Corporate Disclosure Effectiveness: Ensuring a Balanced System that Informs and Protects Investors and Facilitates Capital Formation
Since its inception, the U.S. Chamber’s Center for Capital Markets Competitiveness (CCMC) aims to maintain and advance America’s global leadership in capital formation by supporting capital markets that are the most fair, efficient, and innovative in the world.

The U.S. Chamber of Commerce is the world’s largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.
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Introduction

The U.S. Chamber’s Center for Capital Markets Competitiveness (CCMC) has long encouraged effective communication between companies and investors, which empowers investors to make informed decisions as to how and where to deploy their capital. Accordingly, we believe that the time has come for the Securities and Exchange Commission (SEC) to modernize the public company disclosure regime under the federal securities laws so that it serves investors more effectively.

Disclosure is the foundation of the federal securities laws. The purpose of disclosure is to provide investors with the material information they need to make informed investment and voting decisions—the kinds of decisions that allow investors to protect and advance their interests, that shore up investor confidence, and that facilitate capital formation and spur growth throughout our economy. Disclosure effectiveness, accordingly, should be measured by the degree to which the disclosure regime helps investors understand and evaluate a business when making these decisions. An effective disclosure regime provides all investors—including retail investors and institutional investors—the information they need but does not overwhelm them with extraneous information that can obscure what is material and distract investors from what really matters about a company.

Over the decades since the securities laws were enacted, and especially in more recent years, the disclosure documents that companies file with the SEC have continued to expand, as reflected, for example, by the lengthy annual reports on Form 10-K and proxy statements provided to investors. As many have pointed out, disclosure documents are laden with too much information that is obsolete, unnecessarily repetitive, or otherwise not useful to investors. It should come as no surprise, then, that “information overload” has been identified as a pressing concern with the current disclosure regime. As SEC Chair Mary Jo White explained not long ago, “When disclosure gets to be ‘too much’ or strays from its core purpose, it could lead to what some have called ‘information overload’—a phenomenon in which ever-increasing amounts of disclosure make it difficult for an investor to wade through the volume of information she receives to ferret out the information that is most relevant.”

Information overload strikes a blow to the effectiveness of the disclosure regime that the SEC administers. The essential problem is that investors become inundated with information that is not useful, making it difficult to identify important information about a business. In some instances, investors simply ignore long, dense documents altogether as

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they find much of the information unhelpful or too time-consuming to go through. The problem worsens when disclosures become too complicated. A disclosure that is incomprehensible – even to the most sophisticated investor – can hardly help an investor make an informed decision. 

To have an effective disclosure regime that promotes transparency and the interests of all investors and American business, we must address the problem of information overload. Even as the SEC makes efforts to address this problem, we recognize that there may be calls for the disclosure of additional information in certain areas. It is appropriate for new disclosures to be considered from time to time. That said, when doing so, we must be vigilant in applying the test of materiality to ensure that any expanded disclosure requirements help investors make better-informed investment and voting decisions. 

Modernizing the disclosure regime requires us to rethink what information should be disclosed—as well as how it should be disclosed—with this in mind. We need to streamline and simplify disclosure documents so that SEC filings are more user-friendly and readable for investors. We also need to recognize that not all disclosures are rooted in SEC mandates. Companies often disclose more than is mandated in order to reduce the risk of being second-guessed for having left something out, even if the “something” disclosed is not useful to investors.

Whatever the substantive content of Regulation S-K’s disclosure requirements may be, information should be disclosed in a way that makes it easier for investors to access the information and understand it. Accordingly, as we evaluate disclosure effectiveness, we should consider how technology can be used to improve the way information is presented and delivered to investors.

In rethinking the disclosure regime, the guiding principle should be materiality. Materiality has long been the touchstone for determining the line between what should be disclosed (material information) and what should not have to be disclosed (immaterial information) under the federal securities laws. Almost 40 years ago, the U.S. Supreme Court refused to find that a fact is material just because an investor “might” find it important. Justice Thurgood Marshall, writing for the court in *TSC Industries v. Northway*, explained, “[M]anagement’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.” Marshall was concerned about information overload harming investors and therefore set a more demanding test of materiality. A fact is material, the Court held, if “there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”

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3 *Id.* at 449.
Considering materiality through the eyes of a reasonable investor is significant. Such an approach reduces the risk that disclosure documents will become even more difficult for investors to wade through, as they surely would if disclosure mandates increased based on the almost endless unique or personal interests of different investors. Furthermore, a focus on the reasonable investor helps ensure that what is disclosed is tied to advancing the goals of the federal securities laws, as reflected in the SEC’s mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. Disclosures should not be mandated to advance policy goals that are far afield from those reflected in the SEC’s tripartite mission.

