

MEMO# 15887

April 9, 2003

ICI DRAFT COMMENT LETTER REGARDING NASDAQ CORPORATE GOVERNANCE REFORM PROPOSAL

[15887] April 9, 2003 TO: SEC RULES COMMITTEE No. 32-03 RE: ICI DRAFT COMMENT LETTER REGARDING NASDAQ CORPORATE GOVERNANCE REFORM PROPOSAL As we previously informed you,* the National Association of Securities Dealers through its subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), recently filed with the Securities and Exchange Commission proposed rule changes with respect to Nasdaq-listed companies that would enhance board independence, increase the role of independent directors on board committees, and enhance audit committee responsibilities. The draft letter generally commends Nasdaq for taking steps to improve corporate governance standards for Nasdaq-listed companies. The draft letter notes that the Institute's perspectives on the Proposal are unique in that investment companies are both investors in and issuers of securities. As investors, the Institute strongly supports the objectives of the Proposal - - to enhance investor confidence in the companies that list on Nasdaq, to empower independent directors to more effectively carry out their responsibilities, and to enhance the effectiveness of audit committees. The draft letter also focuses on the application of the Proposal to investment companies and asks that the Proposal be modified so as not to apply to investment companies in some instances and clarified with respect to investment companies in certain other respects. These changes would make the Proposal more consistent with recent actions by the New York Stock Exchange and the SEC regarding corporate governance. Attached is a draft of the Institute's comment letter on the proposal, and the most significant aspects of the letter are summarized below. Independent Directors The Proposal defines, and provides interpretive material regarding, the term, "independent director." The draft letter recommends that the Proposal be modified to clarify that whether a director of an investment company is independent should be determined exclusively under the provisions of Section 2(a)(19) of the Investment Company Act and the rules thereunder. * See Memorandum to Closed-End Investment Company Members No. 32-03, SEC Rules Members No. 43-03, dated April 4, 2003. 2 Nomination of Directors Under the Proposal, listed companies would be required to have a majority of their independent directors or a nominations committee comprised solely of independent directors nominate directors. The draft letter requests that the Proposal be modified so that it would not apply to investment companies if their independent directors nominate other independent directors. Compensation of Officers The Proposal would require listed companies to have either a majority of independent directors or a compensation committee comprised solely of independent directors meeting in executive session determine the compensation of the chief executive officer and certain other officers. The draft letter states that it is not necessary or appropriate for this requirement to apply to investment companies. Audit

Committees The Proposal would expand the items that must be specified in a company's audit committee charter. The draft letter strongly suggests modifying the Proposal so as to harmonize any new audit committee responsibilities required by Nasdaq with recently adopted Rule 10A-3. Under the Proposal, the audit committee would have the sole authority to "appoint, determine funding for and oversee" the independent accountant engaged for the purpose of preparing an audit report. The draft letter recommends that the Proposal be revised to exempt investment companies that fall within the scope of the proposed rule from the requirement that the audit committee be responsible for appointing the independent accountant, in recognition of the fact that Section 32(a) of the Investment Company Act of 1940 requires a majority of disinterested directors to have annually "selected" the independent accountant. Under the Proposal, audit committee members would be required to be able to read and understand fundamental financial statements, and listed companies would be required to certify that they have and will continue to have, at least one member of the audit committee who has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities. This is identical to Nasdaq's existing requirement with respect to audit committee members except that the Proposal would tighten the current requirements by providing that audit committee members would be required to be able to read and understand fundamental financial statements at the time they join the board rather than having these qualifications within a reasonable period of time of joining the board. The draft letter states that we do not object to the proposed change and believe that it should enhance the effectiveness of audit committees if committee members are required to understand financial statements at the time that they join the committee (rather than within a reasonable period of time thereafter). The draft letter strongly recommends, however, that Nasdaq defer action on this aspect of the proposal so that it can harmonize its requirements with analogous NYSE requirements. Comments on the Nasdaq proposal must be submitted to the SEC by next Tuesday, April 15th. Please provide me any comments that you have on the attached draft letter no later than close of business on Friday, April 11th by phone at (202/218-3563), fax (202/326-5827), or e-mail (ddonohue@ici.org). Dorothy M. Donohue Associate Counsel Attachment (in .pdf format)