

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70246; File No. SR-NYSE-2013-40)

August 22, 2013

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Approving Proposed Rule Change Amending 303A.00 of the Exchange's Listed Company Manual to Provide a One-Year Transition Period to Comply with the Internal Audit Requirement of Section 303A.07(c) for Companies Listing in Connection with An Initial Public Offering, or by Means of a Carve-Out or Spin-Off Transaction

I. Introduction

On June 18, 2013, New York Stock Exchange LLC ("NYSE" or the "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1)¹ of the Securities Exchange Act of 1934 ("Exchange Act"),² and Rule 19b-4 thereunder,³ a proposed rule change to amend 303A.00 of the Exchange's Listed Company Manual (the "Manual") to provide a one-year transition period to comply with the internal audit function requirement of Section 303A.07(c) for companies listing in connection with an initial public offering (as new registrants under the Exchange Act) ("IPO"),⁴ or by means of a carve-out or spin-off transaction. The proposed rule change was published for comment in the Federal Register on July 8, 2013.⁵

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78a.

³ 17 CFR 240.19b-4.

⁴ For purposes of Section 303A other than Sections 303A.06 (which incorporates Exchange Act Rule 10A-3 by reference) and 303A.12(b), Section 303A.00 currently provides that a company is considered to be listing in conjunction with an IPO if, immediately prior to listing, it does not have a class of common stock registered under the Exchange Act. Consequently, a company whose common stock has not previously been registered under the Exchange Act is eligible to avail itself of the IPO transition periods in Section 303A.00 regardless of whether that company is conducting a public offering at the time of its initial listing. The Exchange's proposed amendment would provide a one-year transition period for compliance with the internal audit function requirement to all companies currently eligible for the IPO transition periods in Section 303A.00.

⁵ See Securities Exchange Act Release No. 69914 (July 2, 2013), 78 FR 40816.

The Commission received one comment letter on the proposal.⁶ This order approves the proposed rule change.

II. Description of the Proposal

For companies listing on the Exchange in connection with an IPO,⁷ or by means of a carve-out or spin-off transaction, Section 303A.07(c) of the Manual requires that those companies comply with the internal audit function requirement at the time of listing. Specifically, Section 303A.07(c) of the Manual requires that any listed company subject to Section 303A.07 must have an internal audit function to provide management and the audit committee with ongoing assessments of the listed company's risk management processes and system of internal control. A listed company may choose to outsource this function to a third party service provider other than its independent auditor.

According to the Exchange, consistent with the transition provisions of Section 303A.00 of the Manual, any company listing upon transfer from another national securities exchange that does not have an internal audit function requirement has one year from the date of listing to comply with the Exchange's internal audit function requirement in Section 303A.07(c) of the Manual.⁸ Neither the Nasdaq Stock Market LLC ("Nasdaq") nor NYSE MKT LLC ("NYSE

⁶ See Letter from Richard F. Chambers, President and Chief Executive Officer, The Institute of Internal Auditors to Elizabeth M. Murphy, Secretary, Commission, dated July 29, 2013.

⁷ The Commission notes that companies listing on the Exchange must register under Section 12(b) of the Exchange Act.

⁸ Section 303.00 of the Manual states, among other things, that a company previously registered pursuant to Section 12(b) of the Exchange Act must satisfy the requirements of Section 303A, which includes the internal audit function requirement of Section 303A.07(c), within one year of the listing to the extent that the national securities exchange on which it was listed did not have the same requirement, with the exception of Section 303A.06 including, if applicable, the independence requirements of Section 303A.02, which must be complied with at the time of listing.

MKT”) has an internal audit function requirement for companies listing on their exchange. Consequently, any company transferring its listing from Nasdaq or NYSE MKT to the NYSE has one year from the date of listing to comply with the requirement of Section 303A.07(c) of the Manual. By contrast, Section 303A.00 currently does not provide any transition period for compliance with the internal audit function requirement to a company which is listing in connection with: (i) its IPO, or (ii) by means of a carve-out or spin-off transaction.⁹ In its filing, the Exchange stated that it believes that the lack of a transition period in relation to the internal audit function requirement for these categories of newly-listed companies is anomalous in light of the treatment of companies transferring from other markets. Accordingly, the Exchange has proposed to amend Section 303A.00 to extend the application of the one-year transition period to comply with the internal audit function requirement to such categories of newly-listed companies. Further, the Exchange proposed to amend Section 303A.07 to include a sentence explicitly stating that, although Section 303A.00 permits certain categories of newly-listed companies to have a transition period, that all companies that are subject to Section 303A.07 would be required to have an internal audit function no later than one year after their listing date.

