

extent that investors may place a premium on a company that provides security holders with favorable director nomination and communication procedures, a company will be at a disadvantage to other companies that maintain more favorable procedures.

Section 2(b) of the Securities Act,¹⁹⁰ section 3(f) of the Exchange Act¹⁹¹ and section 2(c) of the Investment Company Act¹⁹² 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 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 will be offset by the costs of the new rules, are difficult to quantify.

We requested comment on these matters in the proposing release. We received no comments in response to these requests.

VI. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis has been prepared in accordance with the Regulatory Flexibility Act.¹⁹³ This FRFA involves amendments to Items 7 and 22 of Exchange Act Schedule 14A, Item 5 of Exchange Act Forms 10-Q and 10-QSB, Form N-CSR, and Item 401 of Regulations S-B and S-K. The amendments will expand the disclosure that currently is required in company filings regarding the functions of a company's nominating committee. In addition, the amendments will require disclosure regarding the policies and procedures regarding security holder

communications with boards of directors. An Initial Regulatory Flexibility Analysis was prepared in accordance with the Regulatory Flexibility Act¹⁹⁴ in conjunction with the proposing release. The proposing release included the IRFA and solicited comments on it.

A. Need for the Amendments

The amendments are designed to address the growing concern among security holders over the accountability of corporate directors and the lack of sufficient security holder input into decisions made by the boards of directors of the companies in which they invest. Currently, companies must state whether 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.¹⁹⁵ 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.¹⁹⁶ The amendments are designed to build upon existing disclosure requirements to elicit a more detailed discussion of the policies and procedures of nominating committees as well as the means by which security holders can communicate with boards of directors.

The amended 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 amendments relating to nominating committees will require disclosure about the source of director candidates and the level of scrutiny accorded to each candidate. The amendments relating to security holder communications with directors may strengthen the association among security holders and directors by providing security holders with a better understanding of the means by which they may communicate with board members. For example, the amended disclosure will inform security holders of the manner in which to send communications to the board. Moreover, the amendments 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.

B. Significant Issues Raised by Public Comment

The Initial Regulatory Flexibility Analysis appeared in the proposing release. We requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposals, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposals. While we did not receive any comments that responded directly to the IRFA, we did receive comments addressing the impact on small business issuers. Several commenters supported requiring small companies to provide the disclosure.¹⁹⁷ In that regard, commenters stated, "enhanced disclosure would be of great value to all types of investors."¹⁹⁸ Other commenters recommended granting outright relief to small businesses or deferring application of the rules to small businesses until the Commission evaluates the impact of the rules.¹⁹⁹ One commenter suggested that small companies that have established procedures could comply voluntarily.²⁰⁰

Those commenters who sought relief for small businesses did so for several reasons. One commenter recommended that we not apply the rules to small businesses because it will "waste the money of small publicly held companies, create confusion * * * and provide no useful service to security holders."²⁰¹ This commenter noted that there does not appear to be a significant number of instances where major security holders of small publicly held companies were unable to communicate with boards of directors, particularly because major security holders are in management and/or on the board.²⁰² Further, this commenter was of the view that, because major unaffiliated security holders potentially can impact the trading price of small business securities, management and the board "take the views of major unaffiliated security holders very seriously."²⁰³ This commenter also noted that the board and security holders will not agree on every aspect of running the company and it is not clear why small businesses

¹⁹⁷ See CalPERS; CII; Granary; Letter B; McRitchie2; SERS; SIF; Trillium.

¹⁹⁸ See Letter B; McRitchie2.

¹⁹⁹ See ABA; Archer; Foley; Stoecklein.

²⁰⁰ See ABA.

²⁰¹ See Archer.

²⁰² See *id.*

²⁰³ See *id.*

¹⁹⁰ 15 U.S.C. 77b(b).

¹⁹¹ 15 U.S.C. 78c(f).

¹⁹² 15 U.S.C. 80a-2(c).

¹⁹³ 5 U.S.C. 601.

¹⁹⁴ 5 U.S.C. 603.

¹⁹⁵ See Paragraph (d)(1) of Item 7 of Exchange Act Schedule 14A.

¹⁹⁶ See Paragraph (d)(2) of Item 7 of Exchange Act Schedule 14A, prior to adoption of these amendments.