Council of Institutional Investors®
The voice of corporate governance

August 30, 2016

By email: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Release No. 33-10107, *Amendments to Smaller Reporting Company Definition*

Dear Office of the Secretary:

The Center for Audit Quality ("CAQ") is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs. This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The Council of Institutional Investors ("CII") is a nonprofit nonpartisan association of public, corporate, and union pension funds, and other employee benefit plans, foundations and endowments with combined assets that exceed $3 trillion. Our member funds are major, long-term investors committed to protecting the retirement savings of millions of American workers. CII also has associate members, including CAQ and asset managers with more than $20 trillion in assets under management. CII is the leading voice for effective corporate governance and strong shareowner rights.

The CAQ and CII appreciate the opportunity to comment on the Securities and Exchange Commission's ("Commission" or "SEC") proposal, *Amendments to Smaller Reporting Company Definition* (the "Proposal"). We recognize the Proposal would generally increase the number of companies that can qualify as a smaller reporting company ("SRC") and the intent of the Proposal is to promote capital formation and reduce compliance costs for smaller companies while maintaining investor protections. We support this intent.

In the Proposal the Commission specifically asks the following questions:

15. If we increase the thresholds in the smaller reporting company definition, should we eliminate the provision in the accelerated and large accelerated filer definitions that specifically excludes registrants that are eligible to use the smaller reporting company requirements under Regulation S-K for their annual or quarterly reports, as proposed? Why or why not?

The Proposal would retain the existing $75 million public float threshold for determining whether a company is an accelerated filer as defined in SEC Exchange Act Rule 12b-2 (17 C.F.R. 240.12b-2). In the spirit of investor protection and to avoid indirectly increasing the accelerated filer public float threshold to $250 million, the Proposal also includes an amendment to the accelerated filer definition to eliminate a previous provision that an accelerated filer cannot be an SRC. We strongly support the amendment to the accelerated filer definition proposed by the Commission as it maintains the current accelerated filer public float threshold and provides for the continued protection to investors of approximately 750 additional companies that would qualify for SRC status under the Proposal. As the Commission is aware, this is an important distinction as compliance with Section 404(b) of the Sarbanes Oxley Act ("Section 404(b)")[1] is required for accelerated filers that are not emerging growth companies. We believe increasing the public float threshold for accelerated filers would have a negative impact to investors for the reasons stated below in response to question 16.

16. If we increase the public float threshold in the smaller reporting company definition as proposed, should we also increase the public float threshold in the accelerated filer definition? Why or why not?

We continue to oppose any amendments that would erode Section 404(b) or increase the accelerated filer public float threshold. We believe that any amendment that erodes Section 404(b) would substantially impact the quality of financial reporting by public companies to the detriment of investors and our capital markets more generally. As outlined in our May 6, 2014, letter to the House Financial Services Committee, any change in the accelerated filer threshold that would exempt public companies with public float below $250 million from complying with Section 404(b) would include companies that are important to investors and the capital markets at large. We believe Section 404(b) continues to be significant as it provides investors with reasonable assurance from the independent auditor that a company maintained effective internal control over financial reporting. This assurance is an important driver of confidence in the integrity of financial statements and in the fairness of our capital markets. A Government Accountability Office report found that companies exempted from Section 404(b) experience more financial restatements, as compared to nonexempt companies; and the percentage of exempt companies restating has generally exceeded that of nonexempt companies[2]. According to this report, companies that obtained an auditor attestation generally had fewer financial restatements than those that did not.

Complying with Section 404(b) has a benefit for issuers. Academic research has demonstrated that the cost of capital for companies that voluntarily comply with Section 404(b) is lower than peer companies[3] and has decreased for public companies since enactment of the Sarbanes-Oxley Act, especially for smaller companies[4].

Lastly, while the cost of compliance with Section 404(b) is often cited as a concern by issuers, an SEC study[5] concluded that such costs have declined by approximately 30 percent after the PCAOB adopted

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[1] The Sarbanes-Oxley Act requires that the management of public companies assess the effectiveness of the internal control of issuers for financial reporting. Section 404(b) requires a publicly-held company's auditor to attest to, and report on, management's assessment of its internal control over financial reporting.

[2] Report released by the Government Accountability Office (GAO) entitled *Internal Controls, SEC Should Consider Requiring Companies to Disclose Whether They Obtained an Auditor Attestation (July 2013)*, which can be found at http://www.gao.gov/assets/660/655710.pdf

[3] Cassell, Cory A., Myers, Linda A. and Zhou, Jian, The Effect of Voluntary Internal Control Audits on the Cost of Capital (February 12, 2013)

[4] Stephen, Sheryl-Ann and de Jong, Pieter J, The Impact of Sarbanes-Oxley Act (SOX) on the Cost of Equity Capital of S&P Firms (2012). Journal of Applied Business and Economics vol. 13(2) 2012

[5] Report issued by the SEC in 2011 entitled *Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 For Issuers With Public Float Between $75 and $250 Million*, which can be found at http://www.sec.gov/news/studies/2011/404bfloat-study.pdf

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, and the SEC issued management guidance on Section 404(a) in 2007.

In the interest of shareowners and potential investors, the CAQ and CII strongly support the Proposal as currently constituted and oppose any efforts that would further weaken Section 404(b).

Sincerely,

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Jeff Mahoney
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Council of Institutional Investors

cc:

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