

“The SEC’s Use of Voluntary Disclosure for the
Oversight of Mandatory Disclosure”
by Li, Rogo, Tian, and Zhang

Discussant: Hai Lu

Main Findings

The SEC issues comment letters (CL) on annual reports.

When information asymmetry between the SEC staff and firms are high and the SEC staff are not sure about some issues in annual reports, they turn to other voluntarily disclosed information for more information.

Specifically, the SEC staff are more likely to check out conference call transcripts if:

- More uncertainty words in annual reports (Table 3)
- More negative words in annual reports (Table 3)
- Longer the first CL (Table 4)
- More CL topics (provided by data venter) (Table 4)
- More news articles (Table 5)
- More 8-K filings (Table 5)
- Stronger responses (volume and returns) on earnings announcements in past year (Table 5)
- SEC Staff are busy (December yearend) and have more CLs to process (limited attention story) (Table 6)

Referring to conference calls deters voluntary disclosure -- length of content spoken by insiders reduces, the number of topics discussed in subsequent conference calls, and informativeness of subsequent earnings announcements all decrease (Tables 7 & 8).

General Comments

- The paper is well written and easy to read
- The messages delivered are clear

Discussion approach: Focuses on **motivations, (alternative) mechanism, and tests** (the elements to be considered when a paper is preliminary)

Comment 1: Motivations

Three Research Questions:

- Does the SEC staff use conference call information to help draft their CLs?
- Under what circumstance will they do it? (Costs low and benefits high).
- Any consequences if they do it?

Quite interesting setting, and a big statement:

Information asymmetry  Mandatory disclosure to voluntary disclosure.

Two facts surprise me:

1. The SEC staff's economic incentives are not well linked to job performance, but they are willing to walk an extra mile. Why would they do it? Will they do it regularly or occasionally?
2. In general, the literature finds positive effect of CLs on firms' disclosure and information environment, the paper documents negative impact.

Comment 1: Motivations

How is the job performance of the SEC staff performance measured?

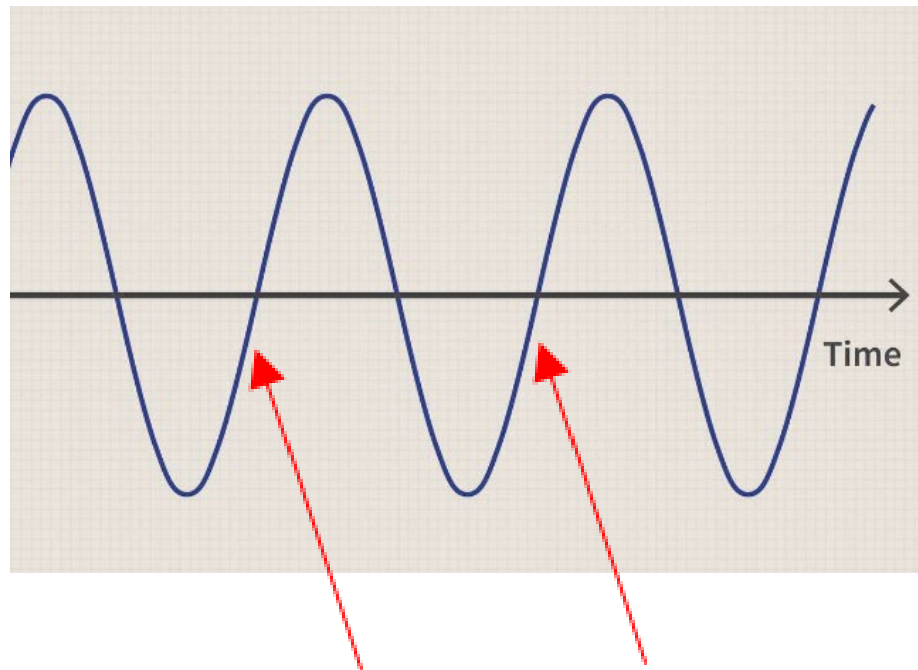
The three reasons stated:

- a) 83% SEC staff like their job, b) 97% of staff indicate that they are willing to put the extra effort to get a job done. The fact that they want to do a good job does not mean they would turn to voluntary disclosure regularly.
- b) How to assess accuracy and completeness? Particularly when 80% staff claim that they are not positive that their differences in performance are recognized in a meaningful way.
- c) Earnings conf call is an informative source.

Comment 2: Mechanism (I)

Motivations come out from reducing information asymmetry.

Conjecture: The degree of information asymmetry is dynamic. When there are information events generating uncertainty, the SEC staff react.



Material events arrive

Comment 2: Mechanism (II)

Is this conjecture true?

SEQ (0.112), M&A (0.387), so 50% of sample obs are associated with seasoned equity offering or M&A activities.

