SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release Nos. 34–48301; IC–26145; File No. S7–14–03]

RIN 3235–AI90

Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing new disclosure requirements and amendments to existing disclosure requirements to enhance the transparency of the operation of boards of directors. Specifically, we are proposing enhancements to existing disclosure requirements regarding the operation of board nominating committees and a new disclosure requirement concerning the means, if any, by which security holders may communicate with members of the board of directors. These proposed disclosure requirements would not mandate any particular action by a company or its board of directors; rather, the proposals are intended to make more transparent to security holders the operation of the boards of directors of the companies in which they invest.

DATES: Comments should be received on or before September 15, 2003.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by one method—U.S. mail or electronic mail—only. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following e-mail address: *rule-comments@sec.gov*. All comment letters should refer to File No. S7–14–03. This number should be included in the subject line if sent via electronic mail. Electronically submitted comment letters will be posted on the Commission's Internet Web site (*http://www.sec.gov*). We do not edit personal information, such as names or electronic mail addresses, from electronic submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Lillian K. Cummins, at (202) 942–2900, Andrew Thorpe at (202) 942–2910, or Grace K. Lee, at (202) 942–2900 in the Division of Corporation Finance, or with respect to investment companies, Christian L. Broadbent, Senior Counsel, Division of Investment Management, at (202) 942–0721, U.S. Securities and Exchange Commission, 450 Fifth Street, NW., Washington DC 20549–0402.

SUPPLEMENTARY INFORMATION: We are proposing amendments to Items 7 and 22 of Schedule 14A [1] under the Securities Exchange Act of 1934.[2] Although we are not proposing amendments to Schedule 14C [3] under the Exchange Act, the proposed amendments will affect the disclosure provided in Schedule 14C, as Schedule 14C requires disclosure of some items of Schedule 14A.

I. Introduction

A. Review of the Proxy Rules Regarding Procedures for the Election of Directors

On April 14, 2003, the Commission directed the Division of Corporation Finance to formulate possible changes in the proxy rules regarding procedures for the election of corporate directors.[4] On May 1, 2003, the Commission solicited public views on the Division's review of the proxy rules relating to the nomination and election of directors.[5] The majority of commenters supported the Commission's decision to direct this review.[6] Reflecting concern over the accountability of corporate directors and recent corporate scandals, commenters generally urged the Commission to adopt rules that would grant security holders greater access to the nomination process and greater ability to exercise their rights and responsibilities as owners of their companies.[7] In addition, many of those commenters noted that current director nomination procedures afford little meaningful opportunity for participation or oversight by security holders.[8]

Many of the comments received in connection with the Division's review evidence a growing concern among security holders that they lack sufficient input into decisions made by the boards of directors of the companies in which they invest.[9] Two particular areas of concern regard the nomination of candidates for election as directors and the ability of security holders to communicate effectively with members of the board of directors.[10]

B. Current Disclosure Regarding Nominating Committees and Security Holder Communications With Boards of Directors

In 1977, the Commission undertook a thorough review of security holder communications, security holder participation in the corporate electoral process, and corporate governance generally. The Commission solicited written comment and held hearings as part of that review. While an important focus of the hearings was security holder access to company proxy materials, the Commission also requested comment on whether more disclosure related to the nominating process and nominating committees would be appropriate.[11]

In response to the Commission's 1977 request, commenters recommended that nominating committees be required to consider security holder nominees, that outside directors comprise all or a majority of nominating committees,[12] and that security holders be advised of ''the existence and purpose of such committee and its standards for director qualifications.''[13] Commenters favoring these requirements indicated their view that they would encourage security holders to contact nominating committee members with their

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[1] 17 CFR 240.14a–101.

[2] 15 U.S.C. 78a *et seq.*

[3] 17 CFR 240.14c–101.

[4] *See* Press Release No. 2003–46 (April 14, 2003).

[5] *See* Release No. 34–47778 (May 1, 2003) [68 FR 24530]. In addition to receiving written comments, the Division spoke with a number of interested parties representing security holders, the business community, and the legal community. Each of the comment letters received, memoranda documenting the Division's meetings, and a summary of the comments are included on the Commission's Web site, *http://www.sec.gov*, in comment file number S7–10–03. [Summary of Comments in Response to the Commission's Solicitation of Public Views Regarding Possible Changes to the Proxy Rules (July 15, 2003)].

[6] *See* 2003 Summary of Comments.

[7] *See id.*

[8] *See id.*

[9] *See id.*

[10] The Division's review also addressed the issue of security holders' ability to access company proxy materials for purposes of nominating candidates for election as directors. The Commission expects that its proposals regarding this significant issue will be included in a separate release published this fall. As such, this proposing release does not address that issue directly. The Division's Staff Report to the Commission, detailing the results of its review of the proxy process related to the nomination and election of directors, can be found on the Commission's Web site at *http://www.sec.gov*. [Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors, Division of Corporation Finance (July 15, 2003)].

[11] *See* Release Nos. 34–13482 (April 28, 1977) [42 FR 23901] and 34–13901 (August 29, 1977) [42 FR 44860].

[12] *See* Re-Examination of Rules Relating to Security Holder Communications, Security Holder Participation in the Corporate Electoral Process and Corporate Governance Generally, Summary of Comments (1978), at 65.

[13] *Division of Corporation Finance, Securities and Exchange Comm'n, Staff Report on Corporate Accountability* (Sept. 4, 1980) (printed for the use of Senate Comm. on Banking, Housing, and Urban Affairs, 96th Cong., 2d Sess.), at A54.

recommendations; however, the commenters were less supportive of disclosure relating to the nominee selection process, the criteria to be applied by the nominating committee in selecting nominees, and the required qualifications of nominees.[14] Those who did not support expanded nominating committee disclosure stated their concern that companies would merely make ''self-serving 'boilerplate' '' disclosures.[15]

In the 1978 release proposing amendments to the proxy rules to include the current disclosure requirements related to nominating committees, the Commission stated generally its belief that the new disclosure requirements would facilitate improved accountability.[16] Specifically, the Commission stated that:

* * * information relating to nominating committees would be important to security holders because a nominating committee can, over time, have a significant impact on the composition of the board and also can improve the director selection process by increasing the range of candidates under consideration and intensifying the scrutiny given to their qualifications. Additionally, the Commission believes that the institution of nominating committees can represent a significant step in increasing security holder participation in the corporate electoral process, a subject which the Commission will consider further in connection with its continuing proxy rule re-examination.[17]

The Commission ultimately adopted nominating committee disclosure standards, currently found in Item 7 of Exchange Act Schedule 14A, that, among other requirements, require a company to state whether they have a nominating committee and, if so, whether the nominating committee will consider security holder nominees.[18]

Following the Commission's adoption of the nominating committee disclosure requirements, a 1980 staff report to the Senate expressed the view that, due to the emerging concept of nominating committees, the Commission should not propose and adopt a security holder access rule at that time.[19] The staff report recommended, however, that the staff monitor the development of nominating committees and their consideration of security holder recommendations.[20]

II. Proposed Disclosure Requirements

A. Enhanced Nominating Committee Disclosure

1. Necessity for the Proposal

Companies currently must disclose whether they have a nominating committee and, if so, whether the committee considers nominees recommended by security holders and how any such recommendations may be submitted.[21] Based on the comments received in response to the Commission's solicitation of public input, it does not appear that the existing disclosure requirements have effected significant change in the transparency of, or increased security holder understanding of, the nominating process. In particular, commenters indicated that the existing disclosure requirements have resulted in mere boilerplate disclosure and, as such, have not provided investors with the information necessary to understand the nominating process at the companies in which they invest.[22]

We are proposing new disclosure requirements that would expand disclosure in company proxy statements regarding the nominating committee and the nominating process. This enhanced disclosure is intended to provide security holders with additional, specific information upon which to evaluate the boards of directors and nominating committees of the companies in which they invest. Further, we intend that increased transparency of the nominating process will make that process more understandable to security holders.

