



Summary of NASDAQ Corporate Governance Proposals As of September 13, 2002

The following provides a detailed summary of NASDAQ's proposed corporate governance reforms, all of which have been approved by NASDAQ's board of directors. NASDAQ is currently engaged in discussions with the SEC staff regarding these proposals, and it is possible that our proposals will be adjusted in response to SEC staff input. Following SEC staff review and input, we will make formal rule filings, which will then be posted on this website. In addition, the rule filings will be published for public comment in the Federal Register.

NASDAQ proposes that changes requiring a company to modify the composition of its board of directors be effective immediately following a company's first annual meeting that is at least 120 days after SEC approval of the changes.

Following is a summary of the proposals:

Stock Options

- Require shareholder approval for the adoption of all stock option plans and for any material modification of such plans. An exemption would permit inducement grants to new employees if such grants are approved by an independent compensation committee or a majority of the company's independent directors. Exemptions will also be available for certain tax-qualified plans (e.g., employee stock ownership plans) and for the assumption of pre-existing grants in connection with an acquisition or merger. Existing option plans will be unaffected under this proposal, unless there is a material modification made to the plan.

Loans to Officers and Directors

- Prohibit loans to officers and directors through the adoption of a NASDAQ rule that mirrors Section 402 of the Sarbanes-Oxley Act of 2002 (the "Act").

Increase Board Independence

- Require a majority of independent directors on the board.
- Require regularly convened executive sessions of the independent directors.
- Require that a company's audit committee or a comparable body of the board of directors review and approve all related-party transactions.
- Prohibit an independent director from receiving any payments (including political contributions) in excess of \$60,000 other than for board service and extend such prohibition

to the receipt of payments by a non-employee family member of the director. An audit committee member may not receive any compensation except for board or committee service, in accordance with the Act.

- Prohibit a director from being deemed independent if any family member of the director is employed as an executive officer, or has been within the past three years, of the issuer or any of its affiliates.
- Expand to cover not-for-profits the current rule prohibiting a director from being considered independent if the company makes payments to an entity where the director is an executive officer and such payments exceed the greater of \$200,000 or five percent of either the company's or the entity's gross revenues
- Prohibit former partners or employees of the outside auditors who worked on a company's audit engagement from being deemed independent for three years.
- Apply a three-year "cooling off" period to directors who are not independent due to: (1) interlocking compensation committees; or (2) the receipt by the director or a family member of the director of any payments in excess of \$60,000 other than for board service.

Heightened Standards of Independence for Audit Committee Members

- Prohibit audit committee members from receiving any payment other than payment for board or committee service, consistent with Section 301 of the Act.
- Prohibit directors from serving on the audit committee in the event they are deemed an affiliated person of the issuer or any subsidiary, consistent with Section 301 of the Act. In this regard, prohibit audit committee members from owning or controlling 20% or more of the issuer's voting securities, or such lower number as may be established by the SEC in rulemaking under Section 301 of the Act. Audit committee members will also be required to meet the NASDAQ independence definition set forth in Rule 4200(a)(14), as amended by the proposals described above.

Strengthen the role of independent directors in compensation and nomination decisions

- Require independent director approval of director nominations, either by an independent nominating committee or by a majority of the independent directors. A single non-independent director would be permitted to serve on an independent nominating committee: (1) if the individual is an officer who owns or controls more than 20% of the issuer's voting securities, or (2) pursuant to an "exceptional and limited circumstances" exception.¹

¹ An "exceptional and limited circumstances" exception is available for an individual who is not an officer or current employee or a family member of such a person. Additionally, such an exception may only be implemented following a determination by the board that the individual's service on the committee is in the best interests of the company and its shareholders. The issuer is also required to disclose the use of such an exception in the next annual proxy statement, as well as the nature of the individual's relationship to the company and the basis for the board's determination.

