SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–50298; File No. SR–NYSE–2004–41]

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. To Amend Section 303A of the NYSE Listed Company Manual Relating to Corporate Governance

August 31, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on August 3, 2004, the New York Stock Exchange, Inc. (''NYSE'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in items I, II, III below, which items have been prepared by the NYSE. The NYSE submitted Amendment No. 1 to the proposal on August 30, 2004.[3] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The NYSE proposes to amend section 303A of the NYSE Listed Company Manual (''Listed Company Manual'') to make (i) clarifying language changes consistent with interpretations that have been provided by the Exchange in response to questions and published Frequently Asked Questions (''FAQs''), and (ii) changes to section 303A.02(b)(iii) to align it more closely with the similar standard in place at the other listing markets.

The text of the proposed rule change appears below. Proposed additions are in *italics*; proposed deletions are in brackets.

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Listed Company Manual

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303A Corporate Governance Standards

General Application

Companies listed on the Exchange must comply with certain standards regarding corporate governance as codified in this Section 303A. Consistent with the NYSE's traditional approach, as well as the requirements of the Sarbanes-Oxley Act of 2002, certain provisions of Section 303A are applicable to some listed companies but not to others.

Equity Listings

Section 303A applies in full to all companies listing common equity securities, with the following exceptions:

Controlled Companies

A *listed* company of which more than 50% of the voting power is held by an individual, a group or another company need not comply with the requirements of sections 303A.01, .04 or .05. A controlled company that chooses to take advantage of any or all of these exemptions must disclose that choice, that it is a controlled company and the basis for the determination in its annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC. Controlled companies must comply with the remaining provisions of Section 303A.

Limited Partnerships and Companies in Bankruptcy

Due to their unique attributes, limited partnerships and companies in bankruptcy proceedings need not comply with the requirements of Sections 303A.01, .04 or .05. However, all limited partnerships (at the general partner level) and companies in bankruptcy proceedings must comply with the remaining provisions of Section 303A.

Closed-End and Open-End Funds

The Exchange considers the significantly expanded standards and requirements provided for in Section 303A to be unnecessary for closed-end and open-end management investment companies that are registered under the Investment Company Act of 1940, given the pervasive Federal regulation applicable to them. However, closed-end funds must comply with the requirements of Sections 303A.06, .07(a) and (c), and .12. Note, however, that in view of the common practice to utilize the same directors for boards in the same fund complex, closed-end funds will not be required to comply with the disclosure requirement in the second paragraph of the Commentary to 303A.07(a), which calls for disclosure of a board's determination with respect to simultaneous service on more than three public company audit committees. However, the other provisions of that paragraph will apply.

Business development companies, which are a type of closed-end management investment company defined in Section 2(a)(48) of the Investment Company Act of 1940 that are not registered under that Act, are required to comply with all of the provisions of Section 303A applicable to domestic issuers other than Sections 303A.02 and .07(b). For purposes of Sections 303A.01, .03, .04, .05, and .09, a director of a business development company shall be considered to be independent if he or she is not an ''interested person'' of the company, as defined in Section 2(a)(19) of the Investment Company Act of 1940.

As required by Rule 10A–3 under the Exchange Act, open-end funds (which can be listed as Investment Company Units, more commonly known as Exchange Traded Funds or ETFs) are required to comply with the requirements of Sections 303A.06 and .12(b) *and (c).*

Rule 10A–3(b)(3)(ii) under the Exchange Act requires that each audit committee must establish procedures for the confidential, anonymous submission by employees of the listed issuer of concerns regarding questionable accounting or auditing matters. In view of the external management structure often employed by closed-end and open-end funds, the Exchange also requires the audit committees of such companies to establish such procedures for the confidential, anonymous submission by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the management company, as well as employees of the management company. This responsibility must be addressed in the audit committee charter.

Other Entities

Except as otherwise required by Rule 10A–3 under the Exchange Act (for example, with respect to open-end funds), Section 303A does not apply to passive business organizations in the form of trusts (such as royalty trusts) or to derivatives and special purpose securities (such as those described in Sections 703.16, 703.19, 703.20 and 703.21). To the extent that Rule 10A–3 applies to a passive business organization, listed derivative or special purpose security, such entities are

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated August 27, 2004, and accompanying Form 19b–4 (''Amendment No. 1''). Amendment No. 1 changed the proposal from a filing submitted pursuant to section 19(b)(3)(A) of the Act to a proposal filed pursuant to section 19(b)(2) of the Act, made certain changes to the description of the proposal, and replaced the original filing in its entirety.

required to comply with Sections 303A.06 and .12(b).

Foreign Private Issuers

Listed companies that are foreign private issuers (as such term is defined in Rule 3b–4 under the Exchange Act) are permitted to follow home country practice in lieu of the provisions of this Section 303A, except that such companies are required to comply with the requirements of Sections 303A.06, .11 and .12(b) *and (c).*

Preferred and Debt Listings

Section 303A does not generally apply to companies listing only preferred or debt securities on the Exchange. To the extent required by Rule 10A–3 under the Exchange Act, all companies listing only preferred or debt securities on the NYSE are required to comply with the requirements of Sections 303A.06 and .12(b) *and (c).*

Effective Dates/Transition Periods

Except for Section 303A.08, which became effective June 30, 2003, listed companies will have until the earlier of their first annual meeting after January 15, 2004, or October 31, 2004, to comply with the new standards contained in Section 303A, although if a *listed* company with a classified board would be required (other than by virtue of a requirement under Section 303A.06) to change a director who would not normally stand for election in such annual meeting, the *listed* company may continue such director in office until the second annual meeting after such date, but no later than December 31, 2005. In addition, foreign private issuers will have until July 31, 2005[,] to comply with the new audit committee standards set out in Section 303A.06, *and will not be required to provide the written affirmations required by Section 303A.12(c) until after that date.* As a general matter, the existing audit committee requirements provided for in Section 303 continue to apply to listed companies pending the transition to the new rules.

