CFA Institute

Council of Institutional Investors®
The voice of corporate governance

April 28, 2020

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Proposed Rule: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information
SEC Release Nos. 33-10750; 34-88093; IC-33795; File No. S7-01-20

Dear Madam Secretary:

CFA Institute[1] and the Council of Institutional Investors[2] is pleased to provide you with our perspectives on areas for consideration in conjunction with the Securities and Exchange Commission's (SEC's or Commission's) *Proposed Rule: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information* ("Proposed Rule"). The Securities Act of 1933 and the Securities Exchange Act of 1934 (collectively, the "Securities Acts" or the "Acts") were transformative to the profession of securities analysis and investment decision-making, and we support the SEC's efforts to ensure that the Acts are updated and remain relevant as markets and technology continue to evolve.

We are providing comments consistent with our objective of promoting fair and transparent capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures – and the related audits – provided to investors and other end users are of high quality. Our advocacy position is informed by our respective memberships who invest,

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[1] CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154-member societies in 77 countries and territories.

[2] The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management. For more information about CII including its board and members, please visit CII's website at http://www.cii.org.

both domestically and globally, and in consultation with CFA Institute's Corporate Disclosure Policy Council ("CDPC").[3]

OVERARCHING CONSIDERATIONS

Summarized below are our perspectives on several overarching considerations that we believe the Commission should bear in mind as it continues to review and update the Acts. In addition, please note that we have provided various letters[4,5] on this topic to the SEC over the last several years.

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[3] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors. CII's General Counsel is currently a member of the CDPC.

[4] *CFA Institute Comment Letters:*
2014 Disclosure Effectiveness Letter (November 2014)
https://www.cfainstitute.org/-/media/documents/comment-letter/2010-2014/20141112.ashx

2016 Business and Financial Disclosure Required by Regulation S-K (October 2016)
https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20161006.ashx

2016 Disclosure Update and Simplification Letter (December 2016)
https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20161207.ashx

2019 Modernization of Regulation S-K Items 101, 103, and 105 (November 2019)
https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20191127.ashx

[5] *Council of Institutional Investors Comment Letters & Petition:*
Business and Financial Disclosure Required by Regulation S-K (July 2016)
https://www.sec.gov/comments/s7-06-16/s70616-49.pdf

Disclosure Update and Simplification (Sept. 2016)
https://www.cii.org/files/issues_and_advocacy/correspondence/2016/September%2022%202016%20comment%20letter%20(final%20with%20letterhead)%20KAB.pdf

Petition for Rulemaking Regarding Disclosures on
Use of Non-GAAP Financials in Proxy Statement CD&As (Apr. 2019)
https://www.sec.gov/rules/petitions/2019/petn4-745.pdf

Proposed Rule on Modernization of Regulation S-K Items 101, 103, and 105 (Oct. 2019)
https://www.sec.gov/comments/s7-11-19/s71119-6312521-193620.pdf

Proposals to Delete Information: Shift the Burden from The Registrant to The Investor and Result in A Loss of Useful Information

Many of the Commission's proposals consist of proposals to eliminate information that is currently required, on the grounds that the information is readily available, either by accessing and compiling the data from prior filings on EDGAR (*e.g.,* proposals to eliminate the Five Year Selected Financial Data and Supplementary Financial Data tables), or because the information can be compiled from various other places in the filing (*e.g.,* proposals to eliminate the Contractual Obligations Table and Off-Balance Sheet Exposures section). ***These proposals have the effect of shifting the burden from a single registrant having to collect or collate such information, on to all the analysts or investors that follow that registrant having to compile the information themselves – an exercise which, by definition, will lead to an increase in the overall amount of work required.***

If we add to this the fact that ***some of the information that the Commission is proposing to eliminate is not actually available to analysts or investors – for example, because the historical information available has not been adjusted for the effects of discontinued operations or restatements of prior periods*** – then we find that the result of these proposals is that the Commission's proposal ***would result in a net loss of important information to investors***.