- Require independent director approval of CEO compensation, either by an independent compensation committee or by a majority of the independent directors meeting in executive session. Require independent director approval of other executive officer compensation, either by an independent compensation committee or by a majority of the independent directors in a meeting at which the CEO may be present. A single non-independent director, who is not an officer, would be permitted to serve, for two years, on the independent compensation committee pursuant to an “exceptional and limited circumstances” exception.²

Controlled Company Exception

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

Empower Audit Committees and Harmonize Listing Standards with the Act

- Require that audit committees have the sole authority to appoint, determine funding for, and oversee the outside auditors, as set forth in Section 301 of the Act.
- Require that audit committees approve, in advance, the provision by the auditor of all permissible non-audit services, as set forth in Section 202 of the Act.
- Require that audit committees have the authority to engage and determine funding for independent counsel and other advisors, as set forth in Section 301 of the Act.
- Require that the audit committee establish procedures for the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls or auditing matters. Additionally, the audit committee is required to ensure that such complaints are treated confidentially and anonymously, as set forth in Section 301 of the Act.
- Require that in selecting the financial expert necessary for compliance with the NASDAQ audit committee composition requirements, issuers consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller or principal accounting officer of an issuer or from a position involving the performance of similar functions, sufficient financial expertise in the accounting and auditing areas specified in the Act.
- Require that all audit committee members be able to read and understand financial statements at the time of their appointment rather than “within a reasonable period of time” thereafter.

² *Ibid*

- Limit the time that a non-independent director may serve on the audit committee pursuant to the “exceptional and limited circumstances” exception set forth in Rule 4350(d)(2)(B) to two years and prohibit that person from serving as the chair of the audit committee. Those directors not satisfying the audit committee independence requirements of the Act are not eligible for this exception.
- Eliminate exceptions for the audit committee requirements for Small Business issuers.

Mandate Director Continuing Education

- Continuing education for all directors will be required, pursuant to rules to be developed by the NASDAQ Listing and Hearing Review Council and approved by the Board.

Accelerated Disclosure of Insider Transactions

- NASDAQ is continuing to explore a requirement for accelerated disclosure of insider transactions that would harmonize with, and reinforce, the provisions of the Act and any SEC rules that may be promulgated thereunder.

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

- Require that non-U.S. issuers disclose any exemptions to NASDAQ’s corporate governance requirements, permissible under the Act or rules promulgated by the SEC thereunder, at the time the exemption is received and on an annual basis thereafter, as well as any alternative measures taken in lieu of the waived requirements.
- Require that non-U.S. issuers file with the SEC and NASDAQ all interim reports filed in their home country, and, at a minimum, file with the SEC and NASDAQ a semi-annual report, including a statement of operations and an interim balance sheet prepared in accordance with the requirements of the home country marketplace. An English translation of any such reports will be required.

Conform and Clarify the Applicability of Certain Quantitative Listing Standards to Non-U.S. Companies

- Require that non-U.S. issuers satisfy the SmallCap initial and continued listing requirements for bid price and market value of publicly held shares that are currently applicable to domestic issuers, subject to an 18-month phase-in period.
- Require that the underlying shares of SmallCap issuers with listed ADRs satisfy the same publicly held shares and shareholder requirements that are applicable to domestic issuers.

Codes of Conduct

- Require all companies to have a code of conduct addressing, at a minimum, conflicts of interests and compliance with applicable laws, rules and regulations, with an appropriate compliance mechanism and disclosure of any waivers to executive officers and directors. Waivers to the code of conduct for officers and directors can only be granted by the independent directors. The code of conduct must be publicly available.

Other Proposals

- Harmonize the NASDAQ rule on the disclosure of material information with SEC Regulation FD so that issuers may use Regulation FD compliant methods such as conference calls, press conferences and web casts, so long as the public is provided adequate notice (generally by press release) and granted access.
- Require that a going concern qualification in an audit opinion be disclosed through the issuance of a press release.
- Clarify that NASDAQ will presume that a change of control will occur, for purposes of the shareholder approval rules, once an investor acquires 20% of an issuer's outstanding voting power, unless a larger ownership and/or voting position is held on a post-transaction basis by: (1) a shareholder, or an identified group of shareholders, unaffiliated with the investor, or (2) the issuer's directors and officers that are unaffiliated with the investor.
- Clarify the authority of NASDAQ to deny re-listing to an issuer based upon a corporate governance violation that occurred while that issuer's appeal of the delisting was pending.
- Clarify that a material misrepresentation or omission by an issuer to NASDAQ may for the basis for delisting (this proposal has been approved by the SEC).