Companies listing in conjunction with their initial public offering will be permitted to phase in their independent nomination and compensation committees on the same schedule as is permitted pursuant to Rule 10A–3 under the Exchange Act for audit committees, that is, one independent member at the time of listing, a majority of independent members within 90 days of listing and fully independent committees within one year. Such companies will be required to meet the majority independent board requirement within 12 months of listing. For purposes of Section 303A other than Sections 303A.06 and .12(b), a company will be considered to be listing in conjunction with an initial public offering if, immediately prior to listing, it does not have a class of common stock registered under the Exchange Act. The Exchange will also permit companies that are emerging from bankruptcy or have ceased to be controlled companies within the meaning of Section 303A to phase in independent nomination and compensation committees and majority independent boards on the same schedule as companies listing in conjunction with an initial public offering. However, for purposes of Sections 303A.06 and .12(b), a company will be considered to be listing in conjunction with an initial public offering only if it meets the conditions of Rule 10A–3(b)(1)(iv)(A) under the Exchange Act, namely, that the company was not, immediately prior to the effective date of a registration statement, required to file reports with the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act.

Companies listing upon transfer from another market have 12 months from the date of transfer in which to comply with any requirement to the extent the market on which they were listed did not have the same requirement. To the extent the other market has a substantially similar requirement but also had a transition period from the effective date of that market's rule, which period had not yet expired, the company will have the same transition period as would have been available to it on the other market. This transition period for companies transferring from another market will not apply to the requirements of Section 303A.06 unless a transition period is available pursuant to Rule 10A–3 under the Exchange Act.

References to Form 10–K

There are provisions in this Section 303A that call for disclosure in a *listed* company's Form 10–K under certain circumstances. If a *listed* company subject to such a provision is not a company required to file a Form 10–K, then the provision shall be interpreted to mean the annual periodic disclosure form that the *listed* company does file with the SEC. For example, for a closed-end fund, the appropriate form would be the annual Form N–CSR. If a *listed* company is not required to file either an annual proxy statement or an annual periodic report with the SEC, the disclosure shall be made in the annual report required under Section 203.01 of the Listed Company Manual.

1. Listed companies must have a majority of independent directors.

Commentary: Effective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest.

2. In order to tighten the definition of ''independent director'' for purposes of these standards:

(a) No director qualifies as ''independent'' unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). Companies must *identify which directors are independent and* disclose *the basis for* th*at*[ese] determination[s].

Commentary: It is not possible to anticipate, or explicitly to provide for, all circumstances that might signal potential conflicts of interest, or that might bear on the materiality of a director's relationship to a listed company [(references to ''company'' would include any parent or subsidiary in a consolidated group with the company)]. Accordingly, it is best that boards making ''independence'' determinations broadly consider all relevant facts and circumstances. In particular, when assessing the materiality of a director's relationship with the *listed* company, the board should consider the issue not merely from the standpoint of the director, but also from that of persons or organizations with which the director has an affiliation. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others. However, as the concern is independence from management, the Exchange does not view ownership of even a significant amount of stock, by itself, as a bar to an independence finding. *The identity of the independent directors and* [T]*t*he basis for a board determination that a relationship is not material must be disclosed in the *listed* company's annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC. In this regard, a board may adopt and disclose categorical standards to assist it in making determinations of independence and may make a general disclosure if a director meets these standards. Any determination of independence for a director who does not meet these standards must be specifically explained. A company must disclose any standard it adopts. It may

then make the general statement that the independent directors meet the standards set by the board without detailing particular aspects of the immaterial relationships between individual directors and the company. In the event that a director with a business or other relationship that does not fit within the disclosed standards is determined to be independent, a board must disclose the basis for its determination in the manner described above. This approach provides investors with an adequate means of assessing the quality of a board's independence and its independence determinations while avoiding excessive disclosure of immaterial relationships.

(b) In addition, *a director is not independent if*:

(i) *The* [A] director [who] is, *or has been within the last three years,* an employee *of the listed company*, or [whose] *an* immediate family member is*, or has been within the last three years,* an executive officer,[1] of the listed company [is not independent until three years after the end of such employment relationship].

Commentary: Employment as an interim Chairman or CEO *or other executive officer* shall not disqualify a director from being considered independent following that employment.

(ii) *The* [A] director [who] *has* receive[s]*d*, or [whose] *has an* immediate family member *who has* receive[s]*d*, *during any twelve-month period within the last three years,* more than $100,000 [per year] in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service)[, is not independent until three years after he or she ceases to receive more than $100,000 per year in such compensation].

Commentary: Compensation received by a director for former service as an interim Chairman or CEO *or other executive officer* need not be considered in determining independence under this test. Compensation received by an immediate family member for service as a*n* [non-executive] employee of the listed company *(other than an executive officer)* need not be considered in determining independence under this test.

(iii) *(A)* The [A] director [who is affiliated with or employed by,] or *an* [whose] immediate family member is *a current partner of a firm that is the company's internal or external auditor; (B) the director is a current employee of such a firm; (C) the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance or tax compliance (but not tax planning) practice; or (D) the director or an immediate family member was within the last three years (but is no longer)* [affiliated with or employed in a professional capacity by,] *a partner or employee of such a firm and personally worked on the listed company's audit within that time* [company's a present or former internal or external auditor of the company is not ''independent'' until three years after the end of the affiliation or the employment or auditing relationship].

