

# The Reardon Firm

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## INTERNET FILING

Brent J. Fields, Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

Re: **Release No. 33-10425; 34-81851; IA-4791; IC-32858; File No. S7-08-17**<sup>1</sup>

Dear Mr. Fields:

On September 13, 2017, the Securities and Exchange Commission's Advisory Committee on Small and Emerging Companies held its final meeting. The SEC will replace this Advisory Committee with the new statutorily established Small Business Capital Formation Advisory Committee.<sup>2</sup>

At this meeting, the Advisory Committee adopted a final report that included recommended areas for consideration by the new committee.<sup>3</sup> As part of the recommendation on scaling disclosure requirements, the Advisory Committee suggested consideration of a study of investors to assess the information investors consider important (*i.e.*, "material") in making investment decisions. The report continued

*such a study would enhance the Commission's ability to make disclosure more relevant to investors, help the Commission meet its obligation to conduct economic analysis, and determine materiality.*<sup>4</sup>

### **After 84 Years**

Eighty-four years after the enactment of the Securities Act of 1933, it is time to have an empirical analysis of what is it that investors consider material. In other words, what information in prospectuses, annual and quarterly reports, proxy statements, and other SEC filings do investors consider important? The methodology exists to determine this, and the study is long overdue. Judges, SEC commissioners and staff, members of Congress, securities professionals and business people all have *opinions* on what is material, but no one seems to have surveyed investors, the people making investment decisions.

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<sup>1</sup> A form of this letter was published on the *Crowdfunding Insider* website. <https://www.crowdfundinsider.com/2017/11/125089-time-empirical-analysis-securities-disclosure/>

<sup>2</sup> I was a member of this advisory committee in 2016 and 2017. The opinions and statements here are exclusively mine. I do not speak for any other person.

<sup>3</sup> Available at <https://www.sec.gov/info/smallbus/acsec/acsec-final-report-2017-09.pdf>.

<sup>4</sup> *Id.* at pp. 14-15. Footnote omitted.

The U.S. Supreme Court has given us a standard for materiality.

*An omitted fact is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to invest.*<sup>5</sup>

Frankly, to a business person, this standard is about as clear as mud. Even securities professionals disagree about how to apply the rule to actual situations.

At the same time, the SEC has its own detailed disclosure requirements for public companies and companies about to go public. This disclosure framework continually expands its requirements. Ever-expanding requirements make SEC-mandated disclosures increasingly burdensome and expensive. Investors regularly complain about seemingly interminable disclosure documents that are not reader-friendly. These requirements and the related costs are driving down the number of IPOs and total public companies.

Now is the time for empirical information showing what investors consider important. The findings would be useful to the SEC as it reviews the current disclosure requirements. In its final report, the outgoing Advisory Committee noted the SEC's "statutory obligation to assess the economic consequences of its rule[s]".<sup>6</sup> This duty includes considering "sufficient empirical data" to make an analysis.<sup>7</sup> Eliminating disclosure of non-material information will reduce public company expenses and discharge the SEC's duty to "promote company efficiency, competition, and capital formation."

Further, results of such a study would be important evidence of materiality in future litigation. An extra bonus would be that whenever a special interest group or Congressperson advocates a new disclosure, there would be evidence, not opinions, as to whether real investors consider that information to be material.

Of course, the study will not answer all questions of materiality. It would, however, answer many questions and offer useful insight into the thinking of real investors.

For example, executives of public companies tell me that analysts are not interested in many of the disclosures currently required. Also, they say that investors want more non-GAAP financial information. An objective study would reveal if these statements are representative of investors' views.

### **Considerations**

I caution that there are important considerations relating to an empirical study of materiality. First, as I said before, the right persons must be surveyed. This means the persons who make investment decisions, not their bosses in the front office, not government or elected officials, not advocacy groups, etc.

The goal in conducting the survey should be to consider only comments from a cross section of the real people who make investment decisions. Others may feel that they have a reason for wanting a favorite disclosure, but the securities laws exist to govern the relationship between issuers

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<sup>5</sup> See, *TSC Industries, Inc. v. Northway, Inc.* 426 U. S. 438 (1976); *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

<sup>6</sup> *Business Roundtable v. SEC*, 647 F.3d 1144, 1150 (DC Cir. 2011), citing Section 3(f) of the Securities Exchange Act and Section 2(c) of the Investment Company Act of 1940. Both these statutory provisions require that, in addition to the protection of investors, the SEC must consider "whether the action will promote efficiency, competition, and capital formation."

<sup>7</sup> *Id.*



(largely companies) and their investors. Of course, total isolation from extraneous influences will never be fully possible. However, the closer the study is to that goal, the more useful the results will be.

Second, the analysis must be independent and objective. Often studies, particularly those emanating from academia, begin with the desired conclusions and build the “facts” to support those conclusions. That kind of “study” is neither objective nor helpful.

Also, questions can be slanted to suggest specific responses. The questioners need to have a knowledge of business and investing, as well as a knowledge of testing methodology. Most people are not qualified to make these inquiries.

Third, much of the existing disclosure system is based on various opinions on materiality. Judges, regulators, members of Congress, academics, investors, professionals—all have different opinions. An in-depth study should start with a blank sheet of paper. This means ignoring for the moment judicial and administrative pronouncements on materiality and instead looking to the survey results. After all, judges, politicians, and government employees are not in the business of making investments. That is what investors do.

Supplanting existing opinions with facts may be volatile. Advocates for specific disclosures are likely to object if a study shows that investors do not consider a favorite disclosure important.

If the don't-distract-me-with-the-facts crowd blocks an SEC-funded study, it may be necessary to find an extra-government organization for this study. Universities, investment groups, and business groups all might be possible sponsors. I hope that someone in this group could be persuaded to fund this study, if necessary

Fourth, an analysis such as I have described will be expensive.

Fifth, the Commission must be willing to accept the study's findings, whatever they may be. It is foreseeable that certain people will be unhappy if the facts show that investors could not care less about a favored disclosure or if investors want to receive more non-GAAP information. Having evidence pointing to what disclosures investors deem material will enable the SEC to make informed decisions consistent with the Commission's legal duties.

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No doubt a study like this will invoke discussion. However, the world's greatest capital markets deserve a disclosure system finally built on facts not opinions.

Sincerely yours,



Patrick A. Reardon

P.S., I feel compelled to note the irony of a release that is 253 pages while claiming key goals are to simplify disclosures and to reduce issuers' costs and burdens.