



New Governance Architecture

REFORMS BRING GREATER INDEPENDENCE AND DISCLOSURE

The highest standards of independence, oversight and transparency — these are the goals of the historic and far-reaching changes in the way the New York Stock Exchange is governed. NYSE members in November voted in favor of the changes, which required amendments to the NYSE constitution, and the Securities & Exchange Commission approved the changes in December.

“The changes represent a significant step forward in meaningful reform of the NYSE’s governance structure and the transparency of its governance processes,” says SEC Chairman William H. Donaldson. “These reforms are designed to strengthen the independence of the NYSE board and key committees, and better insulate the Exchange’s regulatory function from its market operations.”

NYSE Interim Chairman John S. Reed, the principal architect of the new governance platform, says “the reforms create a new structure that best serves our member-owners, our customers and, most importantly, the investing public.”

“What John Reed has accomplished is clearly in the interest of the public and the capital markets,”

says Ned Regan, president of Baruch College, which takes a leading role on issues of transparency and integrity in accounting, auditing and governance through conferences and research. “The changes were quick and decisive. The moves procedurally were very good and very important.”

Bart Ward, CEO and senior portfolio manager of Ward & Co. Ltd., a Minneapolis-St. Paul-based money manager, agrees: “The key thing Mr. Reed is doing is addressing the hard issues point-blank. This, I believe, will put the Exchange back to focusing on the everyday business of a secondary market and expanding domestically and internationally.”

Adds Frank Sullivan, the president and CEO of specialty coatings leader **RPM International Inc.** (RPM): “Addressing from a governance perspective the conflicts between the financial community and the issues of the Exchange is the right thing to do, both for the markets and listed

companies. The changes are well thought out and appropriate. And it’s important to realize they’re the result of a process the NYSE has been undertaking for at least the last year, not just the result of recent events.”

FULLY INDEPENDENT BOARD

First among the changes is a reconstituted Board of Directors (BoD) that for the first time in NYSE history is independent of management, members and listed companies. The new board, which can consist of six to 12 individuals plus a chairman and a CEO, has full fiduciary responsibility and will supervise the Exchange’s regulation, governance, compensation and internal controls. “The Board of Directors, including its chair and the CEO, will be ultimately responsible to the owners

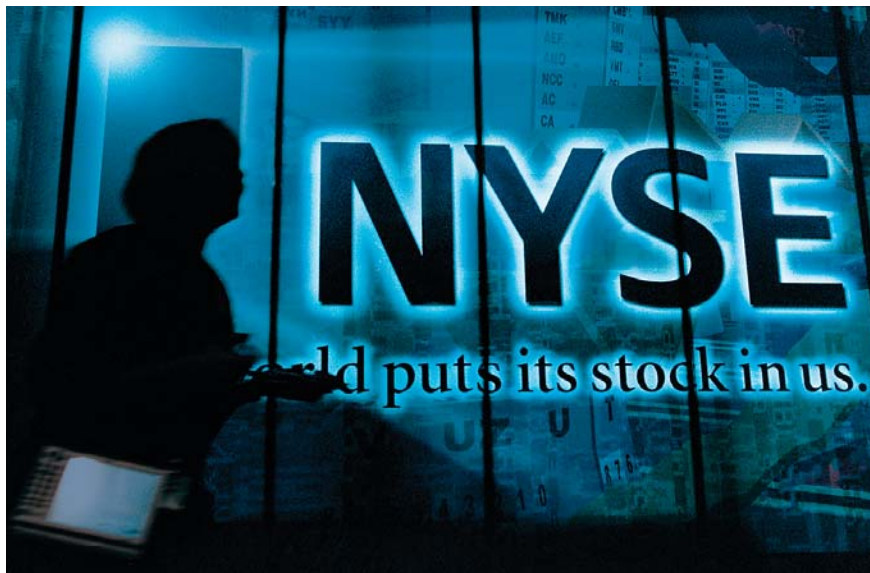
of the Exchange and the investing public for the NYSE’s performance,” says Reed. “People want boards that are independent, transparent and held responsible for ensuring good governance and good behavior.”