Commentary: For purposes of this Section 303A.02(b)(iii) only, the term ''immediate family member'' shall mean a spouse, minor child or stepchild, or an adult child or stepchild sharing a home with the director.

(iv) *The* [A] director *or an immediate family member* [who] is*, or has been within the last three years,* employed[, or whose immediate family member is employed,] as an executive officer of another company where any of the listed company's present executive officers *at the same time* serve*s or served* on that company's compensation committee [is not ''independent'' until three years after the end of such service or the employment relationship].

(v) The [A] director [who] is a[n] *current* [executive officer or an] employee, or [whose] *an* immediate family member is a[n] *current* executive officer, of a company that [makes] *has made* payments to, or receive[s]*d* payments from, the listed company for property or services in an amount which, in any [single] *of the last three* fiscal year*s*, exceeds the greater of $1 million, or 2% of such other company's consolidated gross revenues[, is not ''independent'' until three years after falling below such threshold].

Commentary: In applying the test in Section 303A.02(b)(v), both the payments and the consolidated gross revenues to be measured shall be those reported in the last completed fiscal year of such other company. The look-back provision for this test applies solely to the financial relationship between the listed company and the director or immediate family member's current employer; a listed company need not consider former employment of the director or immediate family member. [Charitable] *Contributions to tax exempt* organizations shall not be considered ''[companies] *payments*'' for purposes of Section 303A.02(b)(v), provided however that a listed company shall disclose in its annual proxy statement, or if the listed company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC, any [charitable] *such* contributions made by the listed company to any [charitable] *tax exempt* organization in which *any independent* [a] director serves as an executive officer if, within the preceding three years, contributions in any single fiscal year *from the listed company to the organization* exceeded the greater of $1 million, or 2% of such [charitable] *tax exempt* organization's consolidated gross revenues. Listed company boards are reminded of their obligations to consider the materiality of any such relationship in accordance with Section 303A.02(a) above.

General Commentary to Section 303A.02(b): *Other than with respect to Section 303A.02(b)(iii),* a[A]n ''immediate family member'' includes a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person's home. When applying the look-back provisions in Section 303A.02(b), listed companies need not consider individuals who are no longer immediate family members as a result of legal separation or divorce, or those who have died or become incapacitated.

In addition, references to the ''company'' would include any parent or subsidiary in a consolidated group with the company.

Transition Rule. Each of the above standards contains a three-year ''look-back'' provision. In order to facilitate a smooth transition to the new independence standards, the Exchange will phase in the ''look-back'' provisions by applying only a one-year look-back for the first year after adoption of these new standards. The three-year look-backs provided for in Section 303A.02(b) will begin to apply only from and after [insert the date which is the first anniversary of the effective date of this listing standard] *November 4, 2004.*

As an example, until [insert the date which is the day prior to the first anniversary of the effective date of this listing standard] *November 3, 2004*, a *listed* company need look back only one year when testing compensation under Section 303A.02(b)(ii). Beginning [[insert the date which is the first anniversary of the effective date of this listing standard]] *November 4, 2004*, however, the *listed* company would

[1] *For purposes of Section 303A, the term ''executive officer'' has the same meaning specified for the term ''officer'' in Rule 16a–1(f) under the Securities Exchange Act of 1934.*

need to look back the full three years provided in Section 303A.02(b)(ii).

3. To empower non-management directors to serve as a more effective check on management, the non-management directors of each *listed* company must meet at regularly scheduled executive sessions without management.

Commentary: To promote open discussion among the non-management directors, companies must schedule regular executive sessions in which those directors meet without management participation. ''Non-management'' directors are all those who are not [company] *executive* officers [(as that term is defined in Rule 16a–1(f) under the Securities Act of 1933)], and includes such directors who are not independent by virtue of a material relationship, former status or family membership, or for any other reason.

Regular scheduling of such meetings is important not only to foster better communication among non-management directors, but also to prevent any negative inference from attaching to the calling of executive sessions. [There need not be a single presiding director] *A non-management director must preside over each executive session of the non-management directors, although the same director is not required to preside* at all executive sessions of the non-management directors. If one director is chosen to preside at *all of* these meetings, his or her name must be disclosed in the *listed* company's annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC. Alternatively, *if the same individual is not the presiding director at every meeting,* a *listed* company [may] *must* disclose the procedure by which a presiding director is selected for each executive session. For example, a *listed* company may wish to rotate the presiding position among the chairs of board committees.

In order that interested parties may be able to make their concerns known to the non-management directors, a *listed* company must disclose a method for such parties to communicate directly with the presiding director or with the non-management directors as a group. *Such disclosure must be made in the listed company's annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC.* Companies may, if they wish, utilize for this purpose the same procedures they have established to comply with the requirement of Rule 10A–3 (b)(3) under the Exchange Act, as applied to listed companies through Section 303A.06.

While this Section 303A.03 refers to meetings of non-management directors, if that group includes directors who are not independent under this Section 303A, listed companies should at least once a year schedule an executive session including only independent directors.

4. (a) Listed companies must have a nominating/corporate governance committee composed entirely of independent directors.

(b) The nominating/corporate governance committee must have a written charter that addresses:

(i) The committee's purpose and responsibilities—which, at minimum, must be to: Identify individuals qualified to become board members, consistent with criteria approved by the board, and to select, or to recommend that the board select, the director nominees for the next annual meeting of shareholders; develop and recommend to the board a set of corporate governance [principles] *guidelines* applicable to the corporation; and oversee the evaluation of the board and management; and

(ii)An annual performance evaluation of the committee.