In particular, we have proposed a number of specific and detailed disclosure requirements because we believe that each of these requirements may be necessary in order to assist security holders in understanding each of the processes and policies of the nominating committees and boards of directors of companies regarding the nomination of candidates for director. We request comment on whether each of these detailed requirements is appropriate for that purpose and whether there are additional specific and detailed disclosures that should be required.

2. Proposed Disclosure Requirements

The amendments we are proposing today would expand the current proxy statement disclosure regarding a company's nominating or similar committee to require:

- A statement as to whether or not the company has a standing nominating committee or a committee performing similar functions[23] and, if the company does not have such a committee, 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 committee and the names of those directors who participate in the consideration of director nominees;[24]
- The following disclosure regarding the nominating process:[25]
- If the nominating committee has a charter, a description of the material terms of the nominating committee charter and disclosure as to where the nominating committee charter is available, which can be the company's Web site;
- If the nominating committee does not have a charter, a statement of that fact;
- If the company is a listed issuer[26] whose securities are listed on a national securities exchange registered pursuant to section 6(a) of the Exchange Act[27] or in an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act[28] that has independence requirements for nominating committee members, disclosure of any instance during the

[14] *See* 1978 Summary of Comments, at 75.

[15] *See id.*

[16] *See* Release No. 34–14970 (July 18, 1978) [43 FR 31945].

[17] *See id.*

[18] *See* Release No. 34–15384 (December 6, 1978) [43 FR 58522].

[19] The Task Force on Corporate Accountability was formed as an outgrowth of the review of the proxy rules that began in 1977. The work of the Task Force culminated in the Staff Report on Corporate Accountability, completed and presented to the Senate Committee on Banking, Housing, and Urban Affairs. *See Staff Report on Corporate Accountability,* at A60–65.

[20] The *Staff Report on Corporate Accountability* states: ''* * * all nominating committees should be open to suggestions of nominees from security holders.'' *Id.*, at A56.

[21] *See* Paragraphs (d)(1) and (d)(2) of Item 7 of Exchange Act Schedule 14A.

[22] *See* 2003 Summary of Comments.

[23] As noted earlier in this release, this disclosure currently is required under Paragraph (d)(1) of Item 7 of Exchange Act Schedule 14A.

[24] Under proposed listing standards, a company that is listed on the NYSE would be required to have an independent nominating committee. Under NASD proposed listing standards, a Nasdaq Stock Market-quoted company would be required to have an independent nominating committee or, in the alternative, have nominees determined by a majority of independent directors. *See* Release Nos. 34–47672 (April 11, 2003) [68 FR 19051] and 34–47516 (March 17, 2003) [68 FR 14451].

[25] For the remainder of our discussion of this proposed disclosure requirement, the term ''nominating committee'' refers to a nominating committee or similar committee or group of directors fulfilling the role of a nominating committee. That group may comprise the full board. If the company has a standing nominating committee or a committee fulfilling the role of a nominating committee, Item 7(d)(1) of Schedule 14A requires identification of the members of that committee. If the company does not have such a standing committee, the proposed amendments to Paragraph (d)(2) of Item 7 of Schedule 14A would require the identification of each director who participates in the consideration of director nominees.

[26] As defined in Exchange Act Rule 10A–3 [17 CFR 240.10A–3].

[27] 15 U.S.C. 78f(a).

[28] 15 U.S.C. 78o-3(a).

last fiscal year where any member of the nominating committee did not satisfy the definition of independence in the listing standards of the market on which they are listed or quoted; [29]

- If the company is not a listed issuer,[30] disclosure of whether each of the members of the nominating committee are independent. In determining whether a member is independent, the company must use a definition of independence of a national securities exchange registered pursuant to Section 6(a) of the Exchange Act or a national securities association registered pursuant to Section 15A(a) of the Exchange Act that has been approved by the Commission (as that definition may be modified or supplemented), and state which definition it used. Whatever definition the company chooses, it would have to apply that definition consistently to all members of the nominating committee and use the independence standards of the same national securities exchange or national securities association for purposes of nominating committee disclosure under this requirement and audit committee disclosure under Exchange Act Rule 10A–3;
- If the nominating committee has a policy with regard to the consideration of any director candidates recommended by security holders, a description of the material elements of that policy, which shall include, but not be limited to, a statement as to whether the committee will consider director candidates recommended by security holders;
- If the nominating committee does not have a policy with regard to the consideration of any director candidates recommended by security holders, a statement of that fact;
- If the nominating committee will consider candidates recommended by security holders, a description of the procedures to be followed by security holders in submitting such recommendations;[31]
- A description of any specific, minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee for a position on the company's board of directors, any specific qualities or skills that the nominating committee believes are necessary for one or more of the company's directors to possess, and any specific standards for the overall structure and composition of the company's board of directors;
- A description of the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by security holders, and any differences in the manner in which the nominating committee evaluates nominees for director based on whether or not the nominee is recommended by a security holder;
- A statement of the specific source, such as the name of an executive officer, director, or other individual, of each nominee (other than nominees who are executive officers or directors standing for re-election) approved by the nominating committee for inclusion on the company's proxy card;
- If the company pays a fee to any third party or parties to identify or assist in identifying or evaluating potential nominees, disclosure of the function performed by each such third party; and
- If the nominating committee (a) receives a recommended nominee from a security holder or group of security holders who individually, or in the aggregate, beneficially owned greater than 3% [32] of the company's voting common stock for at least one year as of the date of the recommendation,[33] and (b) the nominating committee decides not to nominate that candidate, disclosure of: [34]
- The name or names of the security holders who recommended the candidate; and
- The specific reasons for the nominating committee's determination not to include the candidate as a nominee.[35]

As previously discussed, the disclosure that would be required by each of the proposed disclosure standards described above would provide security holders with important information regarding the management of the companies in which they invest. Commenters who responded to the Commission's solicitation of public views indicated the necessity for increased specific disclosure regarding the functioning of the nominating committees of public companies.[36] The disclosure standard we propose today would build upon existing disclosure requirements to require a number of specific disclosures.

We believe that the proposed detailed disclosure requirements regarding the decision to have a nominating committee or not, the nominating committee's charter, if any, its processes for identifying and evaluating candidates, and the minimum qualifications and qualities, skills and standards that the nominating committee believes are necessary or desirable for nominees and the board, are necessary to give security holders a more complete overview of the nominating process for directors of the companies in which they invest. We believe that information as to whether nominating committee members are independent within the requirements of proposed listing standards applicable to a company is meaningful to a security holder in evaluating the nominating process of that company, how that process works, and the seriousness with which it is considered by the company. We believe that identification of the source of each nominee and disclosure as to whether there are third parties that receive compensation related to

[29] For purposes of this disclosure requirement, to the extent the market on which the company is listed permits a member of a nominating committee to rely on an exclusion from applicable independence standards, and a member of a nominating committee is not independent in reliance on that exclusion, this disclosure would not be required.