The SEC has on several occasions assessed the disclosure regime under the federal securities laws. The most recent study is the thoughtful “Report on Review of Disclosure Requirements in Regulation S-K” that the Jumpstart Our Business Startups Act (“JOBS Act”) directed the SEC to undertake. The S-K Report, prepared by the SEC staff, determined:

[T]he Commission’s disclosure requirements should be reevaluated in order to ensure that existing security holders, potential investors and the marketplace are provided with meaningful and, to the extent possible in the Commission’s rules, non-duplicative information upon which to base investment and voting decisions, that the information required to be disclosed by reporting companies continues to be material and that the disclosure requirements are flexible enough to adapt to dynamic circumstances.

Chair White and other Commissioners have individually stressed that it is time to make our disclosure regime more effective.

The CCMC commends the SEC for prioritizing disclosure effectiveness. With sound reforms, investors should be provided with material information about a company in a manner that they can readily access and more easily understand, capital should be raised and allocated more efficiently, and market discipline and corporate governance should improve. Of special note, given the purpose of the JOBS Act, emerging growth companies—those newer and smaller businesses that are a vital source of entrepreneurism, innovation, and job creation in the United States—stand to benefit along with the individuals and institutions

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5 S-K Report at 93.
that invest in them. Indeed, last year’s spike in initial public offerings may be a positive sign of the success of the JOBS Act.

This Report on Corporate Disclosure Effectiveness sets forth concrete ideas for modernizing the disclosure regime under the federal securities laws. Two categories of reforms are discussed for enhancing the utility and value of disclosure documents as the primary channel for public companies to communicate with investors. First, we offer a series of near-term improvements to Regulation S-K that we believe the SEC can enact expeditiously with the widespread support of multiple stakeholders. Second, we discuss several longer-term projects that reflect more fundamental change.

We hope that this report helps advance a constructive collaboration as other parties offer their own suggestions for modernizing the disclosure regime. We look forward to working with the SEC and all market participants and stakeholders with an interest in disclosure effectiveness.

Recommendations

The CCMC has long believed in modernizing the disclosure regime under the federal securities laws. Indeed, this is not the SEC’s first attempt to tackle disclosure reform. The S-K Report reviews various SEC reform efforts over the years. Some of the more recent notable efforts have included the Task Force on Disclosure Simplification (1995–1996), the so-called Aircraft Carrier concept release (1998), Securities Offering Reform (2005), and the 21st Century Disclosure Initiative (2008–2009). Each of the SEC’s prior initiatives sought to improve the content, relevance, and usability of disclosure documents provided to investors.

The CCMC responded to the current momentum for disclosure reform by conducting a number of meetings and interviews with representatives of various public companies and law firms, investment analysts, asset managers, and other market participants and stakeholders with an interest in disclosure. This gave us a wide range of perspectives on this important issue and helped to better inform this report. Several individuals that the CCMC worked with on this project previously worked at the SEC.

The CCMC’s disclosure effectiveness project has focused its attention, for now, on Regulation S-K and the periodic reports under the Securities Exchange Act of 1934 (Exchange Act). We recognize, however, that financial reporting requirements, Regulation S-X, and registration statements under the Securities Act of 1933 (Securities Act) also are worth rethinking to ensure that investors are receiving, in a user-friendly way, the material

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6 See generally id. at 8–29.
information they need to make informed investment and voting decisions without facing an “avalanche of information.”

Just as the CCMC is offering its ideas, we understand that other parties are exploring ways to improve disclosure effectiveness. We welcome all suggestions, whatever their source, to modernize the disclosure regime. Progress can best be achieved through a dialogue among all interested parties. But we reiterate that for disclosure effectiveness to be achieved, disclosure must be grounded in the principle of providing material information to the reasonable investor.

Near-Term Improvements

The first category of reforms targets disclosure improvements that the CCMC believes the SEC can accomplish quickly and with broad support.

The requirement to disclose in a company’s Form 10-K the “general development” of a business, including the nature and results of any bankruptcy, acquisition, or other significant development in the lifecycle of a business (Item 101(a)(1) of Regulation S-K)

The information included under this requirement, the origins of which date back to the earliest days of federal securities law, is undoubtedly useful. Investors would be interested in knowing about the development of a company’s business, including whether a company is going through a merger or has undergone a recent bankruptcy proceeding.

However, in the case of a company that is subject to the reporting requirements of the Exchange Act, information regarding material acquisitions, dispositions, or bankruptcies should already be disclosed in a Form 8-K or other filing given its materiality to the company’s business. Redundant disclosure in reports subsequent to the Form 8-K should not be required. The SEC might choose to make a distinction under this S-K item between new registrants (who may be disclosing the general development of their business, including

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7 While the CCMC’s efforts to date have not focused specifically on reforming accounting standards and financial reporting, we acknowledge the Financial Accounting Standards Board’s (FASB’s) initiative to find potential areas for simplification under U.S. generally accepted accounting principles (U.S. GAAP). We are hopeful that the FASB’s efforts will be complementary to those of the SEC.

8 S-K Report at 32.
prior mergers or bankruptcies, for the first time in a registration statement) and established registrants (who would have disclosed such information in a previous filing).