“Boards must be independent,” agrees Regan. “It’s not about ticket balancing. A board has to have the ability to track the public interest and to move quickly when that’s not being served.”

For Jim Rogers, chairman, president and CEO of **Cinergy Corp.** (CIN), “good governance is grounded in a dedicated, independent and engaged board that balances the interests of all of our stakeholders. There must be very carefully selected independent directors who truly understand the NYSE’s purpose.”

“Independent boards can offer real value in ensuring that conflicts of interest get mitigated early in the governance process,” says Ward. “In the case of the NYSE, a delicate balance must be preserved between attracting individuals who are independent yet have the knowledge and experience to understand the important nuances of the industry they are governing.”

• *Serving on the NYSE’s first BoD under the new governance structure are:* Madeleine K. Albright, 66, founder of Albright Group LLC and former U.S. Secretary of State; Herbert M. Allison Jr., 60, chairman,



president and CEO of TIAA-CREF and former president and COO of **Merrill Lynch & Co. Inc.** (MER); D. Euan Baird, 66, chairman of Rolls-Royce plc and retired chairman, president and CEO of **Schlumberger Ltd.** (SLB); Marshall N. Carter, 63, co-chairman of the U.S. Working Group of Thirty, which developed recommendations for revamping world securities trade-processing processes, and retired chairman of State Street Bank & Trust Co.; Shirley Ann Jackson, 57, president of Rensselaer Polytechnic Institute and former chairman of the U.S. Nuclear Regulatory Commission; James S. McDonald, 50, president and CEO of Rockefeller & Co. Inc. and former partner of Boston law firm Choate, Hall & Stewart; Robert B. Shapiro, 65, former chairman and CEO of **Monsanto Co.** (MON); and Sir Dennis Weatherstone, 72, a trustee of the International Accounting Standards Committee Foundation and former chairman and CEO of **J.P. Morgan Chase & Co.** (JPM).

Albright and Allison are the only members of the NYSE's previous 27-member board. The new directors, who were nominated by Reed and elected by the membership, will serve through June 2004, when they will stand for re-election. Thereafter, board members will be elected annually each June.

"One of the most important aspects of the changes is that there will be fewer board members," says Ward, who reports his firm invests only in NYSE-listed companies. "In the end, the board will have a more cohesive understanding, and each member will be better informed about the broader picture and details pertinent to the Exchange."

In an initial action, the BoD appointed, effective Jan. 15, a new CEO (a role that is now separate

from that of the NYSE chairman), John A. Thain, former president and chief operating officer of **The Goldman Sachs Group Inc.** (GS), who will also serve on the BoD. At press time, progress was under way to select a chairman to replace Interim Chairman John Reed.

"John Thain brings to the Exchange a number of exceptional qualities

for which he is widely known: integrity, intelligence, and extensive knowledge of the financial markets," says Reed. "He is an outstanding choice to lead the Exchange at this critical juncture."

Responsible for the NYSE's regulatory function, the BoD also appointed a Chief Regulatory Officer, or CRO: Richard Ketchum, most recently general counsel of Citigroup's investment bank and former president of Nasdaq, effective June 2. The BoD must also monitor marketplace performance and competitive position; approve strategy; hire, fire and pay management; and ensure a succession plan and appropriate behavior, Reed explains.

The election of solely independent directors is a new approach for the NYSE, which for three decades has had an equal number of industry and non-industry directors. This differs from what is required of listed companies, which must now have a majority of independent directors on their boards (see sidebar, left).

"For the NYSE, the world's largest capital market, it is mandatory that this forum hold itself to the highest ethical standards so the investing public can be confident that listed companies are fairly presented and reliable, and that the Exchange itself conducts its business to these same standards," says **Callaway Golf Co.** (ELY) Chairman and CEO Ron Drapeau.

Cinergy's Rogers agrees that "the tighter standards required of

GOVERNANCE RULES FOR LISTED COMPANIES

All NYSE-listed companies, with some limited exceptions*, must comply with the new corporate governance listing standards that the SEC approved in November. The new governance rules — which become effective by the company's first annual meeting after Jan. 15, 2004 or by Oct. 31, 2004, whichever is earliest, with special timelines for companies with classified boards or listing in conjunction with an IPO — require NYSE-listed companies to meet significant new standards, particularly regarding board independence. In addition to requiring corporate boards to consist of a majority of independent directors, the new standards tighten the definition of "independent director" and strengthen the authority and responsibility of the most significant board committees — the audit, compensation and nominating/corporate governance committees.

