherwise hinders the interests or reputation of the Board.

#### EC7. Gifts, Reimbursements, Honoraria and Other Things of Value

(a) No Board member or professional staff shall, directly or indirectly, solicit or accept any gift, reimbursement, honoraria or anything of monetary value from any source, which might reasonably be viewed as—

(1) interfering with his or her independence, objectivity or responsibilities to the Board; or

(2) otherwise hindering the interests or reputation of the Board.

**Note:** Although this provision does not extend to non-professional staff, such staff should remain cognizant of corresponding duties imposed by EC3 and EC5.

(b) No Board member or staff shall accept payment for or reimbursement of official travel-related expenses from any organization, except—

(1) for travel that is in direct connection with the employee's participation in an educational forum; and

(2) the educational forum is principally sponsored by and the travel-related expenses are paid or reimbursed by—

(A) a federal, state or local governmental body, or an association of such bodies,

(B) an accredited institution of higher learning,

(C) an organization exempt from taxation under 501(c)(3) of the Internal Revenue Code, provided such organization is not principally funded from one or more public accounting firms or issuers, or

(D) institutions equivalent to those in EC 7(b)(2)(A)–(C) outside the United States.

#### EC8. Disqualification

(a) If a Board member or professional staff becomes, or reasonably should become, aware of facts which would lead a reasonable person to believe that he or she, or his or her spouse, spousal equivalent, or dependents, may have a financial interest or other similar relationship which might affect or reasonably create the appearance of affecting his or her independence or objectivity with respect to the Board's function or activities, then he or she shall, at the earliest possible date—

(1) disclose such circumstances and facts, as set forth in subsection (b); and

(2) recuse himself or herself from further Board functions or activities involving or affecting the financial interest or relationship.

**Note 1:** For the purposes of applying this provision to members of an advisory group convened by the Board, those members shall not be considered to lack independence or objectivity with regard to advisory group matters merely because they (or their employer, business partners or clients) are subject to the direct or indirect oversight of the Board.

**Note 2:** Although this provision does not extend to non-professional staff, such staff facing circumstances that may affect their ability to perform their functions should seek advice from the Board's Ethics Officer.

(b) For a member of the Board, disclosure shall be made to all other members of the Board. For professional staff of the Board, disclosure shall be

made to the Board Chair, or his or her designee.

(c) For a period of 12 months commencing on date of appointment or employment, no Board member or professional staff may participate in the making of a decision which is reasonably likely to have a material effect, direct or indirect, on the Board or professional staff member's former employer, business partner or client, when such prior employment terminated within five years from the date of appointment or employment with the Board. For purposes of this section, participating in the making of a decision which affects a former employer, business partner or client to the same degree as similarly situated people or business organizations, does not constitute an "indirect" effect.

#### EC9. Non-Public Information

(a) Unless authorized by the Board, no Board member or staff shall disseminate or otherwise disclose any information obtained in the course and scope of his or her employment, and which has not been released, announced, or otherwise made available publicly.

(b) The provisions of this Section shall continue in effect after the termination of employment or Board membership.

**Note:** Concurrent restrictions on disclosure of non-public information are provided in EC5(c).

#### EC10. Speaking for the Board

Unless authorized to speak on behalf of the Board, Board members and professional staff shall include a disclaimer for any private publication or public statement by indicating that the views expressed are those of the author or speaker and do not necessarily reflect the view of the Board or other Board members or staff.

#### EC11. Ethics Officer

The Board shall designate an Ethics Officer who shall be empowered to—

(a) counsel Board members and staff regarding compliance with or potential violation of this Code;

(b) issue advisory opinions, as deemed necessary, to Board members and staff regarding potential violations of this Code; and

(c) make recommendations to the Board regarding waiver requests and potential violations of, or amendments to, this Code.

#### EC12. Post-Employment Restrictions

(a) Negotiating Prospective Employment

(1) Board members and professional staff may not negotiate prospective

employment with a public accounting firm or issuer, without first disclosing (pursuant to the procedures in Section EC8(b)) the identity of the prospective employer and recusing himself or herself from all Board matters directly affecting that prospective employer.

(2) For purposes of this section, "negotiating prospective employment" means participating in an employment interview; discussing an offer of employment; or accepting an offer of employment, even if the precise terms are still to be developed. Submitting a resume or job application to a group of employers or receiving an unsolicited inquiry of interest that is rejected, do not alone constitute "negotiating prospective employment."