Commentary: A nominating/corporate governance committee is central to the effective functioning of the board. New director and board committee nominations are among a board's most important functions. Placing this responsibility in the hands of an independent nominating/corporate governance committee can enhance the independence and quality of nominees. The committee is also responsible for taking a leadership role in shaping the corporate governance of a corporation.

If a *listed* company is legally required by contract or otherwise to provide third parties with the ability to nominate directors (for example, preferred stock rights to elect directors upon a dividend default, shareholder agreements, and management agreements), the selection and nomination of such directors need not be subject to the nominating committee process.

The nominating/corporate governance committee charter should also address the following items: Committee member qualifications; committee member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board. In addition, the charter should give the nominating/corporate governance committee sole authority to retain and terminate any search firm to be used to identify director candidates, including sole authority to approve the search firm's fees and other retention terms.

Boards may allocate the responsibilities of the nominating/corporate governance committee to committees of their own denomination, provided that the committees are composed entirely of independent directors. Any such committee must have a published committee charter.

5. (a) Listed companies must have a compensation committee composed entirely of independent directors.

(b) The compensation committee must have a written charter that addresses:

(i) The committee's purpose and responsibilities—which, at minimum, must be to have direct responsibility to:

(A) Review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives, and, either as a committee or together with the other independent directors (as directed by the board), determine and approve the CEO's compensation level based on this evaluation; and

(B) Make recommendations to the board with respect to non-CEO *executive officer* compensation, *and* incentive-compensation [plans] and equity-based plans *that are subject to board approval*; and

(C) Produce a compensation committee report on executive *officer* compensation as required by the SEC to be included in the *listed* company's annual proxy statement or annual report on Form 10–K filed with the SEC;

(ii) An annual performance evaluation of the compensation committee.

Commentary: In determining the long-term incentive component of CEO compensation, the committee should consider the *listed* company's performance and relative shareholder return, the value of similar incentive awards to CEOs at comparable companies, and the awards given to the listed company's CEO in past years. To avoid confusion, note that the compensation committee is not precluded from approving awards (with or without ratification of the board) as may be required to comply with applicable tax laws (*i.e.,* Rule 162(m)). *Note also that nothing in Section 303A.05(b)(i)(B) is intended to preclude the board from delegating its authority over such matters to the compensation committee.*

The compensation committee charter should also address the following items: Committee member qualifications; committee member appointment and removal; committee structure and

operations (including authority to delegate to subcommittees); and committee reporting to the board.

Additionally, if a compensation consultant is to assist in the evaluation of director, CEO or [senior] executive *officer* compensation, the compensation committee charter should give that committee sole authority to retain and terminate the consulting firm, including sole authority to approve the firm's fees and other retention terms.

Boards may allocate the responsibilities of the compensation committee to committees of their own denomination, provided that the committees are composed entirely of independent directors. Any such committee must have a published committee charter.

Nothing in this provision should be construed as precluding discussion of CEO compensation with the board generally, as it is not the intent of this standard to impair communication among members of the board.

6. Listed companies must have an audit committee that satisfies the requirements of Rule 10A–3 under the Exchange Act.

Commentary: The Exchange will apply the requirements of Rule 10A–3 in a manner consistent with the guidance provided by the Securities and Exchange Commission in SEC Release No. 34–47654 (April 1, 2003). Without limiting the generality of the foregoing, the Exchange will provide companies the opportunity to cure defects provided in Rule 10A–3(a)(3) under the Exchange Act.

7. (a) The audit committee must have a minimum of three members.

Commentary: Each member of the audit committee must be financially literate, as such qualification is interpreted by the *listed* company's board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee. In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the *listed* company's board interprets such qualification in its business judgment. While the Exchange does not require that a listed company's audit committee include a person who satisfies the definition of audit committee financial expert set out in Item 401*(h)* [(e)] of Regulation S–K, a board may presume that such a person has accounting or related financial management expertise.

Because of the audit committee's demanding role and responsibilities, and the time commitment attendant to committee membership, each prospective audit committee member should evaluate carefully the existing demands on his or her time before accepting this important assignment. Additionally, if an audit committee member simultaneously serves on the audit committees of more than three public companies, and the listed company does not limit the number of audit committees on which its audit committee members serve *to three or less*, then in each case, the board must determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee and disclose such determination in the *listed* company's annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report on Form 10–K filed with the SEC.

(b) In addition to any requirement of Rule 10A–3(b)(1), all audit committee members must satisfy the requirements for independence set out in Section 303A.02.

(c) The audit committee must have a written charter that addresses:

(i) The committee's purpose—which, at minimum, must be to:

(A) Assist board oversight of (1) the integrity of the *listed* company's financial statements, (2) the *listed* company's compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence, and (4) the performance of the *listed* company's internal audit function and independent auditors; and

(B) Prepare an audit committee report as required by the SEC to be included in the *listed* company's annual proxy statement;

(ii) An annual performance evaluation of the audit committee; and

(iii) The duties and responsibilities of the audit committee—which, at a minimum, must include those set out in Rule 10A–3(b)(2), (3), (4) and (5) of the Exchange Act , as well as to:

(A) At least annually, obtain and review a report by the independent auditor describing: the firm's internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor's independence) all relationships between the independent auditor and the *listed* company;

Commentary: After reviewing the foregoing report and the independent auditor's work throughout the year, the audit committee will be in a position to evaluate the auditor's qualifications, performance and independence. This evaluation should include the review and evaluation of the lead partner of the independent auditor. In making its evaluation, the audit committee should take into account the opinions of management and the *listed* company's internal auditors (or other personnel responsible for the internal audit function). In addition to assuring the regular rotation of the lead audit partner as required by law, the audit committee should further consider whether, in order to assure continuing auditor independence, there should be regular rotation of the audit firm itself. The audit committee should present its conclusions with respect to the independent auditor to the full board.