Accordingly, we believe that ***proposals to eliminate this information results in a major step backward, as it converts a fairly routine compliance exercise for the registrant (i.e., that of providing information readily available to the registrant) into a complicated and burdensome effort for investors***, and in some cases results in a loss of comparable information that is not otherwise available to investors. As a result, we do not support any of the proposals to eliminate this information.

Existing Tables: Are Useful and Should Be Retained and Electronically Tagged Rather Than Eliminated

In addition, we note that the ***SEC proposes to eliminate several tables on the grounds that the information is redundant.*** However, ***investors find these tabular presentations to be extremely useful, as they compile information that is often scattered throughout the filing into one central location***. For example, in periods in which a company's liquidity becomes of concern to investors, such as at the present moment, it is useful for investors to be able to turn to a particular section of the filing and readily see what a company's future contractual obligations are, without having to hunt for each piece of information throughout the filing. ***The COVID-19 pandemic is illustrating how the aggregation and tabular presentation of information, such as contractual obligations is very useful to investors***.

We would also note that the preparation of the contractual obligations table is a useful management exercise as it summarizes the obligations in one location and provides management with a picture of such obligations. We know that what gets measured and

disclosed is what gets monitored by management. This is another reason to include the table and enhance as we describe elsewhere herein.

We also disagree with the view that this information is "redundant" because we believe that the tabular presentation provides the raw data, and highlights whether the narrative commentary that either accompanies it or is furnished elsewhere provides the analysis of that data and puts the information into context with the rest of the registrant's financial position, results of operations, and cash flows. Accordingly, ***we believe that the tables regarding five years of selected financial data, two years of selected quarterly financial data, and the contractual obligations table should all be retained***.

In addition, ***to enhance the usability of these tables, we believe that they should be required to be electronically tagged***. As we have noted previously, the use of structured reporting results in greater transparency for regulators, investors, and other users. Moreover, CFA Institute studies have shown[6] that companies often overestimate the costs of implementing structured reporting, and by focusing on proper implementation techniques, companies can reduce costs and create efficiencies, allowing both companies and users to benefit from structured reporting.

Hand-in-hand with tabular presentation is the need for tagging of tabular and textual data in all sections within the MD&A. ***Failure to include such a requirement highlights a lack of understanding with respect to how investors consume registrant filings. It is our view that the SEC should consider data structuring and automation in all that it does***.

MD&A:
Often Falls Woefully Short of Providing Meaningful Analysis and Needs Further Improvement

In our experience, Management's Discussion and Analysis (MD&A) often skimps on, or skips over entirely, the "Analysis" part of the SEC's requirements for this section. For many registrant filings, MD&A in its current state consists primarily of a rote description of increases and decreases in line items without any discussion of the underlying drivers of those changes – an exercise that can easily be done by investors without any input from management. However, we do not believe this is because the objective of this section is unclear to registrants; rather, we believe it results primarily from the SEC's failure to enforce the existing requirements.

In order to encourage a more meaningful analysis of results, the SEC should <u>require</u> that registrants present a table which shows the quantitative and percentage changes in each line item, and <u>prohibit</u> that this information be provided in narrative format. Once the information regarding period-to-period changes is required to be presented quantitatively in a tabular format, the lack of analysis regarding the changes will be more

[6] https://www.cfainstitute.org/-/media/documents/survey/the-cost-of-structured-data-myth-vs-reality-august-2017.ashx

obvious and registrants would presumably be compelled to provide some analysis of the reasons for the changes in the narrative section beneath the tables.

We also believe that ***the SEC should be more explicit in its requirements regarding their expectations from registrants regarding explanations of the***

"cause" of changes in line items and provide examples of expected items to be discussed in the analysis of such changes. We provide examples in the more detailed discussion that follows. Further, we believe the ***SEC needs to more rigorously enforce compliance*** with the requirements of this section, to ensure that registrants provide a meaningful discussion of the major factors that caused changes in line items.

