SEC Adopts Final Rules Relating to Codes of Ethics

The SEC recently adopted final rules under Section 406 of Sarbanes-Oxley, requiring companies to disclose in their annual reports whether they have a qualifying code of ethics that applies to their principal executive, financial and accounting officers, or persons performing similar functions (the "specified officers"), and if not, why not. Companies will also have to make copies of their code of ethics publicly available and disclose publicly any information about changes to or waivers from such a code of ethics. We have previously sent a Securities Alert that describes the SEC's proposed rules, which is available on our web site at www.ropesgray.com under "News and Events." Although the final rules are substantially similar to the proposed rules, the SEC made several important changes and clarifications that are noted below.

Code of Ethics Requirements

Code Standards

- Under the final rules, a code of ethics means written standards that are reasonably designed to deter wrongdoing and promote:
  - honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
  - full, fair, accurate, timely and understandable disclosure in a company's SEC filings and other public communications;
  - compliance with applicable governmental laws, rules and regulations;
  - prompt internal reporting to a person identified in the code of ethics of violations of the code; and
  - accountability for adherence to the code of ethics.
- The final rules eliminated the proposed requirement that a code of ethics also be designed to promote "avoidance of conflicts of interest . . ." The SEC noted that the conduct covered by that standard is addressed sufficiently by the first standard of the adopted definition.

Multiple or Incorporated Codes

- The SEC acknowledged that companies may have separate codes of ethics for different types of officers, provided that each code of ethics meets the new requirements. The rules also indicate that a code of ethics may be incorporated into a broader document that addresses additional topics or applies to people other than the specified officers. [1]

[1] It is common for companies to have a corporate code of conduct applicable to all officers and employees that covers many of the same areas required to be included in a code of ethics.

Certain SRO Requirements

- Under the final rules, companies are not required to adopt codes of ethics, only to disclose whether or not they have adopted one. The NYSE, however, has submitted proposed new listing standards that would require all NYSE-listed companies to adopt a code of business conduct and ethics consistent with the principles enumerated in the listing standards.[2] The NASD has indicated that it also intends to propose new listing standards that would require a code of conduct for NASDAQ-listed companies.

Required Disclosure

Annual Report Disclosure

- The final rules require companies to disclose in their annual reports on Form 10-K (or Form 10-KSB for small business issuers, Form 20-F for foreign private issuers or Form 40-F for Canadian issuers) whether the company has adopted a code of ethics that applies to the specified officers, and if the company has not adopted such a code of ethics, its reasons for not doing so.

Public Availability

- Companies are required to make their codes of ethics publicly available in one of three possible ways. First, as initially proposed, a company may file its code of ethics as an exhibit to its annual report. Alternatively, the final rules allow a company either to post the text of its code of ethics on its internet website in a location where an investor would typically look (e.g., the investor relations section) or to undertake in its annual report to provide a copy of its code of ethics free of charge to any person upon request.

    - If a company chooses to post its code of ethics on its internet website, it must disclose in its annual report its website address and its intention to provide the information in this manner.

    - If a company has its code of ethics incorporated in a broader document, it is only required to file, post or provide the portion of that document that constitutes the qualifying code of ethics applicable to the specified officers.

Changes and Waivers

- Under the final rules, companies must publicly disclose the nature of any amendment to their codes of ethics that apply to any of the specified officers. In addition, if a company has granted a waiver, or implicit waiver, from a provision of its code of ethics to any of its specified officers, the company must publicly disclose the nature of this waiver, the name of the person to whom it was granted and the date of the waiver.

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[2] The NYSE's proposed code of business conduct and ethics would cover directors, officers and employees and would cover a broader range of activities.

- o A company need only disclose changes and waivers relating to any of the five specified standards required to be covered by a code of ethics.

- o A "waiver" is a company's material departure from a provision of its code of ethics, and an "implicit waiver" is a company's failure to take action within a reasonable period of time regarding such a material departure that has been made known to one of the company's executive officers.

- Companies can choose to make this disclosure in one of two ways. First, as initially proposed, a company can disclose the waiver in a Form 8-K within five business days.[3] Second, a company may post the information on its internet website within five business days in a location where an investor would typically look.

  - o If a company chooses to post this information on its internet website, it must disclose in its annual report its website address and its intention to provide the information in this manner.

  - o Additionally, if a company elects to disclose this information on its internet website, the disclosure must remain available on the website for at least 12 months, and the company must retain this information for not less than five years and make it available to the SEC or its staff upon request.

Foreign Private Issuers

- Like a domestic company, a foreign private issuer must disclose whether it has a code of ethics that applies to its specified officers, and if not, why not, and must also make its code of ethics publicly available.

- However, a foreign private issuer will not have to immediately disclose any change to or waiver from its code of ethics in a current report or on its website. Instead, the final rules require that a foreign private issuer disclose any such amendment or waiver that occurred during the fiscal year in its annual report for that year.

  - o A foreign private issuer may alternatively satisfy this disclosure requirement within five days of the change or waiver by filing a Form 6-K or posting the information on its internet website if the issuer disclosed in its annual report its website address and its intention to provide the information in this manner. The SEC has indicated that it will strongly encourage such prompt disclosure.

Effective Date and Transition Period

- The effective date for the final rules is March 3, 2003. The rules provide a transition period so that the new disclosure requirements must be contained in annual reports covering fiscal years ending on or after July 15, 2003 (December 15, 2003 for small business issuers).

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[3] The proposed rules would have required a Form 8-K to be filed within two business days. The SEC indicated that it may shorten this time period when it finalizes its other Form 8-K proposals.

Contact Information

If you have any questions or would like to learn more about the final rules, please contact the lawyer who normally represents you.