(B) *Meet to review and* discuss the *listed* company's annual audited financial statements and quarterly financial statements with management and the independent auditor, including *reviewing* the company's *specific* disclosures under ''Management's Discussion and Analysis of Financial Condition and Results of Operations';

(C) Discuss the *listed* company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies;

Commentary: The audit committee's responsibility to discuss earnings releases, as well as financial information and earnings guidance, may be done generally (i.e., discussion of the types of information to be disclosed and the type of presentation to be made). The audit committee need not discuss in advance each earnings release or each instance in which a *listed* company may provide earnings guidance.

(D) Discuss policies with respect to risk assessment and risk management;

Commentary: While it is the job of the CEO and senior management to assess and manage the *listed* company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled. The audit committee should discuss the *listed* company's major financial risk exposures and the steps management has taken to monitor and control such exposures. The audit committee is not required to be the sole body responsible for risk assessment and management, but, as stated above, the committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken. Many companies,

particularly financial companies, manage and assess their risk through mechanisms other than the audit committee. The processes these companies have in place should be reviewed in a general manner by the audit committee, but they need not be replaced by the audit committee.

(E) Meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors;

Commentary: To perform its oversight functions most effectively, the audit committee must have the benefit of separate sessions with management, the independent auditors and those responsible for the internal audit function. As noted herein, all listed companies must have an internal audit function. These separate sessions may be more productive than joint sessions in surfacing issues warranting committee attention.

(F) Review with the independent auditor any audit problems or difficulties and management's response;

Commentary: The audit committee must regularly review with the independent auditor any difficulties the auditor encountered in the course of the audit work, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management. Among the items the audit committee may want to review with the auditor are: Any accounting adjustments that were noted or proposed by the auditor but were ''passed'' (as immaterial or otherwise); any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any ''management'' or ''internal control'' letter issued, or proposed to be issued, by the audit firm to the *listed* company. The review should also include discussion of the responsibilities, budget and staffing of the *listed* company's internal audit function.

(G) Set clear hiring policies for employees or former employees of the independent auditors; and

Commentary: Employees or former employees of the independent auditor are often valuable additions to corporate management. Such individuals' familiarity with the business, and personal rapport with the employees, may be attractive qualities when filling a key opening. However, the audit committee should set hiring policies taking into account the pressures that may exist for auditors consciously or subconsciously seeking a job with the company they audit.

(H) Report regularly to the board of directors.

Commentary: The audit committee should review with the full board any issues that arise with respect to the quality or integrity of the *listed* company's financial statements, the company's compliance with legal or regulatory requirements, the performance and independence of the company's independent auditors, or the performance of the internal audit function.

General Commentary to Section 303A.07(c): While the fundamental responsibility for the *listed* company's financial statements and disclosures rests with management and the independent auditor, the audit committee must review: (A) Major issues regarding accounting principles and financial statement presentations, including any significant changes in the company's selection or application of accounting principles, and major issues as to the adequacy of the company's internal controls and any special audit steps adopted in light of material control deficiencies; (B) analyses prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements; (C) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the *listed* company; and (D) the type and presentation of information to be included in earnings press releases (paying particular attention to any use of ''pro forma,'' or ''adjusted'' non-GAAP, information), as well as review any financial information and earnings guidance provided to analysts and rating agencies.

(d) Each listed company must have an internal audit function.

Commentary: Listed companies must maintain an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management processes and system of internal control. A *listed* company may choose to outsource this function to a third party service provider other than its independent auditor.

General Commentary to Section 303A.07: To avoid any confusion, note that the audit committee functions specified in Section 303A.07 are the sole responsibility of the audit committee and may not be allocated to a different committee.

8. No change.

9. Listed companies must adopt and disclose corporate governance guidelines.

Commentary: No single set of guidelines would be appropriate for every *listed* company, but certain key areas of universal importance include director qualifications and responsibilities, responsibilities of key board committees, and director compensation. Given the importance of corporate governance, each listed company's website must include its corporate governance guidelines and the charters of its most important committees (including at least the audit, and if applicable, compensation and nominating committees). [Each] *The listed* company['s] *must state in its annual proxy statement or, if the company does not file an annual proxy statement, in the company's* annual report on Form 10-K filed with the SEC [must state] that the foregoing information is available on its website, and that the information is available in print to any shareholder who requests it. Making this information publicly available should promote better investor understanding of the *listed* company's policies and procedures, as well as more conscientious adherence to them by directors and management.

The following subjects must be addressed in the corporate governance guidelines:

- Director qualification standards. These standards should, at minimum, reflect the independence requirements set forth in Sections 303A.01 and .02. Companies may also address other substantive qualification requirements, including policies limiting the number of boards on which a director may sit, and director tenure, retirement and succession.
- Director responsibilities. These responsibilities should clearly articulate what is expected from a director, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.
- Director access to management and, as necessary and appropriate, independent advisors.
- Director compensation. Director compensation guidelines should include general principles for determining the form and amount of director compensation (and for reviewing those principles, as appropriate). The board should be aware that questions as to directors' independence may be raised when directors' fees and emoluments exceed

what is customary. Similar concerns may be raised when the *listed* company makes substantial charitable contributions to organizations in which a director is affiliated, or enters into consulting contracts with (or provides other indirect forms of compensation to) a director. The board should critically evaluate each of these matters when determining the form and amount of director compensation, and the independence of a director.

• Director orientation and continuing education.

• Management succession. Succession planning should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO.

• Annual performance evaluation of the board. The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively.

10. Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.

Commentary: No code of business conduct and ethics can replace the thoughtful behavior of an ethical director, officer or employee. However, such a code can focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability.