[30] As defined in Exchange Act Rule 10A–3.

[31] This disclosure currently is required under Paragraph (d)(2) of Item 7 of Exchange Act Schedule 14A.

[32] In addition to the disclosure proposed today, the Division of Corporation Finance Staff Report, dated July 15, 2003, also recommended new rules to require enhanced security holder access to the nomination process. The issue of the appropriate ownership threshold, if any, for any such enhanced access is a separate issue from the appropriate ownership threshold for the disclosure we are proposing today and is not addressed in this release.

[33] Similar to the method used in Exchange Act Rule 14a–8 [17 CFR 240.14a–8] with regard to shareholder proponents, the percentage of securities held by a nominating security holder, as well as the holding period of those securities may be determined by the company, on its own, if the security holder is the registered holder of the securities. If not, the security holder can submit one of the following to the company to evidence the required ownership and holding period:

(1) a written statement from the ''record'' holder of the securities (usually a broker or bank) verifying that, at the time the security holder made the recommendation, he or she had held the required securities for at least one year; or

(2) if the security holder has filed a Schedule 13D (§ 240.13d–101), Schedule 13G (§ 240.13d–102), Form 3 (§ 249.103), Form 4 (§ 249.104), and/or Form 5 (§ 249.105), or amendments to those documents or updated forms, reflecting ownership of the shares as of or before the date of the recommendation, a copy of the schedule and/or form, and any subsequent amendments reporting a change in ownership level, as well as a written statement that the security holder continuously held the required securities for the one-year period as of the date of the recommendation.

[34] Information available to our Office of Economic Analysis indicates that, of the companies listed on the New York Stock Exchange, Nasdaq Stock Market and American Stock Exchange as of December 31, 2002, more than 70% had at least one institutional security holder that beneficially owned more than 3% of the common equity or similar securities and 13% had five or more such security holders. This information was derived from filings on Exchange Act Form 13F (17 CFR 249.325), that indicated that the filing security holder had held their securities for at least one year.

[35] Disclosure of the names of any recommended candidates would not be required.

[36] *See* 2003 Summary of Comments.

identifying and evaluating candidates, which we expect will generally be executive search firms, provides important information as to the process followed by a company. In the absence of these specific proposed disclosure requirements, we believe that disclosure could be at a level of generality that would not be sufficiently helpful to security holders in understanding the nominating process.

We also believe that it is important for security holders to understand the application of the nominating processes specifically to candidates put forward by security holders. The ability to participate in the nominating process is an important matter for security holders.[37] Disclosure as to whether and how they may participate in a company's nominating process, and the manner in which security holder candidates are evaluated, including differences between how they are evaluated and other candidates are evaluated, therefore represents important information for security holders. Specific disclosure requirements regarding the treatment of candidates put forward by large security holders or groups of security holders that have a long-term investment interest are appropriate, given the particular concerns of these investors as to how they might participate in the nominating process. Again, we believe that specific detailed disclosure requirements are necessary and appropriate to assure the desired degree of clarity and transparency regarding these matters, and that more general requirements may not achieve our desired objective.

3. Interaction of the Proposed Disclosure Requirements With Proposed Listing Standard Amendments of the Markets

The New York Stock Exchange and the Nasdaq Stock Market have proposed revised listing standards that would require listed companies to have independent nominating committees.[38] While these proposed listing standard changes demonstrate the importance of the nominating process and the nominating committee, and represent a strengthening of the role and independence of the nominating committee, they would not require nominating committees to consider security holder nominees or companies to make the disclosures described above. The disclosure requirements we propose today would provide useful information to security holders regarding the nominating process, the manner of evaluating nominees, and the extent to which the boards of directors of the companies in which they invest have a process for considering, and do in fact consider, security holder recommendations. Accordingly, the proposed disclosure requirements would operate in conjunction with any proposed listing standards regarding nominating committees that are adopted.

In response to our solicitation of input into the proxy review by the Division of Corporation Finance, a number of commenters from the business community and their advisors made clear their view that the proposed listing standards regarding nominating committees represent a significant strengthening of the nominating process and should be allowed to take effect and operate before we take any further action regarding the election of directors.[39] Nearly 25 years have passed since the adoption of our disclosure requirements regarding nominating committees. The many comments reflecting a continued lack of security holder access to the director nomination process and security holder dissatisfaction with that process[40] are evidence that the promise of those earlier amendments has not been realized. As such, it is appropriate to consider those additional, constructive steps that we can now take to complement any proposed listing standards that are adopted. We believe that the disclosure requirements we propose today are appropriate steps in this process. We also believe that consideration must be given to additional security holder access to the proxy process in connection with the election of directors, as will be discussed further in a proposing release that we expect to publish this fall.

4. Questions Regarding Enhanced Nominating Committee Disclosure

1. Would increased disclosure related to the nominating committee and its policies and criteria for considering nominees be an effective means to increase security holder understanding of the nominating process, board accountability, board responsiveness, and corporate governance policies?

2. (a) If so, do the proposed specific disclosure standards, including those in each of the following areas, provide security holders with useful information that provides an understanding of a company's nominating process:

- The existence of a nominating committee;
- The nominating committee charter, if any;
- Compliance with applicable nominating committee independence requirements;
- The process for identifying and evaluating candidates;
- The qualifications and standards for director nominees;
- The source of candidates other than those standing for re-election; and
- The involvement of third parties receiving compensation for identifying and evaluating candidates?

(b) If so, do the proposed specific disclosure standards, including those in each of the following areas, provide security holders with useful information that provides an understanding of the ability of security holders to participate in the nominating process:

- Policies for consideration of security holder candidates;
- Procedures for submission of security holder candidates; and
- Specific information regarding consideration of candidates submitted by large, long-term security holders or groups of security holders?

3. As noted above, the proposed disclosure requirements are intended to provide security holders with detailed, specific information that we believe is important. Are there alternative means to better achieve our objective? For example, would it be more appropriate to include a broader, less detailed disclosure standard? Would any of the detailed disclosure requirements within the proposed standard result in disclosure that is unnecessarily detailed for the purpose of providing security holders with useful information regarding the management of the companies in which they invest? If so, describe specifically the basis for that conclusion.

4. We propose to require disclosure of the material terms of the nominating committee charter. Instead of requiring companies to disclose the material terms of the charter, should we require that the company attach the nominating committee charter to the proxy statement? If so, should companies be required to attach it every year? Should we require that the charter be filed with the Commission? Should we require disclosure of any (or only material) amendments to the charter? Does Web site disclosure provide sufficient access

[37] *See id.*

[38] *See* Release No. 34–47672 (April 11, 2003) and Release No. 34–47516 (March 17, 2003). While the NYSE proposal includes an absolute requirement that listed companies have an independent nominating committee, the proposed Nasdaq standards provide that the nomination of directors may, alternatively, be determined by a majority of the independent directors. In discussing the NYSE and Nasdaq proposals, our references to independent nominating committees encompass this alternative under the Nasdaq proposal.

[39] *See* 2003 Summary of Comments.

[40] *See id.*

to investors? Should companies be required to provide investors a copy of the charter upon request?