If there were material events:

- More uncertainty words in annual reports (T3)
- More negative words in annual reports (T3)
- Longer first comment letter (T4)
- More CL topics (provided by data vender) (T4)
- More news articles (T5)
- More 8-K filings (T5)
- Stronger responses (volume and returns) on earnings announcements in past year (T5)

Comment 3: Dynamic arrival of material events leading to information asymmetry

- More uncertainty words in annual reports (T3)
- More negative words in annual reports (T3)
- Longer the first CL (T4)
- More CL topics (provided by data vender) (T4)
- More news articles (T5)
- More 8-K filings (T5)
- Stronger responses (volume and returns) on earnings announcements in past year (T5)

All variables measure one construct

Suggestions:

- 1) Provide a correlation table;
- 2) Have a joint test. Currently, regressions are run separately (R2 from 0.07 to 0.08 from Tables 3 - 6).

Comment 4: When material events disappear, information asymmetry decreases

Findings/Interpretations:

Referring conference calls deters voluntary disclosure, the study finds

- length of content spoken by insiders reduces,
- the number of topics discussed in subsequent conference calls,
- informativeness of subsequent earnings announcements.

Quiet period – disappearing events/asymmetry

all decrease (T7 & 8).

Suggestion:

Separate periods with more or fewer events (8K-filings, etc.).

Comment 5: SEC staff resource constraints

Findings:

SEC Staff turn to conference call transcripts when they are busy (December yearend) and have more CLs to process (limited attention story) (Table 6)

Suggestion:

Tie it better to the literature in research design.

Suggestion: Tie better to the literature

SEC resource constraints	Ege et al., 2020	Unexpected resource constraints reduce the quality of comment letters.
	Gunny and Hermis, 2020	Expected resource constraints do not reduce the quality of comment letters.
Examiner/Reviewer's characteristics	Kubic, 2021	The number of accountants on the review team can increase the quality of comment letters (error detection rates).
	Kubic and Toyne, 2023	Continuity leading to lower quality comment letters (the number of comments that reference accounting standards or SEC guidance; the number of comments that generate longer firm responses; whether firm agree to change their current or future filings).
	Baugh et al., 2022	Individual SEC reviewers have significant influence on the outcomes (reviewer fixed effect is larger than almost any other previously documented determinants).
	Do and Zhang, 2022	SEC staff with MBA degree or CPA qualifications are stricter, reducing the likelihood of future restatements and enhancing the effectiveness of the SEC reviews.

Appendix 2: Comment letter (sample)



DIVISION OF
CORPORATION FINANCE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

May 22, 2014

Via E-mail
Christopher G. Marshall
Chief Financial Officer
Capital Bank Financial Corp.
121 Alhambra Plaza Suite 1601
Coral Gables, Florida 33134

**Re: Capital Bank Financial Corp
Form 10-K for Fiscal Period Ended December 31, 2013
Filed February 28, 2014
File No. 001-35655**

Dear Mr. Marshall:

We have reviewed your filing and have the following comments. In some of our comments, we may ask you to provide us with information so we may better understand your disclosure.

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Please address questions regarding all comments to Marc Thomas, Staff Accountant, at (202) 551-3452 or, if you thereafter need further assistance, to me at (202) 551-3752.

Sincerely,

/s/ Gus Rodriguez

Gus Rodriguez
Accounting Branch Chief

Implications for Asia Studies

	China	U.S.
Regulators	Two Exchanges, very few comment letters issued by the CSRC	SEC
Requirements for the response letter	In theory the exchange can issue multiple CLs until it is satisfied, it is very rare to see the Exchanges send multiple CLs (Duan et al., 2022).	If the SEC deems the company's response unsatisfactory, it can issue additional CL, and the company will again be asked to respond within 10 business days or provide an alternative timeframe.
Public disclosure for CL and RL	<p>Before 2015: No formal disclosure</p> <p>After 2015: The exchanges timely disclose CL and RL on its official websites (usually same day)</p>	<p>Before June 2004: No formal disclosure</p> <p>June 2004-2012: disseminate all review-related correspondences no earlier than 45 days after the completion</p> <p>After 2012: disseminate all no earlier than 20 days after the completion of review</p>
Differences in empirical findings	<p>Significant market reaction to the announcement of CL and RL for annual report (Chen et al., 2018);</p> <p>Targeted firms do not experience significant improvements in their information environments and liquidity (Duan et al., 2022).</p>	<p>No significant market reaction to the announcement of CL for 10-K (Dechow et al., 2016);</p> <p>CL process leads to improvements in disclosure, and higher liquidity (Lowry et al., 2020).</p>

Summary

- Results are promising.
- I enjoy reading it.
- Best luck.