While we are not opposed to the refinements of the existing definitions and requirements that the SEC has proposed, we believe that a concerted emphasis on enforcement in this area may yield more meaningful improvements.

Critical Accounting Estimates: Must Provide A Sensitivity Analysis and Should Be Electronically Tagged to Facilitate Comparison with Critical Audit Matters

Finally, in our view, the addition of disclosures regarding Critical Accounting Estimates in the early 2000s was a welcome improvement to the financial statements and we therefore support its proposed codification into the SEC's formal filing requirements. At the same time, we note that it is rare that registrants provide a quantitative sensitivity analysis of how their critical accounting estimates might impact results if different assumptions had been used. ***To make these disclosures truly meaningful for investors, we believe that such sensitivity analysis should be required and compliance with this requirement should be rigorously enforced*** by the Commission.

In addition, we note that, with the introduction this year of the disclosure of Critical Audit Matters (CAMs), some investors will be interested in comparing these disclosures to registrants' critical accounting estimates. Although we appreciate that CAMs are not necessarily the same as Critical Accounting Estimates, there is a potentially substantial area of overlap, and some investors will find it informative to compare the two. Accordingly, ***we urge the Commission to require that information regarding Critical Accounting Estimates be electronically tagged, in order to facilitate this comparison***. Without the requirement to produce this information in XBRL format, such a comparison will be fairly labor-intensive for investors to perform.

Further Accommodations to Small Reporting Companies (SRCs) in MD&A: Should Not Be Provided

The proposal asks whether the SEC should consider providing further accommodations to SRCs with additional amendments to Item 303. We generally do not support a scaled disclosure regime, as it deprives investors of needed information and results in a reduced information set for investors in smaller companies. SRCs compete for capital with all other public companies. If investors are to allocate capital rationally, they need the same data for all companies. Different reporting requirements within the financial statement

disclosures for differently-sized registrants may also signal to investors that the entities lack comparable quality. Moreover, scaled disclosures can deprive investors of certain material information that they should receive. ***Scaled disclosure may, in some cases, result in insufficient information being provided to conduct a thorough analysis. Accordingly, we generally do not support a further reduction in information provided by SRCs via this or future Commission proposals.***

SPECIFIC CONSIDERATIONS

While we have not responded to the detailed questions within the Proposed Rule, we provide perspectives on the key aspects of the specific proposals below.

Five Year Selected Financial Data: Provides Useful Trend Information and Comparable Data and is Not Always Readily Available to Investors

We do not support the proposal to eliminate the requirement to present five years of selected financial data. The SEC's primary rationale for eliminating this requirement appears to be that historical financial information is easily available in the electronic era, and, therefore, the costs of providing the information outweigh the benefits to investors.

While it is true that historical information is much more readily available than when the requirement for this data was introduced, ***the fact remains that such historical information may not be comparable to the reporting standards used in more recent reports – for example, they would not include the effects of discontinued operations or restatements of prior periods***. Consequently, investors would have a difficult time comparing and contrasting current period reporting with how a registrant has evolved — positively or negatively — over the intervening period. We believe it is less of a burden for a single registrant to present this information than for numerous investors to retrieve the information and then in some cases hazard a guess as to how to conform the prior periods to the current period.

At the same time, we believe that investors absolutely benefit from the ability to readily view five years of selected financial data. Five years is more likely to capture the effects that business cycles may have on a registrant's business model than a shorter period would. In addition, while we note that Item 303 specifically calls for disclosure of material trend information, and the Commission has issued guidance emphasizing the need for trend disclosure to be included in MD&A, we have not noted this disclosure being provided by registrants in MD&A to any significant extent, and have certainly not seen evidence of this type of disclosure encompassing a full five-year trend analysis. ***Accordingly, we believe the benefits of retaining this simple requirement far outweigh the relatively minor cost to registrants of providing this information, especially given that the information is readily available to them, and we urge the Commission to retain this requirement***.