#### (b) Prohibition on Practice Before the Board or Commission

(1) Board members and professional staff shall be restricted from practice before the Board, and the Commission with respect to Board-related matters, for one year following termination of employment or Board membership.

(2) Former Board members and professional staff shall not practice before the Board, or the Commission with respect to Board-related matters, on a particular matter in which the Board member or professional staff participated personally and substantially as a Board or staff member and which involved a specific party or specific parties at the time of such participation.

#### EC13. Waiver

Unless otherwise prohibited by law, the Board (or person to whom the Board may delegate this responsibility as to staff) may grant a request for waiver of any provision of this Code. Such waivers must be requested in writing by the Board member or staff, and evaluated by the Ethics Officer. The Board will only grant waiver requests after a finding that the waiver would not otherwise hinder the interests or reputation of the Board. Waivers will be made available to the public, subject to the withholding of information that would constitute a clearly unwarranted invasion of personal privacy.

#### EC14. Certification

Board members, staff and designated contractors and consultants agree to comply with this Code at the commencement of their service or contract with the Board and shall, throughout the term of their appointment, employment or contract, certify annually in writing their continuing compliance with it.

## II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

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

### A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

#### (a) Purpose

Section 101(g)(3) of the Act requires the Board to establish ethics rules and standards of conduct for members and staff of the Board. Although the Act does not specify a deadline for the establishment of such rules and standards, the Board recognized that establishing a strict, enforceable Code early in the Board's development would send a strong message to the public that it takes its ethical obligations seriously in pursuing its mission to help restore confidence in issuer audits.

The Code consists of 14 sections (EC 1 through 14). Each section of the Code is discussed below.

#### Application of Code

EC1 provides that the provisions of the Ethics Code shall apply, according to their terms, to present and former Board members and staff, the spouses, spousal equivalents, and dependents of Board members and staff, and certain contractors and consultants to the Board. A note to the rule cross-references Rule 3700(e), which provides that members of Board advisory groups are subject to certain provisions in the Ethics Code.

#### EC1. Definitions

EC2 contains definitions of terms used in the Board's Ethics Code.<sup>1</sup>

#### Reference to Rules of the Board

EC2(a) provides that, unless the context requires otherwise, the definitions provided in Section 1001 of the Rules of the Board apply to the words and terms contained in this Ethics Code.

#### Dependent

EC2(c) defines "dependent" as any person who receives more than half of his or her support for the most recent

calendar year from the Board member or staff. The Ethics Code, as proposed, did not contain a definition of "dependent," but had defined the term "immediate family." Two commenters recommended that the Board adopt a definition of "immediate family" that more closely resembles the Commission's definition of "immediate family member" in its auditor independence rules. The Commission's definition of "immediate family" covers an individual's "spouse, spousal equivalent, and dependents."<sup>2</sup>

The Board agreed, in principle, with this recommendation. To promote clarity, however, the Board eliminated its use of the defined term "immediate family" and added "spouse, spousal equivalent, and dependents" directly to those provisions of the Ethics Code that previously used the defined term "immediate family." While the Board only included a definition, based on the Commission's interpretation of Regulation S-X, for "dependent," the Board will interpret each of these terms in a manner consistent with how they are used in the Commission's Regulation S-X definition.<sup>3</sup> Accordingly, "spouse" will mean husband or wife, whether by marriage or common law, and "spousal equivalent" will mean cohabitant occupying a relationship generally equivalent to that of a spouse.

While the definition of "dependent" applies equally to minor or adult dependents, depending on their receipt of support from the Board or staff member, there may be situations in which it might be appropriate for the Ethics Code to apply differently in the case of an adult dependent who does not reside with the Board or staff member. If appropriate and consistent with EC13, the Board envisions that the Board's Ethics Officer or other person to whom the Board delegates waiver authority with regard to staff will recommend a waiver in such situations.

#### Designated Contractors and Consultants

EC2(d) defines the term "designated contractors and consultants" as those persons or business organizations with whom the Board enters into contracts for services, whom the Board (or its designate) determines should be subject to the Code, and for which the contract contains a provision expressly incorporating this Code (in whole or in

part). The Board will develop and maintain a list of designated contractors and consultants, which will be available to the public and will reserve the right to contractually impose additional restrictions and limitations on any contractor or consultant.

