

**MEMO# 16818**

November 26, 2003

# **INSTITUTE DRAFT COMMENT LETTER ON NYSE'S AND NASDAQ'S PROPOSED CORPORATE GOVERNANCE REQUIREMENTS; YOUR VIEWS REQUESTED BY DECEMBER 2ND**

[16818] November 26, 2003 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 63-03 SEC RULES COMMITTEE No. 97-03 RE: INSTITUTE DRAFT COMMENT LETTER ON NYSE'S AND NASDAQ'S PROPOSED CORPORATE GOVERNANCE REQUIREMENTS; YOUR VIEWS REQUESTED BY DECEMBER 2ND As we previously informed you, the Securities and Exchange Commission recently published for comment proposed corporate governance standards and related changes to certain other rules of the New York Stock Exchange and Nasdaq Stock Market, Inc. 1 The SEC simultaneously approved the proposals on an accelerated basis. The Institute has prepared a draft comment letter, a copy of which is attached and summarized below. Comments on the proposals are due to the SEC no later than December 3rd. If you have any comments on the draft comment letter, please contact me no later than December 2nd by phone at 202.218-3563, fax at 202.326-5827, or email at [ddonohue@ici.org](mailto:ddonohue@ici.org). The draft letter commends the NYSE and Nasdaq for taking this initiative to improve corporate governance by enhancing the role of independent directors and strengthening the oversight responsibilities of audit committees. The draft letter notes that the Institute's perspectives on the proposal are as both investors in and issuers of securities. It points out that as investors in equity securities, the Institute's members rely on high-quality financial reporting to make investment decisions. Accordingly, the draft letter states the Institute's general support for the proposals, and states the Institute's belief that the proposals will serve to enhance the interests of investors by improving the governance structure of listed companies and the integrity of financial reporting. The remainder of the draft letter is from the perspective of investment companies as issuers. The draft letter states that the Institute is pleased that the proposals recognize that, because investment companies are subject to pervasive federal regulation, it is not necessary or appropriate to subject them to the proposed requirements with respect to: independent directors; nominating/corporate governance committees; compensation committees; corporate governance guidelines; and codes of business conduct and ethics. 1 See Institute Memorandum to Closed-End Investment Company Committee No. 61-03 and SEC Rules Committee No. 94-03 [16784], dated November 19, 2003. 2 In addition, the draft letter states that the Institute is pleased that the provisions of the NYSE and Nasdaq proposals are consistent and are very similar to analogous provisions in the American Stock

Exchange rules recently published for comment by the SEC. The draft letter points out that such a coordinated approach ensures that the self-regulatory organizations do not compete on the basis of differences in their rules, encouraging a “race to the bottom” to attract new listings, to the ultimate detriment of investors. The draft letter objects to the abbreviated 21-day comment period and recommends that the SEC lengthen it for future significant self-regulatory rules proposals. The NYSE proposal provides that if an audit committee member simultaneously serves on the audit committee of more than three public companies, and the NYSE-listed company does not limit the number of audit committees on which its audit committee members serve, then in each case, the board would be required to determine that such simultaneous service would not impair the ability of the member to effectively serve on the listed company’s audit committee. The draft letter recommends that this requirement be tailored for closed-end investment companies by treating a “fund complex” as one company for this purpose. The draft letter explains that this approach is appropriate because, typically, all funds in a fund complex rely on the same accounting system and are subject to the same internal controls and policies, and that, an investment company’s financial statements are less complicated than the financial statements of operating companies and therefore audit committee oversight requires less time. Accordingly, the time and effort associated with overseeing the financial statements of each additional fund is less than the time and effort involved in serving on the audit committee of an additional operating company. The draft letter also points out that the proposed requirement that all audit committee charters, including investment company audit committee charters, address an annual performance evaluation of the audit committee already would require investment companies to annually assess the duties and functions of their audit committees, which seems sufficient to address the NYSE’s concern. Finally, the draft letter recommends excluding investment companies from the NYSE’s proposed requirement that audit committee members discuss earnings press releases as well as financial information and earnings guidance provided to analysts and rating agencies. The letter points out that unlike operating companies, the computation of an investment company’s earnings is straightforward because they are determined simply by calculating income and gains on portfolio investments less expenses. Moreover, in contrast to operating companies, the Internal Revenue Code essentially requires investment companies to distribute earnings in the calendar year in which they are received. Because of the unique nature of investment companies, they do not have earnings targets, although they often release statements announcing quarterly investment results. These statements neither provide earnings guidance to security analysts nor contain complex detail comparable to earnings reports released by operating companies, thus rendering audit committee oversight of these earnings press releases unnecessary. Dorothy M. Donohue Associate Counsel Attachment (in .pdf format)

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