

which to send communications to the board. Moreover, the proposals aim to enable investors to better evaluate a company's responsiveness to security holder issues and inquiries by illuminating the degree of director involvement with security holder concerns. The proposed disclosure requirements enhance transparency of the policies of boards of directors, with the goal of giving security holders a better understanding of the functions and activities of the boards of the companies in which they invest.

C. Legal Basis

We are proposing the amendments under the authority set forth in Sections 3(b), 12, 14, 23(a) and 36 of the Securities Exchange Act of 1934, as amended, and Sections 20(a) and 38 of the Investment Company Act of 1940, as amended.

D. Small Entities Subject to the Proposed Amendments

The proposed amendments would affect companies that are small entities. Exchange Act Rule 0-10(a)⁷⁸ defines a company, other than an investment company, to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of \$5 million or less on the last day of its most recent fiscal year. An investment company is considered to be a "small business" if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.⁷⁹ As discussed below, we believe that the proposals would affect approximately 575, or 23%, of the small entities that are operating companies. We believe that the proposals also would affect approximately 50 of the small entities that are investment companies.

The Commission received 8,692 separate proxy and information statements in its 2002 fiscal year. We estimate that 6,536, or 80%, of those filings involved the election of directors, and would therefore be affected by the proposals.⁸⁰ Furthermore, we estimate

that 5,257 companies are "listed issuers" (as defined in Exchange Act Rule 10A-3) that are subject to the proxy rules.⁸¹ Because the relevant listing standards of national securities exchanges and the Nasdaq require that listed issuers hold annual meetings, and state law provides for the election of directors at annual meetings, we estimate that at least 5,257 proxy and information statements involve elections of directors,⁸² of which less than 225 operating companies and less than 25 investment companies constitute "small entities."⁸³ Therefore, we deduced that 1,029 proxy and information statements relate to the election of directors for companies that are not "listed issuers."⁸⁴ We estimate that approximately 352 of the proxy and information statements for operating companies that are not "listed issuers" would be filed by small entities affected by the proposed rules.⁸⁵ We also estimate that approximately 25 of the proxy and information statements for investment companies that are not "listed issuers" would be filed by small entities affected by the proposals. Therefore, we estimate that the proposals would, in total, affect approximately 625 small entities.⁸⁶

We request comment on the number of small entities that would not be impacted by our proposals, including any available empirical data.

E. Reporting, Recordkeeping, and Other Compliance Requirements

The proposals are expected to result in minimal additional costs to all subject companies, large or small. Because the current rules already require a company to collect and disclose information about the composition, functions and policies and procedures of its nominating committee, the proposed disclosure should not

impose significant new costs for the collection of information. Thus, the task of complying with the proposed nominating committee disclosure could be performed by the same person or group of persons responsible for compliance under the current rules at a minimal incremental cost. Moreover, if a small entity were to maintain a process for security holders to send communications to its board of directors, company personnel would be aware of such procedures and the disclosure burden would also be minimal. If a small entity does not maintain such a process, then the proposed disclosure would consist of a statement that the board does not have a communications process and the company would state the specific basis for the view of the board of directors that it is appropriate for the registrant not to have such a communications process. To the extent that the proposals influence corporate behavior, however, the costs would extend beyond a disclosure burden. For example, companies may incur additional costs in instituting more responsive policies and procedures regarding director nominations and security holder communications. The proposals, however, would not mandate any specific procedures.

For purposes of the PRA, we estimated that it will take an average of 3 hours per year for companies, large and small, to comply with the proposed disclosure. We estimated that 75% of the compliance burden would be carried by the company internally and that 25% of the compliance burden would be carried by outside professionals retained by the company. Thus, we estimated the annual incremental paperwork burden for a company subject to the proxy rules would be 2.25 hours per company, which translates into an estimated cost of \$191 per company,⁸⁷ and a cost of approximately \$225 per company for the services of outside professionals.⁸⁸

A cost of \$416 per small entity may not, however, constitute a significant economic impact. That conclusion is based on our analysis of 1,245 small entities available on the Compustat database. We found that the average revenue of those small entities is \$2.07 million per company. Therefore, on

⁸¹ We derived this estimate from the database provided by the Center for Research in Securities Prices at the University of Chicago ("CRSP"), the Standard & Poors Research Insight Compustat Database ("Compustat") and SEC Form 1392.

⁸² See, e.g., Rule 302.00 of NYSE listing standards and Rule 4350(e) of Nasdaq listing standards.

⁸³ Data obtained from Compustat indicates that there are less than 225 listed operating companies that are small entities. Information compiled by the Commission staff indicates that there are less than 25 listed investment companies that are small entities.

⁸⁴ $6,536 - 5,257 - 225 - 25 = 1,029$.

⁸⁵ This estimate is based on the proportion of small entities that are reporting companies (2,500) to the total domestic companies quoted on the OTCBB or the Pink Sheets (7,317). We derived the latter figure from the CRSP database.

⁸⁶ The calculation for the total number of small entities is as follows: 225 listed operating companies + 25 listed investment companies + 352 non-listed operating companies + 25 non-listed investment companies = 627.

⁸⁷ We estimate the average hourly cost of in-house personnel to be \$85. This cost estimate is based on data obtained from *The SIA Report on Management and Professional Earnings in the Securities Industry* (Oct. 2001).

⁸⁸ In connection with other recent rulemakings, we have had discussions with several private law firms to estimate an hourly rate of \$300 as the cost of outside professionals that assist companies in preparing these disclosures.

⁷⁸ 17 CFR 240.0-10(a).

⁷⁹ 17 CFR 270.0-10(a).

⁸⁰ We estimate that 20% of all proxy and information statements do not include disclosure about directors. This estimate is based on the proportion of preliminary proxy statements to definitive proxy statements filed in our 2002 fiscal year (2,555/8,639=30%), which has been adjusted downward by 10% to reflect the fact that some preliminary proxy statements contain disclosure about directors. Registrants do not file preliminary proxy statements for security holder meetings where the matters to be acted upon involve only the election of directors or other specified matters. See Exchange Act Rule 14a-6.