MEMORANDUM

TO: File

FROM: Alexandra M. Ledbetter
Office of the Investor Advocate
U.S. Securities and Exchange Commission

RE: File No. S7-06-16

DATE: December 1, 2016

Speeches that Investor Advocate Rick A. Fleming gave on October 24, 2016 and November 19, 2016 address questions posed in the Commission's Business and Financial Disclosure Required by Regulation S-K concept release. The text of each speech is appended to this memo.

Speech

Improving Disclosure with Smart Data

Rick A. Fleming, Investor Advocate

XBRL US Investor Forum 2016: Finding Value with Smart Data
New York, New York

Oct. 24, 2016

Thank you, Campbell [Pryde], for that kind introduction and for inviting me to participate in this forum today.

For more than 80 years, our securities laws have required sellers of securities to disclose all material facts to prospective investors, and this disclosure requirement is a cornerstone of fair and efficient markets. However, our disclosure delivery methods have not kept pace with changes in technology, and there is much that can be done to improve the delivery of information into the modern marketplace. This forum brings together many thought leaders to continue that conversation, and I look forward to hearing your ideas. Having said that, I must remind you that the views I express are my own and do not necessarily reflect those of the Commission, the Commissioners, or Commission staff.

Some of my SEC colleagues will be speaking later today, so I won't belabor their points, but in certain areas the Commission is already making great strides to employ data analytics to accomplish its mission of protecting investors, fostering capital formation, and promoting fair, orderly and efficient markets. For example, the Commission's internally-developed Corporate Issuer Risk Assessment tool aggregates and organizes XBRL-tagged financial data filed by issuers. The Division of Enforcement uses this tool to detect anomalous patterns in financial statements that may warrant further inquiry.[1] Staff throughout the Commission utilize another internally-developed tool, the Financial Statement Query Viewer, to search financial statement data and footnotes across different periods and companies. In addition, the Commission has a text analytics initiative in which staff can identify inconsistencies in narrative disclosures, discrepancies between narrative and numeric disclosures, narrative trending, changes in risk profiles based on sentiment, and other interesting phenomena. These types of tools enable the staff to discern norms, outliers, and patterns in ever larger quantities of information.

As you can imagine, investors can benefit from having similar tools of this nature. Data analytics is useful not only for regulatory purposes, but also for helping investors determine whether a security is a good investment. Thus, it is encouraging to see that the Commission has made progress in utilizing structured data to enhance the disclosure of information to investors. The Commission now requires regulated entities to make a wide range of filings in structured data formats.

However, despite these strides to make better use of technology, there is more that can be done. To tick off a few wish list items—

- I'd like the SEC to embrace the Legal Entity Identifier with the goal of making public company disclosure to the SEC interoperable with disclosure to other reporting regimes, as recommended by the Data Coalition and XBRL US;

- I’d like the SEC to require block-tagging of narrative text disclosures; and
- I’d like the SEC to require detail-tagging within narrative text disclosures.

Within this room, I suspect there is broad consensus that these types of reforms should have been adopted long ago. However, rulemaking is not a simple process. Whenever changes are proposed to securities law disclosure requirements, a common dynamic plays out. Investors tend to favor as much disclosure as possible, while corporate issuers and preparers warn of the burdens and costs of providing the disclosure. The Commissioners must then weigh the competing interests and decide which policies to adopt.

To me, this is one area where technology provides the opportunity for a win-win, because investors and companies can both benefit from greater utilization of structured data. However, the benefits are sometimes indirect, so it may take time before market participants and policymakers can see that the benefits ultimately will justify the costs.

Let’s start by considering the benefits to investors from having expanded access to disclosures in the form of structured data.

Currently, the reports that companies file with the SEC are document-based reports. In particular, the 10-K can be voluminous, with much of the information disclosed in an unstructured format.[2] Searching the unstructured portions is cumbersome—you might thumb through pages of a print-out, or do a ‘Control-F’ word search online. It may be necessary to manually locate and print multiple reports in order to find material that is incorporated by reference, to review prior periods of the same company, or to compare the performance of multiple businesses.

Structured data enables an investor to use enhanced search capabilities. When disclosure is organized and tagged with definitional information, or metadata, software can be written to locate and retrieve what someone is looking for with precision. A search engine that can be trained on a block-tagged description of the company’s business will retrieve results that are more relevant and useful than a search of a larger, unstructured report that lacks metadata sign-posting.

Block tags also can make searching more productive by enabling retrieval of information on a disclosure topic, even when the disclosure itself lacks familiar keywords. Suppose an analyst wants information on an accounting policy. A company might discuss that accounting policy without ever using the analyst’s specific keywords. Block tags can point the search engine to the portion of the filing where the answer to the analyst’s question is likely to be found.

In addition, if everything in a 10-K were tagged appropriately, investors would be able to generate reports that are personally customized. Suppose someone wants all of the information available on a company in an industry with which she’s unfamiliar. Someone else who’s familiar with the company wants only the latest year-end financial results. Structured data enables us to present investors with a menu of available information so that they each can retrieve only that which they wish to see. It also enables creative infographics with instantaneous updates, using data from multiple sources.

Service providers are already demonstrating the power of structured data for investors. Investors now have access to platforms for analyzing financial statements using as-reported company data piped in from the EDGAR XBRL data set.[3] These platforms include data points that other data aggregators historically haven’t provided.[4] They also include data for smaller companies that other data aggregators historically haven’t covered. These enhancements stem from the SEC’s XBRL tagging requirements.

