



NORTH CAROLINA

DEPARTMENT OF STATE TREASURER

JANET COWELL, TREASURER

July 21, 2016

Via Electronic Submission

Mr. Brent J. Fields
Secretary
United States Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-06-16, Request for Public Comments on the Securities and Exchange Commission's Disclosure Effectiveness Initiative

Dear Mr. Fields:

The North Carolina Department of State Treasurer respectfully submits this letter regarding the "Disclosure Effectiveness Initiative" of the United States Securities and Exchange Commission (SEC). Our letter raises general considerations about the scope, content, and format of disclosure and provides a particular recommendation regarding board nominee disclosures in proxy statements.

The North Carolina Department of State Treasurer submits this letter in service of the fiduciary duty under N.C.G.S. § 147-69.7 to invest and manage funds of the North Carolina Retirement Systems solely in the interest of the participants and beneficiaries and in a manner that is consistent with statutes, regulations, and policies.¹

Creation of an Independent Body to Periodically Review Disclosure Requirements²

Markets and technologies change, and we believe that disclosure requirements should also evolve. Adaptation over time is necessary to ensure that disclosure requirements effectively reduce information asymmetry by making material facts equally transparent to investors.

¹ The North Carolina Retirement Systems currently encompass the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, the North Carolina National Guard Pension Fund, the Legislative Retirement Fund, and the Retiree Health Benefit Fund. These funds are invested by the Department of State Treasurer under authority granted by law to the Treasurer of the State of North Carolina.

² As requested by the Commission, we indicate throughout our comment the Commission questions to which our comments pertain. This section of our letter relates primarily to Question #5: "Are there other ways our disclosure requirements could be revised to adapt more easily to future market changes and technological advancements?"

The SEC raises a series of questions about the costs and benefits of automatic sunset provisions for disclosure requirements. Instead of automatic sunset provisions, we believe that a better method for evolving these requirements would be creating an independent body to periodically review the scope, content, and format of disclosure.³

One important advantage of an independent review body relative to automatic sunset provisions is that disclosures continue unless the body rescinds them, instead of the disclosures ending unless the SEC overrides an automatic sunset provision. We believe that disclosures will remain more useful to investors over time if a substantive review is required to change or eliminate requirements, instead of automatic termination or continuation.

An independent review body has several additional advantages. It would be much more adaptable than an expiration provision for addressing future market changes and technological advancements. The independent review body could shape and improve disclosure requirements, balancing benefit and cost, not solely decide to continue or retire specific rules.⁴ Many of those concerns come up in the SEC's questions as part of this Disclosure Effectiveness Initiative, such as:

- What types of disclosure requirements should include automatic sunset provisions?
- What factors should we consider in identifying them?
- What would be an appropriate length of time for any sunset provisions?
- Would this length of time vary with the nature of the rule in question?⁵

We believe that these questions inherently involve discretion and judgment. These considerations are very important because they can help the disclosure system evolve, but we do not believe that they are suitable to proscribed duration periods.

Cost effectiveness is an important consideration in how investors use the information contained in registrants' disclosures. However, cost effectiveness is not a formula that we expect can be integrated effectively into automatic sunset decisions. An independent review body would be able to use its discretion to answer questions like: Cost-effective for whom? And how?

We favor charging this body with evaluating net benefit to investors. Specifically, this standard would consider disclosures in terms of whether they may benefit investors, including but not limited to factoring in the benefit to investors in investment decision-making, costs to investors to consume the information, and the cost to shareholders of complying with the disclosure requirements. Evaluating a "net investor benefit" standard

³ Question #1: "Should the Commission consider including automatic sunset provisions in new disclosure requirements?"

⁴ Question #2: "What are the advantages and disadvantages of automatic sunset provisions?"

