SEC ADVISORY COMMITTEE ON SMALL AND EMERGING COMPANIES

OVERVIEW

For questions on the note below, please contact Daniel Austin at (202) 547-3035.

Yesterday, the SEC held a meeting of the Advisory Committee on Small and Emerging Companies (ACSEC) to discuss i) Regulation S-K disclosure requirements; ii) research regarding corporate board diversity; and iii) outreach to smaller companies about capital raising. The Division of Trading and Markets provided an update on equity market structure initiatives, a tick-size pilot, and the treatment of so-called "finders" that assist companies in capital raising activities.

Key Takeaways

- Committee members agreed that financial disclosure was important and necessary, but that disclosure for smaller and emerging companies should be more principles-based, focused on what investors want, and less repetitive.
- Promoting board diversity is within the purview of the SEC, and disclosure of board diversity is important to shareholders.
- The tick-size pilot program will last two years and be evaluated on an ongoing basis. The SEC's Division of Trading and Markets is continuing to work on an anti-disruptive trading rule that would prohibit certain types of trading when it would be destabilizing during market stress.
- There is a lack of legitimate information available to assist small businesses with raising capital. A coordinated effort among the SEC and other government agencies is needed to address the issue.

SUMMARY

Opening Statements

Chair Mary Jo White

- The Committee provides the Commission and staff with critical and unique input about matters of importance to small and emerging companies.
- Boards with diverse members function better and are correlated with better company performance.
- The tick-size pilot program is reflective of our appreciation that our market structure should promote capital formation for smaller companies, and that one market structure may not fit all companies.

Commissioner Kara Stein

- We need to be thinking differently about what, when, and how information is disclosed.
- Rather than focusing on scaling or limiting disclosure, how we can uniquely assist companies in a cost-effective way.
- Two-year tick size pilot program will look at whether there will be an impact on trading, market-maker interest, and possible liquidity enhancement.

Commissioner Michael Piwowar

[Due to technical difficulties and the unavailability of a transcript of Commissioner Piwowar's statement, his comments will not appear in this summary.]

Regulation S-K Disclosure Requirements

Open Discussion

Stephen Graham, Fenwick & West: Transparency is important, and anything that works to eliminate transparency of material information is not helpful in the long term. The underlying principle continues to be materiality and ensuring what is material is disclosed.

Gregory Yadley, Shumaker, Loop & Kendrick LLP: Much of disclosure has to do with the infrastructure of the company and how it works internally. More principles-based and less structured disclosure would assist small and emerging businesses with regulatory compliance. Often management will pass on the disclosure work to lawyers because management does not have the time.

Laura Yamanaka, teamCFO: A repository of previously disclosed, unchanged information would be useful to prevent repetitive info in new disclosures. We have found that good executives know the status of the company before they receive financials.

Sara Hanks, Crowdcheck: Reg S-K is the bedrock of disclosure. There is an effort by the Commission to make disclosures make sense for companies and investors. Disclosures that are actually read and understood will help investors—are businesses disclosing the necessary information to make an informed investment decision? We need to think about who is reading the disclosures.

Annemarie Tierney, NASDAQ Private Market: Disclosure is necessary, but disclosure costs to smaller reporting companies can be a large percentage of revenue. Boards of directors can be very litigation averse and will continue to pay these large costs to disclose a lot of information, maybe more than necessary.

Xavier Gutierrez, Meruelo Investment Partners: We look at investments all day and can get to the information important to us without flipping through reams of other information. For a small company, executive compensation plans can be explained in a fast, more discernable fashion.

Jonathan Nelson, Hackers/Founders: If disclosure requirements were in plain English, company officials could do some of these disclosures themselves and cut costs. There is more money to be made on the private side for investors where disclosure is not as extensive.

Brian Hahn, GlycoMimetics, Inc.: We had close to 30 pages of risk factors in our most recent 10-K. We can definitely shrink down this area.

Patrick Reardon, The Reardon Firm: One question we need to ask is: who is consuming the information in the disclosure? There is a difference between what analysts ask about and what is contained in disclosures. I favor principles-based disclosure, but it has its pros and cons. The Commission should require registered companies to report routine Exchange Act compliance costs, so we can see the actual costs of being a public company. Market forces will drive issuers to shorten their disclosures because disclosure costs do not necessarily lead to more revenue.

Diversity on Corporate Boards

The Honorable Cari M. Dominguez, Board Member, National Association of Corporate Directors

- Talent diversity is not only the right thing to do but also a good business strategy.
- The U.S. lags behind other nations in the percentage of women on boards. In 2015, among S&P 500 companies, women made up about 20% of all directors.
- Directors and stakeholders agree on the importance of increasing boardroom diversity.
- Board quotas in other countries are mandated through rulemaking or legislative action. Structural, social, and habitual factors are barriers to boardroom diversity.