Other service providers allow investors to combine EDGAR XBRL data with publicly available information from other sources to enable cross-referencing. Other sources could include drug patent expiration data from the Food and Drug Administration and consumer complaint data from the Consumer Financial Protection Bureau.[5] This type of cross-referencing allows investors to more easily consider how consumer sentiment might impact earnings, or how a security breach might impact revenue. These insights previously required time-consuming research, but now they are readily attainable.

Using software that automates different types of analyses makes it easier to spot a company whose numbers “don’t add up.” My colleague Mike Willis predicts that as more people analyze as-reported company data using software that becomes more widely available, it will become harder for companies to get away with reporting deficiencies, or anomalies, or possibly even financial fraud. He likes to say, tongue-in-cheek, that empirical research has shown that the installation of closed-circuit television cameras in a store reduces theft.[6] His point is, isn’t the likely effect of smart data just as obvious?

By prioritizing structured data, and particularly the tagging of text, the Commission could drive even greater innovation in cost-effective enhancements to the packaging and delivery of information. Analytical tools could become more accessible to investors and their intermediaries, and ultimately, these tools could lead to better pricing of securities as information becomes more accessible to market participants. In this way, all investors stand to benefit from structured data, even those who have never heard of it and will never utilize it directly.

Next, let’s consider the potential benefits to corporate issuers who have to provide disclosure. Many companies consider data tagging to be an add-on cost to filing a 10-K or 10-Q. A recent survey indicated that these costs may not be as high as anticipated when XBRL was first adopted,[7] but the costs are still a factor. Companies may be focusing on the costs without appreciating the range of benefits.

In reality, the costs and benefits of reporting in a structured data format are largely related to how the company implements the tagging. Having a financial printer apply tags at the end of the report preparation process will undoubtedly result in a cost increase. However, if the company chooses to standardize data within the company’s internal systems, this will likely result in long-term cost savings.

Currently, many companies still prepare 10-Ks and 10-Qs in a manual assembly process.[8] With distinct lines of business, overseas units, and recent acquisitions, a company might have dozens of databases from which data must be gathered. People from different parts of the company will circulate and combine data, reconcile different versions, deal with formatting issues, and proofread to check that the numbers are all correct. Once gathered, the data will be cut and pasted from the various sources into word processing and spreadsheet applications used for report assembly. It will be reformatted and curated — perhaps arranged in a tabular layout or converted into an infographic. This workflow is labor-intensive and time-consuming, which means that weeks will go by before investors learn the full results of the company’s latest fiscal period.[9]

Now let’s imagine what a more efficient information system could look like.[10] A company might keep its multiple legacy databases but apply to each one an overlay of metadata labels so that computers can retrieve the data needed for reporting purposes. Standardizing data in the databases from which the data originates would allow company personnel to automate the steps of data aggregation. This would shorten the timeframe required for preparing and publishing reports, reduce errors, and allow reporting personnel to devote more of their attention to higher-level review and analysis. In addition, automation of traditionally manual audit activities — such as choosing statistical samples, detecting suspicious transactions, and testing journal entries — would enable auditors to attain their requisite assurance level faster and at a lower cost.

Efficiencies could also be achieved in the filing process that the SEC controls. For example, the reports that companies file with the SEC could simply be a set of data files that consist of financial statement data and block-tagged sections of narrative text, such as a description of the business. A company would not need to concern itself with packaging the information in a document-based report if the packaging could take place within the Commission's software platform or in platforms developed by third parties. As a simple illustration, think of the way tax preparation software works. Taxpayers can use software that captures the relevant data without actually "filling out" the Form 1040, and the form is generated at the end of the process at the touch of a button. The same type of report generation could be used for a 10-K.

In addition to the efficiencies and cost savings that a company can achieve through structured data, an even larger benefit is possible. In my view, structured data should improve the liquidity of shares in the marketplace, particularly for smaller companies, because it enables automation of financial analyses. This makes it easier to analyze a far greater number of companies, including smaller companies, and spot a company that may be quietly outperforming (or underperforming) its competitors. Ultimately, this enhanced ability to identify profit-making opportunities should lead to more trading in those securities. In addition, if investors' research costs go down because of automation, that might encourage them to consider smaller-sized investments, or investments in smaller companies for which the information acquisition costs may now be prohibitive.

To achieve these benefits, it is important for the Commission to be vigilant in requiring greater accuracy and comparability of the data. Toward this end, the Commission recently began allowing companies to voluntarily file structured financial statement data in a format known as Inline XBRL, which is both human-readable and machine-readable.[11] According to the Commission's order, this format could decrease filing preparation costs, improve the quality of structured data, and, by improving data quality, increase the use of XBRL data by investors and other market participants. The rationale is that, as people view filings in the Inline XBRL format, they will see common tagging errors that are prevalent now, which will induce companies to clean up those errors. In my view, we all need to continue working together to improve the comparability and accuracy of data, and I commend the XBRL consortium for its work in developing and refining taxonomies and related guidance.

