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Effecting Effective Disclosure: A Look at the SEC's Initiative

Katayun I. Jaffari and Peter A. Jaslow, The Legal Intelligencer

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It is generally accepted that, year after year, public company disclosure grows in length and complexity. Companies tend to expand their existing disclosure by incorporating new information while retaining disclosure that may no longer be relevant or material. Likewise, few companies can claim to have maintained disclosure free of immaterial or boilerplate information. As a result, investors, regulators and other market participants have routinely expressed concerns regarding the difficulty in deciphering and navigating public company disclosure documents. In response, the U.S. Securities and Exchange Commission initiated a comprehensive analysis of its disclosure rules in order to recommend changes for more effective disclosure. This article discusses the SEC's disclosure effectiveness initiative as well as recommendations made by the SEC for companies to consider implementing while the initiative is ongoing.

Disclosure Effectiveness Initiative

The SEC's focus on disclosure effectiveness originated from a December 2013 study by the commission staff of the disclosure requirements in Regulation S-K, which was mandated by the Jumpstart Our Business Startups Act of 2012. In the study, the staff recommended that the SEC conduct a comprehensive analysis of its disclosure requirements for the purpose of improving disclosure, primarily focusing on the business and financial disclosures required under Regulation S-K and Regulation S-X. This analysis is currently under way, and the SEC has formed teams within the Division of Corporation Finance dedicated to reviewing specific disclosure requirements to identify potential improvements. The SEC has also established a spotlight page on its website to provide updates regarding the initiative. The spotlight page is available at http://goo.gl/jgQuNu. The SEC requested that companies, investors and other market participants submit comments through the spotlight page regarding how to make disclosure more effective.

The goal of the disclosure effectiveness initiative, as explained by Keith Higgins, director of the SEC's Division of Corporation Finance, in several speeches, is to recommend changes to modernize disclosure requirements by eliminating duplicative disclosures, reducing costs to public companies, increasing transparency and identifying potential gaps in disclosure. Reducing the volume of disclosure is not the SEC's only objective; rather, Higgins has explained that the ultimate goal of the disclosure effectiveness initiative is "to put better disclosure into the hands of investors." As part of the initiative, the SEC will also consider how information is disclosed to determine whether the filing of periodic reports continues to be the most effective approach to providing navigable information. Based on the findings, the SEC may consider and propose modernized formats for periodic reports.

Although the SEC's analysis is ongoing, in light of the importance given to the disclosure effectiveness initiative, companies should consider reviewing their disclosure. A proactive review is especially advisable due to the SEC's recommendation that companies begin making changes to enhance the effectiveness of their disclosure. To guide a company in this effort, the SEC has made several specific recommendations for enhancing disclosure in the past year.

Recommendations for Effective Disclosure

In preparation for rule changes resulting from the disclosure effectiveness initiative, the SEC has recommended that companies consider enhancing their disclosure by: (1) reducing repetition, (2) focusing disclosure on material information and (3) eliminating outdated information. Each of these recommendations is designed to improve the navigability of a company's disclosure documents in the absence of final rule changes by the SEC.

Reducing Repetition

The SEC's encouragement of companies to reduce repetitive disclosure stems from its observations that information is often repeated throughout a company's disclosure documents. For instance, information that is included in a company's financial statements, such as disclosure of significant accounting policies, is routinely repeated, almost verbatim, in the company's management's discussion and analysis (MD&A). The SEC has now asked companies to question whether there is a need to repeat such disclosure. If repeating disclosure is not necessary, companies should consider the use of cross-references as an effective alternative.

Focusing Disclosure on Material Information

The SEC has also expressed concern regarding the continued use of generic disclosures that could apply to any company. Companies typically use such disclosures as defensive measures against securities litigation. Risk factor disclosure is a principal example of such potential abuse. To improve disclosure, a company should instead tailor its disclosure to matters that could actually affect the company. Similarly, a company should not simply adopt disclosure made by other companies when preparing its disclosure. Companies should first ask whether such disclosure applies to them.

With this focus in mind, Higgins noted that materiality decisions often arise during the SEC comment process. He acknowledged however that the issuance of a comment "does not mean that [the SEC has] concluded the requested information is material." Further, he explained that it is not desirable for a company to merely acquiesce to comments by providing information that the company does not believe is material. Instead, it is the SEC's expectation that a comment will serve to initiate a dialogue regarding a company's disclosure.

One other related consideration is whether information is being disclosed merely in response to a noted industry trend or SEC "hot topic." Regardless of the trend or hot topic, companies should determine whether such trend or topic is relevant and material to them before incorporating such trend or topic in their disclosure documents.

Eliminating Outdated Information

Finally, the SEC has reminded companies that disclosures should change over time. In doing so, the SEC noted that information incorporated into a company's disclosure is rarely removed. Higgins reassured companies that "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." As a result, companies are encouraged to regularly reexamine existing disclosure and their specific circumstances to confirm whether such disclosure remains material, and if not, whether the disclosure should be removed.

Other Disclosure Considerations

In addition to the foregoing specific recommendations, the SEC has recently encouraged companies to "experiment with the presentation" of information in their periodic reports. Companies should consider alternative disclosure formats that facilitate concise and clear presentation of material information such as executive summaries of material information, tables and graphs.

In addition to MD&A, where executive summaries are often employed, companies should consider whether summarizing material information, either in bullet point or narrative form, in other sections would improve the navigability of their periodic reports. Companies can use such summaries in conjunction with cross-references in order to consolidate disclosure and improve access to important information.

Tables and graphs may be effective in reducing complex or repetitive disclosures. While tables are required for executive compensation disclosure, it may be appropriate to incorporate their use in other portions of a company's periodic reports. For example, many companies provide a comparison of results in MD&A in table form before textual explanations of the changes. Disclosing information in a table or graph allows companies to avoid disclosing such comparison in narrative form, which may sometimes be confusing. Moreover, disclosing such comparison information by way of a table or graph permits companies to focus on the reasons for the changes in the narrative disclosure.

Companies Should Begin Reviewing

Given the importance ascribed to the SEC's disclosure effectiveness initiative and the SEC's specific recommendations for effective disclosure, companies are encouraged to begin reviewing and considering enhancements to their disclosures. Each company should focus on its specific circumstances and disclosure should be tailored to such circumstances. To the extent a company has a concern or question regarding disclosure, the SEC has encouraged companies to submit such concerns or questions on the SEC's spotlight page for the initiative. Moreover, in an October 2014 speech, Higgins expressed the SEC's willingness to speak with companies about their disclosure questions or concerns. Although the SEC will not pre-clear specific disclosures, companies should consider this opportunity as they begin the process of reviewing and enhancing their disclosure.

Katayun I. Jaffari *is a partner in Ballard Spahr's business and finance department and a member of the securities, life sciences/technology, energy and project finance, and mergers and acquisitions/private equity practice groups. She can be reached at jaffarik@ballardspahr.com or 215-864-8475.* ***Peter A. Jaslow*** *is an associate in the firm's business and finance department. He advises clients regarding securities matters, including corporate governance, disclosure, and compliance matters. He can be reached at jaslowp@ballardspahr.com or 215-864-8737. •*