As a general matter, requiring a company to disclose the same or very similar information on multiple occasions is not warranted.

The requirement to disclose financial information for different geographic areas in which a company operates (Item 101(d) of Regulation S-K)

The disclosure requirement under Item 101(d) is duplicative of other mandated disclosures, or at least is superfluous. Investors certainly may have an interest in understanding the financial information of the different operating segments of a company that has business lines in different parts of the world.

However, if a company has operations in a particular region that are material to its business, the company typically would discuss those operations as part of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) under Item 303 of Regulation S-K. Furthermore, U.S. generally accepted accounting principles (U.S. GAAP) require financial disclosures by operating segment. Thus, any disclosures under Item 101(d) that are redundant with other disclosure obligations under Regulation S-K or financial reporting requirements should not be separately required under this item.

The requirement to disclose whether investors can obtain a hard copy of a company’s filings free of charge or view them in the SEC’s Public Reference Room (Items 101(e)(2) and (e)(4) of Regulation S-K)

When investors today want to find a copy of a document a company has filed with the SEC, they can turn to the company’s website, a financial website, or the SEC’s Edgar database. It is widely known that historical SEC reports are available through these media free of charge. Additionally, it does not appear that investors have a great interest in traveling to the SEC’s public reference room (a bank of computers in the Louis Loss Library at SEC headquarters in Washington, D.C.) to view documents they can easily obtain online.

Like many other requirements discussed in this report, before the proliferation of modern technology there was a time when investors found it useful to go to one of the many public reference rooms that the SEC maintained around the country. Likewise, in the past, investors may have been interested in whether an issuer could provide them with free copies of a filing via regular mail. Times have changed.
Because technology has rendered the requirements under Items 101(e)(2) and (e)(4) obsolete, they should be deleted from Regulation S-K.

The requirement to describe principal plants, mines, and other materially important physical properties (Item 102 of Regulation S-K)

In 1935, the SEC adopted a requirement for companies to disclose a general description of the location and condition of their “principal plants and other important units,” as well as a description of how the property was held (e.g., whether it was leased by the company). In 1977, the SEC included this requirement as one of two initial requirements in Regulation S-K. There have been some industry-specific alterations to this item since then, but the requirement remains largely the same as it was in 1977.9

If a property lease or physical property (e.g., plant, mine, other facility) is material to the company’s business, the company’s MD&A—whether as part of the description of its business, results of operations, or financial condition—would discuss the importance of the property or facility to the company. The Item 102 disclosure requirement—particularly for a company for which physical property is not material to its business—may lead to the disclosure of immaterial information to the extent a company ends up disclosing more than is mandated.10 At a minimum, Item 102 requires companies to disclose information that is duplicative with information otherwise disclosed in accordance with Item 303 of Regulation S-K.

More generally, the scope and nature of American businesses has changed dramatically since the SEC adopted the first version of this disclosure requirement in the 1930s. As businesses have moved away from factories and other brick-and-mortar locations, perhaps lengthy disclosures of physical properties for many companies are not a material consideration for investors.

We believe that the SEC should carefully evaluate this requirement with the goal of modernizing it to ensure that immaterial information is not disclosed and that there is no unnecessary repetition.

9 Id. at 36–37.

10 While the current requirement requires disclosure of “the location and general character of the principal plants, mines and other materially important physical properties” of the company and its subsidiaries, in practice, whether pursuant to SEC staff comment or otherwise, companies have erred on the side of more disclosure than is likely relevant under this item.
The requirement that companies discuss material legal proceedings (Item 103 of Regulation S-K)

A discussion of material legal proceedings is one of the SEC’s oldest disclosure requirements, dating back to 1935. Item 103 generally requires a description of material litigation outside the ordinary course of business. Since its migration to Regulation S-K in 1978, Item 103 has not been amended substantively.

Investors presumably have an interest in material legal and governmental proceedings about a company. However, although not identical, there is significant overlap between Item 103 and the financial statement disclosures required under Accounting Standards Codification (ASC) Subtopic 450-20—Loss Contingencies, which has been amended more recently than 1978. Over the past several years, these disclosures have received attention from the SEC’s Division of Corporation Finance and been the subject of SEC staff comment letters. In July 2012, the Financial Accounting Standards Board (FASB) removed from its standard-setting agenda a long-running project to expand the scope of litigation disclosure. Although the FASB’s proposed standard faced criticism from commenters on many fronts, one recurring theme among comment letters was that the revised disclosure would have confused investors by requiring disclosure of information that a reasonable investor would likely find immaterial.

The overlap—if not outright duplication in certain areas—between these two disclosure requirements has contributed to a proliferation of lengthy disclosures containing immaterial information that often clouds investors’ understanding of risk. Furthermore, some have expressed concern that Item 103 creates a number of presumptive quantitative materiality thresholds within its instructions that would not meet the test of materiality articulated by the Supreme Court. For example, most companies interpret current Instruction 2 to Item 103 as requiring disclosure of any liability in excess of 10% of current assets, and Instruction 5.C creates a uniform de minimis standard for certain regulatory litigation at $100,000, implying that a governmental action with a potential sanction of $100,000 or greater is material.