Other countries have embraced smart data with results that portend success for us. I'll tell you about a couple of recent studies. In Belgium, private companies voluntarily provided XBRL-formatted financial statements to banks for the purpose of loan applications. That reduced informational asymmetries between the lenders and borrowers and led to faster credit decisions and lower interest rate spreads.[12] In China, the Chinese Securities Regulatory Commission mandated in 2004 that Chinese-listed firms file XBRL-formatted financial statements. That development led to a decrease in the cost of equity capital for listed companies during the post-adoption period.[13]

In Australia, the government is pursuing a national agenda premised on the idea that information can be 'captured once, and used often' to enhance business efficiency and productivity. [14] Companies in Australia can interact with government services through a single, secure online portal. Company personnel can select the relevant report to be completed and have the report pre-filled automatically with data from the company's internal system software as well as information held by the government. Company personnel can review the pre-filled information, validate it, and then send it securely and directly to the relevant government agency. The information reported has been standardized amongst the various government agencies, so that the same information can be used for multiple reporting purposes.

These success stories should make us more confident about the possibilities for smart data in the United States. However, I will close by noting that while the benefits to investors are easily understood, public companies still need to be shown the potential benefits that can flow from investing resources in information standardization and structuring. On the investor side, entrepreneurs are already developing products to bring the benefits of smart data to a broader population of investors. More needs to be done to bring the benefits to companies. They remain dependent upon software developers coming up with applications that bring a tangible benefit to the bottom line.

Notwithstanding this challenge, the future of smart data looks promising. And on behalf of investors, I thank you for the commitment of all of you who have taken us this far.

Are there any questions?

[1] *See* Andrew Ceresney, Dir., U.S. Sec. and Exch. Comm'n Div. of Enf't, Directors Forum 2016 Keynote Address (Jan. 25, 2016), https://www.sec.gov/news/speech/directors-forum-keynote-ceresney.html.

[2] The financial statements and footnotes of a 10-K are structured. The rest is unstructured.

[3] *See, e.g.,* Calcbench, www.calcbench.com (last visited Oct. 20, 2016).

[4] One example is unremitted earnings of foreign subsidiaries. Another is product warranties. Net operating losses in XBRL can be disaggregated at the federal as well as the state and local levels. While data aggregators historically haven't distinguished these, XBRL lets a user do exactly that.

[5] *See Open Letter(s) to the Commissioner of the SEC*, Idaciti Blog (Jun. 29, 2016), http://hello.idaciti.com/blog/open-letter-s-to-the-commissioner-of-the-sec (responding to a speech by SEC Commissioner Kara M. Stein on May 6, 2016 on disclosure in the digital age).

[6] *See* Leighton Walter Kille & Martin Maximino, *The effect of CCTV on public safety: Research roundup*, Journalist's Res. (Feb. 11, 2014), http://journalistsresource.org/studies/government/criminal-justice/surveillance-cameras-and-crime.

[7] In 2015, the AICPA surveyed 14 XBRL filing agents providing XBRL tagging and filing services to 1,299 small public companies, defined as having a market capitalization of $75 million or less.

> Our survey showed that 69% of the companies paid $10,000 or less on an annual basis for fully outsourced creation and filing solutions of their XBRL filings. Meanwhile, 18% of the companies paid annual costs of between $10,000 and $20,000 for their full service outsourced solutions. Only 8% of companies paid more than $25,000 in annual costs. No company's annual cost exceeded $50,000. Through discussions with the vendors, we found that companies that paid higher annual fees did so due to complexities in their financial statements and rush charges imposed given the many last-minute changes to the fi lings (e.g., filing changes for an IPO)….

See Research Shows XBRL Filing Costs Lower than Expected, Am. Institute of CPAs (2015), https://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/XBRL/DownloadableDocuments/XBRL%20Costs%20for%20Small%20Companies.pdf. As this cost estimate was for full outsourcing, it is not directly comparable to the cost estimate in the Commission's 2009 adopting release for then-new rules requiring public companies to file financial statements and footnotes using XBRL, which contemplated internal burden hours and out-of-pocket costs for software and filing agent services. *See* U.S. Sec. and Exch. Comm'n, Interactive Data to Improve Financial Reporting, Release No. 33-9002 (Jan. 30, 2009), https://www.sec.gov/rules/final/2009/33-9002.pdf.

[8] *See Process Improvement: A Universal Framework for Effecting Change*, Workiva (2016), https://www.workiva.com/sites/workiva/files/pdfs/thought-leadership/process-improvement-universal-framework-for-effecting-change-whitepaper-k1672-20160504.pdf; *see also Disclosure Management: Streamlining the Last Mile* PwC (2012), https://www.pwc.com/gx/en/xbrl/pdf/pwc-streamlining-last-mile-report.pdf.

[9] The earnings release is distributed earlier, but it is an incomplete portrayal of financial results.

[10] *See Data and Technology: Transforming the Financial Information Landscape*, CFA Institute (2016), http://www.cfapubs.org/doi/abs/10.2469/ccb.v2016.n7.1.

[11] U.S. Sec. and Exch. Comm'n, Order Granting Limited and Conditional Exemption Under Section 36(a) of the Securities Exchange Act of 1934 from Compliance with Interactive Data File Exhibit Requirement in Forms 6-K, 8-K, 10-Q, 10-K, 20-F and 40-F to Facilitate Inline Filing of Tagged Financial Data, Release No. 34-78041 (Jun. 13, 2016), https://www.sec.gov/rules/exorders/2016/34-78041.pdf.

