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21st Century Initiative — New Transparency and Disclosure for U.S. Corporations — the Process Begins

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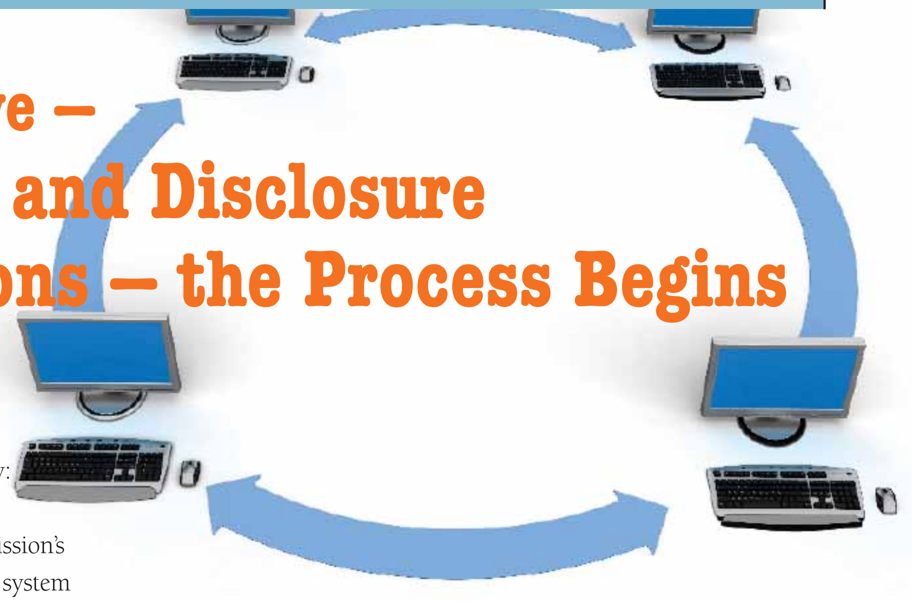

21st Century Initiative – New Transparency and Disclosure For U.S. Corporations – the Process Begins

BY LOIS YUROW

In January, the Securities and Exchange Commission published a report entitled "Toward Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System." Written by staff spearheading the Commission's 21st Century Disclosure Initiative, the report proposes a new system of disclosure designed to provide transparent and accessible information for investors, and to make filing and distributing information more accurate, efficient, and cost-effective for companies.

The 21st Century Disclosure Initiative

The Commission announced the 21st Century Disclosure Initiative back in June 2008, and put "plain English" expert (also an English professor and lawyer) Bill Lutz in charge. The stated goal of the Disclosure Initiative is to create "a modernized disclosure system that leverages technology . . . to meet the marketplace's needs." The SEC followed that announcement a few months later by introducing Interactive Data Electronic Applications (IDEA), an interactive "information portal" that will replace the 15-year old EDGAR filing system.

The publication of "Toward Greater Transparency" concludes the first phase of the Disclosure Initiative. Next, the Commission will consider forming an advisory committee to turn the report's broad recommendations into detailed proposals. Finally, the Commission will consider rulemaking based on those proposals.

IROs Consider: a New System of Disclosure

The overriding idea of the proposed disclosure system is that we should be using modern technology more aggressively to improve the way information is filed and disseminated. EDGAR stores information in text or document-based formats, and has a cumbersome search process. In contrast, the proposed disclosure system would create individual "company files" on the IDEA platform, each holding interactive data that can be searched, analyzed, compared, and updated easily.

The proposed disclosure system has four key components.

Interactive data. Today many companies offer an interactive version of their financial data, typically in XBRL. Under the proposed disclosure system, all data, including narrative non-financial information, would be electronically tagged to make it interactive and searchable.

Central data warehouse. All information would be stored in a central data warehouse, accessible in varying degrees to SEC staff, public companies, industry professionals, and investors. For example, investors could only access public information, while companies would have unfettered access to their own confidential files. The data warehouse would maintain the master version of all original filings and all updates, and investors and regulators would be able to extract and manipulate whatever data they want to create reports that meet their specific needs.

Filing methods. The SEC report suggests giving companies a choice of methods to comply with their filing obligations. For instance, companies could continue to upload 10-Ks and proxy statements in essentially the same way they have been filing on EDGAR, or use internal software that interacts directly with SEC software to transfer information with limited human involvement.

Distribution. There are several ways that information could be disseminated from the data warehouse. Investors or market professionals could search for complete filings or discrete data, or they could feed data from the warehouse directly into analytical tools. Suppose an investor wanted to track EPS for ten companies in her portfolio. She could use a software application to pull that information from IDEA as it is filed and plug it into a spreadsheet she maintains on her personal computer. IROs could do the same thing to extract the information they want to highlight for investors. Bill Lutz expects a "robust third-party market" for analytical software that will make this all possible.

Not Everything Will Change

The report does not propose any substantive changes in the current disclosure rules, though the Commission anticipates that rules will be adjusted so that companies can provide non-financial information in a standardized format that is susceptible to data tagging. An interested investor or SEC staffer could still construct a complete and familiar-looking annual report or proxy statement out of the individual pieces of information in a company's file.

Similarly, the current filing schedule for periodic reports would remain the same. The difference is that companies would be required to file only *new* and *changed* information. A company that hasn't altered its business description or properties would not re-file those pieces of its periodic reports; the business description and description of property in the company file would remain "alive."

Lois Yurow

If the content and the timing of the current disclosure system are being carried over, are the Disclosure Initiative recommendations merely form over substance? Bill Lutz says ***no***. Studies indicate that investors generally are satisfied with the types of information public companies are required to provide, but they also are "drowning" in it. The proposed disclosure system will enable investors to "manage and use information" by making it easier to find precisely what they want and by facilitating the use of software applications to analyze it all.

Everyone Wins

If implemented, the proposed system of disclosure would confer benefits on investors, filers (and their IROs), and the Commission.

- Investors would get customizable information in an accessible interactive format. They could analyze data, identify trends, and make comparisons over time or across companies with relative ease and little expense.
- Public companies would be able to automate and streamline the filing process, which would reduce human error and disclosure costs. Even better — they can file core data (like the company's primary address) just once, and reuse that filing unless the information changes.
- Commission staff and IROs would gain basically the same advantages as investors: it will be much easier to find and analyze the information they need to perform their jobs.

Are There Downsides?

Clearly there are many advantages to facilitating convenient interactive filings and eliminating redundant disclosure. But are there also risks? Will companies let their core information grow stale if they aren't forced to read it anew each time they file? Will investors understand that companies remain bound by the current paper-based filing schedule, or will they expect more frequent updates? Will it be difficult for investors who still want paper documents to get them? And if companies are required to continue producing paper documents at the same time they are uploading interactive data, does that cancel out the advantages of the proposed system for filers? If the SEC proceeds to phase two of the Disclosure Initiative and appoints an advisory committee, these are among the issues the members may consider.

Conclusion

With the markets in their present state of havoc, some critics question whether the Disclosure Initiative is a good use of Commission resources. In a recent speech before NIRI's New York chapter, Bill Lutz addressed that concern indirectly: "I believe that limited access to … information for investors may have been a contributing factor to the recent market turmoil …. It would not have averted this crisis, but improved transparency would have surely blunted some of the pain we are suffering."

"Toward Greater Transparency" (a very readable 20 pages) is available on the SEC's website, as is more information about IDEA and the Disclosure Initiative. See: ***www.sec.gov*** IRU

Lois Yurow *practiced corporate and securities law for several years and now helps public companies use plain English principles in their disclosure documents and investor communications. Contact her at* ***lois@securitieseditor.com***.