5. We propose to require disclosure of any instances where a member of a company's nominating committee did not satisfy the applicable listing requirements for independence. In addition, we propose to require similar disclosure for unlisted companies. We request comment on whether the disclosures will help inform investors about the independence of the nominating committee. If the markets do not adopt the proposed amendments to the listing standards, are there disclosures that we could require that would achieve the same purposes? Should we require companies whose securities are not listed on an exchange or quoted in the Nasdaq Stock Market to disclose whether the members of their nominating committee, if any, meet any of the independence definitions of the proposed amendments to the listing standards? Is it appropriate to let issuers choose which definition? Should disclosure be required even if the noncompliance has been cured by the time the proxy statement is prepared?

6. We propose to require disclosure concerning a nominating committee's policy with regard to the consideration of security holder recommendations. If a committee has no policy, should we require the company to disclose the reason it does not have a policy? In the absence of a formal policy, are there other disclosures a company should be required to provide to investors to help them understand the standard(s) a committee uses in determining a suitable candidate?

7. Where security holders have the ability to recommend a nominee for a company's board of directors, meaningful participation by security holders should be facilitated by disclosure of information regarding the process for security holder nominations. As such, we have proposed to require disclosure of the procedures for submitting recommendations. Should we require disclosure during the year of any changes made to the procedure, for example in the next Form 10–Q or Form 10–QSB or on Form 8–K?

8. We have proposed requiring disclosure of information regarding criteria used by a nominating committee to screen nominee candidates and the minimal qualifications that the committee believes must be met by a nominee. Are there other eligibility requirements or qualifications about which investors should be informed? Should we require the company to disclose when it chooses candidates who do not meet the criteria? Should there be a specific disclosure requirement as to whether the company applies the same criteria to candidates recommended by security holders as to company nominees?

9. We have proposed that companies be required to describe the source of each of their nominees for director other than nominees who are executive officers or directors standing for re-election—including the name of each source—and their nominating committee's process for identifying and evaluating candidates. In addition to the name of each candidate's sponsor, should we require disclosure of any financial interest between the candidate and sponsor? Should we require disclosure of any other interest? Is the name of the source important to security holders? Instead, should we require disclosure of the person's title (*e.g.*, chief executive officer) or simply whether the source is an officer or director of the company? Should we require the name of the source only where the source is a director of the company, an employee of the company, or related to a director or employee of the company? If the source is not a director, an employee, or related to a director or employee, should we permit the source to be identified by category rather than name (*e.g.*, security holder, third party firm paid by the company)? Are the proposed exceptions to the requirement appropriate?

10. We have proposed requiring disclosure of information regarding the function performed by any third parties paid by the company. Should we require a company to disclose the methodology the third party uses to select candidates? Should we require a company to identify any such third parties?

11. We propose to require disclosure regarding candidates that were recommended by certain security holders and rejected by the nominating committee. Would this type of disclosure raise privacy issues for rejected candidates, even if the candidates were not specifically named in the company's disclosure? Would it raise privacy issues for the recommending security holders? The proposed disclosure requirements with regard to rejected security holder-recommended candidates would not preclude a company from naming the candidates, though such disclosure would not be required under the proposed rule. Should the rule specify that companies should not disclose the names of rejected candidates? Should the rule specify that companies must include the name of any rejected candidate who consents to being so identified in the company's proxy statement?

12. Are the proposed threshold requirements for a security holder recommendation that would trigger additional disclosure requirements by the company (*i.e.*, recommendations from security holders that have beneficially held more than 3% of the company's securities for at least one year) appropriate? If not, what ownership threshold, if any, would be appropriate (*e.g.*, no threshold, 1%, 2%, 4%, 5%, or higher) and what holding period, if any, would be appropriate (*e.g.*, no threshold, 2 years, 3 years, 4 years, or longer)? Should we use a different threshold, such as the three, four, or five largest security holders who are not directors or officers of the company? As proposed, the rules would not require that the nominating security holder indicate an intent to continue to own the securities for any specified period of time. Should we include such a requirement? If so, what is the appropriate period over which the security holder must intend to continue to own the securities (*e.g.*, through the date of the related security holder meeting, six months after the recommendation, one year after the recommendation, or longer)? Is the proposed method to determine whether a security holder or group of security holders meets the threshold requirements to trigger additional disclosure by the company appropriate? For example, are the means of proving ownership appropriate? If not, what would be a more appropriate means? Is it appropriate to calculate ownership as of the date of the recommendation? If not, what other date would be more appropriate? Should we include a specific method of determining beneficial ownership for purposes of this disclosure item? For example, should securities underlying options be included or excluded for purposes of calculating the ownership threshold?

13. Would the proposed disclosure requirements have unintended adverse effects on the nominating process? Would they increase the burdens on members of nominating committees or discourage service on nominating committees? If so, please provide specific reasons supporting your responses to these questions.

B. Disclosure Regarding the Ability of Security Holders To Communicate With the Board of Directors

1. Necessity for the Proposal

During the past proxy season, as well as in the recent review of the proxy rules relating to the nomination and

election of directors, we have become increasingly aware of investors' desire for a means by which to communicate with the directors of the companies in which they invest.[41] Although Exchange Act Rule 14a–8 already creates a possible mechanism for security holders to seek further access to communicate with the board, investors and investor advocacy groups have indicated that this mechanism would be enhanced meaningfully by a process that allows security holders to communicate directly with board members.[42]

Providing security holders with disclosure about the process for communicating with board members would improve the transparency of board operations, as well as security holder understanding of the companies in which they invest. The Commission has published a NYSE listing standard proposal that states: ''In order that interested parties may be able to make their concerns known to non-management directors, a company must disclose a method for such parties to communicate directly and confidentially with the presiding director [of the non-management directors] or with non-management directors as a group.'' [43] This method could be analogous to the method in the NYSE listing standards that will be required by Exchange Act Rule 10A–3 regarding audit committees. These standards would require that ''[e]ach audit committee * * * establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.'' [44]

In response to our solicitation of input into the proxy review by the Division of Corporation Finance, representatives of the business community commented that disclosure regarding the means by which security holders may communicate directly with the board of directors would address issues of accountability and responsiveness without extensive disruption or costs.[45] Comments from investors and investor advocacy groups also indicated the view that this disclosure would be helpful; [46] however, these commenters also noted that disclosure alone would not address all issues, as, for example, a process for security holders to communicate with board members would not ensure that board members would be responsive to security holder concerns.[47]

2. Proposed Disclosure Requirements

In making investment decisions, investors may wish to consider the corporate governance practices of companies. Further, disclosure regarding whether a company has a process for security holders to send communications to the board of directors will increase the transparency for security holders of this important aspect of board processes at the companies in which they invest. We have proposed a number of specific and detailed disclosure requirements regarding communications by security holders with the board of directors because we believe that each of these requirements may be necessary in order to give security holders a better understanding of the manner in which security holders can engage in these communications. We request comment on whether each of these detailed requirements is appropriate for that purpose and whether there are additional specific, detailed disclosure requirements that should also be included in these disclosure requirements.