[12] D. Kaya et al., *The benefits of structured data across the information supply chain: Initial evidence on XBRL adoption and loan contracting on private firms* J. Account. Pub. Pol'y 35, 417-436 (2016) (surveying evidence that banks charge lower interest rate spreads to voluntary adopters of XBRL as compared to non-adopters, using a sample of Belgian private firms between the years of 2005-2007).

[13] S. Chen et al., *How Does XBRL Affect the Cost of Equity Capital? Evidence from an Emerging Market* 14 J. Int'l Acct. Res. 2, 123-145 (2015) (focusing on a sample of listed companies at the Shanghai Stock Exchange and the Shenzhen Stock Exchange in China during the years of 2005-2011).

[14] *See* Standard Business Reporting, http://www.sbr.gov.au/about-sbr/what-is-sbr (last visited Oct. 20, 2016).

Modified: Oct. 24, 2016

Speech

Moving Forward with the Commission's Disclosure Effectiveness Initiative

Rick A. Fleming, Investor Advocate
U.S. Securities and Exchange Commission[1]

NASAA Corporation Finance Training, Houston, Texas

Nov. 19, 2016

Thank you, Bill [Beatty], for that kind introduction and for not only inviting me to participate in this event today, but for accommodating my schedule so I could make it work. It is nice to be back among my NASAA friends.

As you all may be aware, the Commission has undertaken a comprehensive “Disclosure Effectiveness Initiative” to review and modernize public company reporting requirements in Regulation S-K and Regulation S-X. The initiative is, at least in part, responsive to congressional mandates found in the JOBS Act[2] and the FAST Act.[3]   The JOBS Act, as you know well, introduced a number of exemptions from disclosure and capital-raising requirements for emerging companies. The more recent FAST Act requires the Commission to revise Regulation S-K “to further scale or eliminate requirements” in order to reduce the burden on smaller and emerging companies, and to eliminate provisions that are “duplicative, overlapping, outdated, or unnecessary.”[4]

In some respects, the Disclosure Effectiveness Initiative is broader in its objectives and scope than is mandated by the JOBS Act or the FAST Act. These broader objectives are reflected in a concept release the Commission published in April 2016.[5] In the S-K concept release, the Commission discusses, and requests public comment on, many ideas for modernizing business and financial disclosure requirements in Regulation S-K.

Today, I’d like to offer a few of my own ideas on the Commission’s Disclosure Effectiveness Initiative. Let me remind you, though, that the views I express are my own and do not necessarily reflect those of the Commission, the Commissioners, or Commission staff.

My initial observation is that the Disclosure Effectiveness Initiative can dispense with some low-hanging fruit with relative ease. No one wants disclosure requirements that are truly duplicative, overlapping, or outdated, and investors are not clamoring for rules that are unnecessarily burdensome, needlessly complex, or that result in distracting clutter. To the extent that the FAST Act addresses these types of issues, it reflects what I think is a fair criticism that the Commission does not do a very good job of updating or streamlining its rules.

That said, investors *do* want disclosure rules that get companies to produce all the information that is important for investment and voting decisions. With this information, they can make well-informed decisions about allocating their capital. In this way, the disclosure requirements serve as a foundation for businesses to raise capital and our markets to thrive.

To that end, I believe we should judge the success of the Disclosure Effectiveness Initiative primarily in terms of the enhanced utility of corporate disclosures for the investing public. As the Initiative moves forward, the Commission should focus, first and foremost, on meeting the informational needs of investors. And, for this project to be successful, we must start by acknowledging that the Commission's methods for determining the needs of investors are as outdated as some of the disclosure rules.

Rulemaking and Investor Outreach

Why is this? Well, the Commission's formal rulemaking process is necessary and important, but it has limitations. In my view, the process tends to give an advantage to sophisticated stakeholders who are experienced in interacting with the Commission in rulemaking and other contexts. Investors—and especially individual "retail" investors—tend not to participate. Notwithstanding the very thoughtful comments that have been received on the Disclosure Effectiveness Initiative to date, I worry that the Commission is largely missing experiential knowledge gained from investors' first-hand consumption of the information that our disclosure requirements are designed to elicit. The input often seems to be at least one or two steps removed from the perspective of people who pore over 10-Ks and other disclosure documents.

To me, it seems reasonable to assume that most investors are totally unaware of rulemakings at the Commission and would be overwhelmed by the length and complexity of the rulemaking releases. The sheer volume of Disclosure Effectiveness Initiative proposals—by my count, six rulemaking releases totaling 1,084 pages and 577 questions between April 15 and August 31 this year—has made it difficult for investors to provide meaningful input into the public comment process.

Moreover, investors face a well-documented collective action problem in that, although they comprise a constituency that is very large, the benefit to any particular individual or entity seems too small to outweigh the bother of reading 1,000+ pages and responding to hundreds of questions. But their perspectives are no less valid or important than those of the entrenched stakeholders who typically submit comment letters.