The new standards require:

- Listed companies to have a majority of independent directors.
- Non-management directors to meet at regularly scheduled executive sessions without management.
- Listed companies to have an audit committee, a nominating/corporate governance committee and a compensation committee, each composed entirely of independent directors.
- Boards to adopt and publicly disclose for each committee a charter addressing at a minimum the responsibilities described in the Exchange rules.
- Listed companies to adopt and disclose corporate governance guidelines addressing director qualification standards, responsibilities, access to management, compensation, orientation for new board members, and board member continuing education, as well as management succession and annual board performance evaluation.
- Listed companies to adopt and disclose a code of business conduct and ethics for directors, officers and employees. The company must promptly disclose any waivers of the code for directors or executive officers.
- Listed foreign private issuers following home-country practices to disclose any significant departures in their corporate governance practices from those followed by domestic companies under NYSE listing standards.
- Each listed-company CEO to certify to the NYSE annually that he or she is not aware of any violation of NYSE governance listing standards and promptly notify the Exchange after any executive officer becomes aware of any material noncompliance.
- Listed companies to give shareholders the opportunity to vote on all equity-based compensation plans, with limited exceptions. (The SEC approved this requirement separately in June 2003.)

*Certain exceptions are made for controlled companies (more than 50 percent of the voting power is held by an individual), limited partnerships and companies in bankruptcy, closed-end and open-end funds, business development companies (a type of closed-end management investment company), and other entities such as trusts, derivatives and special-purpose securities. Foreign private issuers are permitted to follow home-country practice in lieu of most of these requirements.

For the full final rule text, visit: <http://www.nyse.com/pdfs/finalcorpgovrules.pdf>.

us make sense. We think of our listing as an opportunity to accumulate capital. For a capital-intensive company like ours, it's a small cost to pay. We work hard to align with the letter and the spirit of the standards. And the Exchange's commitment to meeting its requirements for listed companies shows it's walking the talk."

"You lead by example," adds Ward. "It's just that simple."

Says Sullivan of the listed-company requirements: "I applaud them. They're the kinds of things RPM has been doing for 30 years. The requirements are not terribly onerous, and are exactly the right thing to do for companies that have access to the public's capital."

"As CEO of a listed company, I believe it is extremely important that investors have confidence in financial results and in knowing that companies are governed with the integrity to ensure shareholder interests are forefront," adds Drapeau. "For these companies, requiring a board's majority to be independent helps to ensure this. That said, however, I am a strong believer that you cannot legislate integrity."

THE BOARD OF EXECUTIVES

Another significant change to the NYSE's governance structure is the new Board of Executives (BoE). Serving an advisory role to the BoD, the separate BoE will consist

of 22 individuals representing NYSE constituents, balanced among listed companies, major broker-dealers, the trading-floor community, lessor members, institutional investors and large public funds, and individual investors. In addition, the BoE includes the NYSE chairman and the CEO.

"It's a perfect fit," says Regan about the new BoE. "It's what you have to do to make sure constituents have a voice."

The BoE will meet at least six times a year to discuss Exchange performance, membership issues, listed-company issues and public issues relating to market structure and performance. The BoE will meet with

the Exchange's BoD in joint session several times annually and provide the BoD with reports of deliberations. BoE members will serve on joint committees with members of the BoD. BoE members, however, do not serve on the Regulatory Oversight & Regulatory Budget Committee; the Audit Committee; the Nominating & Governance Committee; or the Human Resources & Compensation Committee, which are described on pages 41 and 42. BoE members' terms also expire in June 2004. At press time, 19 of the 22 members had been appointed:

- *Representing investors on the new BoE are:* Laurence D. Fink, chairman and CEO, **BlackRock Inc.** (BLK); Richard H. Moore, state

treasurer, North Carolina; Allen Reed, president and CEO, GM Asset Management; and Kurt Stocker, professor, Northwestern University Medill School of Journalism.