We are proposing that companies include the following information in their proxy materials where action is to be taken with respect to the election of directors:

- A statement as to whether or not the company's board of directors provides a process for security holders to send communications to the board of directors and, if the company does not have a process for security holders to send communications to the board of directors, 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 process;
- If the company has a process for security holders to send communications to the board of directors:
- A description of the manner in which security holders can send such communications to the board;
- Identification of those board members to whom security holders can send communications;
- If all security holder communications are not sent directly to board members, a description of the company's process for determining which communications will be relayed to board members, including disclosure of the department or other group within the company that is responsible for making this determination; and
- A description of any material action taken by the board during the preceding fiscal year as a result of communications from security holders.

We believe that the proposed specific disclosure requirement regarding whether a board has a process by which security holders can communicate with it is necessary to give security holders a better picture of a critical component of the board's interaction with security holders. Specific, detailed disclosure regarding that process, if it exists, is important to security holders in evaluating the nature and quality of the communications process. We believe that information regarding material actions taken by the board as a result of communications with security holders is significant to security holders in evaluating the quality and responsiveness of the communications process. In the absence of these proposed specific disclosure requirements, we believe that disclosure could be at a level of generality that may not be sufficiently helpful to security holders in understanding and evaluating the communications process.

3. Questions Regarding Disclosure of the Ability of Security Holders To Communicate With the Board of Directors

1. Would increased disclosure relating to security holder communications with board members be an effective means to improve board accountability, board responsiveness, and corporate governance policies? Would this disclosure be useful to security holders?

2. If so, do the proposed specific disclosure standards, including those in each of the following areas, provide security holders with important information that provides an understanding of a company's process for communications with the board:

- The existence of such a process;
- A description of the manner in which security holders can communicate with the board;

[41] For example, two pension funds submitted proposals seeking greater security holder access to corporate boards. The AFSCME Employees Pension Plan submitted a security holder proposal to The Kroger Co. to amend Kroger's bylaws to provide for the creation of a security holder committee to communicate with the board regarding security holder proposals under Exchange Act Rule 14a-8 that were approved but not adopted. *The Kroger Co.* (April 11, 2003). In addition, several New York City employee pension funds submitted security holder proposals to Advanced Fibre Communications, Inc. and PeopleSoft, Inc. requesting that these Nasdaq-listed companies establish an ''Office of the Board of Directors'' to facilitate communications between non-management directors and security holders, including meetings, based on the proposed NYSE standard. *Advanced Fibre Communications, Inc.* (March 10, 2003); *PeopleSoft, Inc.* (March 14, 2003).

[42] *See* 2003 Summary of Comments.

[43] Release No. 34–47672 (April 11, 2003).

[44] Exchange Act Rule 10A–3.

[45] *See* 2003 Summary of Comments.

[46] *See id.*

[47] *See id.*

• Identification of board members to whom communications can be sent;
• The process, if any, for determining which communications will be passed on to board members; and
• A description of material actions taken as a result of security holder communications with the board?

3. As noted above, the proposed disclosure standards are intended to provide security holders with specific, detailed information that we believe is important. Are there alternative means to better achieve our objectives? For example, would it be more appropriate to include a broader, less detailed disclosure standard? Would any of the detailed disclosure requirements within the proposed standard result in disclosure that is unnecessarily detailed for the purpose of providing security holders with important information regarding the process of communicating with the board? If so, please describe specifically the basis for that conclusion.

4. Security holders who desire to communicate directly with individual directors, committees, and independent members of boards are often uncertain of the procedures to follow to contact directors. As such, we have proposed requiring disclosure with regard to security holder communications with board members. If no director accepts communications individually, should the company disclose why? Should companies be required to disclose the process they use to record and keep security holder communications?

5. We have proposed requiring disclosure of the means by which companies ''filter'' security holder requests to communicate with board members. Should there be disclosure of the specific person who determines which communications are sent to board members? Should there be disclosure of whether management plays a role in ''filtering'' the security holder communications that are intended for directors?

6. We have proposed requiring disclosure regarding any material actions taken in response to security holder communications. Are there any categories of communications or actions that should be excluded from coverage of the rule? For example, should the rule only apply to formal petitions to the entire board? Should this rule address specifically security holder proposals under Exchange Act Rule 14a–8? For example, should the rule make clear that disclosure is not required with regard to communications relating to proposals under Exchange Act Rule 14a–8? Alternatively, should those communications be included specifically within the disclosure requirement?

7. Do companies currently provide a means for allowing security holders to communicate with board members? If so, how effective have these methods been in improving board accountability, board responsiveness, and corporate governance policies? Is it easier for larger minority security holders to communicate with board members?

8. Because not all companies would be subject to any listing requirements that would allow security holders to communicate with board members, would a disclosure requirement alone be sufficient with regard to companies not subject to those listing requirements?

9. Should communications with board members that are addressed in the disclosure requirements be limited to independent directors or extend to the entire board?

10. We are using the term ''communications'' very broadly to discourage companies from taking a formalistic view as to disclosure regarding which communications are relayed and considered. We do not, however, intend this disclosure standard to require disclosure regarding communications with the board of directors from management of the company, employees of the company, or other agents of the company, where such persons happen also to be security holders. Should we include a specific limitation on the term ''communications'' in this disclosure standard? If so, how do we prevent companies from taking an unduly restrictive view of the term ''communications'' for purposes of this disclosure standard?

11. The proposed rules relating to communications are disclosure standards only and would not require companies to establish procedures for security holders to communicate with directors. Should we nonetheless provide guidance to companies or otherwise address what we would view as appropriate procedures for companies to implement with regard to security holder communications with board members? If so, what procedures would be most appropriate and why? What would be the cost to companies of implementing and maintaining such procedures? How much time would directors and other company personnel be required to expend in implementing and maintaining such procedures? What other unintended burdens or other consequences would fall on directors as a result of such procedures? Could we give useful guidance in this area and, if so, how?

C. Investment Companies

We are proposing to apply the new disclosure requirements regarding board nominating committees and security holders' communications with members of boards to proxy statements of investment companies (''funds'').[48] Funds are currently required to comply with Exchange Act Schedule 14A when soliciting proxies, including proxies relating to the election of directors.[49] Item 22(b)(14)(iv) of Exchange Act Schedule 14A requires funds to disclose the same information about nominating committees that is currently required for operating companies by Item 7(d)(2).[50] As with operating companies, the enhanced disclosure provided by the amendments may benefit fund security holders by improving the transparency of the nominating process and board operations, as well as increasing security holders' understanding of the funds in which they invest.

The proposals would require disclosure as to whether or not the members of a fund's nominating committee are ''interested persons'' of the fund as defined in Section 2(a)(19) of the Investment Company Act,[51] rather than independent under the listing standards of a national securities exchange or national securities association, as in the case of operating companies.[52] We are requiring disclosure with respect to the Section 2(a)(19) test for members of nominating committees for funds because that test is tailored to capture the broad range of affiliations with investment advisers, principal underwriters, and others that are relevant to ''independence'' in the case of funds.

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[48] *See* proposed Paragraphs (e) of Item 7 and (b) of Item 22 of Exchange Act Schedule 14A.

[49] *See* Investment Company Act of 1940 Rule 20a–1[17 CFR 270.20a–1] (requiring funds to comply with Regulation 14A [17 CFR 240.14a–1 '' 14a–101]), Schedule 14A, and all other rules and regulations adopted pursuant to Section 14(a) of the Exchange Act [15 U.S.C. 78n] that would be applicable to a proxy solicitation if it were made in respect of a security registered pursuant to Section 12 of the Exchange Act [15 U.S.C. 78l]).