One way to address this would be for the Commission to make its rulemaking process more accessible. We could foster greater investor participation in Commission rulemaking through so-called Web 2.0 strategies that lower barriers to participation.[6] For example, in 2013 the Consumer Financial Protection Bureau used an online, discussion board-type forum to invite discussion of an advance notice of proposed rulemaking on debt collection.[7] The forum, called "RegulationRoom," was created by researchers at Cornell University who study civic participation. The CFPB was seeking input[8] from the public on how new rules for debt collectors might better protect consumers without imposing unnecessary burdens on industry. It tried out RegulationRoom "to make it easier for consumers and others to understand what the Bureau [was] considering, to share their information, experiences, and concerns, and to discuss possible ideas and solutions."[9] During the time commenting was open, 8,480 people visited the forum and 224 people posted 956 comments.[10] The RegulationRoom team (from Cornell) moderated the discussion, posted draft summaries of the discussion, and invited all users who had registered or commented to review the drafts and suggest additions or changes. The team then submitted a final summary to the CFPB.[11]

A similar idea comes from a white paper published by The Center for Audit Quality and George Washington University's Institute for Corporate Responsibility.[12] They referred to their idea as a "10-K Muse Project" and envisioned teams competing to rewrite sections of already published Form 10-Ks with the objective of making the content more informative or otherwise useful to investors. Participation could be via an open, online platform incorporating voting and commenting mechanisms so that the

participants could discuss the ideas that are generated and rank them. Online processes that allow participants to generate ideas could result in the development of breakthrough solutions to specific problems or challenges.

While these forms of outreach would be conducive to exploring new ideas, directions and strategies, outreach in the form of investor testing would assist the Commission in refining the development of specific ideas.[13] One Disclosure Effectiveness commenter suggested that we emulate the CFPB's "Know Before You Owe" outreach initiative.[14] In 2012-2013, the CFPB developed new federally-required mortgage disclosure forms intended to alert home buyers to certain costs associated with mortgage debt. The CFPB designed prototypes and refined their development through an iterative process that entailed field-testing the efficacy of the disclosures in structured, one-on-one interviews.[15] The CFPB later cited its outreach and the feedback it received in its proposing release[16] and adopting release,[17] both of which make clear that the initiative was highly worthwhile.

A number of proposals under consideration in the Disclosure Effectiveness Initiative are conducive to this sort of field-testing. For instance, the S-K concept release poses questions about ways in which the ability of investors to access and use disclosures might be enhanced by the manner in which the information is presented and delivered and the Commission could utilize investor testing to assess investor preferences regarding these questions. For example, the Commission could host focus group discussions to drill down further on the findings of recent private sector electronic surveys on ways to improve proxy statement disclosure.[18] The Commission could try out different information delivery ideas and evaluate the user experience before finalizing rule changes.

All of this outreach would not be an end in itself but rather a means to an end—adding to this Initiative an important stakeholder perspective which is underrepresented. Without more extensive, proactive outreach, only those who are highly motivated will likely respond to the Commission's requests for comment. And those views may have an outsized influence in shaping the Commission's policy determinations.

It's time for the Commission to try different strategies to ensure that policy determinations are on track to meet investors' needs.

Scaled Disclosure Requirements

Let me turn, now, to one of my biggest fears regarding the Disclosure Effectiveness Initiative—the scaling of disclosure. When people think of ways to reduce the burdens on issuers, they often jump to the conclusion that we should just scale the disclosure requirements so that smaller issuers are required to disclose less information. I think this is a dangerous path for both issuers and their investors.

Unfortunately, some small-business advocates seem to lack an appreciation of the benefits of disclosure. As an asset manager recently reminded me, large institutional investors are expected to fend for themselves to a large degree. If given the choice between investing in a company that provides full disclosure or one that provides scaled-back disclosure, the choice is easy. Investors will tend to gravitate toward the companies that play by the full set of disclosure rules. Is it any wonder, then, that the shares of smaller companies tend to be less liquid in the secondary markets? The Commission is currently conducting a tick-size pilot to try to encourage liquidity in smaller company shares, but I believe enhancements to disclosure could be more successful in attracting investors to these companies. I also believe the Commission could make much better use of technology to make it easier for companies to provide that disclosure.[19]

In part, the Commission's consideration of further scaling of its disclosure requirements is driven by congressional mandates. The JOBS Act, in particular, scaled back disclosure requirements for a significant number of companies by introducing a new set of exemptions for so-called "emerging growth companies."[20] Similarly, the FAST Act requires the Commission to revise Regulation S-K "to further scale or eliminate requirements" for emerging growth companies and other smaller issuers.[21]

On June 27, 2016, the Commission issued a proposal to expand the definition of a smaller reporting company, or SRC.[22] The proposed amendments would enable a company with less than $250 million of public float to provide scaled-back disclosures as an SRC. In addition, if a company did not have a public float, it would be permitted to provide scaled-back disclosures if its annual revenues were less than $100 million. Raising the thresholds in the SRC definition could be considered responsive to the FAST Act directive because it would expand the number of companies that qualify as SRCs and thereby qualify for scaled disclosure.[23] But it goes so far that, under the revised public float threshold, some 41.8% of the total number of registrants would be able to provide scaled-back disclosures to the investing public.[24]

My chief complaint about the proposal to change the SRC definition is that it is not faithful to the dual mandates of the FAST Act. Although the Act mandated that the Commission "further scale" disclosures and eliminate duplicative requirements, it also mandated that the Commission do this "while still providing all material information to investors" and, if necessary, conduct further study to determine the efficacy of such revisions.

