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The Unexpected Benefits of Mandatory Disclosure

SEC Forum on Small Business Capital Formation

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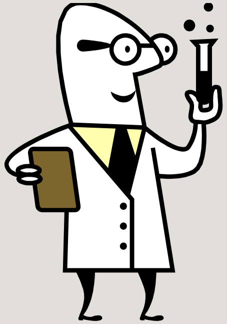
Overview

A. Objective: balance the costs and benefits of mandatory disclosure.

B. Evidence: unexpected benefits from mandating disclosure.



B. Evidence of unexpected benefits from:

1. 1964 Exchange Act Amendments.
2. 1999 OTCBB mandatory disclosure rule.
3. The JOBS Act of 2012.

1. 1964 Exchange Act Amendments:

Provisions triggering periodic reporting obligations:

- Section 12(a) – Trading on a national exchange **(1934)**
- Section 15(d) – After a public offering **(1936)**
- Section 12(g) – More than [$10] million in assets and 500 shareholders of record **(1964)**
- Section 12(g) – Modified up to 2,000 shareholders **(JOBS Act of 2012)**

B. Evidence of unexpected benefits from forcing companies public and mandating disclosure.

Event	Firms affected (median in 2015 $s)	Economic Consequence
1964 Amendments	Forced hundreds of OTC firms to file publicly ($68 mil. market cap.)	New filers shares rose between 11.5% and 22% (Greenstone et al., 2006).

2. 1999 OTCBB mandatory disclosure rule:

Provisions required OTCBB firms to comply with periodic reporting obligations or exit OTCBB:

- Before rule, 1,360 firms already complied with periodic reporting requirements, while over 3,600 firms did not.
- Some firms (826) started to comply with periodic reporting requirements; most firms (2,600 or 76%) exited the OTCBB, rather than comply.

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1999 SEC Rule	**Forced hundreds of OTCBB firms to file publicly ($36 mil. market cap.) or exit.**	**Ongoing OTCBB filers shares rose 3.4% (Bushee & Leuz, 2005).**

3. The JOBS Act of 2012.

IPO On-Ramp provisions for Emerging Growth Companies ("EGCs"):

- Confidential Submissions of Draft S-1
- Reduced disclosure at IPO: only 2 (vs. 3) years audited financials, less executive compensation disclosure
- Phase-in periodic disclosure obligations:
  - Complying with new accounting standards (most EGCs opted out);
  - Auditor attestation of effectiveness of management internal controls over financial reporting (SOX 404(b)) (almost all EGCs do not include auditor's attestation).

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JOBS Act of 2012	**Reduced mandatory IPO disclosure obligations for EGCs ($77 mil. sales).**	**Direct costs unchanged; underpricing rose from 14.5% to 24% (Berdejo, 2015).**

Conclusions:

1. Mandatory public disclosure can benefit firms in unexpected ways (other studies support this).
2. I am not claiming that the specific information currently required to be disclosed is optimal.
3. We should hesitate before reducing disclosure obligations based on intuitions about cost/benefit tradeoffs.

5. Questions?