

Clients & Friends Memo

SEC Focuses on Investor Perspective and Use of Technology with New Concept Release

May 6, 2016

On April 13, 2016, the U.S. Securities and Exchange Commission issued a [concept release](#) on the business and financial disclosures required by Regulation S-K. The release is part of an ongoing comprehensive evaluation by the SEC of disclosure requirements in response to statutory mandates in the FAST Act and JOBS Act (more information on which can be found at the [Disclosure Effectiveness Initiative](#)). This review also includes the [Report on Review of Disclosure Requirements in Regulation S-K](#) and forthcoming reports on Regulation S-X.

This concept release, which fills 93 pages in the Federal Register and poses 340 numbered requests for comment, is organized around three general areas: disclosure framework, specific information requirements and the presentation of information.

Key Takeaways

- The release does not change or propose to change any rules or regulations. Instead, it provides comments on possible future revisions and rulemaking.
- If suggestions made in the release are implemented, they would result in significant changes to the Regulation S-K disclosure requirements. In particular, future rulemaking could have sweeping implications if the SEC adopts a new general disclosure standard that is different from the current materiality standard.
- Changes proposed in the release, in particular potential rulemaking on social issues and structured data/XBRL expansion, could increase disclosure costs to issuers and investors.
- The topics covered in the release may indicate areas of disclosure on which the SEC Staff is focused and might comment on when reviewing company reports and filings.
- The release does not address disclosure requirements in Regulation S-K that relate to executive compensation and governance, or the required disclosures for foreign private issuers, business development companies or other categories of registrants, which are expected to be addressed in separate concept releases.

Due to the significance of potential changes, both from a disclosure and cost perspective, companies and investors may want to provide input on the matters addressed by the release through the comment process. The deadline for comments is July 21, 2016.

Disclosure Framework

Materiality Standard. Notably, the release poses multiple questions about whether the longstanding materiality standard for Regulation S-K disclosure should be replaced with rules mandating disclosure that may be “important or useful” to certain audiences of investors, regardless of whether a “reasonable investor would consider the information important in deciding how to vote or make an investment decision.” These questions tie into the release’s distinction between “principles-based” and “rules-based” disclosure requirements, and its inquiry as to whether disclosure rules should trend toward being principles- or rules-based.

Audience. The SEC requests comments on how the disclosure framework might address the needs of investor audiences with differing levels of sophistication more effectively. In this context, the release notes that some required disclosures may be useful to unsophisticated investors but not to sophisticated institutional investors and vice-versa. The discussion of this topic in the release is not conclusive, but it does suggest that future rulemaking may call for increased requirements for XBRL, XML or other structured or interactive data disclosures in order to help different audiences conduct comparative analyses using company disclosure, particularly when considered in connection with the release’s discussion of the presentation and delivery of information.

Costs. The release discusses compliance and competitive costs, and acknowledges that additional disclosure requirements can increase administrative and compliance costs, but suggests that technological advances can offset the increases. The SEC also notes that new mandatory disclosures could increase companies’ competitive risks or economic costs, but indicates that its confidential treatment request system mitigates these concerns. Presumably, future specific rulemaking proposals will address regulatory costs in greater detail. However, the release, taken as a whole, appears to focus more on increasing disclosure requirements, as opposed to simplifying disclosure burdens and reducing costs.

Specific Information Requirements

Business Disclosures. The SEC requests comments on the scope of several specific line item disclosure requirements in Regulation S-K, including:

- core business information, including description of the business;
- company performance information, including MD&A;
- risk factors and related disclosures;
- information regarding a company’s securities and securityholders;

- industry specific disclosure guide requirements;
- public policy and sustainability matters;
- exhibit requirements; and
- scaled disclosure requirements.

Of these, the release emphasizes company performance, risk factors and public policy and sustainability matters. For performance disclosures, the SEC suggests that it may consider eliminating requirements that overlap with financial statement disclosures, such as selected financial data and supplementary financial information.

MD&A. The release invites comments on how MD&A disclosures can be made more useful and whether the many sources of guidance on MD&A preparation from prior reform efforts should be consolidated into a single source to aid companies and investors in understanding the requirements. More generally, the SEC is considering whether to propose more or updated industry-specific disclosure requirements and whether certain requirements adopted in the past are no longer sufficiently relevant to be required due to changes in business practices.

Risk Disclosures. The release repeats familiar observations about risk factors and related disclosures: they are frequently lengthy and somewhat generic, while acknowledging that requirements for safe harbor treatment under the Private Securities Litigation Reform Act contributes to the length of risk factor disclosure. The SEC is considering requirements to disclose the probability of adverse outcomes and to require presentation of risk factors in the order of significance, with a separate summary of the most significant risks. The release also asks for comments on how to make the risk factor requirements more effective at requiring disclosure “capturing emerging risks” such as those associated with cybersecurity, climate change and arctic drilling.

Social Issues. The SEC gives a significant amount of attention to public policy and sustainability topics, sometimes also referred to as environmental, social and governance matters. The release notes the SEC’s past determination in 1975 that disclosure requirements regarding such social matters should not be broadly imposed absent a “specific congressional mandate or unless, under the particular facts and circumstances, such matters are material.” At the same time, the SEC is considering whether a variety of public policy or sustainability matters are material or “of increasing significance to voting and investment decisions.” Topics being considering for disclosure requirements include climate change, political spending and lobbying activities, resource scarcity, corporate social responsibility, carbon asset risks and stranded asset risks. The SEC suggests that it may propose disclosure requirements on such topics on the basis that some investors consider the information significant or important to voting and investment decisions, without necessarily being information that a reasonable investor would consider material.