⁵ These questions are contained in the Commission's paragraph numbered as Question #1.

requires discretion, judgment, and knowledge of different investors' needs – qualities that a review body is well equipped to offer. Information that may be helpful for some will not be helpful for all and, in fact, it may harm their interests by being a distraction, obfuscation, or creating a dead weight cost to the registrant. Additionally, the “net investor benefit” standard helpfully can vary based on the format and method of disclosure since format and method affect investors' costs of consuming information.

Format and Use of Disclosure⁶

One reason why disclosure regulation should evolve is investors' growing capacity to analyze very large data sets. This capacity allows institutional investors who hold thousands of equity and credit positions to understand the comparative context of these investments much more clearly, but investors' use of these analytical tools depends on the way in which registrants disclose information. Investors would benefit from registrants using consistent methods for calculating the same data points and registrants then publishing this data in a format suited for computer-based quantitative analysis.⁷

The SEC should revise its rules to require disclosure that is formatted to facilitate investment and voting decisions. Disclosures that have different formats and are dense with descriptive responses are not helpful when we, as an institutional investor, want to evaluate companies relative to one another. It may also be harmful when important information gets obfuscated. One way to hide a needle is to create a haystack, and the current range of format options makes it possible to create an information haystack. Registrants' current disclosures often focus on descriptive responses and lack machine-readability.

Scale is a key reason why institutional investors need for registrants to disclose material information in a well-formatted and uniform way. We believe that disclosure regulations should be designed to allow an investor to compare and contrast information readily and quickly across thousands of companies, and this function depends on disclosure information being streamlined, tabular, and machine-readable. For example, the North Carolina Department of State Treasurer has petitioned the SEC, together with eight other institutional investors, for a rule that would require registrants to standardize their disclosure of board composition using a matrix format.⁸

⁶ Question #320: “How could we facilitate or encourage better presentation of disclosure by registrants?”

⁷ Question #321: “Would further prescribing the order and format for presenting information in annual or quarterly reports improve readability or increase comparability across registrants? Would such standardized requirements enhance the ability of investors and third parties to use disclosures, including for large-scale processing and analyses, in a more timely and efficient way?”

⁸ Question #324: “Should we revise any of our current disclosure rules to require a standardized tabular or graphic presentation rather than, or in addition to, the narrative disclosure we currently require? Which disclosures could be improved by a requirement for tabular or graphic presentation? Would such a presentation improve comparability of disclosure across registrants?”

Computing and formatting disclosure data in these ways would allow institutional investors to use EDGAR more as a primary source and to use third-party aggregations and analyses less. Even in these circumstances, institutional investors will continue using third-party firms as an important source of analysis. Third-party analysts are often focused on narrower and deeper issues than investors, who have to synthesize a broader range of inputs. As a result, we believe that the SEC should also consider how these third parties use regulatory disclosures as a separate factor for choosing how to scope and construct those disclosures.^{9,10}

Amendment of Proxy Rule Regarding Board Nominee Disclosure

Investors increasingly use information about how boards are composed to evaluate the quality of a company's governance, and investors need this information about tens of thousands of people to be formatted for computer-based analysis.¹¹ These points underpin our April 2015 petition to the SEC for rule making about how registrants disclose the composition of their boards.¹²

Our underlying belief is that boards which include directors of diverse backgrounds and experiences will think more critically and better govern their companies. Investors need transparent and standard information about boards' composition in order to evaluate registrants' board nominees effectively.

We take this opportunity to reiterate our specific goal. It is our recommendation that the SEC amend Item 407(c)(2)(v) of Regulation S-K to require registrants to use a chart or matrix to disclose their board nominees' gender, race, ethnicity, skills, experiences, and qualifications.¹³ This specific disclosure will provide investors with necessary information to evaluate whether the prospective director nominees bring the requisite attributes and skills to the board.