With that in mind, here are some of the scaled-back disclosure requirements that are applicable to companies that meet the SRC definition:

- Smaller reporting companies may provide a business description encompassing the development of the business over the last three years instead of the last five.
- SRCs are not required to provide the table of selected financial data specified in Item 301 of Regulation S-K or the quarterly financial data specified in Item 302.
- The MD&A need only cover the two most recently completed fiscal years, instead of three, and the disclosure need not include the table of contractual obligations.
- The executive compensation disclosure need only cover three named executive officers rather than five, and two years of data rather than three. Not required: the compensation discussion and analysis, the grants of plan-based awards table, the option exercises and stock vested table, the pension benefits table, the non-qualified deferred compensation table, disclosure of compensation policies and practices related to risk management, and pay ratio disclosure.
- With respect to related party transactions, SRCs are not required to provide a description of the policies and procedures they might have for the review, approval or ratification of such transactions.
- Under Regulation S-X, SRCs need only provide two years of income statements, cash flow statements, and changes in stockholders' equity statements, rather than three years.
- With respect to providing financial statements of businesses that they acquired or are about to acquire, they need only provide two years of acquiree financial statements rather than three years.
- The age requirements for financial statements are less stringent.[25]

It is difficult for me to fathom how those things can be eliminated "while still providing all material information to investors" as directed by the FAST Act.[26]

To cite just one example, this past summer the *Wall Street Journal* reported a "widespread" practice in the oil and gas industry of incentivizing executives to drill even if commodity prices made drilling uneconomical.[27] In essence, their incentive compensation was tied to production, not profitability. The *Journal* examined compensation data for 2015 disclosed by the companies in annual meeting proxy statements and found that few companies had adjusted their pay plans despite the sustained rout in commodity prices. At one company singled out in the article, the CEO received a sizable bonus for exceeding production and reserve growth targets, even though the company's earnings plummeted and the stock lost 77%. More than half of the CEO's bonus amount was tied to those targets. That's precisely the sort of information that would be material to a reasonable investor, and it could be especially relevant at a company with a small public float. But SRCs are not required to provide detailed disclosure about bonus compensation.[28]

I've been wrong before, and maybe I'm wrong about the degree to which the changes to the SRC definition would reduce the availability of material information. However, at a minimum, I think the Commission should take advantage of the FAST Act provision which allows the Commission to conduct further study to determine the efficacy of contemplated S-K revisions, instead of proposing revisions that may be ill-advised.[29] I think the Commission needs a much better understanding of the unintended consequences that may follow from reductions in disclosure. For example, in addition to studying the impact on liquidity, as I noted earlier, the Commission should study the relative risk of investments in smaller companies vis-à-vis larger companies, and whether it even makes sense to reduce disclosure in those smaller companies if they present a higher risk to investors.

Millennials

I would like to conclude with a note about the future. For all Commission rulemaking, I think we need to consider what the world will look like ten years from now because, if you think about it, the rules may not be amended again for at least that long. This means that we need to consider not only the informational needs of today's Baby Boomer investor, but also tomorrow's Millennial investor.

The Millennial generation is poised to be the largest generation in the history of both the United States and the world.[30] The oldest of the Millennials are in their thirties, and many of them are at the beginning of their careers.[31] This generation will be a force in the U.S. economy for decades to come.

Many Millennials have begun their careers with significant financial challenges. Some were coming of age during the Great Recession, which impacted their career paths, and all of them continue to negotiate a post-recession economy.[32] They generally have higher debt, primarily from student loans, compelling them to live at home longer, marry and start families later, and postpone purchasing a home.[33]

Despite these financial hardships and economic uncertainty, Millennials as a group are accumulating significant wealth. For example, a 2014 study by the Shullman Research Center found that Millennials accounted for approximately 23 percent of millionaires.[34] This generation also is set to receive a large portion of the estimated $30 trillion in assets that will be inherited from Baby Boomers.[35] It is expected that by 2038, Millennials will become the most important financial generation in America based on their size, age, and investment power.[36] While 2038 may seem far off, our financial markets and regulatory structure will need to evolve to meet the needs of these future investors, and the time to begin anticipating those needs is now.

Millennials, like all generations, have been shaped and greatly impacted by the world they grew up in.[37] Their priorities and expectations are starkly different from previous generations.[38] They have seen increased racial diversity, climbing costs of higher education, and defining events such as the terrorist attacks of September 11, 2001.[39] They are also motivated by social causes, wellness, and collaboration.[40] Millennials, as a generation, have different expectations, different ideas about how the world works, and different priorities with respect to their work, their lives, and their investments than prior generations.[41]

Millennials are the most educated generation[42] and they have been shaped by technology, with much of the technological innovation coinciding with their childhood.[43] They have had unparalleled access to computational power because they have grown up at a time when the "frontiers of technology have appeared unlimited" and the cost of creating and distributing digital content fell drastically.[44] As a generation of digital natives, Millennials are among the most demanding when it comes to technology and innovation.[45] They have become accustomed to using technology in every aspect of life,[46] and they expect immediate access to information.[47] They take advantage of high-tech tools, social networking platforms, websites, and mobile applications to do many things, including picking stocks and finding financial planners.[48]

In contrast to prior generations, particularly the Baby Boomers, Millennials are skeptical and inquisitive about investment strategies and industry professionals.[49] Unlike the generations before them, they tend to take the opposite of a no-questions-asked approach to investing.[50] As Millennials naturally become investors, their technological savvy will force change in financial markets. Market participants and industry professionals will be forced to differentiate themselves through innovative user experiences and e-features rather than simply offering different financial products.[51] As a generation that has come of age when start-ups and alternative investments may seem to be the norm, some predict a shift from traditional investment products to alternative investments such as venture capital and private equity.[52]

In addition to market participants, regulators also need to consider the characteristics and needs of this new generation of investors. For example, the Commission should continue its progress toward modernizing how data is structured and delivered to investors. The Commission should also consider how the informational needs of investors may change over time. For more than 80 years, companies have been required to disclose all material facts to investors—namely, any fact that a reasonable investor would consider important in making an investment or voting decision.[53] But, what is important to investors is likely different today than it was in 1933. Today's investor, and especially the Millennial generation, may place greater importance on environmental, social, and governance aspects of a business,[54] and the Commission should be prepared to respond to those changes.