Several provisions in Section 303A.07 set forth duties of the audit committee with respect to the internal audit function requirement. In its filing, the Exchange has proposed to amend those provisions to clarify the duties of the audit committee with respect to the internal audit function during any transition period applicable to IPOs, transfers from another national

⁹ Section 102.01B of the Manual defines a carve-out as the initial offering of an equity security to the public by a publicly traded company for an underlying interest in its existing business (which may be subsidiary, division, or business unit). For all practical purposes, a carve-out is the same as an IPO, as it involves the listing of a newly-public company in connection with the initial public offering of its common stock. A spin-off involves the distribution by a listed company of all of the outstanding common stock of a subsidiary to the listed company’s shareholders and the listing of the new company, generally without any concurrent offering.

securities exchange, carve-outs and spin-offs. The Exchange has proposed to amend the following sections of the Manual as described below:

- Section 303A.07(b)(i)(A) currently requires that the audit committee's charter must provide that the committee will assist board oversight of: (1) the integrity of the listed company's financial statements, (2) the listed company's compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence, and (4) the performance of the listed company's internal audit function and independent auditors. The proposed amendment would provide that if the listed company does not yet have an internal audit function because it is availing itself of a transition period pursuant to Section 303A.00, the company's charter must provide that the committee will assist board oversight of the design and implementation of the internal audit function.
- Section 303A.07(b)(i)(E) currently states that the audit committee's charter must provide that the committee will meet separately, periodically, with management, internal auditors (or other personnel responsible for the internal audit function) and independent auditors. The proposed amendment would provide that if the listed company does not yet have an internal audit function because it is availing itself of a transition period pursuant to Section 303A.00, the audit committee must meet periodically with the company personnel primarily responsible for the design and implementation of the internal audit function.
- Section 303A.07(b)(i)(F) currently requires the audit committee's charter to provide that the committee will review with the independent auditor any audit problems or difficulties and management's response. This review is required to

include, among other things, a discussion of the responsibilities, budget and staffing of the listed company's internal audit function. The proposed amendment would provide that if the listed company does not yet have an internal audit function because it is availing itself of a transition period pursuant to Section 303A.00, this review should include a discussion of management's plans with respect to the responsibilities, budget and staffing of the internal audit function and the company's plans for the implementation of the internal audit function.

- Section 303A.07(b)(i)(H) currently states that the audit committee's charter must provide that the committee will report regularly to the board of directors to review, among other things, the performance of the company's internal audit function. The proposed amendment would provide that if the listed company does not yet have an internal audit function because it is availing itself of a transition period pursuant to Section 303A.00, the audit committee should review with the board management's activities with respect to the design and implementation of the internal audit function.

In its filing, the Exchange stated its belief that providing a transition period to comply with the internal audit function requirement to companies listing in connection with their IPO or by means of a carve-out or spin-off transaction does not, in its view, give rise to any novel regulatory issues that do not arise in connection with the existing transition provision for companies transferring from another national securities exchange. The Exchange stated that it believes that providing a transitional period after listing for a newly public company to establish its internal audit function would benefit investors by making the company's implementation of the internal audit function more effective and efficient and reducing the costs that a company

faces in its first year as a public company. The Exchange further believes that the proposed transition period would also limit any interference by the Exchange's internal audit requirement with a company's business decision regarding the timing and use of resources relating to its initial listing. In that regard, the Exchange noted in its filing that newly-public companies are typically in the process of upgrading their accounting systems and internal controls and hiring additional staff to meet the greater demands placed on public companies. The Exchange in support of its proposal also stated its belief that a one-year transition period would give a newly-appointed audit committee an opportunity to become familiar with the internal controls and risk management of the company and determine what kind of internal audit function is suitable for the company given its specific circumstances.

As noted in its proposal, the Exchange believes that given the limited scope of the proposed transition provision and the fact that other national securities exchanges do not have comparable rules, the extension of the transition provision to IPOs, carve-outs and spin-offs is consistent with the protection of investors and the public interest and that investors would be at least as well protected by having these companies listed on the Exchange, where they would be subject to such a requirement after the transition period.