Two commenters indicated that they believed the original definition was overly vague and could apply to all providers of goods and services to the Board. The proposing release provided a two-part test for designated contractors and consultants. It indicated that designated contractors and consultants are those persons with whom the Board entered into contracts for services and for which the contracts expressly incorporated the Code, in whole or in part. Based upon these concerns, the Board added a third criterion—a requirement that the Board determine, on a case-by-case basis, whether, and to what degree, each contractor or consultant should be subject to the Code.

#### Honoraria

EC2(e) defines "honoraria" as anything with more than a nominal value, whether provided in cash or otherwise, and which is provided in exchange for a speech, panel participation, publication or lecture. EC2(e) further indicates that neither the waiver or conference fee, nor the acceptance of a modest speakers-only meal shall constitute honoraria. "Nominal value" will initially be interpreted to mean fair market value of \$50 or less.

#### Practice

EC2(f) defines "practice" as it relates to activities before the Board or Commission. Subparagraph (1) of the definition provides that practice means knowingly acting as an agent or attorney for, or otherwise representing any person (other than oneself) in any formal or informal appearance before the Board or Commission. Subparagraph (2) provides an alternative meaning, indicating that practice also means making any oral or written communication on behalf of any person (other than oneself) to, and with the intent to influence, the Board or Commission.

This definition, as incorporated in EC12(b), is intended to restrict affected persons from certain representational activities. However, this definition, as incorporated by EC12(b), is not intended to prevent affected persons from participating in the preparation of documents, communications, presentations or the like, provided the affected persons do not appear before, or

<sup>1</sup> See Rule 2-01(f)(13) of Regulation S-X, 17 CFR 210.1-01(f)(13).

<sup>2</sup> See Commission Final Rule: Revision of the Commission's Auditor Independence Requirements, Release No. 33-7919 (November 21, 2000) (describing these terms in the context of the rule's definition of "close family members").

<sup>1</sup> Certain definitions in the Board's rules that are self-explanatory are not discussed below.

speak to, the Board, and are not the signatory of any written correspondence or communication to the Board.

The Board added a note to this subsection that clarifies that participating in the financial reporting process as an officer or director of an issuer or participating in an audit or an issuer does not, by itself, constitute practice before the Board.

#### Professional Staff or Professional Staff of the Board

EC2(g) defines the terms "professional staff" or "professional staff of the Board" as those persons who are employed by the Board and who are exempt from minimum wage and overtime provisions under Federal law.

#### Staff or Staff of the Board

EC2(h) defines the terms "staff" or "staff of the Board" as those persons who are employed by the Board.

#### EC3. General Principles

EC3 provides broad principles designed to maintain the highest standards of ethical conduct among Board members and staff, and to provide the public with confidence in the objectivity of the Board's decisions by seeking to avoid both actual and perceived conflicts of interest among Board members and staff. The three subparagraphs to paragraph (a) are intended to guide Board members and staff when a situation is not covered by the Code's specific standards.

EC3(a)(1) instructs Board members and staff to at all times be mindful of their responsibilities to the Board, the sensitivity of their positions, and the need for public confidence in the objectivity and deliberative process of the Board. EC3(a)(2) instructs Board members and staff to take great care to conduct themselves and all of their activities in such a manner so that their personal investments or other personal activities will not affect their professional independence or objectivity, or otherwise hinder the interests or reputation of the Board. EC3(a)(3) further instructs Board members and staff to recognize that the degree of public confidence in the function and activities of the Board depends heavily upon the observance of both the letter and spirit of this Code.

EC3(b) prohibits Board members and staff from acting in a manner that creates or reasonably results in the appearance of certain situations described in subparagraphs (1) through

(5),<sup>4</sup> regardless of whether specifically prohibited by this Code.

The Board, or its Ethics Officer, may issue interpretative guidance relating to these principles.

One commenter indicated that he did not believe the Board's general principles provided any meaningful guidance to the Board or its staff. Recognizing that the general principles are meant to be broad enough to guide the conduct of members and staff in those situations in which a specific provision of the Code does not apply, the Board concluded that its general principles are sufficient and has not changed them.

#### EC4. Financial and Employment Interests

EC4 limits Board members and/or professional staff from certain financial and employment interests. Subparagraph (a) prohibits Board members and professional staff from being owed or owing any financial or other obligation to a former employer, business partner, client or publisher, with limited exceptions. The Board extended this prohibition to a Board member or professional staff's publisher.