Ready or not, we are in the midst of a generational shift that will change the securities marketplace. But one thing will not change—investors will still count on those markets being fair. The challenge, particularly for regulators, will be to simultaneously think bigger and more creatively while exercising an appropriate level of caution to protect investors in an evolving world.

Thank you.

[1] The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author's colleagues on the Commission staff.

[2] Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

[3] Fixing America's Surface Transportation Act of 2015, Pub. L. No. 114-94, 129 Stat. 1312 (2015).

[4] *Id*. at Section 72002. The requirement to make revisions would not apply to provisions for which the Commission determines that further study is necessary to determine their efficacy.

[5] Business and Financial Disclosure Required by Regulation S-K, Exchange Act Release No. 77599 (Apr. 15, 2016), 81 Fed. Reg. 23915 (Apr. 22, 2016), https://www.federalregister.gov/d/2016-09056.

[6] *See* C. Farina and M. Newhart, *Rulemaking 2.0: Understanding and Getting Better Public Participation*, IBM Center for the Business of Government (2013), http://www.businessofgovernment.org/report/rulemaking-20-understanding-and-getting-better-public-participation.

[7] *See* Regulation Room, http://regulationroom.org/rules/consumer-debt-collection-practices-anprm (last visited Nov. 15, 2016).

[8] *See* Debt Collection (Regulation F), 12 C.F.R. pt. 1006, 78 Fed. Reg. 67847 (Nov. 12, 2013), https://www.gpo.gov/fdsys/pkg/FR-2013-11-12/pdf/2013-26875.pdf. .

[9] *Id*. at 67848.

[10] *See* Summary of Discussion on RegulatonRoom.org, Debt Collection (Regulation F), Docket No. CFPB-2013-0033 (Apr. 15, 2014), https://www.regulations.gov/document?D=CFPB-2013-0033-0400.

[11] *See id*.

[12] *See Initiative on Rethinking Financial Disclosure,* The Center for Audit Quality and The George Washington University School of Business' Institute for Corporate Responsibility, (Nov. 2014), https://issuu.com/gwbusiness/docs/caq_gwreport_v1.0?e=12156310/10026320%27.

[13] A number of commenters have called on the Commission to conduct such testing. *See*, *e.g.*, Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors (Jul. 8, 2016) (suggesting that the SEC conduct user testing to assess the impact of potential changes in disclosure formatting and delivery). *See also* Kara M. Stein, Comm'r, SEC, *Disclosure in the Digital Age: Time for a New Revolution* (May 6, 2016) (calling for investor testing), available at https://www.sec.gov/news/speech/speech-stein-05062016.html.

[14] *See* Letter from Heather Slavkin Corzo, Director, Office of Investment, AFL-CIO (Nov. 20, 2015).

[15] *See* Consumer Fin. Protection Bureau, *Know Before You Owe Mortgages*, http://www.consumerfinance.gov/know-before-you-owe/compare/.

[16] *See* Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (Regulation X) and the Truth In Lending Act (Regulation Z), 12 C.F.R. pts. 1024 and 1026, 77 Fed. Reg. 51115 (Aug. 23, 2012), https://www.gpo.gov/fdsys/pkg/FR-2012-08-23/pdf/2012-17663.pdf.

[17] *See* Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (Regulation X) and the Truth In Lending Act (Regulation Z), 12 C.F.R. pts. 1024 and 1026, 78 Fed. Reg. 80225 (Dec. 31, 2013), https://www.gpo.gov/fdsys/pkg/FR-2013-12-31/pdf/2013-28210.pdf.

[18] *See Highlights from RR Donnelley's Groundbreaking Investor Survey: What You Need to Know Before Drafting Your Next Proxy*, RR Donnelley (surveying institutional investors during August and September of 2013) available at: https://www.niri.org/NIRI/media/NIRI/Documents/GCM.pdf; and *2015*

Investor Survey: Deconstructing Proxy Statements – What Matters to Investors, RR Donnelley, Equilar Inc. and Stanford University, available at: https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf.

[19] *See* Rick A. Fleming, Investor Advocate, SEC, *Improving Disclosure with Smart Data* (Oct. 24, 2016), available at: https://www.sec.gov/news/speech/improving-disclosure-with-smart-data.html.

[20] *See supra* note 2.

[21] *See supra* note 3.

[22] *See* Amendments to Smaller Reporting Company Definition, Exchange Act Release No. 78168 (Jun. 27, 2016), 81 Fed. Reg. 43130 (Jul. 1, 2016), https://www.gpo.gov/fdsys/pkg/FR-2016-07-01/pdf/2016-15674.pdf.