Supplementary Financial Data:
Provides Useful Information to Investors Regarding the Fourth Quarter

We do not support the proposal to eliminate the requirement of Item 302(a) to provide two years of selected quarterly financial data. As the Proposal notes, certain of the information provided pursuant to this requirement, such as a separate presentation of certain fourth quarter information and the effect of a retrospective change in the earliest of the two years, is not duplicative of previously provided information, and therefore important information would be lost to investors. For example, where the data changes from what was previously reported, having the revised data in an annual report allows investors to readily understand the effects of the changes if the information were no longer required. More specifically***, absent the existing requirements in Item 302(a)(2), the effect of a retrospective change on the earliest of the two years presented in the Form 10-K would never be presented to investors***.

In addition, ***we agree with the commenter who noted that investors find it useful to see fourth quarter results presented discretely, rather than having to infer them based on the annual results and the interim results through the third quarter***; and in the absence of a Form 8-K filing containing information on the fourth quarter, any numbers derived from this calculation are at best approximate. Again, we believe the proposal to eliminate this information is an example of the SEC shifting the burden from one registrant providing information that is readily available to it, onto many investors who will have to compile the information themselves, which will lead to system-wide inefficiencies and an overall increase in work performed.

Contractual Obligations Table:
A Useful Way to Display a Company's Future Cash Obligations and
Should Be Integrated into the Capital Resources Section

We <u>absolutely do not support the proposal to eliminate</u> the requirement in Item 303(a)(5) to provide <u>a contractual obligations table</u>. The information contained in this table is not duplicative and it is critical to assessing the cadence or funding of liabilities. When the Commission implemented this disclosure requirement, its purpose was to ensure that aggregated information about contractual obligations was presented in one place, and we believe that this rationale still holds true. ***We believe there is significant merit in combining a registrant's various obligations that may be scattered throughout the filing into one user-friendly, central location for the complete display of the entirety of a firm's future cash obligations. This is especially the case during periods of liquidity stress, such as the world economy is currently undergoing with the COVID-19 pandemic when investors find it extremely useful to be able to turn to a single section of a registrant's filing for a snapshot picture of a registrant's future cash commitments***[7]. At the same time, we are not opposed to also hyperlinking the individual line items to the financial statements, and in fact we believe this hyperlinking facilitates

[7] In a recent academic paper, *Towards a Financial Statement Based Approach to Modeling Systemic Risk in Insurance and Banking*, the contractual obligations table was shown to be useful in assessing the potential distress risk of a financial institution hit by a systemic risk.

the reconciliation of the aggregate totals provided in the table to the information provided in the various notes in the financial statements.

We would also note that the preparation of the contractual obligations table is a useful management exercise as it summarizes the obligations in one location and provides management with a picture of such obligations. We know that what gets measured and disclosed is what gets monitored by management. This is another reason to include the table and enhance as we describe elsewhere herein.

Moreover, while we acknowledge that much of the information may be duplicative with information required in the footnotes to the financial statements, there is some information provided that is not required elsewhere, such as commitments regarding purchase obligations. We acknowledge that the Commission would address this by introducing a new requirement to disclose "material contractual obligations" in the Capital Resources section, which would presumably capture these purchase obligations, but we believe it is much simpler to retain the table as is, where these purchase obligations are clearly presented.

We also agree with those who commented that the current table does not go far enough in that it does not provide insight into the registrant's ability to pay its obligations as they become due. Therefore, we encourage the Commission to ***enhance the table*** to require a narrative explanation to accompany the table to address these considerations. To this end, we believe ***that rather than eliminating the table, it should be combined with the Commission's proposal to amend current Item 303(a)(2), Capital Resources, to specify that a registrant should broadly disclose all material cash commitments, rather than merely all its future capital expenditures***. In this way, investors would be able to view a table that summarizes a registrant's future cash commitments in a concise and comparable format which is then elaborated upon by a narrative discussion of what the cash commitments represent and how the registrant intends to meet its commitments as they become due. We believe that this approach would preserve the merits of having a standardized, uniform table that is easily understood by investors while also addressing the need for a discussion of the impacts of these future commitments on a registrant's capital resources.