EC4(a)(1) restricts Board members and professional staff from being owed any financial or other obligation, except those items contained in subparagraphs (A) through (F).<sup>5</sup>

One commenter requested that the Board define what it meant by "routine banking and other routine commercial relationships" as identified in EC4(a)(1)(A) and EC4(a)(2)(A). The Board will apply this exception to those arrangements that are akin to those generally available to the public at large through arms-length negotiations. The Board does not believe that the exception requires further refinement in the Code.

EC4(a)(1)(C) excepts from the general prohibition benefits under a bona fide pension, retirement, group life, health or accident insurance, or other employee welfare or benefit plan maintained by a former employer and related to prior services for the former employer, business partner or client. This rule does not prevent Board members or staff from receiving ongoing bona fide pension payments, even if the funding for those payments is tied to the profitability of the former employer. Board members and professional staff, however, remain subject to EC8. As

<sup>4</sup> The situations described in these subparagraphs are self-explanatory and are not discussed below.

<sup>5</sup> Certain excepted items under this subparagraph are self-explanatory and are not discussed below.

discussed in more detail below, EC8(a) requires Board members and professional staff to disclose circumstances that would lead a reasonable person to believe that the Board or staff member may have a financial interest that might affect or reasonably create the appearance of affecting his or her independence or objectivity and to recuse himself or herself from participating in functions or activities involving or affecting the financial interest. If a Board or staff member were receiving pension payments, the funding for which is tied to the profitability of a former employer, that would constitute the type of financial interest requiring disclosure and recusal from matters involving that former employer pursuant to EC8(a).<sup>6</sup>

EC4(a)(1)(D) and (E) each excepts payments and the like for prior service. EC4(a)(1)(D) excepts profit-sharing, stock bonus or other payments related to prior services for the former employer, business partner or client, while EC4(a)(1)(E) excepts royalties or other like payments with respect to writings and recordings completed prior to commencement of employment with the Board.

EC4(a)(2) restricts Board members and professional staff from owing any financial or other obligation, except those items contained in subparagraphs (A) through (D).<sup>7</sup>

EC4(b) reiterates the statutory constraints on Board members receiving profits of, or payments from, public accounting firms. As proposed, EC4(b) was limited to Board members only. Based on public comment, this subparagraph was extended to spouses, spousal equivalents, and dependents of Board members.

#### EC5. Investments

EC5 addresses the issue of investments by Board members and staff and their spouses, spousal equivalents, and dependents.

EC5(a) provides that there are no prohibited investments by Board members, staff and their spouses, spousal equivalents, and dependents, except that subparagraph (1) restricts Board members and professional staff from having any financial interest in a public accounting firm.<sup>8</sup>

<sup>6</sup> EC8 also generally restricts Board members and staff from participating in making a decision which is reasonably likely to have a material effect on their former employer for one year after joining the Board.

<sup>7</sup> The items excepted under this subparagraph are self-explanatory and are not discussed below.

<sup>8</sup> The Board revised EC5(a) to not cover Board members and professional staff's spouses, spousal  
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EC5(b) instructs Board members and professional staff to at all times be mindful of their responsibilities to the Board and to avoid personal financial activities which might affect or reasonably create the appearance of affecting their independence or objectivity.

EC5(c) instructs Board members and staff to at all times be mindful that, in the course and scope of their employment activities, they may obtain knowledge of confidential, non-public information which, if disclosed, might affect the value of particular securities or investments and places restrictions on the disclosure and use of non-public information. Subparagraph (1) prohibits the dissemination or disclosure of any confidential, non-public information obtained by virtue of their position with the Board, whether that information may be considered to be "material" under the securities laws or not and subparagraph (2) restricts the use of such information for the financial gain of themselves or others.

EC5(d) was added at the suggestion of several commenters and requires that Board members and professional staff annually disclose their holdings in securities of issuers, including exchange-traded options and futures. Disclosure statements must be filed with the Ethics Officer. In addition, Board members' disclosure statements will be made available to the public.

For initial disclosures, newly appointed members or newly hired professional staff have 60 days from the date of commencement of service with the Board to complete and file the necessary statements. Current Board members and professional staff have 60 days from the effective date of the Code to file the necessary statements.

For subsequent disclosures, Board members and professional staff shall file the necessary statements on May 1, commencing the first year following the initial disclosure.