11 S-K Report at 76.

These types of quantitative thresholds may not in fact be set at levels material for all, or even most, companies. The S-K Report acknowledges that thresholds of this type may need to be updated.13

We recommend changes to Item 103 that move away from presumptive materiality thresholds in favor of a principles-based approach premised on traditional materiality standards. Namely, disclosure should be required only if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to invest or vote. This would further the S-K Report’s recommendation of reevaluating the SEC’s disclosure requirements to ensure that they are flexible enough to adapt over time. To avoid unnecessary redundancy, we also suggest resolving any overlap between Item 103 and relevant accounting standards and financial reporting requirements.

The requirement to disclose which public market a company’s shares are traded on and the high and low share prices for the preceding two years (Items 201(a)(1)(i), (ii), (iii), and (iv) of Regulation S-K)

In the past, investors may have looked to a company’s Form 10-K or other SEC filing to find where the company’s equity was listed or historical information about the company’s stock price.

When this requirement was formally added to Regulation S-K in 1980,14 investors did not have access to the Internet, smartphones, and other technology to retrieve stock information. Today, by contrast, investors can go online and, within a matter of seconds, pull up historical price information on any number of stocks, either through a financial website, smartphone application, or a company’s own website.

Given the technological capabilities now widely available, the requirement to disclose where a company’s equity is listed and historical stock price information in SEC filings is obsolete and should no longer be included under Regulation S-K.

In making this recommendation, we draw a distinction between new registrants and established companies with respect to disclosing the principal market or markets on which the company’s stock is listed. A new registrant’s registration statement on Form S-1 or Form S-11 should disclose where the company’s common equity will be listed.15


14 Id. at 69.

15 We also note that Form 8-K requires the prompt disclosure of certain information regarding a company’s common equity exchange listing, including a transfer of such listing.
The requirement to disclose the frequency and amount of dividends for a company’s stock during the preceding two years (Item 201(c) of Regulation S-K)

Companies are required to disclose in their Form 10-K a history of the amount and frequency of dividend payments on their stock, a requirement that stretches as far back as the 1930s. Dividend information is relevant to investors, particularly those seeking to own shares in companies that pay recurring dividends. Nonetheless, investors today are unlikely to search through SEC filings to find this information.

Like historical stock prices, the requirement to disclose details about past dividend payments in an annual filing may have been appropriate in the past, but technology has presented investors with faster and easier ways to access and analyze dividend information. Many companies—including those that are eager to show a record of increasing dividends—post on their websites a full history of the frequency and amount of dividends they have paid over the years.

Again, a number of websites and smartphone applications also make this information easy to obtain, literally at the click of a button. As with historical stock prices, the requirement to disclose historical dividend payments in SEC filings is obsolete and should be removed from Regulation S-K.

The requirement to display a graph showing the company’s stock performance over a period of time (Item 201(e) of Regulation S-K)

While performance graphs, charts, and tables can be a valuable tool for investors, many question whether investors, in practice, rely on the dated Item 201(e) performance chart included in SEC filings. Today, a host of websites, smartphone applications, and other technological means allow investors to study the performance of a particular stock over almost any period of time no matter how short or long. In addition, by going online, investors can easily access or create an up-to-date comparison of a company’s stock performance against that of other companies or against an index of the investor’s choosing.

16 S-K Report at 69.
Since the SEC contemplated deleting this disclosure requirement in 2006, technology and the tools available to investors have only become more sophisticated and widely available. Accordingly, the Item 201(e) performance graph is no longer needed and should not be required.

The requirement to disclose any changes in and disagreements with accountants (Item 304 of Regulation S-K)

Issuers are currently required to disclose in various documents information surrounding the termination of a relationship with their principal auditor. Originally adopted under Regulation S-X, this requirement became part of Regulation S-K in 1980.

This information is useful to investors, but there is no longer a need to mandate its disclosure in annual reports and proxy statements to the extent the same information has been disclosed in a Form 8-K filing. Similar to our observation above regarding the general development disclosure requirement under Item 101(a)(1), we believe that if investors have already been provided with Item 304 information in a Form 8-K filing (e.g., Item 304(a) of Regulation S-K), it is unnecessary to require separate duplicative disclosure in other subsequent SEC filings.

The requirement to disclose certain transactions with related parties (Item 404(a) of Regulation S-K)

This requirement provides that companies must disclose any transactions with “related persons” (such as a director or executive of the company or their immediate family) and creates a presumptive materiality threshold of $120,000. This amount is scaled for smaller reporting companies but not for other companies.

The Item 404(a) materiality threshold was last updated in 2006 when the SEC increased it from $60,000, where it had been set since the early 1980s, to $120,000. While we believe that material related party transactions is useful information for investors making investment and voting decisions, we also believe that the SEC should again revisit the threshold to consider whether $120,000 is appropriate for all companies and thus whether Item 404 is serving its intended purpose. Specifically, the SEC should consider deleting any quantitative threshold from Item 404(a) and instead require only the disclosure of material related party transactions. Another option would be to implement a scaled approach to

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17 Id. at 70, n. 230.

