

Testimony on “Oversight of the SEC’s Division of Corporation Finance”

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**Before the
United States House of Representatives Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises**

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Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for inviting me to testify today on behalf of the U.S. Securities and Exchange Commission (Commission) about the Division of Corporation Finance’s (Division) activities and responsibilities.

The mission of the Commission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. The Division promotes this mission by overseeing the agency’s review of company disclosure to the investing public and seeking to ensure that investors have access to materially complete and accurate information upon which to make voting and investment decisions. The Division also promotes this mission by reviewing registered securities transactions and administering the regulations under which exempt offerings are conducted.

The Division’s authority is derived primarily from the Securities Act of 1933 and the Securities Exchange Act of 1934 (Exchange Act).

While not descriptive of the full scope of the Division’s initiatives and mandates, generally the Division carries out its mission in three areas: selectively reviews company filings, provides interpretive advice to market participants and the public about the securities laws and corresponding regulations, and makes rulemaking recommendations to the Commission on matters within the Division’s expertise. Below is an overview of those activities.

Review of Filings

The Division regularly and systematically reviews the disclosures and financial statements of reporting companies to monitor and enhance compliance with disclosure and accounting requirements. The Sarbanes-Oxley Act of 2002 requires the Commission to review the disclosures and financial statements of companies reporting under the Exchange Act at least once every three years and more frequently where circumstances warrant. In addition to these mandated reviews, the Division selectively reviews registration statements and other filings made for public offerings, business combination transactions, and proxy solicitations. The Division’s staff has broad discretion to select filings for review. While the Division does not

publicly disclose detailed information about the selective review criteria, they include both transaction and company matters as well as matters relating to shareholder rights.

The Division consistently exceeds the mandated Sarbanes-Oxley Act requirement by reviewing the disclosure of many companies more often than once every three years. In so doing, we remain focused on the financial statements and disclosures of the approximately 2,500 companies that comprise nearly 98% of total market capitalization. During fiscal 2013, the Division reviewed the filings of more than 4,500 reporting companies. Based upon our work in the first nine months of fiscal 2014, I expect our reporting company review statistics will be comparable this year.

The staff members conducting filing reviews are assigned to one of thirteen offices and have specialized industry, accounting, and disclosure expertise. In the course of a filing review, the Division's staff will conduct an evaluation of company disclosure and will, as appropriate, issue comments to elicit better compliance with applicable disclosure requirements. In response to staff comments, a company may amend its financial statements or other disclosures to provide additional or enhanced information in the filing that is subject to the review or, in some instances, may provide improved disclosure in future filings. A company may also provide supplemental information so the staff can better understand the company's disclosure decisions. The Division coordinates with other offices and divisions within the Commission on complex or interconnected issues that arise within these reviews. Where appropriate, the Division refers matters to the Commission's Division of Enforcement.

To increase the transparency of the filing review process, after the Division completes a filing review the comment letters and company responses to those letters are made public on the SEC website. Each comment letter is designed to elicit more effective disclosure based on the specific facts and circumstances of the company and should not be interpreted as generally applicable to all companies. The Division also continues to look at ways to improve the quality and consistency of our comments as well as the overall effectiveness of our filing review process.

Interpretive Advice

The Division also provides advice to market participants and the public through interpretive releases, staff legal and accounting bulletins, the Division's financial reporting manual, no-action and interpretive letters, compliance and disclosure interpretations, and staff disclosure guidance topics. All of these are available on the Commission's website. In addition, the Division provides responses to thousands of telephone and e-mail inquiries from investors, companies, and other market participants. In addition, each year the Division responds to over 400 no-action letter requests, including over 300 requests relating to shareholder proposals.

Proxy Advisory Firm Guidance

A recent example of the interpretive advice the Division provides is a staff legal bulletin on proxy advisory firms issued last month along with the Commission's Division of Investment Management. Proxy advisory firms participate in the proxy process by, among other things,

assisting institutional investors and investment advisers in analyzing and making voting recommendations on the various matters that are presented for shareholder approval. The Commission sought information about the role of proxy advisory firms in the proxy process in a concept release in 2010 and at a public roundtable that the Commission held last December. The staff legal bulletin issued on June 30, 2014 provides guidance on the availability and requirements of two exemptions from the federal proxy rules that are often relied upon by proxy advisory firms. It also provides guidance about investment advisers' responsibilities under the Investment Advisers Act of 1940 in voting client proxies and retaining proxy advisory firms.

Rulewriting

The Division also recommends to the Commission new rules or changes to existing rules and, in doing so, collaborates with staff from across the agency, including staff from the Division of Economic and Risk Analysis. The Division's recent rulewriting activities have focused primarily on implementation of the mandatory rulemaking provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and the Jumpstart Our Business Startups Act (JOBS Act). These rulemakings have involved a substantial effort, which I will briefly summarize.

