

Act²⁵⁷ require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. The amendments are designed to enhance the quality and accountability of the financial reporting process and may help increase investor confidence, which implies increased efficiency and competitiveness of the U.S. capital markets. Increased market efficiency and investor confidence also may encourage more efficient capital formation. As noted above, however, the requirements could have certain indirect negative effects, such as inconsistent application across all competitors. In addition, the requirements, while providing great flexibility for implementation, do remove a certain amount of individual control over the corporate governance process, which could have the possible effect of stifling more efficient approaches from being implemented if they were to develop.

If a company found the requirements too onerous, it could be dissuaded from accessing the U.S. public capital markets, which could impact capital formation. The possibility of these effects and their magnitude if they were to occur are difficult to quantify. We are adopting several limited exemptions from the requirements to alleviate some of the burdens companies may face where consistent with investor protection. For example, the limited exemption for new public companies is intended to counteract any disincentive the requirements may have on a company's willingness to access the public capital markets.

We requested comments on these analyses in the Proposing Release. We received no comments in response to these requests.

VI. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis, or FRFA, has been prepared in accordance with the Regulatory Flexibility Act.²⁵⁸ This FRFA involves new rules and amendments to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with several enumerated standards relating to the issuer's audit committee. An Initial Regulatory Flexibility Analysis

("IRFA") was prepared in accordance with the Regulatory Flexibility Act²⁵⁹ in conjunction with the Proposing Release. The Proposing Release included the IRFA and solicited comments on it.

A. Need for the Amendments

We are adopting new Exchange Act rule 10A-3 to comply with the mandate of the Sarbanes-Oxley Act and new section 10A(m)(1) of the Exchange Act. The amendments are intended to enhance investor confidence in the fairness and integrity of the securities markets by increasing the competence and independence, and hence effectiveness, of listed company audit committees. In addition, the amendments change current disclosure requirements regarding audit committees to increase the transparency of these committees. We believe that these amendments will help to improve the quality and accountability of financial disclosure and oversight of the process by qualified and independent audit committees.

B. Significant Issues Raised by Public Comment

We received no comments in response to the IRFA.

C. Small Entities Subject to the Amendments

The amendments will directly affect the national securities exchanges that trade listed securities, none of which is a small entity as defined by Commission rules. Exchange Act rule 0-10(e)²⁶⁰ states that the term "small business," when referring to an exchange, means any exchange that has been exempted from the reporting requirements of Exchange Act rule 11Aa3-1.²⁶¹ The amendments also will directly affect national securities associations. No affected national securities association is a small entity, as defined by 13 CFR 121.201.

The amendments may have an indirect effect on some small entities. We also have defined the term "small business" in Exchange Act rule 0-10(a) to be an issuer, other than an investment company, that, on the last day of its most recent fiscal year, had total assets of \$5 million or less and when used with reference to an investment company, an investment company together with other investment companies in the same group of related investment companies with net assets of \$50 million or less as of the end of its

most recent fiscal year.²⁶² Under these limits, depending on other restrictions imposed by the various SROs, such as quantitative listing standards, a small entity may be listed on a national securities exchange or a national securities association. We estimate that 7,250 issuers are listed on a national securities exchange or traded on Nasdaq, and we estimate that 6,640 of these issuers are not investment companies.²⁶³ We estimate that less than 225, or approximately 3%, of the issuers that are not investment companies,²⁶⁴ and less than 25, or approximately 4% of the issuers that are investment companies,²⁶⁵ are "small entities" for purposes of the Regulatory Flexibility Act that possibly could be affected by the amendments.

D. Reporting, Recordkeeping, and Other Compliance Requirements

Under the amendments, national securities exchanges and national securities associations are directed to prohibit the listing of any security of an issuer, both large and small, that is not in compliance with certain enumerated standards regarding the issuer's audit committee. These standards relate to: The independence of audit committee members; the audit committee's responsibility to select and oversee the issuer's independent accountant; procedures for handling complaints regarding the issuer's accounting practices; the authority of the audit committee to engage advisors; and funding for the independent auditor and any outside advisors engaged by the audit committee.

Small entities will need to comply with these standards if they wish to have their securities listed on a national securities exchange or a national securities association. The rules will not require an entity to maintain an audit committee. However, the Exchange Act now provides that in the absence of an audit committee, the entire board of directors will be considered to be the audit committee. There are reasons to believe that many small entities currently have separately-designated audit committees.²⁶⁶ However, not all of the audit committees of these small entities may comply with the new requirements. A small entity whose board or audit committee does not comply with the new requirements will

²⁶² See Exchange Act rule 0-10(a).

²⁶³ See note above.

²⁶⁴ We derived this estimate from the Standard & Poors Research Insight Compustat Database.

²⁶⁵ We derived this estimate from information compiled by Commission staff.

²⁶⁶ See, e.g., NACD, 2001-2002 Public Company Governance Survey (Nov. 2001).

²⁵⁷ 15 U.S.C. 80a-2(c).

²⁵⁸ 5 U.S.C. 601.

²⁵⁹ 5 U.S.C. 603.

²⁶⁰ 17 CFR 240.0-10(e).

²⁶¹ 17 CFR 240.11Aa3-1.