[50] Funds are subject to Items 7 and 22(b) of Exchange Act Schedule 14A when soliciting proxies regarding the election of directors. Currently, in lieu of the disclosure required by Paragraphs (a)–(d)(2) of Item 7, funds must provide the information required by Item 22(b). *See* Paragraph (e) of Item 7. The Commission's proposals would amend Paragraph (e) of Item 7 to apply the disclosure requirements regarding nominating committees in Paragraph (d)(2) of Item 7 to funds, and would delete the current disclosure requirement regarding nominating committees in Paragraph (b)(14)(iv) of Item 22 as duplicative.

[51] 15 U.S.C 80a–2(a)(19).

[52] Proposed Item 22(b)(14)(ii) of Exchange Act Schedule 14A.

Questions Regarding the Application of the Proposals to Funds

1. Should the proposed amendments that would require disclosure regarding the operations of board nominating committees apply to funds? Should the proposed amendments that would require new disclosure concerning the means by which security holders may communicate with members of boards apply to funds? Are there any aspects of the proposed amendments that should be modified in the case of funds?

2. Should we apply the ''interested person'' standard of Section 2(a)(19) of the Investment Company Act in requiring disclosure regarding the independence of members of a fund's nominating committee? Should we instead apply a different standard to funds, such as the listing standards of national securities exchanges or national securities associations?

D. General Request for Comment

We request and encourage any interested person to submit comments regarding:

- The proposed amendments that are the subject of this release;
- Additional or different changes; or
- Other matters that may have an effect on the proposals contained in this release.

We request comment from the point of view of companies, investors, and other market participants. With regard to any comments, we note that such comments are of great assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments, as well as a discussion of specific alternatives if applicable.

III. Paperwork Reduction Act

A. Background

The proposed amendments to Exchange Act Schedule 14A contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[53] We are submitting the proposal to the Office of Management and Budget (''OMB'') for review in accordance with the PRA.[54] The titles for the collections of information are:

(1) ''Proxy Statements—Regulation 14A (Commission Rules 14a–1 through 14a–15 and Schedule 14A)'' (OMB Control No. 3235–0059);

(2) ''Information Statements—Regulation 14C (Commission Rules 14c–1 through 14c–7 and Schedule 14C)''[55] (OMB Control No. 3235–0057); and

(3) ''Rule 20a–1 under the Investment Company Act of 1940, Solicitations of Proxies, Consents and Authorizations'' (OMB Control No. 3235–0158).[56] The first two titles were adopted pursuant to the Exchange Act and set forth the disclosure requirements for proxy and information statements filed by companies to ensure that investors can make informed voting or investing decisions.[57] The third title was adopted pursuant to the Investment Company Act and concerns the solicitation of proxies, consents and authorizations with respect to securities issued by registered investment companies. The hours and costs associated with preparing, filing, and sending these schedules constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Under the proposals, we would expand the disclosure that is currently 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. Compliance with the proposed disclosure requirements would be mandatory. There would be no mandatory retention period for the information disclosed, and responses to the disclosure requirements would not be kept confidential.

For purposes of the PRA, we estimate the annual incremental paperwork burden for all companies to prepare the disclosure that would be required under our proposals to be approximately 19,557 hours of company personnel time and a cost of approximately $1,955,000 for the services of outside professionals.[58] That estimate includes the time and the cost of preparing disclosure that has been appropriately reviewed by executive officers, the disclosure committee, in-house counsel, outside counsel, and members of the board of directors.[59] 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.

We derived the above estimates by estimating the total amount of time it would take a company to prepare and review the proposed disclosure. We estimate that over a three-year time period, the annual incremental disclosure burden would be an average of 3 hours per form. This estimate is based on the assumption that companies spend a greater amount of time preparing the disclosure in year one and will become more efficient in preparing the disclosure over the next two years.[60] This estimate represents the average burden for all companies, both large and small, that are subject to the proxy rules. We expect that the disclosure burden could be greater for larger companies and lower for smaller companies. The estimate also has been adjusted to reflect the fact that not all proxy and information statements involve action to be taken with respect to the election of directors, and therefore would not require companies to provide the proposed disclosure.[61]

[53] 44 U.S.C. 3501 *et seq.*

[54] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

[55] Exchange Act Schedule 14C requires disclosure of some items of Exchange Act Schedule 14A. Therefore, while we are not proposing to amend the text of Exchange Act Schedule 14C, the proposed amendments to Exchange Act Schedule 14A must also be reflected in the PRA burdens for Exchange Act Schedule 14C.

[56] Investment Company Act Rule 20a–1 requires registered investment companies to comply with Exchange Act Regulation 14A or 14C, as applicable. Therefore, the annual responses to Investment Company Act Rule 20a–1 reflect the number of proxy and information statements that are filed by registered investment companies.

[57] The proxy rules apply only to domestic companies with equity securities registered under Section 12 of the Exchange Act and to investment companies registered under the Investment Company Act [15 U.S.C. 80a *et seq.*]. There is a discrepancy between the number of annual reports by reporting companies and the number of proxy and information statements filed with the Commission in any given year. This is because some companies are subject to reporting requirements by virtue of Section 15(d) of the Exchange Act [15 U.S.C. 78o], and therefore are not covered by the proxy rules. In addition, companies that are not listed on a national securities exchange or Nasdaq may not hold annual meetings and therefore would not be required to file a proxy or information statement.

[58] For convenience, the estimated PRA hour burdens have been rounded to the nearest whole number.

[59] 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.

[60] We estimate that it will take 6 hours to prepare the disclosure in year one, 3.13 hours in year two, and 2.03 hours in year three.

[61] 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

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B. Revisions to PRA Reporting and Cost Burden Estimates

Table 1 below illustrates the incremental annual compliance burden of the collection of information in hours and in cost for proxy and information statements under the Exchange Act and Investment Company Act. The burden was calculated by multiplying the estimated number of responses by the estimated average number of hours each entity spends completing the form. We have based our estimated number of annual responses on the actual number of filers during the 2002 fiscal year. We estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden of preparation is carried by outside professionals retained by the company at an average cost of $300 per hour. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours.

TABLE 1.—CALCULATION OF INCREMENTAL PRA BURDEN ESTIMATES

	Annual responses	Incremental hours/form	Incremental burden	75 percent company	25 percent professional	$300 Prof. cost
	(A)	(B)	(C) = (A) × (B)	(D) = (C) × 0.75	(E) = (C) × 0.25	(F) = (E) × $300
SCH 14A	7,188	3.00	21,564.00	16,173	5,391.00	$1,617,300.00
SCH 14C	446	3.00	1,338.00	1,004	334.50	$100,350.00
Rule 20a–1	1,058	3.00	3,174.00	2,381	793.50	$238,050.00
Total	8,692			19,557		$1,955,700.00

C. Solicitation of Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we solicit comments to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of our estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609, with reference to File No. S7–14–03. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–14–03, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW., Washington, DC 20549. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

IV. Cost-Benefit Analysis

A. Background

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 directors[62] and on May 1, 2003, the Commission solicited public views on that undertaking.[63] 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.[64] 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.[65] However, having reviewed the existing proxy rules and submissions from public commenters, we believe reforms may be necessary to improve the current disclosure regime. 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.

