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SEC Embarks on Potential Modernization of Regulation S-K

Last week, the Securities and Exchange Commission issued a [concept release](#) on modernizing the business and financial disclosure required by Regulation S-K, the central repository for the SEC's non-financial statement disclosure requirements. The release seeks public comment on 340 different questions, many with several sub-questions, spanning a wide range of disclosure issues from the extremely high-level ("Should we limit prescriptive disclosure requirements and emphasize a principles-based approach?" ... "Do investors, registrants and the markets benefit from quarterly reporting?") to targeted queries regarding the form and substance of specific line item disclosures. In addition, the release requests input regarding the potential for new line item requirements to cover non-financial topics of public policy and sustainability. The SEC is also seeking comment regarding the manner of providing public company disclosures to investors, including the effectiveness of the EDGAR system and the appropriate use of company websites as a disclosure tool. The release does not cover the compensation and governance disclosures typically included in proxy statements, which will be considered in a subsequent phase of the SEC's disclosure review initiative.

We applaud the SEC's acknowledgment that the structure and effectiveness of the disclosure system should be reviewed in light of modern investor needs and disclosure practices. Set forth below are what we believe should be the SEC's key areas of focus in this initiative.

*Disclosures in the New Paradigm.* As we have written [elsewhere](#), a developing new paradigm for corporate governance prioritizes sustainable value over short-termism, and integrates long-term corporate strategy with engagement between companies, their directors and long-term shareholders. We believe that the SEC's reforms should be crafted with this new paradigm in mind, so that the disclosure system facilitates the communication of information that investors want to hear and that companies want to convey.

In some respects, the release is an important step in this direction. For example, the release asks whether registrants should provide an executive-level "overview of their performance in the most recent year as well as expectations and concerns for the coming year, similar to what a CEO might report to the Board of Directors." Such an overview could be a useful means for explaining to investors how management and the board think about performance, strategy, expectations, capital allocation priorities, future drivers of growth, key risks and other important topics of concern.

Similarly, disclosure about the company's approach to risk management, another area of inquiry in the release, potentially can be useful for investors, in order to better understand how companies are adapting to and dealing with evolving issues relating to, for example, cybersecurity. Likewise, environmental, social and governance ("ESG") issues, discussed in the release, have become a focus of engagement between investors and companies.

*Facilitating Relevant Disclosures.* That companies and investors want to broaden their communication on topics such as those mentioned above is demonstrated by the increasing discussion of these topics outside of periodic filings. For example, companies often present detailed

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“deep dive” reviews of their strategy, performance, capital allocation, etc. on “investor days,” and are increasingly discussing ESG and related issues on dedicated sections of their websites.

This observation—that companies are communicating about issues of concern to investors outside of Exchange Act filings—provides important context. Put simply, many companies and investors do not view Forms 10-K and 10-Q as an effective means of communicating. This is partly because companies understand that investors do not want to wade through all of the information in an Exchange Act filing in order to find the information that is most relevant to them. Over time, Exchange Act periodic reports have become ever more prescriptive, with increasing line-item disclosure requirements and SEC guidance as to content. As acknowledged in the release, the Supreme Court “has held that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision.” Yet it is difficult to conclude that all or even most of the information required to be included in Exchange Act filings meets this standard of materiality. Furthermore, the risk of liability for failure to disclose information also encourages companies to overdisclose, in order to minimize the risk of a claim that some fact or risk, in hindsight and in a regime laden with prescriptive requirements, arguably should have been disclosed, even if it was reasonably viewed at the time as immaterial and not required to be disclosed. As a result, many companies feel compelled to sacrifice usefulness and accessibility in favor of protection from legal risk through overdisclosure and standardized disclosure such as “boilerplate” risk factors. Such overdisclosure not only burdens corporate resources—at the expense of all shareholders—but often buries shareholders in an avalanche of information that ultimately limits the practical utility of Exchange Act filings.

This context has significant implications for the SEC’s review of the disclosure system. As an initial matter, simply adding more line items to Forms 10-K and 10-Q—even on topics that companies and investors may want to communicate about in the new paradigm—may be counterproductive. Disclosures added to these periodic filings pursuant to new mandates may end up being written with a view to minimizing legal risk rather than maximizing informativeness. Periodic filings will become even lengthier, and even less likely to be reviewed by investors.

The SEC should adopt reforms that facilitate the inclusion of relevant, readable disclosure, and eliminate incentives for unhelpful overdisclosure. For example, the SEC could adopt a rule providing that, if the company chooses to include in its Form 10-K an executive-level overview of the type described above, the overview would be deemed “furnished” rather than “filed,” similar to the current treatment of the compensation committee report. The SEC also could expressly provide that the safe harbors for forward-looking statements are available for such an executive-level overview, similar to the SEC’s position that forward-looking disclosures in management’s discussion and analysis are eligible for the safe harbors. Disclosure of risk management, sustainability and ESG-related information also could be encouraged if the SEC makes clear that such disclosure does not create incremental liability risk, for example, through an interpretation that such disclosure does not detract from the protection afforded by risk factor disclosures. Risk factor disclosure could be streamlined if registrants were given more comfort that their disclosure obligations truly are limited to the actual line item requirement for risk factors, which provides for “the most significant factors that make an investment in a registrant’s securities speculative or risky.”

The SEC should also provide greater flexibility in the types of information required. For example, the extensive prescriptions regarding the manner in which companies must describe their

business in their Form 10-K could be replaced with more high-level, principles-based requirements that give companies more flexibility (subject, of course, to antifraud rules) to supplement and/or replace detailed narrative disclosure with more easy-to-read formats (which may include graphics) to convey this information.

*Flexibility in Communicating to Different Investor Audiences.* The SEC should also expand companies' ability to satisfy disclosure requirements by posting information on their website and incorporating it by reference into their filings. This would allow companies the choice to use their SEC filings to provide more focused discussion of key financial information in a standardized way, to serve the needs of market participants who may value standardization (e.g., active institutional investors and research analysts who regularly review disclosures of significant numbers of companies on a comparative basis), while using other media to convey information in a more customized and high-level way for investors who benefit more from readability than standardization and granular detail. The SEC also should facilitate the use of modern technology such as social media platforms to communicate with investors, as many companies already are doing. This may also require, for example, that certain online materials accessed and made available through filings, nonetheless not be deemed "filed" for liability purposes.

As an overarching principle, the SEC's approach to these matters should be voluntary, rather than prescriptive, to give each company a range of options as to how to communicate with its investors in the most effective way given its particular circumstances and to allow best practices to develop in the marketplace.

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The Regulation S-K concept release represents an important step towards modernization of the disclosure system. We urge the SEC to prioritize companies' flexibility to communicate with investors about the topics most relevant to them, through user-friendly and customizable methods, accessible within the SEC system, while taking advantage of technological advances. Such an approach will best serve the goal of investor protection in a way that is both robust and continues to be effective as methods of communication and areas of investor concern inevitably continue to change.

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