

The Materiality Standard for Public Company Disclosure: Maintain What Works

A foundational principle of the U.S. securities laws is that public companies have an obligation to publicly disclose information to prospective investors and shareholders so that they may make informed investment and proxy voting decisions. To help identify information that is most useful to investors and filter out less significant information, the Congress that adopted the federal securities laws in the 1930s incorporated the materiality principle as a fundamental tenet to the disclosure requirements under the federal securities laws. The Securities and Exchange Commission (SEC) similarly incorporated the principle of materiality into its rules. Thus, for approximately eight decades, the principle of materiality has been embedded in the disclosure framework that governs how public companies disclose information to the investing public. Not only does this foundational principle serve investor protection well by filtering out irrelevant material, but the concept also naturally evolves over time to address new issues and developments and takes into account the facts and circumstances relevant to each company.

Policymakers should maintain the materiality standard for determining what information public companies must disclose to investors. The time-tested standard is proven effective in protecting investors and helping them make informed investment and voting decisions.

In the recent past, Congress has abandoned strict adherence to this bedrock materiality principle and sought to use the federal securities laws to address issues irrelevant to investment or voting decisions. Specifically, Congress enacted legislation requiring public companies to disclose information in SEC filings relating to conflict minerals and payments to foreign governments for resource extraction and mine safety – irrespective of the materiality of the information to investors and that the federal securities laws are ill-equipped to effectively address these issues. The SEC and public companies – and, ultimately, the investing public – have borne enormous costs and burdens in adopting, complying with and monitoring these new types of requirements.

Instead of benefitting investors, these mandates require expending extensive SEC resources proposing, adopting and implementing regulations that distract from its core statutory objectives, including investor protection. Compliance costs for public companies and their shareholders have been extraordinary in many cases. Investors also receive information that is irrelevant and distracting to their investment and voting decisions. Congress's

experiment in using the federal securities laws to address social concerns without any consideration of materiality has failed to achieve its stated objective.

It is also important to note that these requirements apply only to U.S. public companies. The thousands of large and small companies that have not accessed the U.S. public capital markets are not required to make these disclosures. This highlights the arbitrary, incompatible and distortive impact of the requirements, underscoring that pursuing a set of laws specifically designed for one purpose to instead achieve a completely unrelated objective is ineffective.

Nevertheless, various groups are now advocating for disclosure of additional information to address issues of societal concern, such as human trafficking and levels of political contributions, again without regard to whether the information is material to investors. To the extent these issues deserve the attention of policymakers, none should be addressed through the required SEC disclosure framework for public companies, absent a materiality component.

Deviation from the principle of materiality is costly to public companies, fails to serve the interests of investors and distracts the SEC from its core mission. In the future, Congress should avoid repeating the mistake of using the federal securities laws to address alleged societal concerns. Further, Congress should promptly move to repeal statutory provisions previously adopted under the federal securities laws that have raised these concerns.