Each code of business conduct and ethics must require that any waiver of the code for executive officers or directors may be made only by the board or a board committee and must be promptly disclosed to shareholders. This disclosure requirement should inhibit casual and perhaps questionable waivers, and should help assure that, when warranted, a waiver is accompanied by appropriate controls designed to protect the *listed* company. It will also give shareholders the opportunity to evaluate the board's performance in granting waivers.

Each code of business conduct and ethics must also contain compliance standards and procedures that will facilitate the effective operation of the code. These standards should ensure the prompt and consistent action against violations of the code. Each listed company's website must include its code of business conduct and ethics. [Each] *The listed* company['s] *must state in its annual proxy statement or, if the company does not file an annual proxy statement, in the company's* annual report on Form 10–K filed with the SEC [must state], that the foregoing information is available on its website and that the information is available in print to any shareholder who requests it.

Each *listed* company may determine its own policies, but all listed companies should address the most important topics, including the following:

• Conflicts of interest. A ''conflict of interest'' occurs when an individual's private interest interferes in any way—or even appears to interfere—with the interests of the corporation as a whole. A conflict situation can arise when an employee, officer or director takes actions or has interests that may make it difficult to perform his or her company work objectively and effectively. Conflicts of interest also arise when an employee, officer or director, or a member of his or her family, receives improper personal benefits as a result of his or her position in the company. Loans to, or guarantees of obligations of, such persons are of special concern. The *listed* company should have a policy prohibiting such conflicts of interest, and providing a means for employees, officers and directors to communicate potential conflicts to the *listed* company.

• Corporate opportunities. Employees, officers and directors should be prohibited from (a) taking for themselves personally opportunities that are discovered through the use of corporate property, information or position; (b) using corporate property, information, or position for personal gain; and (c) competing with the company. Employees, officers and directors owe a duty to the company to advance its legitimate interests when the opportunity to do so arises.

• Confidentiality. Employees, officers and directors should maintain the confidentiality of information entrusted to them by the *listed* company or its customers, except when disclosure is authorized or legally mandated. Confidential information includes all non-public information that might be of use to competitors, or harmful to the company or its customers, if disclosed.

• Fair dealing. Each employee, officer and director should endeavor to deal fairly with the company's customers, suppliers, competitors and employees. None should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair-dealing practice. *Listed* [C]*c*ompanies may write their codes in a manner that does not alter existing legal rights and obligations of companies and their employees, such as ''at will'' employment arrangements.

• Protection and proper use of company assets. All employees, officers and directors should protect the company's assets and ensure their efficient use. Theft, carelessness and waste have a direct impact on the *listed* company's profitability. All company assets should be used for legitimate business purposes.

• Compliance with laws, rules and regulations (including insider trading laws). The *listed* company should proactively promote compliance with laws, rules and regulations, including insider trading laws. Insider trading is both unethical and illegal, and should be dealt with decisively.

• Encouraging the reporting of any illegal or unethical behavior. The *listed* company should proactively promote ethical behavior. The company should encourage employees to talk to supervisors, managers or other appropriate personnel when in doubt about the best course of action in a particular situation. Additionally, employees should report violations of laws, rules, regulations or the code of business conduct to appropriate personnel. To encourage employees to report such violations, the *listed* company must ensure that employees know that the company will not allow retaliation for reports made in good faith.

11. Listed foreign private issuers must disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards.

Commentary: Foreign private issuers must make their U.S. investors aware of the significant ways in which their [home country] *corporate governance* practices differ from those [followed by] *required of* domestic companies under NYSE listing standards. However, foreign private issuers are not required to present a detailed, item-by-item analysis of these differences. Such a disclosure would be long and unnecessarily complicated. Moreover, this requirement is not intended to suggest that one country's corporate governance practices are better or more effective than another. The Exchange believes that U.S. shareholders should be aware of the significant ways that the governance of a listed foreign private issuer differs from that of a U.S. listed company. The Exchange underscores that what is required is a brief, general summary of the significant differences, not a cumbersome analysis.

Listed foreign private issuers may provide this disclosure either on their web site (provided it is in the English language and accessible from the United States) and/or in their annual report as distributed to shareholders in the United States in accordance with Sections 103.00 and 203.01 of the Listed Company Manual (again, in the English language). If the disclosure is only made available on the web site, the annual report shall so state and provide the web address at which the information may be obtained.

12. (a) Each listed company CEO must certify to the NYSE each year that he or she is not aware of any violation by the company of NYSE corporate governance listing standards*, qualifying the certification to the extent necessary*.

Commentary: The CEO's annual certification [to the NYSE that, as of the date of certification, he or she is unaware of any violation by the company of] *regarding* the NYSE's corporate governance listing standards will focus the CEO and senior management on the *listed* company's compliance with the listing standards. Both this certification to the NYSE, *including any qualifications to that certification,* and any CEO/CFO certifications required to be filed with the SEC regarding the quality of the *listed* company's public disclosure, must be disclosed in the company's annual report to shareholders or, if the company does not prepare an annual report to shareholders, in the company's annual report on Form 10–K filed with the SEC.

(b) Each listed company CEO must promptly notify the NYSE in writing after any executive officer of the listed company becomes aware of any material non-compliance with any applicable provisions of this Section 303A.

(c) Each listed company must submit an executed Written Affirmation annually to the NYSE. In addition, each listed company must submit an interim Written Affirmation each time a change occurs to the board or any of the committees subject to Section 303A. The annual and interim Written Affirmations must be in the form specified by the NYSE.