Separate Discussion of Off-balance Sheet Arrangements:
Helps Investors Understand a Company's Overall Exposures to These Arrangements
We do not support the proposal to eliminate a separate discussion of off-balance sheet arrangements, as required by Item 303(a)(4), with a new requirement to discuss such obligations in the broader context of MD&A. While we support the proposal to require registrants to discuss commitments or obligations arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on such registrant's financial condition, results of operations, liquidity, cash requirements, or capital resources even when the arrangement results in no obligation being reported in the registrant's consolidated balance sheets, we believe that maintaining a separate section devoted to such commitments remains important for investors. ***We are aware that many of the requirements in Item 303(a)(4) overlap with***

U.S. GAAP requirements; however, as the proposal notes, the location of these off-balance sheet disclosures is not prescribed by U.S. GAAP, such that they may be dispersed throughout the notes to the financial statements, and as a result, obtaining a complete picture of an entity's off-balance sheet exposures can be challenging for investors. Accordingly, we do not support the elimination of this section.

At the same time, ***we do not oppose the SEC's requirement to address such off-balance sheet arrangements in the other areas of the filing that they pertain to***. We believe that it is important that registrants integrate a discussion of these exposures into the various other topics they may pertain to, such as the liquidity or capital resources sections, as this will help investors understand how these arrangements fit into the broader context of the registrant's business.

MD&A Disclosure:
Often Does Not Provide Meaningful Analysis of Results and Must Be Improved
We strongly agree that Item 303(a), MD&A, needs to be improved. In our experience, many, if not most, registrants merely present a narrative discussion of changes (increases/decreases) in line items without addressing the underlying reasons why these changes have occurred. We agree with the observation from one commenter that MD&A generally devolves into "an exercise where management provides a quantitative analysis, which most investors can recompute … from the financial statements."

At the same time, we do not believe that the objectives of MD&A as presently set forth are particularly unclear – indeed, the name of the section itself, Management's Discussion ***and Analysis*** of Financial Condition and Results of Operations – clearly conveys the intent of this section. ***While we are not opposed to the proposal to add an "Objective" section to Item 303(a) that explains the purpose of this section, we do not believe that adding this will in and of itself result in a meaningful improvement to registrants' filings***. ***Similarly, the proposal to amend*** current Item 303(a)(3)(iii) and Instruction 4 to Item 303(a) ***to clarify that a registrant should include in its MD&A a discussion of the "reasons underlying" material changes from period-to-period in one, or more, line items, rather than the "cause" for such changes, while not objectionable, seems fairly trivial in nature and unlikely to elicit major changes***.

To ensure that registrants provide a meaningful discussion of the major factors that "cause" of changes in line items, we believe the SEC should be more explicit in its requirements and provide examples of expected items to be discussed in the analysis of such changes. Examples would include, but are not limited to, a discussion of:

a) economic trends and industry conditions that impact sales and costs related to key products and services including whether sales or revenues are attributable to changes in prices or to changes in volume of goods or services that are sold;[8]

[8] In this regard, we support the proposal to modify the instructions to Item 303(a)(3)(iii) to clarify that "material changes" in net sales or revenues, rather than solely "material increases" in these line items, must be attributed to either changes in prices, or to changes in the volume of goods or services sold, as well as the proposal to modify Item 303(a)(3)(ii), results of operations, to require that registrants must disclose known events that are reasonably

b) information on fixed and variable costs in the cost structure;
c) information on primitive value drivers of most businesses such as materials, labor costs and the maintenance capex needed to survive as a business;
d) currency effects on every line item (as they are likely unsustainable in the future);
e) large acquisitions as a separate segment or required discussion so that investors can discern whether the synergies are actually emerging as expected; and
f) the productivity of new investments (capex, R&D) as opposed to older investments.

