

need to set up a procedure for every communication with security holders.<sup>204</sup>

One commenter noted that increasing the incremental cost to small businesses by a certain number of hours and assuming that the staff is available already is flawed.<sup>205</sup> One commenter believed that the benefits of increased disclosure would not outweigh a small business issuer's need to reduce expenses.<sup>206</sup> This commenter noted that, as regulatory requirements increase, small businesses will have to hire additional staff or reduce the number of hours spent managing the company.<sup>207</sup>

After reviewing these comments, we are convinced that issues relating to corporate accountability and security holder rights affect small companies as much as they affect large companies. The concerns raised by the commenters addressed primarily the cost of establishing and maintaining new board policies and procedures "not the cost of the disclosure required by the amendments. A small business issuer is not required to adopt new policies and procedures under the amendments. Thus, we do not believe that applying the rules to small business issuers would be inconsistent with the policies underlying the small business issuer disclosure system. Like other issuers, small business issuers should incur relatively minor compliance costs to fulfill their disclosure obligations, and should find it unnecessary to hire extra personnel. To the extent small businesses decide to adopt such policies, they are likely to do so because they believe the benefits justify the costs.

### C. Small Entities Subject to the Amendments

The amendments will affect companies that are small entities. Exchange Act Rule 0-10(a)<sup>208</sup> 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.<sup>209</sup> As discussed below, we believe that the amendments will affect approximately 805, or 32%, of the small entities that are operating companies. We believe that the amendments also will 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 6,954, or 80%, of those filings involved the election of directors, and therefore will be affected by the new disclosure requirements.<sup>210</sup> 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.<sup>211</sup> Because the relevant listing standards of national securities exchanges and 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.<sup>212</sup> Of these proxy and information statements, less than 225 relate to operating companies and less than 25 relate to investment companies that constitute "small entities."<sup>213</sup> Therefore, we deduced that 1,697 proxy and information statements relate to the election of directors for companies that are not "listed issuers."<sup>214</sup> We estimate that approximately 580 of the proxy and information statements for operating companies that are not "listed issuers" will be filed by small entities affected by

the new rules.<sup>215</sup> We also estimate that approximately 25 of the proxy and information statements for investment companies that are not "listed issuers" will be filed by small entities affected by the new disclosure requirements. Therefore, we estimate that the amendments will, in total, affect approximately 855 small entities.<sup>216</sup>

We requested comment on the number of small entities that would be impacted by our proposals, including any available empirical data. We received no responses to this request.

### D. Reporting, Recordkeeping, and Other Compliance Requirements

The amendments are expected to result in some additional costs to comply with the disclosure requirements. Because the current rules already require a company to collect and disclose information about the composition, functions, policies and procedures of its nominating committee, the disclosure should not impose significant new costs for the collection of information. Thus, the task of complying with the 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 also would be minimal. If a small entity does not maintain such a process, then the disclosure will consist of a statement that the board does not have a communications process and a statement of the specific basis for the view of the board of directors that it is appropriate for the company not to have such a communications process.

To the extent that the new rules influence corporate behavior, however, the costs will 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 new disclosure

<sup>209</sup> *Id.*

<sup>210</sup> We estimate that 20% of all proxy and information statements do not include disclosure about directors, and therefore would not include the disclosure required by the amendments. This estimate is based on the proportion of preliminary proxy statements to definitive proxy statements filed in our 2002 fiscal year (2,555/8,692=29%), which has been adjusted downward by 9% to reflect the fact that some preliminary proxy statements contain disclosure about directors. This estimate is based on the rationale that preliminary proxy statements are less likely to contain disclosure about directors because 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.

<sup>211</sup> We derived this estimate from the database provided by the Center for Research in Securities Prices at the University of Chicago, the Standard & Poors Research Insight Compustat Database ("Compustat"), and SEC Form 1392.

<sup>212</sup> See, e.g., Rule 302.00 of NYSE listing standards and Rule 4350(e) of Nasdaq listing standards.

<sup>213</sup> 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.

<sup>214</sup> 6,536-5,257=1,697.

<sup>215</sup> 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 individuals within the organization called <http://www.pinksheets.com> and from the OTCBB Web site at <http://www.otcbb.com>.

<sup>216</sup> The calculation for the total number of small entities is as follows: 225 listed operating companies + 25 listed investment companies + 580 non-listed operating companies + 25 non-listed investment companies = 855.

<sup>204</sup> See *id.*

<sup>205</sup> See *id.*

<sup>206</sup> See Stoecklein.

<sup>207</sup> See *id.*

<sup>208</sup> 17 CFR 240.0-10(a).