The intent of the proposed disclosure requirements is 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 applied 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 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 Commission has considered a variety of reforms to achieve its

election of directors or other specified matters. *See* Exchange Act Rule 14a–6 [17 CFR 240.14a–6].

[62] *See* Press Release No. 2003–46 (April 14, 2003).

[63] *See* Release No. 34–47778 (May 1, 2003) [68 FR 24530].

[64] *See* Paragraph (d)(1) of Item 7 of Exchange Act Schedule 14A.

[65] *See id.* at Paragraph (d)(2).

regulatory objectives. As one possible approach, we considered requiring companies to include the security holder's proxy card in the company mailing. Alternatively, we considered amending or reinterpreting Exchange Act Rule 14a–8(i)(8)[66] to allow security holder proposals requesting access to the corporation's proxy card for the purpose of making nominations. As an initial step in our efforts to reform the rules and regulations regarding security holder oversight of the companies in which they invest, the current proposals take a more measured approach by building on existing disclosure requirements.

B. Benefits

The proposed rules would benefit security holders because they will assist security holders in better understanding their rights of ownership by focusing attention on the scope and efficacy of the policies and procedures that companies maintain to nominate directors and to enable security holders to communicate with directors. The more precise disclosure requirements in the proposals 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, increasing the amount and quality of information available to investors concerning board policies and procedures may improve investor confidence because investors may be able to identify the degree to which companies are responsive to security holder concerns. By providing greater transparency of board policies, we anticipate that the proposals would allow investors to make more informed choices when deciding how to invest.

To the extent that security holders would rather invest in companies with boards that maintain policies and procedures that provide greater security holder oversight, companies may have incentives to adopt more meaningful policies and procedures regarding director nominations and security holder communications. The proposed rules also may encourage companies to consider their existing policies in relation to policies adopted by other companies and could facilitate competition among companies to adopt policies that reduce costs to security holders. For example, if security holder board nominees are given adequate consideration through the nominating process, a security holder may choose to submit its candidate to the nominating committee rather than incur the expense of soliciting proxies to support the nominee. Moreover, the proposed disclosure of the manner in which security holders can send communications to the board may encourage a less costly communication process for providing recommendations to the board than the current process embodied in Exchange Act Rule 14a–8.

Request for Comment

- We solicit quantitative data to assist our assessment of the benefits of increased disclosure regarding nominating committees and security holder-director communications.
- Are there any public companies that currently provide information to the public regarding their policies and procedures related to the functioning of the nominating committee or security holder communications with directors? If so, is there any data on whether investors find this information to be useful?

C. Costs

The proposed rules would impose new disclosure requirements on companies subject to the proxy rules.[67] We estimate that complying with the proposed disclosures would entail a relatively small financial burden. The proposed disclosures are designed to build upon existing disclosure requirements to elicit a more detailed discussion of the functions of the nominating committee as well as the means by which security holders can communicate with the board of directors. Thus, the task of complying with the proposed disclosure could be performed by the same person or group of persons responsible for compliance under the current rules. 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.

For purposes of the PRA, we estimate the annual incremental paperwork burden for all companies to prepare the disclosure that would be required under our proposals to be approximately 19,557 hours of company personnel time (2.25 hours per company),[68] which translates into an estimated cost of $1,662,000 ($191 per company).[69] We also estimate a cost of approximately $1,955,000 for the services of outside professionals ($225 per company).[70] The figures above include the estimated burdens for investment companies. For investment companies, we estimate the incremental burden to be 2,381 hours of company personnel time (2.25 hours per company), which translates into an estimated cost of $202,385 ($191 per company). We also estimate a cost for investment companies of approximately $238,050 for the services of outside professionals ($225 per company). 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. We have not included these costs in our analysis of the additional disclosure requirement, but have sought comment regarding such costs and related matters.

Request for Comment

- What are the direct and indirect costs associated with the proposed rules?
- What are the costs in the first year of compliance versus subsequent years?
- To the extent that the proposals influence corporate behavior, what costs would a company incur to institute responsive policies and procedures regarding director nominations and security holder communications?
- We solicit quantitative data to assist our assessment of the costs associated with increased disclosure regarding nominating committees and security holder-director communications.

D. Small Business Issuers

Although the proposed rules apply to small business issuers, we do not anticipate any disproportionate impact on small business issuers. Like other issuers, small business issuers should incur relatively minor compliance costs, and should find it unnecessary to hire extra personnel. The issues of corporate accountability and security holder rights affect small companies as much as they affect large companies. Thus, we do not

[66] Exchange Act Rule 14a–8(i)(8) permits a company to exclude a security holder proposal from its proxy statement if the proposal ''relates to an election for membership on the company's board of directors or analogous governing body.''

[67] The proxy rules apply only to domestic companies with equity securities registered under Section 12 of the Exchange Act and to investment companies registered under the Investment Company Act.

[68] 3 hours × 75% = 2.25 hours.

[69] 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).

[70] 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.

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 Act[71] 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 Act[72] and Section 2(c) of the Investment Company Act[73] 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.

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 directors[74] 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

[71] 15 U.S.C. 78w(a)(2).

[72] 15 U.S.C. 78c(f).

[73] 15 U.S.C. 80a–2(c).

[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).

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

[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.

[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.

average, the estimated $416 compliance expense would constitute approximately .02% of a small entity's revenues. We encourage written comments regarding this analysis. We solicit comments as to whether the proposed changes could have an effect that we have not considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

F. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no rules that conflict with or completely duplicate the proposed rules. There is a partial overlap with current disclosure requirements about nominating committees in proxy and information statements. This overlap is necessary because the proposed disclosures are designed to build upon existing disclosure requirements to elicit a more detailed discussion. The current requirements do not include much of the information specifically targeted for inclusion in the proposed rules.

G. Significant Alternatives

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

We have drafted the proposed 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 does not seem appropriate to develop separate requirements for small entities involving clarification, consolidation or simplification of the proposed disclosure.

We have used design rather than performance standards in connection with the proposals for two reasons. First, based on our past experience, we believe the proposed disclosure would be more useful to investors if there were enumerated informational requirements. The proposed mandated disclosures may be likely to result in a more focused and comprehensive discussion. Second, more precise disclosure requirements in the proposals 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 would improve the Commission's ability to enforce the proposed rules. Therefore, adding to the disclosure requirements in existing proxy and information statements appears to be the most effective method of eliciting the disclosure.

H. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding: (i) The number of small entities that may be affected by the proposals; (ii) the existence or nature of the potential impact of the proposals on small entities discussed in the analysis; and (iii) how to quantify the impact of the proposed revisions. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, or in the alternative, a certification under Section 605(b) of the Regulatory Flexibility Act, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (''SBREFA''),[89] a rule is ''major'' if it has resulted, or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a ''major rule'' for purposes of SBREFA. We solicit comment and empirical data on: (a) The potential effect on the U.S. economy on an annual basis; (b) any potential increase in costs or prices for consumers or individual industries; and (c) any potential effect on competition, investment or innovation.