- *Representing listed companies on the new BoE are:* Louis Camilleri, chairman and CEO, **Altria Group Inc.** (MO); and Mel Karmazin, president and COO, **Viacom Inc.** (VIA).

- *Lessor members of the BoE are:* Joseph A. Mahoney and Donald Stone.

- *Representing member firms that deal with the public are:* James E. Cayne, chairman and CEO, **The Bear Stearns Cos. Inc.** (BSC); John J. Mack, co-CEO of **Credit Suisse Group** (CSR) and CEO, Credit Suisse First Boston LLC;

E. Stanley O'Neal, chairman and CEO, Merrill Lynch; Henry M. Paulson Jr., chairman and CEO, Goldman Sachs; Philip Purcell, chairman and CEO, **Morgan Stanley** (MWD); Thomas A. Renyi, chairman and CEO, **The Bank of New York Co. Inc.** (BK); and William B. Summers Jr., chairman, McDonald Investments Inc., a unit of **KeyCorp** (KEY).

- *Representing specialist firms are:* John F.X. Dolan, partner, Van der Moolen Specialists USA; and Peter J. Murphy, CEO, Bear Wagner Specialists.

- *And trading-floor brokers on the BoE are:* Robert H. McCooey Jr., president and CEO, The Griswold Co.; and Doreen Mogavero, president and CEO, Mogavero, Lee & Co.

NYSE GOVERNANCE STRUCTURE	
BOARD OF DIRECTORS (BOD)	BOARD OF EXECUTIVES (BOE)
<p>RESPONSIBILITIES</p> <ul style="list-style-type: none"> • The fiduciary • Ultimate responsibility for NYSE performance • Accountable to the investing public and to the community at large • Regulatory oversight 	<p>RESPONSIBILITIES</p> <p>Advising the BoD and management on:</p> <ul style="list-style-type: none"> • NYSE operations • NYSE evolution within context of market structure and performance • The public spokesman role of the NYSE, its Chairman and its CEO
<p>COMPOSITION</p> <ul style="list-style-type: none"> • Six to 12 independent directors • NYSE CEO • NYSE Chairman 	<p>COMPOSITION</p> <p>22 individuals representing key NYSE constituents, including:</p> <ul style="list-style-type: none"> • Institutional investors/public pension funds • Individual investors • Listed companies • Lessors not affiliated with member firms • "Upstairs" trading firms • Specialist firms • Floor brokers <p>Plus:</p> <ul style="list-style-type: none"> • NYSE Chairman • NYSE CEO
<p>MEETINGS</p> <ul style="list-style-type: none"> • Meets both separately from and jointly with the BoE 	<p>MEETINGS</p> <ul style="list-style-type: none"> • Periodically meets jointly with BoD • Lessor and floor representatives meet separately with BoD annually
<p>STANDING BOD COMMITTEES</p> <ul style="list-style-type: none"> • Regulatory Oversight & Regulatory Budget Committee • Human Resources & Compensation Committee • Audit Committee • Nominating & Governance Committee • Regulation, Enforcement & Listing Standards Committee <p>Joint Committees:</p> <ul style="list-style-type: none"> • Quality of Markets/Public Policy Committee • Market Structure & Strategy Committee • Finance Committee 	<p>STANDING BOE COMMITTEES</p> <ul style="list-style-type: none"> • Market Performance Committee • Allocation Committee
<p>ADVISORY COMMITTEES</p> <ul style="list-style-type: none"> • Report to BoD 	

“I’m very encouraged,” says BoE member Kurt Stocker. “The new board members will come to work without a predetermined agenda, and the BoE members will each have a representative point of view. This seems to make a lot of sense. Now it’s all in the doing. Good boards will no longer be measured just on policy, structure and composition — they will be evaluated on their behavior.”

ADVISORY COMMITTEES

Stocker also chairs the NYSE’s Individual Investors Advisory Committee (IIAC). This committee and several others, primarily consisting of individuals not serving on the BoE, continue to serve advisory roles to the BoD. Like the BoE, these committees are organized to represent a range of constituencies, allowing the BoD and management to hear from these constituencies regularly and thus maintain a broad perspective on the market and its participants.