18 Id. at 46–47.

19 Id. at 99, n. 327 (suggesting revisiting quantitative thresholds under Regulation S-K).
disclosure of related party transactions for all companies. Scaling for larger companies could be based on a percentage of total assets, as is currently done for smaller reporting companies, or some other financial metric such as a percentage of total revenue.

These recommendations are effective options for providing investors with timely and material information under Item 404 without distracting them with immaterial information that does not assist their understanding and evaluation of a company.

The requirement to disclose the ratio between earnings and fixed charges (Item 503(d) of Regulation S-K)

First adopted by the SEC in 1954, this requirement was intended to show a company’s ability to cover fixed charges to its business.20 Over time, however, as the SEC began to require similar disclosures in other filings and financial modeling became more sophisticated, the usefulness of this disclosure to investors has continued to diminish. As long ago as 1980, the SEC issued a concept release asking whether this requirement should be retained.21

Recognizing the sophistication of financial modeling today and investors’ ability to analyze detailed financial information through a multitude of online tools using different data sources, the Item 503(d) disclosure requirement is outdated and should be removed. It already is the case that smaller reporting companies do not have to comply with this item.

The requirement to file certain exhibits (Item 601 of Regulation S-K)

The current requirement for an exhibit index similar to the one under Item 601 was added to Regulation S-K in 1980,22 and aside from minor updates, it has not undergone any significant revision in subsequent years.

The S-K Report observed that the exhibit requirements, among other things, “should be reviewed in connection with a reassessment of the presentation of non-financial statement information. . . .”23 We concur that any comprehensive review of disclosure effectiveness should reconsider whether the existing list of documents and agreements has

20 Id. at 44.
21 Id. at 45.
22 Id. at 31–32, n. 85.
23 Id. at 32, n. 86.
kept pace with current investor needs for material information. A more immediate difficulty with the current presentation of the exhibit information is that it requires investors to search through historical filings in Edgar to locate exhibits of interest. The S-K Report notes that this process “can cause frustration to market participants.”

In the near term, an improvement would be to mandate hyperlinks within an exhibit index to documents incorporated by reference. This change would eliminate the need to parse through historical filings in search of a desired document. Over the longer term, we recommend reevaluation of the entire exhibit filing regime.

The requirement to disclose recent sales of unregistered securities and a description of the use of proceeds from registered sales (Item 701 of Regulation S-K)

Variations of this requirement date back to the very first registration forms adopted by the SEC, and the current Regulation S-K requirement was established in 1982. Among other critiques, this requirement is said to have become less useful to investors over time, given that the same disclosure appears elsewhere in a company’s SEC filings. Specifically, if a company completes a material sale of securities to investors, companies typically discuss the transaction as part of MD&A liquidity and capital resources disclosures, if material. In addition, for a company subject to Exchange Act reporting requirements, Form 8-K generally requires prompt disclosure of unregistered sales of equity securities, thus requiring the same basic disclosure as currently is separately required to be included in a company’s Forms 10-Q and 10-K.

Accordingly, we believe that Item 701 should be eliminated as duplicative with these other disclosure requirements.

Longer-Term Improvements

The second category of reforms targets longer-term improvements that we will continue studying in the coming months. Although these topics require more analysis and consideration, we believe it is important to identify them now to stimulate additional dialogue as the SEC considers broader reforms. As for these broader reforms, the discussion

24 Id. at 102.

25 Id. at 73. The SEC made minor modifications to Item 701 in the mid-1990s. Id.
below indicates the direction of some of the more fundamental changes to the public company disclosure regime that we encourage the SEC to pursue.

**Compensation Discussion & Analysis (CD&A)**

The SEC's disclosure rules on executive compensation were overhauled in 2006 with the adoption of the Compensation Discussion & Analysis (CD&A) requirement in Item 402 of Regulation S-K. These rules, as amended in 2006, greatly expanded tabular disclosure concerning executive compensation of named executive officers and directors. They also required a new narrative discussion and analysis of executive compensation. According to the SEC's adopting release, the 2006 amendments were “intended to provide investors with a clearer and more complete picture of the compensation earned by a company’s principal executive officer, principal financial officer and highest paid executive officers and members of its board of directors.”

Since its adoption, CD&A has been the subject of substantial commentary by the SEC and SEC staff, and public companies have received countless comment letters on the topic. A search of the SEC’s Edgar database revealed more than 8,000 staff comment letters using the term “compensation discussion” issued between January 1, 2007, and June 1, 2014. The complexity of the SEC’s rules and interpretations, coupled with the technical nature of the broader subject of executive compensation, means that in-depth expertise is required to understand what CD&A requires a company to disclose. When in doubt about whether something needs to be disclosed, the norm seems to be to disclose it, even if the information is not useful to investors.