13. The NYSE may issue a public reprimand letter to any listed company that violates a NYSE listing standard.

Commentary: Suspending trading in or delisting a *listed* company can be harmful to the very shareholders that the NYSE listing standards seek to protect; the NYSE must therefore use these measures sparingly and judiciously. For this reason it is appropriate for the NYSE to have the ability to apply a lesser sanction to deter companies from violating its corporate governance (or other) listing standards. Accordingly, the NYSE may issue a public reprimand letter to any listed company, regardless of type of security listed or country of incorporation, that it determines has violated a NYSE listing standard. For companies that repeatedly or flagrantly violate NYSE listing standards, suspension and delisting remain the ultimate penalties. For clarification, this lesser sanction is not intended for use in the case of companies that fall below the financial and other continued listing standards provided in Chapter 8 of the Listed Company Manual or that fail to comply with the audit committee standards set out in Section 303A.06. The processes and procedures provided for in Chapter 8 govern the treatment of companies falling below those standards.

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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 NYSE included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in item IV below. The NYSE has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

On November 4, 2003, the Commission approved Section 303A of the Listed Company Manual.[4] Section 303A sets out the Exchange's corporate governance requirements applicable to listed companies. Since the date that Section 303A was approved, the Exchange staff has received numerous phone calls and e-mail requests for clarification and interpretations of these standards. Many of the questions and interpretive requests focused on similar issues or specific language that was causing confusion. Most have related to Section 303A.02(b), which establishes five bright line tests that directors must satisfy in order to be eligible to be deemed independent for purposes of board and committee membership.

On January 29, 2004, the Exchange posted a series of FAQs relating to Section 303A on the Exchange's Web site at *http://www.nyse.com*. The Exchange subsequently updated these FAQs on February 13, 2004, to provide further clarification and additional interpretations.

Based on the FAQs and the NYSE's experiences in working with listed companies and their legal counsels on issues and questions related to Section 303A, the Exchange has noted several issues which need clarification or, in one case, change.

The following outlines the proposed amendments to Section 303A of the Listed Company Manual:

Section 303A.02—Independence definition

The Exchange proposes to amend Section 303A.02(a) of the Listed Company Manual to clarify that companies are required to identify which of their directors have been deemed independent. The Exchange has been of the opinion that the existing language strongly implied that obligation, but believes it is appropriate to make the language explicit to remove any ambiguity.

The Exchange proposes to amend Section 303A.02(b)(i) of the Listed Company Manual to add a definition of the term ''executive officer.'' The Exchange also proposes to make minor cleanup changes throughout Section 303A to provide consistency when utilizing this term. Additionally, the Exchange proposes to amend the commentary to Sections 303A.02(b)(i) and (ii) to clarify that service as an interim executive officer (and not just an interim Chairman or CEO, as currently provided) will not trigger the look-back provisions in those sections.

The Exchange proposes to amend Section 303A.02(b) of the Listed Company Manual to reformulate the wording of the bright line independence tests to more accurately reflect how the applicable look-back periods should be applied. The Exchange also believes the reformulated language is considerably easier to read and understand.

One of the most significant language difficulties presented was in Section 303A.02(b)(ii) of the Listed Company Manual, which precludes independence where a director or family member receives more than $100,000 in direct compensation. The wording suggested that under certain circumstances the look-back period might be as long as four years. The revised formulation would make clear that the period should not be longer than 36 months.

The Exchange proposes to revise the *Commentary* to Section 303A.02(b)(v) of the Listed Company Manual to clarify

[4] *See* Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (SR–NYSE–2002–33).

the treatment of contributions under this test. The language as originally adopted referred to ''charitable organizations.'' According to the Exchange, it has become clear through discussions with listed company representatives that a company can have business relationships (as a vendor, for example) with a charitable organization, and the Exchange believes there is no reason why payments related to such business relationships should not be covered by the test in (b)(v). What the Exchange intended to distinguish, and to cover with disclosure under the *Commentary*, are ''contributions≥ made to a charitable or tax exempt organization.

The NYSE is proposing a change to the substance of Section 303A.02(b)(iii) of the Listed Company Manual, which precludes independence where a director or family member is employed by, or affiliated with, a present or former internal or external auditor. According to the NYSE, a number of companies are finding directors precluded from independence because of past personal or family member affiliations with an auditing firm, even though the person involved never worked on the listed company account. The Exchange notes that the standards of the Nasdaq Stock Market, Inc. (''Nasdaq'') and the American Stock Exchange LLC (''Amex'') are more narrow than the current NYSE standard. For example, the Nasdaq and Amex standards implicate only former partners or employees of the audit firm who worked on the company's audit. Accordingly, the Exchange proposes to revise its standard so that it would cover any director or immediate family member who is a current partner of the audit firm, any director who is a current employee of the audit firm, any immediate family member who is a current employee of the audit firm participating in the firm's audit, assurance or tax compliance (but not tax planning) practice, and any former partner or employee of the audit firm who personally worked on the listed company's audit during the past three years. Finally, the Exchange states that to avoid what many believed to be the overbroad definition of ''immediate family member'' in connection with this standard, the definition of that term for purposes only of Section 303A.02(b)(iii) would be revised to parallel the description of family member utilized by the Commission in Exchange Act Rule 10A–3(e)(8).[5]

As a result of the proposed change to Section 303A.02(b)(iii) of the Listed Company Manual, there is a category of person that would not have been impacted by existing Section 303A.02(b)(iii) that would be precluded from independence under the revised standard, namely, a director with a family member who is a current partner of the audit firm. Under the existing standard, such a family member did not impact the director's independence if the family member did not act in ''a professional capacity'' at the audit firm. Under the revised standard, any family member who is a current partner of the audit firm would preclude the director from being considered independent. To avoid suddenly changing the status of a current director, the Exchange would give companies until their first annual meeting after January 1, 2005, to replace a director who was independent under the NYSE's existing rule but not under the revised rule.