For example, in addition to the IIAC, the Institutional Traders Advisory Committee and the Pension Managers Advisory Committee represent various investor interests. Meanwhile, the Listed Company Advisory Committee and its European, Latin American and Pacific Rim counterparts represent the views of listed companies. Diverse industry interests are represented through the Exchange Traders Advisory Committee, the Upstairs Traders Advisory Committee and the Legal Advisory Committee.

INDEPENDENT REGULATION

The new architecture also separates the NYSE’s regulatory function from its marketplace function and from influence by members and member organizations. CRO Richard Ketchum will report directly to the board’s new *Regulatory Oversight & Regulatory Budget Committee*. Among other responsibilities, this committee — consisting solely of independent

directors — determines the Exchange’s regulatory plan, programs, budget and staffing proposals annually. Its members are Committee Chairman Marshall Carter, Shirley Jackson and Dennis Weatherstone.

“While the regulatory function remains close to the marketplace, only the independent directors bridge the substantive division between the marketplace and the regulatory function,” explains Carter. “In particular, the CEO, while a vital partner to the CRO, does not supervise the CRO. This separation ensures the full independence of the CRO from the management of the Exchange and is the kind of independence the SEC and persons doing business with the NYSE want to see.”

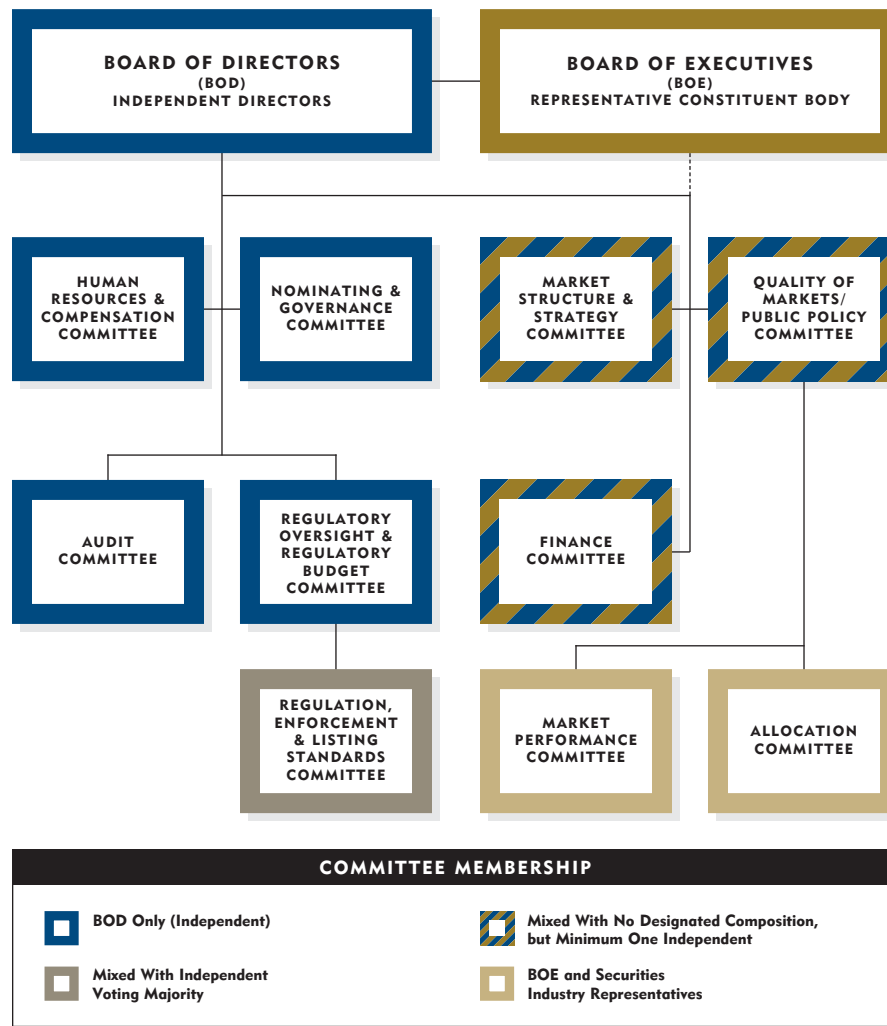
“I believe the proposal, which has a regulatory function reporting solely to board members who are independent of the market, meaningfully insulates the regulatory function,” says Donaldson. “It also effectively addresses concerns about board objectivity and freedom from undue influence.”