The form and content of the disclosure shall be included in the Board's ethics manual and will require disclosure of investments based upon categories—such as individual operating company holdings, mutual fund holdings, index fund holdings, exchange-traded options holdings, stock

equivalents and dependents. Under EC8(a), if a Board member or professional staff's spouse, spousal equivalent, or dependent had a financial interest in a public accounting firm, that interest would have to be disclosed and the Board or staff member would be recused from participating in any matter involving that public accounting firm. In addition, Board member spouses, spousal equivalents, and dependents are subject to the restrictions on payments from public accounting firms in EC4(b).

futures holdings and other holdings the Board deems relevant.

It is currently contemplated that all values will be disclosed in ranges, and based on market value. For example, a Board member or professional staff member would be required to identify whether their assets in mutual funds were between two fixed dollar values—\$0–\$50,000, \$50,000–\$100,000, etc.

It is further contemplated that broad based classes of investments, such as mutual fund holdings, could be disclosed in lump sum (*i.e.*, all mutual fund holdings could be aggregated for convenience), while individual holdings (equities, options and futures) would be required to be specifically identified, along with the range of valuation for each issue.

#### EC6. Outside Activities

EC6 governs the participation in outside activities for Board members and staff.

EC6(a) provides that no member of the Board may undertake any employment or other activity for compensation outside of service to the Board.

EC6(b) dictates that staff of the Board may only undertake other employment or other activity for compensation with the express and specific approval of the Board or such person to whom the Board may delegate such approval authority. As with other delegations of Board functions, section 101(g)(2) of the Act will define the parameters of the delegation.

While EC6(b) applies to all paid outside activities, the Board envisions that the Board's Ethics Officer or other person to whom the Board delegates approval authority will recommend approval on a case-by-case basis, or, where appropriate, a "blanket" basis for those activities unrelated to the Board's oversight and which would not otherwise impair staff independence or hinder the reputation of the Board.

EC6(c) prohibits any outside activities by Board members and staff, whether or not for compensation, that violate certain general principles that are specified in subparagraphs (1) through (3) of EC6(c).<sup>9</sup>

#### EC7. Gifts, Reimbursements, Honoraria and Other Things of Value

EC7 places restrictions on the receipt of gifts, honoraria, reimbursement for travel and other things of value by Board members and professional staff. EC7(a) provides that no Board member or professional staff shall, directly or

indirectly, solicit or accept any gift, reimbursement, honoraria or anything of monetary value from any source, under the circumstances described in subparagraphs (1) and (2).<sup>10</sup>

EC7(b) describes the circumstances under which, and from whom, travel reimbursement may be paid.

Subparagraph (1) limits such reimbursements for travel that is in direct connection with the employee's participation in an educational forum.

Subparagraph (2) further limits reimbursement to educational forums that are principally sponsored by and the travel-related expenses are paid or reimbursed by a federal, state or local governmental body or an association of such bodies, an accredited institution of higher learning, an organization exempt from taxation under 501(c)(3) of the Internal Revenue Code (provided such organization is not principally funded from one or more public accounting firms or issuers), or equivalent institutions outside the United States.

At the request of a commenter, the Board added association of governmental bodies to the list of organizations from which travel expenses may be reimbursed. The Board also added equivalent institutions outside the United States to make clear that this provision of its Ethics Code applies equally to non-U.S. entities.

#### EC8. Disqualification

EC8 contains provisions requiring the disclosure, recusal and disqualification from participation in certain matters by Board members or professional staff.

As referenced above in EC4, EC8(a) provides that if a Board member or professional staff becomes, or reasonably should become, aware of facts which would lead a reasonable person to believe that he or she (or his or her spouse, spousal equivalent, and dependents) may have a financial interest or similar relationship which might affect (or reasonably create the appearance of affecting) his or her independence or objectivity, then he or she must, at the earliest possible date, take the actions described in subparagraphs (1) and (2). Subparagraph (1) requires disclosure of such circumstances and facts. Subparagraph (2) instructs the Board member or professional staff to recuse himself or herself from further Board functions or activities involving or affecting the financial interest or relationship.

At the suggestion of several commenters, the Board imposed a

<sup>9</sup> The circumstances described in these subparagraphs are self-explanatory and are not discussed below.

<sup>10</sup> The circumstances described in these subparagraphs are self-explanatory and are not discussed below.

"reasonable person" standard to use to determine whether a financial relationship requires disclosure and disqualification.