Although CD&A was intended to illuminate a company’s executive compensation practices and philosophy, the discussion at most companies has instead resulted in a narrative that is dense and laden with technical jargon and immaterial information. CD&A can be impenetrable, even for sophisticated investors. The length of CD&A alone—a 20-page narrative is not uncommon and it has been known to run on for over 40 pages at some companies—can obscure what is material. To the extent investors struggle to comprehend

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27 In addition to “Staff Observations in the Review of Executive Compensation Disclosure” published in late 2007, the staff in the Division of Corporation Finance has published approximately 70 Compliance and Disclosure Interpretations on Item 402 of Regulation S-K as of the date of this report. Executive compensation is also a common topic of speeches given by the staff and Commissioners at conferences, roundtables, and other settings.
CD&A, it can lead to misunderstandings in the marketplace and impair the ability of investors to make informed decisions. Although companies share some responsibility for this state of affairs, it exists as a natural outgrowth of the rules. In short, CD&A has become the archetypal example of the “avalanche of information” that Justice Marshall predicted and warned against.

We share the S-K Report’s view that executive compensation disclosure should be reassessed fundamentally “to confirm that the required information is useful to investors,” particularly when considered from the perspective of a reasonable investor. In short, reforms are needed to ensure that CD&A provides investors with the material information they need to make informed investment and voting decisions but does not inundate them with information that is not useful for understanding and evaluating a company.

**Management’s Discussion and Analysis (MD&A)**

The SEC has repeatedly described MD&A as a vehicle for explaining a company’s financial condition and results of operations “through the eyes of management.” Item 303 of Regulation S-K, which sets forth the MD&A requirement, generally reflects a principles-based approach to disclosure.

We agree with the S-K Report’s view that a disclosure regime based on broad principles, similar to Item 303, could “address the tendency toward implementation of increasing layers of static requirements.” Accordingly, we support the SEC in considering how a more principles-based approach to disclosures other than MD&A may enhance disclosure effectiveness. We reiterate, however, that the touchstone of any disclosure requirement must be materiality as seen through the eyes of a reasonable investor.

Beyond Item 303’s principles-based disclosure requirements concerning liquidity, capital resources, and results of operations, more prescriptive and specific disclosure requirements have been added over time to Item 303 that may duplicate disclosures required elsewhere in a company’s disclosure documents. For example, Item 303(a)(4) requires a specific separate discussion of off-balance-sheet arrangements “that have or are reasonably likely to have a current or future effect on the [company]’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.” Item 303(a)(5) requires prescriptive tabular

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30 S-K Report at 98.
disclosures of contractual obligations. In each of these disclosure requirements, the categories of “off-balance-sheet arrangements” and “contractual obligations” are largely defined by the existing accounting standards and, indeed, are separately required disclosures in a company’s financial statements under GAAP.

As with other Regulation S-K items identified in this report, current accounting standards and financial reporting requirements have evolved to overtake these two disclosure requirements, rendering them largely redundant. Moreover, a company already is required to discuss material impacts on its financial condition and results of operations. Therefore, we encourage the SEC to consider whether the one-size-fits-all disclosure requirements of Items 303(a)(4) and (a)(5) are beneficial to investors. It does not seem necessary for these items to mandate the disclosure of information that is substantially similar to what a company would cover when discussing its financial condition and results of operations or that is addressed by the company’s financial statements, including the notes thereto.

The SEC should also consider revising the time periods required to be discussed as part of a company’s MD&A. To focus investors on the most important information to help them “separate the wheat from the chaff,” it would be more appropriate to require discussion of only the most recently completed annual or quarterly period. Narrative discussions concerning prior periods, which typically repeat information disclosed in previous SEC filings, can create more confusion and distraction than elucidation among investors.

As is the case for CD&A, we believe that MD&A is ripe for reexamination with the goal of streamlining the disclosure requirements, eliminating redundancy, and reinforcing the guiding principle of materiality so that MD&A is more useful for investors.

**Repetition**

Another cause of information overload that undercuts disclosure effectiveness is the repetition of disclosures in multiple places throughout filings that companies make with the SEC. For example, in an annual or quarterly report, the same basic disclosures about a recent financing may appear in the narrative accompanying the description of the business, in MD&A, and in one or more notes to the financial statements. By way of further example, a disclosure about material litigation may be repeated in the discussions regarding legal proceedings and risk factors, in MD&A, and in the financial statement notes. As discussed below, an explanation of risk-related matters may appear in many places throughout the narrative sections of Form 10-K or 10-Q, plus in the financial statement notes.