RPM’s Sullivan says he strongly supports the Exchange’s decision to address the “balance between technology and the people-based specialist system and its approach to the regulatory piece. It’s important to maintain a regulatory function at the Exchange. It worked well in the past, and I think people will continue to be effective — even better — with the new governance

in place. To split it off or cede that responsibility to some third party would be detrimental to listed companies and market participants.”

Three other board-appointed committees consisting exclusively of independent directors play key roles in the NYSE’s governance:

- *The Human Resources & Compensation Committee* is charged with assuring that Exchange staff is paid in accordance with appropriate compensation benchmarks. Its members are Committee Chairman Euan Baird, Herbert Allison, Madeleine Albright, Marshall Carter, Shirley Jackson, James McDonald, Robert Shapiro and Dennis Weatherstone.



- *The Audit Committee* oversees the Exchange's financials and ensures that proper internal controls are in place. Its members are Committee Chairman James McDonald, Herbert Allison and Robert Shapiro.
- *The Nominating & Governance Committee* structures the board's annual self-evaluation, ensures the Exchange's governance procedures are on the cutting edge and each year proposes a slate of directors for election by the members. Its members are Committee Chairman Madeleine Albright, Herbert Allison, Euan Baird, Marshall Carter, Shirley Jackson, James McDonald, Robert Shapiro and Dennis Weatherstone.

The BoD used a special transitional provision in the Exchange's constitution to appoint to the *Regulatory Enforcement & Listing Standards Committee* two past members of the Committee for Review who are neither current directors nor members of the BoE: A. James Jacoby, Tradition (Asiel) Securities Inc.; and Committee Chairman Larry Sonsini, chairman and CEO, Wilson Sonsini Goodrich & Rosati. The balance of this committee is made up of members of the BoD and BoE: Marshall Carter, John Dolan, Shirley Jackson, Doreen Mogavero, Robert Shapiro, William Summers and Dennis Weatherstone.

TRANSPARENCY

To ensure workings of the board are transparent, the Exchange will disclose annually the board committee charters and activity reports; membership on the BoD, the BoE and the various standing and advisory committees; and the facts establishing each board member's independence, including any non-director relationship between board members and the NYSE itself as well as any material relationships among board members.

The Exchange will also make public how members and investors can communicate with the NYSE's directors, how top management is compensated, as well as the Exchange's nominating procedures, charitable activities, political activities and contributions.

"The new architecture empowers a board of directors with the independence to address issues objectively and the constituent input to address them intelligently," Reed adds. "With a new board and permanent management in place, the Exchange will be in a position to openly and collectively address issues of market performance, access and market structure that — in addition to self-regulation — are important to the continual modernization of our capital markets."

"The fact that the Exchange's day-to-day operations have gone on without missing a beat tells me there must be a consistent level of good governance in place," adds Rogers. "This is a true barometer of the confidence in the Exchange. There is no question as to the importance of the NYSE to our shareholders and our company, which is something we don't take for granted."

"Remember, as a secondary market the NYSE is second to none," Ward says. "This is especially true when one looks at the shortcomings of other markets in terms of pricing mechanisms, liquidity, market impact of trades and market depth." This is something to which RPM's Sullivan can attest: "Since we moved from the Nasdaq in 1998, we have seen the liquidity in our stock increase, the spread in our trading decline, and the breadth of our investor base improve. What we appreciate most is that the Exchange still brings a people element, a relationship that you don't get in other trading environments. And that's very healthy." □

HERBERT
ALLISONEUAN
BAIRDSHIRLEY
JACKSONJAMES
MCDONALDJOHN
REEDMADELEINE
ALBRIGHTDENNIS
WEATHERSTONEROBERT
SHAPIROMARSHALL
CARTERMEMBERS OF THE FIRST BOARD OF DIRECTORS UNDER
THE NYSE'S NEW GOVERNANCE STRUCTURE