



U.S. Securities and Exchange Commission

Remarks at The SEC Speaks in 2013

by

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U.S. Securities and Exchange Commission

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Thank you, Craig [Lewis], for the kind introduction and for your leadership of the SEC's division of economists, the Division of Risk, Strategy, and Financial Innovation (Risk Fin). I commend Risk Fin's economic analysis, including the work the division does to help us integrate data into the Commission's decision making.

Needless to say, it is not just our economists who have been working hard. The entire SEC staff has continued to show its diligence, professionalism, and dedication in advancing the agency's mission. So I want to say "thank you" to everyone at the Commission for all that you do on behalf of the American public. The SEC remains a great agency because of your commitment and determination.

Before beginning the rest of my remarks, let me remind you that the views I express here today are my own and do not necessarily reflect those of the Securities and Exchange Commission or my fellow Commissioners.

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Disclosure is the cornerstone of the federal securities laws. For nearly 80 years, the SEC's signature mandate has been to use disclosure to promote transparency. In his March 29, 1933, message to Congress, President Roosevelt said about the mandatory disclosure regime that would come to characterize federal securities regulation:

Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit.

There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

The proposal adds to the ancient rule of caveat emptor, the further doctrine, "let the seller also beware." It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.¹

The essence of the disclosure philosophy of securities regulation is that investors, when armed with information, are well-positioned to evaluate their investment opportunities and to allocate their capital as they see fit. When investors are able to make informed decisions, it is more likely that the capital that fuels our economy will finance more productive enterprises than if investors did not have the benefit of useful information when deciding how to invest.

In addition, as then-Professor (now Justice) Stephen Breyer explained years ago, although

it may require certain disclosures, disclosure regulation, as compared to other forms of regulation, “does not regulate the production processes, the output, price, or allocation of products, or otherwise restrict the influence of individual choice in the marketplace as directly.”² Applying this sentiment to the federal securities laws, I would highlight as a virtue of the tradition of disclosure regulation that it does not prohibit issuers from raising capital just because the government is skeptical of an offering’s merits, does not dictate corporate governance arrangements, does not require that companies be run in a certain way by mandating or banning particular activities, and does not contemplate that the government will pick winners and losers or bail out a firm that is failing because of its troubled business. In other words, as a regulatory mechanism, what disclosure does is promote investor choice, favor private ordering over one-size-fits all directives, and encourage innovation and competition. The disclosure philosophy of securities regulation defers to the judgment of the marketplace by allowing investors to evaluate for themselves how they want to invest and with whom they want to transact.

More to the point, mandatory disclosure, by ensuring that investors have the important information they need to make informed judgments,³ leverages market discipline as a means of accountability that obviates the need for more substantive government regulation of our financial markets. Through their investments, investors are able to bring pressure to bear on directors and officers — the individuals who are charged with managing an enterprise — to serve the best interests of investors. More specifically, transparency enables investors to better evaluate the financial condition and performance of companies and to invest in ways that support well-run businesses while exiting or pressing for change at firms that are struggling to compete or that take undue risks. Directors and officers, therefore, are incentivized to run the business profitably because investors’ capital allocation decisions effectively “reward” and “punish” corporate behavior.⁴ It is worth noting that this market discipline dynamic is part and parcel of the critique against identifying certain financial institutions as “too big to fail.” Namely, the efficacy of the market discipline that good disclosure enables is undercut if investors have reason to believe that the government will backstop a firm that is failing.

From what I have described, it should be apparent that disclosure regulation stands in sharp contrast to the extensive regulatory burdens, commands, and restrictions that make up the Dodd-Frank Act — sweeping legislation that is spawning reams of new rules and regulations that I worry will overregulate our financial system and in turn suppress our country’s economic growth. Dodd-Frank represents what to my mind is a disquieting expansion of the federal government’s control over the economy.

To be clear, the disclosure philosophy of securities regulation does not presuppose that investors are perfect decision makers. Simply consider what behavioral finance teaches us about investor decision making: That even when investors are provided with useful information, certain cognitive biases and decision-making shortcuts (or so-called heuristics) may lead investors to make unfortunate decisions. Having said this, disclosure regulation recognizes that, given the diversity of perspectives and interests that the marketplace embodies and the accountability that market forces bring about, the collective judgment of the marketplace is a worthy alternative to more heavy-handed government control of private sector conduct and capital flows. For the test is not whether investors are perfect decision makers; rather, the test is whether it is preferable to leave certain decisions to market participants instead of relying more on government officials, who also err, to dictate results through regulation.

