New York Law Journal
A NEW YORK LAW JOURNAL SPECIAL SECTION
An ALM Publication
Compliance
WWW.NYLJ.COM
MONDAY, OCTOBER 27, 2014

# An **Opportunity** To Improve Disclosure

**BY BONNIE J. ROE**

The U.S. Securities and Exchange Commission has recently undertaken a review of its principal regulations for periodic reporting by publicly traded companies, in response to claims that the reporting process has become overly burdensome and that investors are blinded by "disclosure overload" that makes it difficult to discern the important facts within a mass of detail.

The announcement of the project on the SEC's website under the title, "Disclosure Effectiveness," indicates that the SEC's Division of Corporation Finance is reviewing the requirements of Regulation S-K and Regulation S-X with a view to improving the disclosure regime for the benefit of both companies and investors. According to the announcement, the SEC will initially consider the business and financial information required in reports on Forms 10-K, 10-Q and 8-K. A second phase will focus on governance and executive compensation information provided by companies in their proxy statements. The SEC's website solicits comments from the public on the Disclosure Effectiveness project. Notable among the comments received so far are those of the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness and the Society of Corporate Secretaries and Governance Professionals, but many more can be expected over the coming months, as the topic has drawn attention and interest from a variety of different perspectives.


BIGSTOCK

### Calls for Reform; Concerns

Disclosure reform has a long history. The SEC's own process over the years has resulted in a number of improvements we take for granted, such as: an integrated reporting system, coordinating requirements for securities offerings and continuous disclosure; scaled disclosure for smaller issuers; the EDGAR electronic filing system; Plain English initiatives; electronic delivery of proxy statements and other information; and the ability of issuers to provide certain information through their websites rather than in filed documents. These and other SEC initiatives over the years are nicely summarized in the SEC's Report on Review of Disclosure Requirements in Regulation S-K, dated December 2013, produced in response to §108 of the Jumpstart Our Business Startups Act, or JOBS Act, which required the SEC to report to Congress on how the registration process could be made more efficient and less burdensome for emerging growth companies.

The SEC's December 2013 report came to the sensible yet unsatisfying conclusion that further study was necessary. The report nonetheless outlined some of the themes that can be expected to emerge from the SEC's current project for disclosure reform:

- A more principles-based approach that would allow companies to emphasize material points in "layered" disclosure and counteract the tendency of a rules-based system to require all companies to address points that may be relevant only to a few;
- An evaluation of reporting requirements for smaller companies, with a view to determining whether additional accommodations can be offered to them;
- A re-assessment of methods of information delivery and presentation, though the EDGAR system and other means; and
- An effort to improve the readability and navigability of disclosure documents, includ-

BONNIE J. ROE *is a partner at Cohen & Gresser.*

ing an exploration of whether technology can be used to make disclosure documents easier to prepare and to use.

The report also suggested reviewing substantive requirements, such as the basic business description, to see if they emphasized those matters that are material to companies today, and rationalizing the exhibit list to make it more user-friendly.

A less patient note is sounded by various critics of the current disclosure system. These critics have raised a number of concerns, including that:

- The multiplication of reporting requirements, imposed either by statute or regulation, have resulted in voluminous disclosures that may be redundant or not material to a company's business;
- Disclosure overload and complexity may interfere with our ability to absorb and process the information that is required;
- The costs of disclosure, in terms of management time as well as legal and accounting costs, may exceed the benefits and impose too great a burden on public companies; and
- Disclosure cost and complexity may discourage U.S. companies from going public, adversely impact smaller companies and drive foreign companies away from U.S. markets.

Against this background, it is important to note that many institutional investors feel that they would like to have more disclosure, rather than less. U.S. capital markets benefit from transparency, and U.S. public companies benefit from investor confidence in the integrity of the reporting system. While it may be possible to scale back reporting requirements for smaller companies, and there may be many ways to update, rationalize and improve the effectiveness of disclosure for all companies, the overall goal of the Disclosure Effectiveness project should be to increase transparency and improve access to material information.

### Prospects for Reform

Regulatory reform of all types is ultimately (and necessarily) an incremental process, involving significant work on the part of the relevant government agency in drafting proposed regulations, seeking public comment and ultimately adopting the new or revised regulations. An undertaking as ambitious as the Disclosure Effectiveness project would likely take many years and many iterations under the best of circumstances. As it stands, the completion of the regulations required by the Dodd-Frank Wall Street Reform and Consumer Protection Act and the JOBS Act will take precedence over the Disclosure Effectiveness project, and other projects of pressing importance could also take priority. A change in administrations in 2016 could also affect priorities. One can easily imagine the Disclosure Effectiveness project suffering the fate of the 21st Century Disclosure Initiative, announced in 2008 and thereafter abandoned, or the seemingly monumental conceptual reforms proposed in 1998 that were nicknamed the "Aircraft Carrier" in recognition of their breadth and scope, which were similarly abandoned.

Regulatory reform of the SEC's disclosure system under Regulation S-K and Regulation S-X may be slow in coming, but there are changes that **companies can implement on their own** to improve disclosure.

In short, the likelihood of a substantial re-write of Regulation S-K and Regulation S-X coming soon is relatively minimal. Nonetheless, the process of examining individual disclosure requirements to determine their continued relevance and usefulness may ultimately shape the way existing rules are interpreted, and may also result in incremental changes in regulation either as a direct result of the Disclosure Effectiveness project or indirectly over time.

