

requirements, however, do not mandate any specific procedures.

For purposes of the PRA, we estimated that it will take an average of approximately 3 hours per year for companies, large and small, to comply with the new disclosure requirements. We estimated that 75% of the compliance burden will be carried by the company internally and that 25% of the compliance burden will be carried by outside professionals retained by the company. Thus, we estimate the annual incremental paperwork burden for a company subject to the proxy rules will be 2.4 hours per company, which translates into an estimated cost of \$204 per company,²¹⁷ and a cost of approximately \$240 per company for the services of outside professionals.²¹⁸ A cost of \$444 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 average, the estimated \$444 compliance expense will constitute approximately .02% of a small entity's revenues, based on the Compustat data.

E. Agency Action To Minimize Effect on Small Entities

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposals, we considered the following alternatives:

(a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities;

(b) The clarification, consolidation, or simplification of disclosure for small entities;

(c) The use of performance rather than design standards; and

(d) An exemption for small entities from coverage under the proposals.

The Commission has considered a variety of reforms to achieve its regulatory objectives. As one possible approach, we considered requiring companies to include the security holder's proxy card and materials in the

company mailing. Alternatively, we considered amending or reinterpreting Exchange Act Rule 14a-8(i)(8)²¹⁹ to allow security holder proposals requesting access to the company's proxy card for the purpose of making nominations. We believe that the current disclosure requirements are the most cost-effective approach to address specific concerns related to small entities because the proposals build on existing disclosure requirements.

We have drafted the new disclosure rules to require clear and straightforward disclosure of a company's policies and procedures regarding the nomination of directors and security holder communications. Separate disclosure requirements for small entities would not yield the disclosure that we believe to be necessary to achieve our objectives. In addition, the informational needs of investors in small entities are typically as great as the needs of investors in larger companies. Therefore, it did not seem appropriate to develop separate requirements for small entities involving clarification, consolidation, or simplification of the disclosure.

We have used design rather than performance standards in connection with the new requirements for two reasons. First, based on our past experience, we believe the disclosure will be more useful to investors if there are enumerated informational requirements. The mandated disclosures may be likely to result in a more focused and comprehensive discussion. Second, more precise disclosure requirements will promote more consistent disclosure among a cross-section of public companies because they will have greater certainty as to the required disclosure. In addition, more precise disclosure requirements will improve our ability to enforce the rules. Therefore, adding to the disclosure requirements in existing proxy and information statements appears to be the most effective method of eliciting the disclosure.

VII. Statutory Basis and Text of Amendments

The amendments are being adopted pursuant to sections 2,²²⁰ 6,²²¹ 7,²²² 10,²²³ and 19²²⁴ of the Securities Act, sections 3(b),²²⁵ 12, 13,²²⁶ 14, 15,

23(a)²²⁷ and 36²²⁸ of the Exchange Act, as amended, and sections 8,²²⁹ 20(a),²³⁰ 30,²³¹ 31,²³² and 38²³³ of the Investment Company Act, as amended.

List of Subjects

17 CFR Parts 228, 229, 240 and 249

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of the Amendments

■ In accordance with the foregoing, the Securities and Exchange Commission amends Title 17, chapter II of the Code of Federal Regulations as follows:

PART 228—INTEGRATED DISCLOSURE SYSTEM FOR SMALL BUSINESS ISSUERS

■ 1. The general authority citation for Part 228 is revised to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77jjj, 77nnn, 77sss, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-29, 80a-30, 80a-37, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350.

* * * * *

■ 2. Amend § 228.401 by adding paragraph (g) to read as follows:

§ 228.401 (Item 401) Directors, Executive Officers, Promoters and Control Persons.

* * * * *

(g) Describe any material changes to the procedures by which security holders may recommend nominees to the registrant's board of directors, where those changes were implemented after the registrant last provided disclosure in response to the requirements of Item 7(d)(2)(ii)(G) of Schedule 14A (§ 240.14a-101), or this Item.

Instructions to paragraph (g) of Item 401:

1. The disclosure required in paragraph (g) need only be provided in a registrant's quarterly or annual reports.

2. For purposes of paragraph (g), adoption of procedures by which security holders may recommend nominees to the registrant's board of directors, where the registrant's most recent disclosure in response to the requirements of Item 7(d)(2)(ii)(G) of Schedule 14A (§ 240.14a-101), or this Item, indicated that the registrant did not have in place such procedures, will constitute a material change.

²¹⁷ 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* (October 2001).

²¹⁸ 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.

²¹⁹ 17 CFR 240.14a-8(i)(8).

²²⁰ 15 U.S.C. 77b.

²²¹ 15 U.S.C. 77f.

²²² 15 U.S.C. 77g.

²²³ 15 U.S.C. 77j.

²²⁴ 15 U.S.C. 77s.

²²⁵ 15 U.S.C. 78c(b).

²²⁶ 15 U.S.C. 78m.

²²⁷ 15 U.S.C. 78w(a).

²²⁸ 15 U.S.C. 78mm.

²²⁹ 15 U.S.C. 80a-8.

²³⁰ 15 U.S.C. 80a-20(a).

²³¹ 15 U.S.C. 80a-29.

²³² 15 U.S.C. 80a-30.

²³³ 15 U.S.C. 80a-37.