Future efforts at enhancing disclosure effectiveness should seek to pare back requirements to repeat the same or sufficiently similar information in multiple places within a disclosure document. Greater coordination between the SEC and accounting standard-setters also may be appropriate to prevent new instances of repetition between narrative and financial statement disclosures from being introduced. Similarly, the SEC and accounting
standard-setters should work together to limit instances of divergence between narrative and financial statement disclosures so that, for example, an SEC requirement about pending litigation does not seek to elicit different disclosure than an analogous accounting standard on the topic.\(^{31}\)

In addition, the SEC should consider reforms to mitigate the repetition of historical information already discussed in earlier disclosure documents. As discussed above concerning MD&A, a Form 10-K, for example, should focus more on what occurred in the most recent year, and a Form 10-Q should focus more on what occurred in the most recent quarter, by mandating less discussion about prior periods unless the comparison is material.

Not all repetition is the result of specific Regulation S-K mandates or accounting standards and financial reporting requirements. Companies often disclose more than is required—or at least than is useful for investors—out of fear of liability, substantiating the Supreme Court’s “avalanche of information” concern.

Companies should take a fresh look at their disclosures and take steps to address any unnecessary repetition. To assist in the effort to eliminate repetition, the SEC should consider providing clear guidance to issuers that repetition is not necessary and that stale information can be deleted from their disclosure documents. As the director of the SEC’s Division of Corporation Finance recently said, “Yes, as unsettling as I am sure this can be for some, it is perfectly all right to remove disclosure when it is immaterial or outdated even if it was included in a prior filing in response to a staff comment.”\(^{32}\) The director also expressly discouraged issuers from repeating themselves. These statements are a good start, but the SEC should consider a more formal pronouncement to these effects.

### Risk Disclosure

The SEC’s requirements for the disclosure of risk have expanded in a piecemeal fashion over many decades. Companies are required to discuss risks to the business under various items of Regulation S-K, including, among others, Item 101 (Description of Business), Item 103 (Legal Proceedings), Item 303 (MD&A), Item 305 (Quantitative and Qualitative Disclosures About Market Risk), and Item 503 (Risk Factors).

In addition to requiring overlapping risk disclosures, many items in Regulation S-K concerning risk have not been updated in recent years to reflect developments in financial

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\(^{31}\) This suggestion echoes our recommendation above regarding Item 103 of Regulation S-K.

reporting. For example, the SEC adopted Item 305 in 1997 to address a perceived gap that existed at the time concerning disclosures around derivatives and other financial instruments sensitive to market risk. Since then, financial reporting in accordance with evolving accounting standards has greatly expanded. ASC Topic 815—Derivatives and Hedging provides substantial guidance about hedge accounting in financial statements, among other things. But Item 305 has gone unchanged since 1997, although certain disclosures it requires are now redundant with a public company’s financial reporting obligations.

Demonstrating the degree of redundancy between Item 305 and other Regulation S-K items, many public companies do not provide a stand-alone disclosure responding to Item 305 at all, instead cross-referencing to MD&A. Indeed, there is lingering confusion in the marketplace as to what specific disclosures are required under this item, one of the most complicated disclosure requirements to parse in all of Regulation S-K.

Over the longer term, a more fundamental rethinking about how companies disclose material risk and their approach to risk management is in order. One possibility would be to combine the various risk discussions that are otherwise scattered throughout a disclosure document into a single, centralized narrative. It also is worth exploring whether a reformulated risk discussion should highlight the material operational and financial risks that management views as most significant to the business so that the top risks receive particular attention.

Accordingly, we support the S-K Report’s idea to consider consolidating “requirements relating to risk factors, legal proceedings and other quantitative and qualitative information about risk and risk management into a single requirement.” Such a consolidated discussion would reduce redundancy and articulate for investors a valuable holistic view of risk through the eyes of management. As with our other recommendations, the revamped risk disclosure should be grounded in the principle of materiality—only risks that are material to a reasonable investor’s investment and voting decisions should have to be disclosed.

A Revised Delivery System

Our discussion has focused primarily on reforming substantive disclosure requirements, guided by the principle of materiality. But we believe any analysis of disclosure effectiveness would be incomplete without discussing the fundamental format of disclosure—namely, how information is presented and delivered to investors.

The SEC’s current disclosure regime for Exchange Act reports, which is premised on self-contained reports delivered (or made available) at regular intervals, is grounded largely in

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33 S-K Report at 77.

34 Id. at 99.
a bygone era of communication via physical documents by mail before the proliferation of
the Internet, email, and smartphones. The introduction of the Edgar system 20 years ago
made these reports and other SEC filings more easily accessible in electronic format.
However, the basic layout of Form 10-K, Form 10-Q, Form 8-K, and the proxy statement
has gone unchanged for decades, even as the number of substantive disclosures in these and
other SEC reports has multiplied and technology has advanced.

We believe it is time to rethink the format of public company reports and the
fundamentals of how information is delivered to investors, with the goal of enhancing the
usability and value of public company disclosures for investors in the modern technological
era. Modern technology allows us to shape a more effective disclosure regime, and we
should take advantage of it.