### The Promise of Technology

One type of change that is likely to take hold over the next few years is in the way information is filed and made available to the public through EDGAR. The SEC's procurement office, the Office of Acquisitions, has announced a process to seek bids for EDGAR modernization, and any updates are likely to increase the ease of filing and access to documents on the SEC's website, simply by virtue of incorporating more up-to-date technology. One can only hope that whatever system is adopted will be flexible enough to support innovations in the filing and presentation of information over time.

Currently, the outward face of EDGAR is essentially an online filing cabinet, with the home page for each company providing links to the company's SEC reports, arranged in reverse chronological order and identified only by the EDGAR form type. To find information concerning a U.S. company's executive officers and directors, you would need to know that information of this type is usually found in the company's proxy statement, but might also be found in the company's Annual Report on Form 10-K or other documents, and might be updated in a Current Report on Form 8-K. For the proxy statement disclosure, you would click on the most recent document labeled "DEF 14A," with the further (but not very helpful) description of "other definitive proxy statements." You would search through this document, which ideally would have hyperlinks from the table of contents, in order to find a list of directors and information elsewhere about "named executive officers." If you wanted a list of all officers, you would probably have to go to the 10-K. To be sure that your information was up-to-date, you would need to check the recent reports on Form 8-K, which could be numerous, but you would most likely want those indicating that they were filed pursuant to Item 5.02 of Form 8-K. If you also wanted to see the CEO's employment contract, you would go back to the Form 10-K, to peruse the exhibit list, and learn that the original agreement was included as an exhibit to a Form 8-K filed three years ago, and the employment agreement amendment was included with a 10-Q filed more recently.

This system is workable for securities lawyers, analysts and similar professionals who are familiar with how documents are filed. Even for such persons, however, the process is time-consuming and fraught with the possibility of missing a piece of information or update. For other persons, it means that EDGAR is not particularly useful, even though it is free, and they will go to more user-friendly sources.

One proposal likely to be considered in

the Disclosure Effectiveness project would be to change the organization of information on each company's page on the SEC website. This proposal was also a central feature of the now abandoned 21st Century Disclosure Initiative and was referred to in the SEC's December 2013 report pursuant to the JOBS Act. The basic idea is to make it easier to locate company information on the SEC website by including links to such information under some general headings on the initial page devoted to the company. For example, there might be a heading entitled "directors and officers" and other headings entitled "business description," "financial information" and "risk factors." Exhibits could be organized under a single heading, to enable investors to quickly locate the basic documents and any amendments.

Many variants of this proposal are possible. To retain the sense that information is provided periodically based on specific form requirements, the home page links to "directors and officers," for example, might merely take you to the sections of various filings that contained information relevant to this topic, clearly marked with the date the disclosure was made. Users of this "form-based" system would still have to click on the proxy statement disclosure for basic information and then click on the Form 8-K for updates, but the system would, for example, automatically group together all links to information about directors and officers. While it would undoubtedly take both time and effort to design and implement such a system, it is relatively easy to imagine that it could be implemented with an appropriate information management system, together with tagging of information as it is filed.

A more radical change might be to have a unified set of disclosures for each company on the SEC website so that, for example, a single click under the directors and officers heading would take you to an up-to-date list of such persons, while other clicks might take you to more detailed information on compensation, stock ownership and board committee membership. Critics of this system express concerns that it could require companies to update information more regularly and more thoroughly than currently necessary, because the basic architecture of the annual reporting system with periodic updates would not be as visible on the website.

Other technological changes that have been proposed include improvements to the search engine capabilities of EDGAR, which can be welcomed without upsetting current disclosure rules or imposing additional burdens on reporting companies. Still other proposals would require increased use of interactive data formats for financial disclosures and possibly other information. The current requirement to provide financial statement information in the interactive data format known as XBRL (extensible business reporting language) has not been popular with reporting companies, and XBRL has not been used to any great extent by investors. With time and possible tinkering with the features of XBRL, however, this may change, as both reporting companies and investors get more comfortable with using and providing more information in XBRL format.

### Other Improvements

Regulatory reform of the SEC's disclosure system under Regulation S-K and Regulation S-X may be slow in coming, but there are changes that companies can implement on their own to improve disclosure. One has only to compare the proxy statements for a number of major companies from 2014 to the same group from 2008 or earlier, to see a general improvement in style and readability. Though the more recent proxy statements are, if anything, more voluminous, they are better organized, with an executive summary and table of contents, and they frequently have brief summaries at the beginning of each section. There is more consistent use of Plain English, and better formatting, with occasional charts and graphs. Some thought has gone into answering possible questions in a simple and direct fashion: for example, through a chart of governance practices that the company follows, and those that it does not follow. In short, there seems to be more effort made in actually communicating. Some companies have even sent a draft of their proxy statement to a professional communications company to help reorganize and reformulate the discussion of their executive compensation and governance practices and improve the overall appearance of the document.

These changes may have begun in response to comments from the staff of the SEC, which have often focused on the readability of the "Compensation Disclosure and Analysis" section of the proxy statement, which (like other descriptions of executive compensation and governance matters) must use Plain English pursuant to Rule 13a-20 under the Securities Exchange Act of 1934, as amended. But the motivation for the most significant changes may have been the vulnerability that companies have felt in the face of challenges from shareholders, particularly once they had to comply with "say-on-pay" voting requirements. The ordinary annual proxy statement has become a vehicle for shareholder communications on issues that count. Once begun, the changes have spread from company to company, so that the trend towards better disclosure has grown stronger each year.

Whatever the reasons for better proxy disclosures, the changes can serve as a model for improvements in the style and format of other disclosures. Public companies and the SEC can both contribute to improvements in disclosure within the existing regulatory framework. This may take some work and creativity, but should reap rewards in terms of better shareholder communications.





COHEN & GRESSER LLP