VIII. Statutory Basis and Text of Proposed Amendments

The proposed amendments to Items 7 and 22 of Schedule 14A are being proposed pursuant to 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.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

Text of the Proposed Amendments

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

PART 240—GENERAL RULES AND REGULATION, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7202, 7241, 7262, and 7263; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Amend § 240.14a–101 by:

a. Revising paragraph (d)(2) of Item 7;

b. Revising the reference ''paragraphs (a) through (d)(2)'' in paragraph (e) of Item 7 to read ''paragraphs (a) through (d)(1) and (d)(2)(ii)(D)'';

c. Adding paragraph (h) to Item 7;

[89] Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996).

d. Revising the reference ''paragraphs (d)(3), (f), and (g)'' in the introductory text of paragraph (b) of Item 22 to read ''paragraphs (d)(2), (d)(3), (f), (g), and (h)'';

e. Revising the last sentence of the introductory text of paragraph (b)(14) of Item 22;

f. Revising paragraph (b)(14)(ii) of Item 22;

g. Removing the semi-colon and ''and'' from the end of paragraph (b)(14)(iii) of Item 22 and in their place adding a period;

h. Removing paragraph (b)(14)(iv) of Item 22; and

i. Adding an Instruction directly after paragraph (b)(14)(iii) of Item 22.

The additions and revisions read as follows.

§ 240.14a–101 Schedule 14A. Information required in proxy statement.

Schedule 14A Information

* * * * *

Item 7. Directors and executive officers.

* * * * *

(d)(1) * * *

(2)(i) If the registrant does not have a standing nominating committee or committee performing similar functions, state the specific basis for the view of the board of directors that it is appropriate for the registrant not to have such a committee and identify each director who participates in the consideration of director nominees;

(ii) Provide the following information regarding the registrant's director nomination process:

(A) If the nominating committee has a charter, describe the material terms of the nominating committee charter and disclose where a current copy of the charter is available, which can be the registrant's Web site;

(B) If the nominating committee does not have a charter, state that fact;

(C) If the registrant is a listed issuer (as defined in § 240.10A–3), whose securities are listed on a national securities exchange registered pursuant to Section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or in an automated inter-dealer quotation system of a national securities association registered pursuant to Section 15A(a) of the Exchange Act (15 U.S.C. 78o–3(a)) that has independence requirements for nominating committee members, disclose any instance during the last fiscal year where any member of the nominating committee did not satisfy the definition of independence in the applicable listing standards;

(D) If the registrant is not a listed issuer (as defined in § 240.10A–3), disclose whether each of the members of the nominating committee are independent. In determining whether a member is independent, the registrant must use a definition of independence of a national securities exchange registered pursuant to Section 6(a) of the Exchange Act (15 U.S.C. 78f(a)) or a national securities association registered pursuant to Section 15A(a) of the Exchange Act (15 U.S.C. 78o–3(a)) that has been approved by the Commission (as that definition may be modified or supplemented), and state which definition it used. Whatever definition the company chooses, it must apply that definition consistently to all members of the nominating committee and use the independence standards of the same national securities exchange or national securities association for purposes of nominating committee disclosure under this requirement and audit committee disclosure required under § 240.10A–3;

(E) If the nominating committee has a policy with regard to the consideration of any director candidates recommended by security holders, provide a description of the material elements of that policy, which shall include, but not be limited to, a statement as to whether the committee will consider director candidates recommended by security holders;

(F) If the nominating committee does not have a policy with regard to the consideration of any director candidates recommended by security holders, a statement of that fact;

(G) If the nominating committee will consider candidates recommended by security holders, describe the procedures to be followed by security holders in submitting such recommendations;

(H) Describe any specific, minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee for a position on the registrant's board of directors, describe any specific qualities or skills that the nominating committee believes are necessary for one or more of the registrant's directors to possess, and describe any specific standards for the overall structure and composition of the registrant's board of directors;

(I) Describe the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by security holders, and any differences in the manner in which the nominating committee evaluates nominees for director based on whether or not the nominee is recommended by a security holder;

(J) State the specific source, such as the name of an executive officer, director, or other individual, of each nominee (other than nominees who are executive officers or directors standing for re-election) approved by the nominating committee for inclusion on the registrant's proxy card;

(K) If the registrant pays a fee to any third party or parties to identify or assist in identifying or evaluating potential nominees, disclose the function performed by each such third party; and

(L) If the registrant's nominating committee receives a recommended nominee from a security holder who beneficially owned greater than 3% of the registrant's voting common stock for at least one year as of the date the recommendation was made, or from a group of security holders who beneficially owned, in the aggregate, greater than 3% of the registrant's voting common stock, with each of the securities used to calculate that ownership held for at least one year as of the date the recommendation was made, and if the nominating committee chooses not to nominate that candidate:

(*1*) State the name or names of the security holders who recommended the candidate; and

(*2*) State the specific reasons for the nominating committee's determination not to include the candidate as a nominee.

Instructions to paragraph (d)(2):

1. For purposes of Item 7(d)(2)(ii), the term ''nominating committee'' refers not only to nominating committees and committees performing similar functions, but also to groups of directors fulfilling the role of a nominating committee, including the entire board of directors.

2. For purposes of Item 7(d)(2)(ii)(L), the registrant need not identify the recommended candidate.

3. For purposes of Item 7(d)(2)(ii)(L), the percentage of securities held by a nominating security holder, as well as the holding period of those securities, may be determined by the registrant if the security holder is the registered holder of the securities. If the security holder is not the registered owner of the securities, he or she can submit one of the following to the registrant to evidence the required ownership percentage and holding period:

A. A written statement from the ''record'' holder of the securities (usually a broker or bank) verifying that, at the time the security holder made the recommendation, he or she had held the required securities for at least one year; or

B. If the security holder has filed a Schedule 13D (§ 240.13d–101),

Schedule 13G (§ 240.13d–102), Form 3 (§ 249.103), Form 4 (§ 249.104), and/or Form 5 (§ 249.105), or amendments to those documents or updated forms, reflecting ownership of the shares as of or before the date of the recommendation, a copy of the schedule and/or form, and any subsequent amendments reporting a change in ownership level, as well as a written statement that the security holder continuously held the securities for the one-year period as of the date of the recommendation.

* * * * *

(h)(1) State whether or not the registrant's board of directors provides a process for security holders to send communications to the board of directors and, if the registrant does not have such a process for security holders to send communications to the board of directors, state the specific basis for the view of the board of directors that it is appropriate for the registrant not to have such a process.

(2) If the registrant has a process for security holders to send communications to the board of directors:

(i) Describe the manner in which security holders can send communications to the board;

(ii) Identify those board members to whom security holders can send communications;

(iii) If all security holder communications are not sent directly to board members, describe the registrant's process for determining which communications will be relayed to board members, including identification of the department or other group within the registrant that is responsible for making this determination; and

(iv) Describe any material action taken by the board of directors during the preceding fiscal year as a result of communications from security holders.

* * * * *

Item 22. Information required in investment company proxy statement.

* * * * *

(b) * * *

(14) * * * Identify the other standing committees of the Fund's board of directors, and provide the following information about each committee, including any separately designated audit committee and any nominating committee:

* * * * *

(ii) The members of the committee and, in the case of a nominating committee, whether or not the members of the committee are ''interested persons'' of the Fund as defined in Section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a–2(a)(19)); and

* * * * *

Instruction to paragraph (b)(14): For purposes of Item 22(b)(14), the term ''nominating committee'' refers not only to nominating committees and committees performing similar functions, but also to groups of directors fulfilling the role of a nominating committee, including the entire board of directors.

* * * * *

Dated: August 8, 2003.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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