Dodd-Frank Rulemaking

Since the passage of the Dodd-Frank Act, the Division has been involved in numerous rulemakings the Commission has adopted, including, among others, final rules on revising the definition of "accredited investor" to exclude the value of a person's primary residence, say-on-pay and say-on-frequency votes for executive compensation, disclosures about representations and warranties and asset-level review of asset-backed securities, compensation committee listing standards and disclosure, disqualification of felons and other bad actors from certain offerings, and specialized disclosure related to mine safety and conflict minerals. Most recently, the Division made recommendations for two rule proposals that the Commission voted to publish for public comment:

- *Credit Risk Retention.* The Commission is working with multiple federal regulators to jointly develop risk retention rules, as required by Section 941 of the Dodd-Frank Act. These rules will address the appropriate amount, form, and duration of required risk retention for securitizers of asset-backed securities. In March 2011, the Commission joined its fellow financial regulators in proposing rules to implement Section 941 and, after receiving and reviewing extensive public comment, in August 2013 re-proposed these rules with several significant modifications. The staff currently is considering the numerous comments received on the re-proposal and working with the other agencies' staff in developing appropriate recommendations for a final rule.
- *Pay Ratio Disclosure.* As required by Section 953(b) of the Dodd-Frank Act, in September 2013 the Commission proposed rules that would amend existing executive compensation rules to require public companies to disclose the ratio of the compensation of a company's chief executive officer to the median compensation of its employees. The Commission has received over 128,000 comment letters on the proposal, including

more than 950 unique comment letters. Division staff is carefully considering those comments and is preparing recommendations for the Commission for a final rule.

The Division, along with other Commission staff and the Commission, also continues work to finalize rules relating to the offering process, disclosure, and reporting for asset-backed securities. Further, the Division continues to work to implement provisions of the Dodd-Frank Act relating to executive compensation matters and payments by resource extraction issuers. Finally, the Division and other Commission staff currently are conducting a review of the accredited investor definition, as mandated by Section 413 of the Dodd-Frank Act.

JOBS Act Rulemaking

The Division also is responsible for preparing recommendations on most of the Commission mandates under the JOBS Act, and rulewriting teams in the Division have been working to complete these mandates in collaboration with other Commission staff.

- In July 2013, the Commission adopted the final rules under Title II of the JOBS Act to allow general solicitation and general advertising for offers and sales made under Rule 506, provided that all securities purchasers are accredited investors and issuers take reasonable steps to verify their status. The rules became effective in September 2013. At the same time it adopted these rules, the Commission issued a rule proposal designed to enhance our ability to assess the development of market practices in Rule 506 offerings and address investor protection concerns that may arise with the use of general solicitation by issuers. The Commission has received over 860 comment letters on the proposal, including more than 550 unique comment letters, and the Division is working on recommendations for the Commission.
- In October 2013, the Commission proposed rules to implement Title III of the JOBS Act to provide a new exemption for the offer and sale of securities through crowdfunding, an evolving method to raise capital using the Internet. The Commission has received over 300 comment letters and the Division is preparing recommendations for the Commission on final rules.
- In December 2013, the Commission proposed rules to implement Title IV that would build upon existing Regulation A, which is an exemption from registration for small offerings of securities, to enable companies to offer and sell up to \$50 million of securities within a 12-month period. The Commission has received over 100 comment letters and the Division is preparing recommendations for the Commission on final rules.
- The Division also is preparing recommendations for the Commission to implement the changes made by Titles V and VI with regard to the thresholds for registration and deregistration under Section 12(g) of the Exchange Act, which were effective immediately upon enactment of the JOBS Act.

Study and Review of Public Company Disclosure Effectiveness

Over the years, the Commission and its staff have undertaken efforts to modernize, simplify, and otherwise make disclosure more effective. In December 2013, as required by Title I of the JOBS Act, Commission staff submitted to Congress a report in which the staff presented its review of Regulation S-K. The report described the historical development of the current disclosure regime, and recommended further efforts to study the disclosure rules to determine how the rules may be modernized, made more effective, and simplified to reduce the costs and other burdens for emerging growth companies, while simultaneously improving the readability and navigability of disclosure documents for investors.

Following the issuance of the report, Chair White directed the staff to develop specific recommendations for the Commission's consideration to update the rules in Regulations S-K and S-X that specify what a company must disclose in its filings. The Division is leading the Commission staff's efforts in this regard. The goal is to comprehensively review the requirements and make recommendations on how to update them to facilitate timely, material, and more meaningful disclosure by companies to their shareholders. As part of this review, the Division will consider ways to enhance the presentation and communication of information to shareholders, including how the use of technology can play a role in facilitating shareholders' access to information. Initially, the Division is focusing its review on the business and financial disclosures required by periodic and current reports, including Forms 10-K, 10-Q, and 8-K. As part of this review, staff members are coordinating with the Financial Accounting Standards Board to identify ways to improve the effectiveness of disclosures in corporate financial statements and to minimize duplication with other existing disclosure requirements. Subsequent phases of the project will include compensation and governance information included in proxy statements.

A key component of the Division's review includes public outreach. The staff is seeking input from a broad range of companies, investors, and other market participants on how to improve disclosure and make it more effective and meaningful for investors.

Conclusion

Thank you again for inviting me to discuss the Division's activities and responsibilities. I also would like to emphasize that the overview that I have shared with you today does not fully capture the tremendous commitment of the staff of the Division to our mission of investor protection and capital formation. I am happy to answer your questions.