

believe that applying the proposed rules to small business issuers would be inconsistent with the policies underlying the small business issuer disclosure system.

E. Request for Comments

To assist the Commission in its evaluation of the costs and benefits of the proposed disclosure discussed in this release, we request that commenters provide views and data relating to any costs and benefits associated with the proposed rules.

V. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act⁷¹ requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The proposed rules are intended to make information about the functions of a company's nominating committee of the board of directors, as well as the ability of security holders to communicate with the board of directors, more transparent to investors. We anticipate that the proposed rules would provide increased information upon which to evaluate the functioning of boards of directors and make investment decisions. The proposed rules may affect competition because they would allow companies to consider their existing policies in relation to policies adopted by other companies. As a result, companies may compete to adopt policies that effectively balance security holder and director interests and therefore attract investors.

We have identified one possible area where the proposed rules could potentially place a burden on competition. The proposed disclosure would enable investors to compare companies' policies and procedures for director nominations and communications with directors. To the extent that investors would place a premium on a company that provides security holders with favorable director nomination and communication procedures, a company would be at a disadvantage to other companies who maintain more favorable procedures. We request comment regarding the degree to which our proposed disclosure requirements would create

competitively harmful effects upon public companies, and how to minimize those effects. We also request comment on any disproportionate cross-sectional burdens among the firms affected by our proposals that could have anti-competitive effects.

Section 3(f) of the Exchange Act⁷² and Section 2(c) of the Investment Company Act⁷³ require us, when engaging in rulemaking that requires us 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. We believe the proposed disclosure will make information about the operation of a company's director nomination process more transparent. In addition, disclosure regarding the means by which security holders may communicate directly with a company's board of directors may increase security holder involvement in the companies in which they invest. As a result, we believe that investors may be able to evaluate a company's board of directors more effectively and make more informed investment decisions. We believe that as a consequence of these developments, there may be some positive impact on the efficiency of markets and capital formation. The possibility of these effects, their magnitude if they were to occur, and the extent to which they would be offset by the costs of the proposals are difficult to quantify. We request comment on these matters and how the proposed amendments, if adopted, would affect efficiency and capital formation. Commenters are requested to provide empirical data and other factual support to the extent possible.

VI. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed revisions to Items 7 and 22 of Exchange Act Schedule 14A. Under the proposals, we would expand the disclosure that currently is required in company proxy or information statements regarding the functions of a company's nominating committee. In addition, the proposals would require disclosure regarding the policies and procedures regarding security holder communications with the board of directors.

⁷² 15 U.S.C. 78c(f).

⁷³ 15 U.S.C. 80a-2(c).

A. Reasons for the Proposed Action

On April 14, 2003, the Commission directed the Division of Corporation Finance to formulate possible changes in the proxy rules and regulations regarding procedures for the election of directors⁷⁴ and on May 1, 2003, the Commission solicited public views on that undertaking.⁷⁵ Submissions from the public on this matter identified two particular areas of concern: the process for nominating candidates for election as directors and the ability of security holders to communicate effectively with the board of directors. After considering all of the comments on this matter, the Commission is proposing to expand disclosure in company proxy statements regarding the nominating committees of boards of directors and communications between security holders and directors.

Currently, companies must state whether or not they have a nominating committee and, if so, must identify the members of the nominating committee, state the number of committee meetings held, and briefly describe the functions performed by such committees.⁷⁶ In addition, if a company has a nominating or similar committee, it must state whether the committee considers nominees recommended by security holders and, if so, must describe how security holders may submit recommended nominees.⁷⁷ The proposed disclosures are designed to build upon existing disclosure requirements to elicit a more detailed discussion of the policies and procedures of the nominating committee as well as the means by which security holders can communicate with the board of directors.

B. Objectives

The proposed disclosure requirements are designed to enhance transparency of the policies of boards of directors, with the goal of providing security holders a better understanding of the functions and activities of the boards of the companies in which they invest. For example, the proposal relating to nominating committees would require disclosure about the source of director candidates and the level of scrutiny accorded to each candidate. The proposal relating to security holder communications with directors seeks to strengthen the association among security holders and directors. For example, the proposed disclosure would inform security holders of the manner in

⁷⁴ See Press Release No. 2003-46 (April 14, 2003).

⁷⁵ See Release No. 34-47778 (May 1, 2003).

⁷⁶ See Paragraph (d)(1) of Item 7 of Exchange Act Schedule 14A.

⁷⁷ See *id.* at Paragraph (d)(2).

⁷¹ 15 U.S.C. 78w(a)(2).