Presentation and Delivery of Information

Scaled Disclosure. The FAST Act calls for a general review of the SEC's disclosure requirements to further scale or eliminate burdens on Emerging Growth Companies, accelerated filers, smaller reporting companies and other smaller issuers. In response, the release seeks comments on whether the categories of smaller companies and methods for evaluating company size can be improved and whether certain companies should be disqualified from reduced disclosure requirements due to "bad actor" or similar characteristics. Noteworthy requests for comment include whether smaller reporting companies should be exempt from XBRL structured data tagging requirements and whether semiannual reports, instead of existing quarterly report requirements, should be required.

"Layered" Disclosure. The release discusses the potential to reduce duplicative disclosure and improve navigation in large company reports by increased use of cross-references, hyperlinks and incorporation by reference. This discussion builds on the suggestion of increasingly "layered" disclosure: using summaries and overview sections with references and links to more detailed disclosure in other parts of a report. The discussion of cross-referencing and increased use of incorporation by reference is inherently inconclusive because, as the SEC notes, repeating similar information in more than one part of a report may improve the usefulness of disclosure by combining relevant information in one place in a discussion of a particular topic, but has the risk of obscuring important information due to repetition. In contrast, the extensive use of cross-referenced or incorporated information may decrease the level of undesirable repetition but make it more difficult to form a coherent view of all information important to a particular topic. These competing effects will be important in evaluating many of the suggested reforms, such as allowing companies to disclose information on their websites, rather than through the SEC's EDGAR reporting system, and allowing reports to omit previously reported information, such as early years of selected and supplemental financial data.

Data Tagging. Building on prior initiatives, the release seeks input on whether increased use of "structured" disclosures, which are disclosures that have been formatted and labeled with specified machine-readable data labels or "tags" using XBRL, XML or a similar protocol, should be required, including possible extension of XBRL requirements to MD&A and other narrative disclosures. Sophisticated investors increasingly take advantage of existing structured disclosures for comparative and trend analysis. However, the SEC also notes significant costs and risks of data entry errors due to the redundant nature of preparing tagged presentation of information in addition to conventional financial statements and reports. To address initial startup and ongoing costs of structured data tagging, the release seeks input on whether the requirements should be scaled to exempt smaller companies and what approaches may decrease the costs for smaller companies and investors to use structured data.

* * *

If you have any questions about this Clients & Friends Memo, please feel free to contact any of the following attorneys or your Cadwalader contact:

William P. Mills Partner	+1 212 504 6436	william.mills@cwt.com
Gillian Emmett Moldowan Special Counsel	+1 212 504 6004	gillian.moldowan@cwt.com
Daniel F. Zimmerman Senior Attorney	+1 212 504 5663	daniel.zimmerman@cwt.com

Appendix A: Key Questions for Comment

Noteworthy questions from the release to which companies and investors may wish to respond include the following. Numbers in parentheses correspond to the numbering in the release.

1. Should the Commission consider including automatic sunset provisions in new disclosure requirements? If so, what types of disclosure requirements should include these provisions? What factors should we consider in identifying them? What would be an appropriate length of time for any sunset provisions? Would this length of time vary with the nature of the rule in question? (Request 1)
2. Should we revise our principles-based rules to use a consistent disclosure threshold? If so, should a materiality standard be used or should a different standard, such as an “objectives-oriented” approach or any other approach, be used? If materiality should be used, should the current definition be retained? Should we consider a different definition of materiality for disclosure purposes? If so, how should it be defined? (Request 6)
3. Should registrants assume some level of investor sophistication in preparing their disclosures? If so, what level or levels of sophistication? How should investor sophistication be measured? What are the risks or other disadvantages to investors if registrants either underestimate or overestimate the level of investor sophistication and resources when preparing their disclosures? Does disclosure protect all investors if it is tailored to a subset of the investor community? (Request 14)
4. In addition to scaled disclosure and confidential treatment, are there other accommodations that we could make to reduce costs for registrants while still providing investors with the information that is important or useful to making informed investment and voting decisions? (Request 22)
5. How could we update Item 101(c) [Narrative Description of Business] to better reflect changes in the way businesses operate? Are there particular categories or types of registrants for which these disclosure requirements are more or less relevant? (Request 32)
6. Risk profiles of registrants are constantly changing and evolving. For example, registrants today face risks, such as those associated with cybersecurity, climate change, and arctic drilling, that may not have existed when the 1964 Guides and 1968 Guides were published. Is Item 503(c) [Risk Factors] effective for capturing emerging risks? If not, how should we revise Item 503(c) to make it more effective in this regard? (Request 154)
7. Are there specific sustainability or public policy issues that are important to informed voting and investment decisions? If so, what are they? If we were to adopt specific disclosure requirements involving sustainability or public policy issues, how could our rules elicit meaningful disclosure on such issues? How could we create a disclosure framework that would be flexible enough to address such issues as they evolve over time? Alternatively,

what additional Commission or staff guidance, if any, would be necessary to elicit meaningful disclosure on such issues? (Request 216)

8. Some of the Commission's guidance limiting the use of cross-referencing pre-date the expanded use of technology that allows registrants to hyperlink to referenced disclosure. In light of technological changes that allow hyperlinks...should we reconsider those rules that seek to provide investors with information in a single location? (Request 294)
9. To the extent that information about a registrant is readily available on its website, what are the benefits of continuing to require disclosure of the same information in the registrant's filings? What would be the impact on registrant liability, accuracy of reported information or investor protection generally if we eliminated disclosure requirements for information that investors routinely access from websites? (Request 315)
10. In requiring structured data [XBRL, XML or similarly tagged data], the Commission has sought to make disclosure easier for investors to access, analyze and compare across reporting periods, registrants, and industries. Are there other technologies that could make disclosure easier for investors to access, analyze and compare? If so, how should we incorporate these technologies into our disclosure requirements? (Request 340)