Section 303A.03—Requirements for Non-Management Directors

The Exchange proposes to revise Section 303A.05(b) of the Listed Company Manual to clarify that a non-management director must preside over each executive session of the non-management directors, although the same director is not required to preside at all executive sessions of the non-management directors.

Section 303A.05—Requirements for Compensation Committees

The Exchange proposes to revise Section 303A.05(b) of the Listed Company Manual to clarify that the non-CEO compensation on which the committee should focus is that of the executive officers. The Exchange also proposes to make clear that the board has the ability to delegate its authority to approve non-CEO executive officer compensation to the compensation committee.

Section 303A.07—Duties of the Audit Committee

The Exchange proposes to revise Section 303A.07(c)(iii)(B) of the Listed Company Manual to clarify that the audit committee must meet to review and discuss the company's financial statements and must review the company's specific Management's Discussion and Analysis disclosures.

Sections 303A.09 and .10—Disclosures of Guidelines and Codes

The Exchange proposes to amend Sections 303A.09 and .10 of the Listed Company Manual to specify that the disclosure must be in the annual proxy statement (or, if the company does not file a proxy statement, then in the Form 10–K), in order to be consistent with the other disclosure requirements of Section 303A.

Section 303A.11—Foreign Private Issuer Disclosures

The Exchange proposes to amend Section 303A.11 of the Listed Company Manual to clarify that foreign private issuers are required to provide disclosure of the significant differences between the Section 303A requirements and the actual corporate governance practices of the foreign private issuer, as opposed to the general corporate governance practices of the foreign private issuer's home country.

Section 303A.12—Certifications and Affirmations

The Exchange proposes to amend the language of Section 303A.12 of the Listed Company Manual to clarify that any qualifications to the annual CEO certification must be specified and disclosed. The Exchange also proposes to add Section 303A.12(c) to specifically require that companies submit Annual and Interim Written Affirmations to the NYSE. The NYSE believes this clarifies the Exchange's intention to carry forward the written affirmation requirement currently found in Section 303 of the Listed Company Manual. Proposed Section 303A.12(c) is the mechanism by which listed companies would be required to provide the NYSE with ongoing details of compliance or non-compliance with Section 303A. The proposed changes would also amend the General Application of Section 303A of the Listed Company Manual to specify that listed Exchange Traded Funds that are open-end management investment companies, foreign private issuers, and preferred and debt listed companies (to the extent such companies must comply with Section 303A.06 of the Listed Company Manual) would be required to submit the Annual and Interim Written Affirmations.

2. Statutory Basis

The NYSE states that the basis for the proposed rule change under the Act is the requirement under Section 6(b)(5) under the Act[6] that an exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

[5] 17 CFR 240.10A–3(e)(8).

[6] 15 U.S.C. 78f(b)(5).

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

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

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

The Exchange has neither solicited nor received written comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change 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 Exchange consents, the Commission will:

A. By order approve such proposed rule change, as amended; or

B. Institute proceedings to determine whether the proposed rule change 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 rule change, as amended, 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 e-mail to *rule-comments@sec.gov*. Please include File Number SR–NYSE–2004–41 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–NYSE–2004–41. 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 Room. Copies of such filing also will be available for inspection and copying at the principal office of the NYSE. 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–NYSE–2004–41 and should be submitted on or before September 29, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[7]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. E4–2090 Filed 9–7–04; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–50296; File No. SR–PCX–2004–49]

Self-Regulatory Organizations; Pacific Exchange, Inc; Order Approving a Proposed Rule Change To Amend Rules Governing the Archipelago Exchange by Adding a New Order Modifier Entitled ''Don't Arb Me''

August 31, 2004.

On June 3, 2004, the Pacific Exchange, Inc. (''PCX'' or ''Exchange''), through its wholly owned subsidiary, PCX Equities, Inc. (''PCXE''), filed with the Securities and Exchange Commission (''Commission''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend its rules governing the Archipelago Exchange (''ArcaEx''), the equities trading facility of PCXE, to add a new order type entitled the ''Don't Arb Me'' modifier. The proposed rule change was published for comment in the **Federal Register** on July 28, 2004.[3] The Commission received no comment letters on the proposal. This order approves the proposed rule change.

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.[4] In particular, the Commission believes that the proposed rule change is consistent with section 6(b)(5) of the Act,[5] which requires, among other things, that the rules of the Exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and, in general, to protect investors and the public interest. In addition, the Commission believes that the proposed rule change is consistent with provisions of section 11A(a)(1)(C)(i) of the Act,[6] which states that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure economically efficient execution of securities transactions.

Specifically, the Commission believes that the proposal should promote increased efficiency and effectiveness in the Exchange's market operation and enhanced investment choices available to investors over a broad range of trading scenarios. The Commission also believes that allowing the Exchange to implement the ''Don't Arb Me'' modifier should facilitate enhanced order interaction and foster price competition. In addition, the Commission notes that the ''Don't Arb Me'' modifier was developed in response to Exchange participants' requests for the additional functionality.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[7] that the proposed rule change, as amended, (SR–PCX–2004–49) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[8]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. E4–2091 Filed 9–7–04; 8:45 am]

BILLING CODE 8010–01–P

[7] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 50054 (July 21, 2004), 69 FR 45104.

[4] In approving this proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[5] 15 U.S.C. 78f(b)(5).

[6] 15 U.S.C. 78k–1(a)(1)(C)(i).

[7] 15 U.S.C. 78s(b)(2).

[8] 17 CFR 200.30–3(a)(12).