In addition, we believe to facilitate a more meaningful analysis by registrants, the SEC should <u>require</u> that registrants present a table which shows the quantitative and percentage changes in each line item. Once the information regarding period-to-period changes is presented quantitatively, ***registrants would not be able to fill up the narrative discussion with descriptions of such quantitative changes and would be forced to provide meaningful analysis of the causes driving the changes***.

Finally, we also believe that the ***SEC needs to more rigorously enforce compliance with the requirements of this section***, to ensure that registrants provide a meaningful discussion of the major factors that caused changes in line items.

Comparison of Interim Periods:
Should Remain Standardized but Registrants Should Be Permitted to Provide Additional Analysis to Preceding Periods if More Relevant
We strongly oppose the proposal to modify Item 303(b) to permit registrants a choice of comparing their most recently completed quarter to <u>either</u> the corresponding quarter of the prior year <u>or</u> to the immediately preceding quarter. We believe that the current prescribed disclosures are important for providing uniformity of information essential to making assessments. While we recognize that not all businesses are seasonal in nature, we believe the current requirement strikes a reasonable balance of providing information that is most relevant to investors.

It is our view that if registrants believe that comparison to the immediately preceding quarter is relevant, they already have the flexibility to provide such comparisons on a voluntary basis, and arguably are required to do so if they believe that such trends are more material to their business.

Requirement to Disclose Critical Accounting Estimates:
Should be Codified and the Need to Provide Sensitivity Analyses Should be Reinforced
We ***support the proposal to amend Item 303(a) to explicitly require disclosure of critical accounting estimates***. We believe this disclosure has been helpful to investors to identify areas that are particularly subject to estimation in the financial statements.

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likely to cause a material change in the relationship between costs and revenues, such as known or reasonably likely future increases in costs of labor or materials or price increases or inventory adjustments.

However, it is our experience that while most registrants provide a summary of their critical accounting estimates, many (if not most) registrants do *not* provide a quantitative sensitivity analysis (as set forth in the 2003 MD&A Interpretive Release) of how such estimates would change under different conditions or using different assumptions. We believe compliance with this aspect of the disclosure is crucial for investors, as it gives them a better sense of how results are affected by management's estimates. Accordingly, we believe that the Commission should reinforce the need for such disclosure in its codification of this requirement, perhaps by including additional quantitative examples, and should also step up its enforcement of this requirement in its ongoing review of registrant filings.

In addition, we urge the Commission to ***require that information regarding Critical Accounting Estimates be electronically tagged.*** With the introduction this year of Critical Audit Matters (CAMs), ***some investors will want to compare the disclosure of such CAMs to registrants' critical accounting estimates***, and it is a fairly cumbersome process to do so if such information is not provided in machine-readable format.

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Thank you again for the opportunity to provide our input on this Proposed Rule. If you or your staff have questions or seek further elaboration of our views, please contact either of us at [redacted] or [redacted] or by email at [redacted] or [redacted]

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters CPA, CFA
Senior Head, Global Financial Reporting Policy
CFA Institute

/s/ Jeffrey P. Mahoney

Jeff Mahoney Esq., CPA
General Counsel
Council of Institutional Investors

cc:

The Honorable Jay Clayton, Chairman, U.S. Securities and Exchange Commission
The Honorable Commissioner Hester M. Peirce, U.S. Securities and Exchange Commission
The Honorable Commissioner Elad L. Roisman, U.S. Securities and Exchange Commission
The Honorable Commissioner Allison Herren Lee, U.S. Securities and Exchange Commission

Mr. William H. Hinman, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission

Mr. Sagar Teotia, Chief Accountant, U.S. Securities and Exchange Commission
Mr. Rick Fleming, Investor Advocate, U.S. Securities and Exchange Commission