III. Comments

The Commission received one comment letter on the proposed change from The Institute of Internal Auditors ("the IIA").¹⁰ Given the important role of a robust internal audit function, the IIA believes that all organizations, whether publicly traded or privately held, should have an internal audit function. In its comment letter, the IIA stated that it opposes the Exchange's

¹⁰ The IIA stated that it is a globally recognized authority of the internal auditing profession and represents more than 180,000 members, one-third of whom reside in the United States.

proposed rule change because it will relax an important governance requirement. Additionally, the IIA stated that because newly-public companies are typically upgrading their accounting systems and internal controls and hiring additional staff to meet the greater demands placed on public companies, an internal audit function would assist the board and senior management in assessing these critical systems and internal controls as they are being developed, implemented, enhanced and/or upgraded. Regarding NYSE's statement that a one-year transition period would give a newly-appointed audit committee the opportunity to become familiar with the internal controls and risk management of the company and determine a suitable internal audit function for the company, the IIA stated its belief that there was greater value to the company's board of directors, management, and investors in having a chief audit executive on staff as soon as possible to assist in developing the internal audit function and providing expert advice and counseling on internal control and risk management during such a formative stage for the company and the audit committee. Additionally, the IIA acknowledged that other national securities exchanges do not have rules comparable to NYSE's rules, but nevertheless stated its belief that NYSE should continue to set the standard for U.S. company listing requirements and not weaken its stance as those rules apply to IPOs, new registrants, carve-outs and spin-offs. The IIA also believes that companies that understand the important role that internal audits play in overall good corporate governance will comply with more than just the minimum aspects of any governance rule.

IV. Discussion and Commission Finding

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to a

national securities exchange.¹¹ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹² in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that the proposed rule change, which would provide a one-year transition period to comply with the internal audit requirement of Section 303A.07(c) for companies listing in connection with an IPO or by means of a carve-out or spin-off transaction, is consistent with the Act. The Commission notes that this change will provide a transition period to comply with the internal audit function requirement to companies listing in connection with an IPO, or by means of a carve-out or spin-off transaction, while retaining its general requirement that all such companies must have an internal audit function no later than one year from the company's listing date. Moreover, the Commission notes that with this change, companies listing in connection with an IPO, or by means of a carve-out or spin-off transaction will be subject to the same one year deadline to comply with the internal audit function requirements of Section 303A.07(c) that applies to any company listing upon transfer from another national securities exchange that does not have the same internal audit function requirement.

The Commission has also considered the comment letter of the IIA and agrees that an internal audit function plays an important role in overall good corporate governance for all public

¹¹ In approving the proposed rule changes, the Commission has considered their impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(5).

companies. The Commission notes, however, that as of the date of this order, no other national securities exchange has comparable rules requiring listed companies to maintain an internal audit function.¹³ The Commission also notes that the transition is limited in duration and that during any transition period the audit committee will continue to have a role in overseeing the listed company's financial systems and internal controls over financial reporting and will also be involved in overseeing the design and implementation of the company's internal audit function during that period. In this regard, the Exchange has specifically amended its rules to make clear, as required to be set forth in the audit committees' written charter provisions, that a listed company's audit committee still has responsibilities as to the oversight of the design and implementation of the company's internal audit function during any one year transition period, as well as a requirement, to review and discuss management's plans with respect to the responsibilities, budget and staffing of the internal audit function and plans for its implementation. These charter provisions and responsibilities of the audit committee should help to ensure that the internal audit function is being developed with oversight from the audit committee during the transition period, and is on track to be implemented no later than one year from the company's listing on the Exchange.

¹³ The Commission notes that Nasdaq had previously proposed to require listed companies to have an internal audit function similar to NYSE's requirement prior to the change being approved in this order. However, on May 7, 2013 Nasdaq withdrew its proposal. Nasdaq stated it was withdrawing its proposal so that it may fully consider the comments submitted on it, but that it "... remains committed to the underlying goal of the proposal, to help ensure that listed companies have appropriate processes in place to assess risks and the system of internal controls, and intends to file a revised proposal ." See Securities Exchange Act Release 69792 (June 18, 2013), 78 FR 37867 (June 24, 2013). To date, Nasdaq has not filed a revised proposal. NYSE MKT had also filed a proposal to adopt an internal audit function requirement but withdrew its proposal on May 14, 2013. (SR-NYSEMKT-2013-41) The Commission continues to believe, as noted above, that an internal audit function is important for listed companies.

The Commission further notes that, although this proposed rule change will allow certain companies a one-year transition period, these same companies will continue to be subject to the requirements of Section 13(b)(2)(B) of the Exchange Act, and the rules thereunder, that require registered companies to devise and maintain a system of internal accounting controls. The Commission believes that an internal audit function can, among other things, assist newly listed companies on the NYSE in meeting their obligations under Section 13(b)(2)(B). As a result, companies eligible to avail themselves of the proposed transition period are encouraged to implement an internal audit function as quickly as possible.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act¹⁴ that the

¹⁴ 15 U.S.C. 78f(b)(2).

proposed rule change (SR-NYSE-2013-40) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Kevin M. O'Neill
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).