The Board also added two clarifying notes following EC8(a). The first note clarifies that for the purposes of applying this provision to members of an advisory group, those members shall not be considered to lack independence or objectivity with regard to advisory group matters merely because they (or their employer, business partners or clients) are subject to the direct or indirect oversight of the Board. The second note advises non-professional staff to seek the counsel of the Ethics Officer if they face circumstances concerning financial relationships that may affect their ability to perform their functions.

EC8(b) indicates that for a member of the Board, disclosure shall be made to all other members of the Board. For professional staff of the Board, disclosure shall be made to the Board Chair, or the person or persons designated by the Chair (e.g., the Ethics Officer).

EC8(c) restricts Board members and professional staff for a period of 12 months commencing on date of appointment or employment from participating in the making of a decision which is reasonably likely to have a material effect on the Board or professional staff member's former employer, business partner or client, when such prior employment terminated within five years from the date of appointment or employment with the Board.

Several commenters requested that the Board clarify that broad policy decisions are not "indirect effects." In response to this suggestion the Board added language that indicates that participating in the making of a decision that affects a former employer, business partner or client to the same degree as similarly situated people or business organizations, does not constitute an "indirect" effect. This is meant to cover matters of general applicability to a broad class of persons.

#### EC9. Non-Public Information

EC9 restricts Board members and staff from disseminating or disclosing certain information. Subparagraph (a) provides that unless authorized by the Board, no Board member or staff shall disseminate or otherwise disclose any information obtained in the course and scope of his or her employment, and which has not been released, announced, or otherwise made available publicly and subparagraph (b) provides that the restriction in EC9 shall continue in

effect after the termination of employment or Board membership. As proposed, the restriction on disclosure of non-public information only applied for five years after the Board or professional staff member left the Board. Due to the importance of preserving confidential information, the Board decided to strengthen this provision by extending its application indefinitely.

#### EC10. Speaking for the Board

EC10 provides that, unless authorized to speak on behalf of the Board, Board members and professional staff shall include a disclaimer for any private publication or public statement by indicating that the views expressed are those of the author or speaker and do not necessarily reflect the view of the Board or other Board members or staff.

#### EC11. Ethics Officer

EC11 directs the Board to designate an Ethics Officer with the power and responsibilities identified in subparagraphs (a) through (c).<sup>11</sup>

#### EC12. Post-Employment Restrictions

EC12 imposes certain post-employment restrictions on Board members and professional staff. Subparagraph (a)(1) prohibits Board members and professional staff from negotiating prospective employment with a public accounting firm, without first disclosing (pursuant to the procedures in section EC8(b)) the identity of the prospective employer and recusing himself or herself from all Board matters directly affecting that prospective employer.

Subparagraph (a)(2) was added at the request of several commenters and defines "negotiating prospective employment" to mean participating in an employment interview; discussing an offer of employment; or accepting an offer of employment, even if the precise terms are still to be developed. Submitting a resume or job application to a group of employers, or receiving an unsolicited inquiry of interest that is rejected, do not alone constitute "negotiating prospective employment." This additional language is consistent with Regulations Concerning Post Employment Conflicts of Interest (5 CFR 2637.101 *et seq.*), to which federal government employees are subject.

Subparagraph (b) contains two restrictions on former Board members and professional staff. First, it restricts Board members and professional staff from practicing before the Board, and

the Commission with respect to Board-related matters, for one year following termination of employment or Board membership. Second, the Board added EC 12(b)(2), which provides that former Board members and professional staff shall not practice before the Board, or the Commission with respect to Board-related matters, on a particular matter in which the Board member or professional staff participated personally and substantially as a Board or staff member and which involved a specific party or parties at the time of such participation. The Board based this restriction on the comparable restriction applicable to federal government employees in 18 U.S.C. 207(a). Since this rule is limited to particular matters, it would not cover matters of general applicability, such as rulemakings the person participated in while at the Board.

#### EC13. Waiver

EC13 establishes a mechanism for the Board to waive any provision of the Ethics Code, provided the granting of the waiver would not otherwise be prohibited by law. EC13 provides that waivers must be requested in writing by the Board member or staff, and evaluated by the Ethics Officer and that the Board will only grant waiver requests after a finding that the waiver would not otherwise hinder the interests or reputation of the Board. Subject to section 101(g)(2) of the Act, the Board may delegate approval authority as to staff requests.

Several commenters suggested that the Board disclose waivers of its Ethics Code. In response to these comments, the Board decided to make waivers available to the public, subject to withholding information that would constitute a clearly unwarranted invasion of personal privacy.<sup>12</sup> The Board believes that this approach provides for transparency of the Board's administration of its Ethics Code, while still protecting individuals' privacy interests.

