

NEW NYSE RULES FOR AUDIT COMMITTEES OF LISTED COMPANIES

Applicability

The new rules only apply to companies listed on the NYSE, including

- closed-end funds
- open-end exchange traded funds (ETFs)
- business development companies

Independence of Audit Committee Members

Covered funds must have an audit committee that complies with Rule 10A-3 under the Securities Exchange Act of 1934 (the “Exchange Act”), i.e., each member of the audit committee must be

- a member of the Board of Directors
and
- “independent”

For investment companies, independence means that

- the director is not an “interested person” of the fund within the meaning of Section 2(a)(19) of the 1940 Act
and
- the director does not accept, directly or indirectly, any consulting, advisory or other compensatory fee from the fund or any subsidiary of the fund.

For this purpose, prohibited “compensatory fees” exclude (1) compensation in his or her capacity as a member of the audit committee, the board of directors or any other board committee and (2) compensation under a retirement plan (including deferred compensation) for prior service with the fund that is not contingent on continued service.

The rule does not allow for a de minimus exception regarding the receipt of prohibited compensation. Also, payments to spouses, minor children and children sharing a home with a committee member would be considered a prohibited indirect payment.

Number of Audit Committee Members

An audit committee must have a minimum of three members, each of whom must be financially literate and at least one of whom must have accounting or related financial management expertise. This does not represent a change from current rules.

Boards of most listed companies must determine that a person's service on more than three audit committees simultaneously does not impair his or her ability to serve effectively. This does not apply to registered funds, given that this is common practice in the fund industry for funds in the same fund complex.

Audit Charter and Audit Committee Duties

The new rules will necessitate several important changes to audit committee charters and how audit committees function.

Listed funds must have a charter that:

- sets forth the committee's purpose, which must, at a minimum, be
 - to assist Board oversight of
 1. the integrity of the fund's financial statements
 2. the fund's compliance with legal and regulatory requirements
 3. the independent auditor's qualifications and independence
 4. the performance of the fund's internal audit function, if any, and independent auditors and
 - to prepare an audit committee report to be included in the fund's annual proxy statement, if required to be prepared
- mandates an annual performance evaluation of the audit committee
- addresses the duties and responsibilities of the committee, including, at a minimum,
 - at least annually, obtaining and reviewing an independent auditor's report concerning, among other things, the audit firm's internal quality-control procedures and material issues raised in any quality control reviews or peer reviews in the last five years

The NYSE Commentary states that the audit committee is expected to evaluate the auditor's qualifications, performance and independence, including:

- reviewing and evaluating the lead partner
- assuring the regular rotation of the lead audit partner
- considering the regular rotation of the audit firm itself

The Audit Committee should present its conclusions about the auditor to the full Board.

- discussing the annual and semi-annual financial statements, with management and the auditors

- discussing the fund's earnings press releases, as well as financial information and earnings guidance given to analysts and rating agencies

For closed-end funds, this would more typically involve considerations of press releases concerning dividend payments.

The NYSE commentary notes that the audit committee need not discuss each earnings press release prior to issuance, but rather can determine the types of information to be disclosed and the type of presentation to be made.

- discussing policies with respect to risk assessment and risk management (i.e., the fund's major financial risk exposure and the steps management has taken to monitor and control such exposure)
- meeting separately, periodically, with management, with internal auditors (if any) and with independent auditors

Listed funds (other than BDCs) are not required to have an internal audit function.

- reviewing with the independent auditor any audit problems or difficulties and management's response

The NYSE commentary states that the audit committee may wish to specifically review:

1. any accounting adjustments, including immaterial ones
2. any management letter issued
3. any communications between the audit team and the audit firm's national officers on auditing or accounting matters

- setting clear hiring policies for employees or former employees of the independent auditors
- reporting regularly to the Board

The audit committee's responsibilities must also include certain duties specified in Rule 10A-3 under the Exchange Act:

- appointing, compensating, retaining, terminating and overseeing the work of the auditors, including resolving disagreements between management and the auditors regarding financial reporting

- establishing “whistleblower” procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters
- retaining authority to engage independent counsel or other advisers
- the provision by the fund of appropriate funding, as determined by the audit committee, to compensate auditors and advisers retained by the audit committee

CEO Certifications

The fund’s CEO must certify to the NYSE annually that he or she is not aware of any violation of the NYSE’s corporate governance listing standards. This certification must be disclosed in the fund’s annual report to shareholders.

In addition, a fund’s CEO must “promptly” notify the NYSE in writing of any material non-compliance with any applicable provisions of the NYSE’s corporate governance listing standards.

Application to Business Development Companies

Additional requirements apply to BDC’s, including the requirement to have an internal audit function.

Application to ETFs

None of the NYSE corporate governance standards described above apply to ETFs other than the independence requirement for committee members and the requirement to inform the NYSE of material non-compliance with applicable listing standards.

* * * * *

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our web site is located at www.willkie.com.

November 26, 2003

Copyright © 2003 by Willkie Farr & Gallagher LLP

All Rights Reserved. This memorandum may not be reproduced or disseminated in any form without the express permission of Willkie Farr & Gallagher LLP. This memorandum is provided for news and information purposes only and does not constitute legal advice or any invitation to an attorney-client relationship. While every effort has been made to ensure the accuracy of the information contained herein, Willkie Farr & Gallagher LLP does not guarantee such accuracy and cannot be held liable for any errors in any reliance upon this information.