Efforts at modernizing the presentation and delivery of public company reports have
been discussed before. For example, the SEC’s 21st Century Disclosure Initiative released a
report in January 2009 that sought to explore “the possibility of using modern technology to
move from a document-based disclosure system that requires the repeated filing of the same
information in often lengthy static documents to an interactive data disclosure system that
avoids redundancies and makes the information more accessible.” The report made a
number of recommendations for moving forward, most notably by advocating for the
further exploration of what it described as a centralized “company file” to replace the
current process for delivering investor information.

Importantly, under this type of system companies would not be required to repeat
prior disclosures on a regular basis, but would be required to discuss additional
developments that are material. This type of system would make it easier for investors to
identify the most current material information about a company without having to wade
through historical information to ferret out what is most relevant. A variation of the
company file concept would be to allow companies at least to satisfy certain disclosure
obligations—perhaps those describing the business, the management team, and the board—
by cross-referencing the company’s website, assuming this information is adequately
disclosed there.

The events of the financial crisis overtook other SEC priorities and little progress has
been made on this front since 2009. We note, however, that the S-K Report identified the
concept of a company file as one for further study, an initiative we firmly endorse and
recommend that the SEC undertake.36

35 Staff Report of 21st Century Disclosure Initiative, “Towards Greater Transparency: Modernizing the
Securities and Exchange Commission’s Disclosure System” (Jan. 2009), at 4, available at

36 S-K Report at 98.
The actual modernization of disclosure delivery by the SEC is not without precedent. For example, at about the same time that the 21st Century Disclosure Initiative completed its report, the SEC undertook a substantial simplification of mutual fund disclosure. Specifically, the SEC adopted new rules in January 2009 to allow mutual funds to satisfy their prospectus delivery obligations under the Securities Act by providing a summary prospectus to investors, so long as the statutory prospectus and certain other information are made available on the Internet. In making these revisions, the SEC observed that fund prospectuses were “criticized by investor advocates, representatives of the fund industry and others as being too long and complicated.” Further, the SEC noted that “[t]oo frequently, the language of prospectuses is complex and legalistic.” Animating factors for the SEC’s decision to modify its rules included a desire to employ a “streamlined document with other more detailed information provided elsewhere,” reflecting investor surveys that indicated “that investors prefer to receive information in concise user-friendly formats.” The mutual fund summary prospectus captures the concept of “layering” disclosures so that investors can more easily focus on what is most important while still being able to easily access the other information that is made available. To that end, the SEC declared:

Technology has the potential to replace the current one-size-fits-all mutual fund prospectus with an approach that allows investors, their financial intermediaries, third-party analysts and others to tailor the wealth of available information to their particular needs and circumstances.

Although mutual funds present some different disclosure considerations than those that are relevant to most public companies, the SEC’s basic observations about the faults of long and complicated disclosure documents, the needs of investors, and the power of technology to benefit investors are universal.

Any effort at enhancing disclosure effectiveness should consider not just what is disclosed but also how information is presented and delivered to investors. We acknowledge that such an effort may require substantial modifications of the existing Edgar system. Nonetheless, the benefits of moving toward a company file or something like it seem to be considerable. While it may take time to fully think through and then implement a company file approach to disclosure, using technology to achieve a more layered approach to

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38 74 Fed. Reg. at 4547.

39 Id.

40 Id.

41 Id. at 4548.
disclosure may be achievable more readily. Accordingly, we will continue to consider options for layering disclosures and encourage the SEC to do the same.

As these ideas are studied further, potential areas of inquiry may include the following:

- How might investors—both retail and institutional—use disclosures differently if the information were presented and delivered in a more accessible way?
- How can technology be used to provide a better experience to investors as they review public company disclosures?
- Should the SEC move to a company file or other centralized electronic depository for disclosure in lieu of the historic Form 10-K, Form 10-Q, Form 8-K, and proxy statement?
- Is there investor demand for increased use of interactive data?
- Are there other techniques for streamlining disclosures and allowing investors to customize the information available to them without reducing the material information investors can access?
Conclusion

The SEC has the opportunity to enhance the effectiveness of the public company disclosure regime by modernizing the regime for the 21st century. This report lays out the CCMC’s philosophy and recommendations for a modern disclosure regime refocused on the core principle of materiality. While it is appropriate for disclosure requirements to evolve, it also is important that they do so in a manner that retains the focus on information that is important to a reasonable investor’s ability to understand and evaluate a business.

As for the CCMC’s specific recommendations, there is no reason to delay enacting the near-term improvements while the second category of longer-term reforms continues to be studied and analyzed. The near-term improvements would achieve meaningful progress that informs and protects investors and facilitates capital formation, and we encourage the SEC to move these reforms forward at this time.

The CCMC may issue additional recommendations going forward. We recognize, for example, that Regulation S-K items aside from those we address in this report may warrant rethinking and that Regulation S-X also might be able to be improved upon.

We look forward to collaborating with the SEC and other stakeholders and interested parties in the SEC’s disclosure effectiveness reform efforts so that we end up with a disclosure regime that is optimal for investors overall—a regime that provides investors with the material information they need to make informed investment and voting decisions and that fosters capital formation and economic growth.