#### EC14. Certification

EC14 provides that Board members, staff, and designated contractors and consultants agree to comply with this Code at the commencement of their service with the Board and shall annually certify in writing their continuing compliance with it. The Board modified this provision to also apply to designated contractors and

<sup>11</sup> The powers and responsibilities described in these subparagraphs are self-explanatory and are not discussed below.

<sup>12</sup> This standard is based on, and consistent with, one of the exemptions to the Freedom of Information Act. See 5 U.S.C. 552(b)(6).

consultants after careful consideration of recommendations by commenters.

**(b) Statutory Basis**

The statutory basis for the proposed rules is Title I of the Act.

*B. Board's Statement on Burden on Competition*

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

*C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others*

The Board released its proposed Code for public comment on April 18, 2003. See PCAOB Release No. 2003-004 (April 18, 2003). The Board received eight written comment letters on its proposal. A copy of PCAOB Release No. 2003-004 and the comment letters received in response to the PCAOB's request for comment are available on the PCAOB's Web site at [www.pcaobus.org](http://www.pcaobus.org).

The Board has carefully considered all comments it has received. In response to the written comments received, the Board clarified and modified certain aspects of its proposed Code. Specifically, the Board made 12 principal changes to its proposal. First, the Board revised its proposal to clarify that the Code's application to "designated contractors and consultants" will require a three step process: first, there must be a contract for services; second, the Board (or its designate) must determine that the Code should be applied to the contractor, in whole or in part; and last, the contract must contain specific provisions incorporating those portions of this Code applicable to the contractor. Second, the Board eliminated the definition of "immediate family" and clarified which provisions of the Ethics Code apply to a Board or staff member's spouse, spousal equivalent, and dependents. Third, the Board decided to impose the obligation upon Board members and professional staff to disclose their personal investments, and those of their spouses, spousal equivalents and dependents, in the securities of issuers.

Fourth, the Board decided to expand the narrow list of sponsors who are permitted to pay for Board-related travel to include associations of governmental (federal, state or local) bodies and non-U.S. institutions equivalent to the permissible domestic sponsors. Fifth, the Board created a "reasonable person" standard for Board members and professional staff to use to determine

whether a financial relationship requires disclosure and disqualification. Sixth, the Board clarified that, in the context of members of an advisory group,<sup>13</sup> independence and objectivity are not *per se* impaired because the group member's employer, business client or partner is subject to the Board's direct or indirect oversight.

Seventh, the revised Code clarifies that Board members and professional staff are not required to disqualify themselves from participating in making or developing broad policies or procedures which may have some effect on a former employer, business partner or client, so long as the policy or procedure effects all similarly situated people and organizations to the same degree. Eighth, the Board chose to define those circumstances which trigger (and do not trigger) the requirement for Board members and professional staff to internally disclose when they are "negotiating prospective employment" with a public accounting firm or issue.<sup>14</sup> Ninth, the Board required designated contractors and consultants to certify compliance with the Code (as applied to them) to the same extent as Board members and staff.

Tenth, the Board added a restriction on former Board members and professional staff participating in a matter they personally and substantially participated in while at the Board. Eleventh, the Board extended indefinitely the restriction on former Board members and professional staff from disclosing non-public Board information. Twelfth, and finally, the Board chose to make publicly available information on waivers of the Ethics Code. Additional discussion of the Board's response to these and other comments it received is included in section II(a)(A) above.

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

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

(a) By order approve such proposed rules; or

<sup>13</sup> See PCAOB Release No. 2003-009, and PCAOB Rule 3700 (regarding advisory groups).

<sup>14</sup> When this disclosure is triggered, Board members and professional staff must also disqualify themselves from participating in decisions directly affecting the prospective employer.

(b) Institute proceedings to determine whether the proposed rules should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All submissions should refer to File No. PCAOB-2003-04 and should be submitted by October 17, 2003.

By the Commission.

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

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-48505; File No. SR-ISE-2003-20]

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the International Securities Exchange, Inc. To Simplify the Manner in Which a Contrary Exercise Advice Is Submitted and To Extend by One Hour the Time for Members To Submit Contrary Exercise Advices**

September 17, 2003.

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 August 12, 2003, the International Securities Exchange, Inc. ("ISE" or "Exchange") submitted to the Securities and

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

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