Currently, Item 407(c)(2)(v) of Regulation S-K requires registrants to identify the minimum skills, experiences, and attributes that all board candidates and nominees are expected to possess. This current disclosure presents a challenge because it is difficult for investors to determine racial, ethnic, and gender diversity of directors and director nominees. Although some corporations provide aggregate board diversity information, board level data

⁹ Question #19: "To what extent should the reliance of certain investors on market prices or third-party analyses, rather than using disclosure directly, be a factor in determining the type of investor to which disclosures should be targeted?"

¹⁰ Question #20: "To what extent should we consider the needs of other market participants, such as professional securities analysts and other third parties, in revising our disclosure requirements? What would be their needs?"

¹¹ Question #320: "How could we facilitate or encourage better presentation of disclosure by registrants?"

¹² Cowell, Janet, et al. "Petition for Amendment of Proxy Rule Regarding Board Nominee Disclosure – Chart/Matrix Approach," 31 March 2015, available at <https://www.sec.gov/rules/petitions/2015/petn4-682.pdf>.

¹³ Question #324: "Should we revise any of our current disclosure rules to require a standardized tabular or graphic presentation rather than, or in addition to, the narrative disclosure we currently require?"

is not available for all companies, and individual director diversity attributes are not uniformly reported.¹⁴ As a result, investors who are concerned with gender, racial, and ethnic diversity must do their own investigation to obtain this information. This work can be time consuming, expensive, and fraught with inaccuracies.

Our proposed revision would require registrants to indicate each nominee's gender, race, ethnicity, skills, experiences, and attributes in a chart or matrix. We propose amending Regulation S-K of the Securities Act of 1933 (last amended December 16, 2009, effective February 28, 2010), 17 C.F.R. § 229.407(c)(2)(v), as follows [added language is underlined]:

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, and describe any specific qualities or skills that the nominating committee believes are necessary for one or more of the registrant's directors to possess. When the disclosure for this paragraph is presented in a proxy or information statement relating to the election of directors, these qualities, along with the nominee's gender, race, and ethnicity should be presented in a chart or matrix form.

Composition of Independent Review Body to Encompass Perspectives on Scope, Content, and Format

All of our comments come together regarding an important question the composition of the independent review body that we have proposed. If the SEC adopted this proposal, we believe that it should include investors, registrants, and third-party analysts. This is an inclusive model, and we propose it with two goals in mind. One is to make regulatory disclosure decisions with the benefit of a wide range of perspectives. The other is to create an institutional forum for investment-related dialogue among these parties. Here we emphasize "investment-focused": our highest priority in sending this comment is to elevate the priority on transparency as an input for investment.

An independent review body tasked with reviewing disclosure effectiveness is most likely to be effective itself if it is composed deliberately, provided with a strong Chair for leadership, and has set its rules to elicit collaboration.

¹⁴ See Catalyst Alliance for Board Diversity, *Missing Pieces: Women and Minorities on Fortune 500 Boards – 2012 Census*, (2013): http://www.catalyst.org/system/files/2012_abd_missing_pieces_final_8_15_13.pdf. Although some data is reported by company for organizations with 40% or more diversity, gender, race, and ethnicity are not reported for specific board members.

Conclusion

The SEC's Disclosure Effectiveness Initiative addresses a very important priority for investors and comes at a pivotal time in the progress of technology, the use of data, the foresightedness of registrants and investors alike, and the standards of corporate governance.

The North Carolina Department of State Treasurer appreciates the opportunity to comment on the Disclosure Effectiveness Project. It is our belief that investors need more and better information from registrants about director nominees in order to evaluate how individual directors can function together as a critical-thinking unit. More generally, we believe that it is essential for registrants to format their disclosures to facilitate investment and proxy voting decisions. Participants and beneficiaries of retirement plans, including those of the North Carolina Retirement Systems, have a significant interest in these revisions.

Sincerely,

A handwritten signature in blue ink that reads "Janet Cowell". The signature is fluid and cursive, with a large initial "J" and "C".

Janet Cowell

Treasurer of the State of North Carolina