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Disclosure is powerful, but that does not mean that more disclosure is always better than less. So I want to take this chance to emphasize a concern that I have discussed on other occasions. My concern is “information overload,” a risk of mandatory disclosure that has been present for some time and that is exacerbated as disclosures become more complex. Almost 40 years ago, Al Sommer, when serving as an SEC Commissioner himself, remarked that the “expansion of disclosure has gone forward unremittingly” and expressed a measure of discomfort over the “quantity and complexity” of the information that investors faced even then.⁵

In the years since then, disclosures have continued to pile up,⁶ with some of them being of questionable value. Much more is disclosed today than ever before, be it because of regulatory requirements, because investors demand certain information, or because companies, acting defensively, disclose more information to reduce the risk that they could be challenged in litigation for not having disclosed enough.⁷

The information overload concern is that investors will have so much information available to them that they will sometimes be unable to distinguish what is important from what is not. Too frequently, investors get overwhelmed or distracted, misplacing their focus on information that is only marginally useful. The goal of informed investor decision making is not advanced if investors overlook or do not take the time to study valuable information because there is simply too much information to try to engage it constructively. Investors are further challenged if the disclosures they receive are overly complex making it difficult to discern what the information that is considered means. Disclosures, after all, need to be understandable.⁸

The trouble with all of this is that when information is not processed and interpreted by investors effectively, investor decision making may not improve with additional disclosure. Ironically, if investors are overloaded, more disclosure actually can result in less transparency and worse decisions, in which case capital is allocated less efficiently and market discipline is compromised.

In response to this concern, let me conclude with a practical suggestion that I have offered before. In fashioning the disclosure regime at the core of the federal securities laws, we must account for the fact that too much disclosure, particularly when it is too complex, can be counterproductive. We need to recognize the impact on investor decision making as investors find themselves having to confront expanding volumes of information, some of which can be a challenge to understand with the kind of clarity that one might hope for. It would be better for investors to be provided with shorter, more manageable SEC filings, for example, instead of the lengthy documents they receive today.

While new disclosures that are material may be required from time to time so that investors have the key information they need about a firm and its prospects, we should be open to the idea that certain current disclosures should be more narrowly focused or otherwise scaled back, if not excluded entirely from what is mandated to be disclosed. At a minimum, going forward, we should not add to the problem by expanding what companies must disclose to include information that is not material to evaluating a company's business.

Whatever is disclosed should be presented, when practicable, in a more accessible, straightforward manner — such as charts, graphs, tables, and summaries — so that the information is more digestible and understandable. A simpler presentation can make it easier for investors to focus on and process the information that matters most. As people continue to communicate and access information in innovative ways, the disclosure regime may need to evolve to accommodate the new realities of how individuals interact and keep themselves informed. Social media and mobile devices, for example, may allow us to think differently about how disclosures can be packaged and distributed to investors.

In sum, so that the practice of disclosure lives up to its promise, we must ensure that what is disclosed and how it is disclosed in fact empowers investors to make better decisions. What we need is a top-to-bottom review of our disclosure regime to help us do just that.

Thank you.

¹ S. Rep. No. 73-47, at 6-7 (1933) & H.R. Rep. No. 73-85, at 1-2 (1933).

² Stephen Breyer, *Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform*, 92 Harv. L. Rev. 549, 579 (1979); see also *id.* at 580 (discussing “disclosure regulation” generally).

³ Mandatory disclosure not only means that the government will require certain disclosures,

but it also anticipates the importance of antifraud provisions, such as section 10(b) of the 1934 Act and Rule 10b-5 thereunder, in helping to ensure that the information that is disclosed is truthful.

⁴ See generally Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (1970).

⁵ A.A. Sommer, Jr., Commissioner, U.S. Securities & Exchange Commission, *Differential Disclosure: To Each His Own*, Address at the Second Emanuel Saxe Distinguished Accounting Lecture (Mar. 19, 1974), available at <http://www.sec.gov/news/speech/1974/031974sommer.pdf> at 9, 18; see also A.A. Sommer, Jr., Commissioner, U.S. Securities & Exchange Commission, *Current Problems of Disclosure*, Remarks Before the National Association of Securities Dealers (Nov. 12, 1974), available at <http://www.sec.gov/news/speech/1974/111274sommer.pdf>.

⁶ For a general overview, see, for example, KPMG & Financial Executives Research Foundation, *Disclosure Overload and Complexity: Hidden in Plain Sight* (2011), available at <http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/disclosure-overload-complexity.pdf>.

⁷ As to this last point, Justice Marshall, in the landmark case of *TSC Industries v. Northway*, 426 U.S. 438 (1976), warned against information overload when determining the test of “materiality” under the federal securities laws:

We are aware, however, that the disclosure policy embodied in the proxy regulations is not without limit. Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good. The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management’s fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information — a result that is hardly conducive to informed decisionmaking.

Id. at 448-49 (citation omitted).

⁸ See, e.g., Breyer, *supra* note 2, at 580 (stating that the effectiveness of disclosure turns, in part, on whether the “public can understand the information disclosed”).

<http://www.sec.gov/news/speech/2013/spch022213tap.htm>