[23] *See id.* at 43133.

[24] *See id.* at 43140.

[25] *See id*. at 43132 (summarizing the scaled disclosure accommodations available to smaller reporting companies in Regulation S–K and Regulation S–X).

[26] It is possible for the Commission to change the definition of an SRC separate and apart from its authority under the FAST Act; in my view, however, if the Commission proceeds with the proposed change to the SRC definition, it should make more clear that it is acting under its discretionary rulemaking authority, not because it is mandated by the FAST Act.

[27] *See* Ryan Dezember, *Oil Firms Are Still Paying CEOs to Pump*, Wall St. J. (May 16, 2016), http://www.wsj.com/articles/oil-bust-has-little-impact-on-industry-executive-bonuses-1463391000.

[28] *See* Item 402(o)(5) of Regulation S-K (17 CFR 229.402).

[29] *See supra* note 3, Sec. 72002(3).

[30] *See* Richard Fry, *Millennials overtake Baby Boomers as America's Largest Generation*, Pew Research Center (April 25, 2016), http://www.pewresearch.org/fact-tank/2016/04/25/millennials-overtake-baby-boomers/; Chuck Mackie, *Getting to the New Normal – Financial Services in the Millennial Age*, Maven Wave (July 21, 2016), http://www.mavenwave.com/fusion-blog/financial-services-in-the-millennial-age/.

[31] The Council of Economic Advisers, *15 Economic Facts About Millennials* (Oct. 2014), at 3 n.1., *available at* https://www.whitehouse.gov/sites/default/files/docs/millennials_report.pdf.

[32] Gary R. Mottola, Ph.D., FINRA Foundation Financial Capability Insights, The Financial Capability of Young Adults—A Generational View (Mar. 2014), http://www.finra.org/sites/default/files/14_0100%201_IEF_Research%20Report_CEA_3%206%2014%20%28FINAL%29_0_0.pdf. *See also* The Council of Economic Advisers, *supra* note 31 at 3.

[33] *See* Goldman Sachs, http://www.goldmansachs.com/our-thinking/pages/millennials/index.html (last visited Aug. 11, 2016); *see also* Chuck Mackie, *supra* note 30.

[34] Robert Frank, *Millennial Millionaires Just Want to Get Rich*, Inside Wealth, CNBC (Mar. 2014), http://www.cnbc.com/2014/03/28/why-millenial-millionaires-are-different.html.

[35] Baby Boomers are set to transfer an estimated $30 trillion in assets to their heirs in North America alone. Ameritas, White Paper, *The New Alpha Rules: Bridging the Gap* (Dec. 17, 2014), http://www.investmentnews.com/assets/docs/CI977471217.PDF; *see* Chance Barnett, Contributor, *How Millennials Will Change the Face of Finance & Investing*, Forbes (Sept. 14, 2016), http://www.forbes.com/sites/chancebarnett/2016/09/14/how-millennials-will-change-the-face-of-finance-investing/#eb4d40a31f09; The Council of Economic Advisers, *supra* note 28 at 3; *see* Mottola, *supra* note 32.

[36] *See* Goldman Sachs, *supra* note 33.

[37] Mottola, *supra* note 32.

[38] *See* Goldman Sachs, *supra* note 33.

[39] *Id*.

[40] *Id.*; Chuck Mackie, *supra* note 30.

[41] *See, e.g.*, Barry Salzberg, *I Am Millennial. Hear Me Roar!*, LinkedIn (Jan. 20, 2015), https://www.linkedin.com/pulse/i-am-millennial-hear-me-roar-barry-salzberg?trk=pulse-det-nav_art.

[42] The Council of Economic Advisers, *supra* note 28 at 3; *see* Mottola, *supra* note 32.

[43] The Council of Economic Advisers, *supra* note 28 at 7.

[44] *Id*.

[45] *See* Alessandra Malito and Ellie Zhu, *Client Expectations: More Tech,; lower fees*, InvestmentNews (May 14, 2015), http://www.investmentnews.com/article/20150514/FREE/150519955/client-expectations-more-tech-lower-fees.

[46] Brett Relander, *How Millennials Use Tech & Social Media to Invest*, Investopedia (Feb. 27, 2015), http://www.investopedia.com/articles/investing/022715/how-millennials-use-tech-social-media-invest.asp.

[47] *See* Goldman Sachs, *supra* note 33; *see also* Chuck Mackie, *supra* note 30.

[48] *Id*.

[49] *See* Michael Liersch, Director of Behavioral Finance, Merrill Lynch, *Millennials and Money* (2013), http://www.pbig.ml.com/Publish/Content/application/pdf/GWMOL/PBIG_Millenials_and_Money.pdf.

[50] *See id*.

[51] Chance Barnett, Contributor, *How Millennials Will Change the Face of Finance & Investing*, Forbes (Sept. 14, 2016), http://www.forbes.com/sites/chancebarnett/2016/09/14/how-millennials-will-change-the-face-of-finance-investing/#eb4d40a31f09.

[52] *Id.*

[53] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

[54] *See., e.g.*, Maryann Busso, *Millennials Are Coming and They Want Sustainable Investments*, Bloombergmarkets (Oct. 26, 2016), http://www.bloomberg.com/news/articles/2016-10-26/millennials-are-coming-and-they-want-sustainable-investments.