Open Discussion

Stephen Graham, Fenwick & West: The disclosure requirement is not defined, so it has not been as helpful as hoped in generating useful feedback. The SEC cannot mandate diversity, and I would not be in favor of quotas; however, diversity should be an interest to shareholders because of the economic perspective.

Gregory Yadley, Shumaker, Loop & Kendrick LLP: If the SEC encourages diversity, I think that will help further diversity at the board and management level.

Laura Yamanaka, teamCFO: Diversity is a difficult conversation, but it is important to have the conversation and discuss various positions. People usually make changes in business because of money and information, so demonstrating how diversity will help businesses succeed will lead to more diverse representation.

Sara Hanks, Crowdcheck: Board diversity is very much in the purview of this Committee because small companies may not address diversity until they go public. There are search firms targeted with finding specific board candidates, but the challenge is pairing candidates with the right company.

Annemarie Tierney, NASDAQ Private Market: I think part of the problem for women is that there is still not a clear path to becoming a board director. We need to ask: how do we encourage a more diverse population to self-select to become board members? Putting pictures of board members in a proxy statement can help start the diversity conversation.

Xavier Gutierrez, Meruelo Investment Partners: Diversity is a business imperative. If you look at who is creating businesses in the country, it looks much differently than it did decades ago. We have to be careful of what it means to be diverse, including socio-economic diversity. It would bother me if I were asked to be on a board just to meet a quota, but there needs to be something that does have an impact on board diversity.

Jonathan Nelson, Hackers/Founders: We have been working on gender diversity in Silicon Valley, but there is a lot of pushback from venture capital firms. I think having the option to fill out the diversity disclosure form would help companies address diversity.

Patrick Reardon, The Reardon Firm: Need to address how diversity is good for a particular business's bottom line. Forcing diversity upon businesses will not be productive. Fashioning diversity to a good business argument will lead to more diversity.

Kyle Hauptman, Main Street Growth Project: Those who talk the most about diversity do not necessarily know as much about, or are exposed to, diversity as they claim. Government guidance, although not necessarily mandated, can be very influential on the private sector.

Michael Pieciak, NASAA: According to some studies, the board quotas in Norway and the resulting diversity have led to better corporate governance.

Betsy Murphy, SEC, Corporate Finance: Some investors have been pushing for more disclosure to respond to the lack of board and corporate diversity. There will be a proposal to amend the diversity disclosure rule to require more specificity on the race, ethnicity, and gender of directors and nominees.

Update on Equity Market Structure, Tick-Size Pilot, and Treatment of "Finders"

Stephen Luparello, Director, Division of Trading and Markets

- The tick-size pilot program went into effect on Monday and will last two years. We will evaluate the pilot program data on an ongoing basis. We are looking forward to tick-size data and the effects on market quality.
- We are working on an anti-disruptive trading rule that would prohibit certain types of trading when it would be destabilizing during market stress.

Open Discussion

Gregory Yadley, Shumaker, Loop & Kendrick LLP: A lot of people were hoping that the SEC would take the lead in addressing unregistered broker-dealers, rather than pass it to FINRA. The SEC would do a better job of protecting investors and furthering capital formation. We are trying to get people regulated in a reasonable fashion. Some "finders" should not have to be totally within the purview of FINRA broker-dealer regulation.

Sara Hanks, Crowdcheck: A lot of unanswered questions about "finders," particularly on online platforms.

Patrick Reardon, The Reardon Firm: The problem of unregistered broker-dealers has been going on for 16-19 years. I think Congress is going to have to act because the SEC has failed to act. Simplified registration would help separate those who are stealing from the honest people who are not registering because of the costs.

Outreach to Smaller Companies about Capital Raising

Open Discussion

Stephen Graham, Fenwick & West: Many small businesses do not understand how to raise capital or where to find capital resources.

Laura Yamanaka, teamCFO: If the SEC or Small Business Administration ("SBA") compiled a legitimate list of capital formation resources, it would be a huge help to small business owners and investors.

Sara Hanks, Crowdcheck: There are some fantastic incubators and accelerators that the SBA knows about.

Xavier Gutierrez, Meruelo Investment Partners: Many young businesses need to understand that the capital needs of a startup are quite different from that of an established business.

Jenny Kassan, Jenny Kassan Consulting: More resources and education on capital formation would help lawyers, entrepreneurs, and members of the public.

Sebastian Gomez, SEC, Corporate Finance: We have been conducting outreach with other government agencies on capital formation for small businesses. We have also talked with angel investors about other ways to raise capital besides Rule 506(b). Part of the challenge is what the SEC can say and do for business owners at events regarding capital formation, because we cannot endorse or promote a particular entity.