

## CORPORATE & SECURITIES, FINANCIAL SERVICES REGULATORY & ENFORCEMENT UPDATE

### Securities and Exchange Commission Holds Roundtable Discussion on 21<sup>st</sup> Century Disclosure Initiative

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On October 8, 2008, the US Securities and Exchange Commission (SEC) held a roundtable discussion exploring concepts for a new financial disclosure system as part of its 21<sup>st</sup> Century Disclosure Initiative, the Commission's most recent effort to modernize its disclosure system. The Roundtable focused heavily on replacing the Electronic Data Gathering, Analysis and Retrieval (EDGAR) system with a new disclosure reporting platform, the Interactive Data Electronic Applications (IDEA). As envisioned, IDEA would incorporate eXtensible Business Reporting Language (XBRL) tagging to allow investors to access financial data in an interactive manner. The 21<sup>st</sup> Century Disclosure Initiative will use IDEA's platform to implement wide-ranging changes to the disclosure system. Participants at the Roundtable discussed issues arising out of this modernization effort.

#### Background

The 21<sup>st</sup> Century Disclosure Initiative builds on prior SEC efforts to enhance and modernize financial disclosure. Since 2004, the SEC has promoted use of XBRL tagging for disclosures in general and for disclosure of financial information in particular.

Beginning in 2005, reporting companies have been able to voluntarily utilize XBRL tags and, in May 2008, the SEC proposed a rule to require the largest public companies to add XBRL tags to financial statements.<sup>1</sup>

The SEC has held other roundtables on interactive data. The first, on June 12, 2006, focused on providing better disclosure to mutual fund investors. Information gathered from that discussion was used to formulate the SEC's proposal to require a summary prospectus for mutual funds.<sup>2</sup> Other discussions have focused on XBRL tagging and its use in providing interactive data reporting.<sup>3</sup>

The 21<sup>st</sup> Century Disclosure Initiative was announced in June 2008 as an internal effort to fundamentally rethink financial disclosure. The Initiative will combine efforts to utilize new technology to improve the quality and accessibility of financial data with measures to simplify and consolidate the collection of that information.

To lead the Initiative, Chairman Cox appointed Dr. William Lutz, Emeritus Professor of English at Rutgers University. Dr. Lutz has worked frequently with the SEC on disclosure issues and played a key role in

the SEC's Plain English Initiative. He was instrumental in preparing the SEC's Plain English Handbook, a manual to help public companies and mutual funds write in clear and understandable prose when preparing SEC filings. The current Initiative, however, goes far beyond the Plain English initiative and, if pursued, could fundamentally reconstitute the way public filings are made and reviewed. As Dr. Lutz describes it, this Initiative is an agency wide effort to move from the current form-based system of disclosure to a "company file," where investors can find information in the formats that serve them best.

The Initiative includes the preparation, by the end of the year, of a high-level study that will provide a blueprint for the SEC's move toward a structured database form of disclosure. The current roundtable is part of the first phase of this Initiative. The intended second phase would be the appointment of an advisory committee to review the plan and make recommendations to the SEC. The plan would be implemented in the final phase, in which the SEC, over a multi-year period, would adopt the committee's recommendations.

### Panel Discussions

The roundtable was divided into two panels, the first discussing investors' use of EDGAR to investigate financial data and the second discussing how a modernized system of disclosure might work. Although Dr. Lutz introduced the panels, the moderators were John White and Buddy Donahue, respectively

the directors of the Division of Corporation Finance and the Division of Investment Management, the two SEC Divisions concerned most directly with disclosure. Panelists consisted of mutual fund and operating company representatives, investor advocates, academics, lawyers and others.

The first panel agreed that only sophisticated individual investors use EDGAR to conduct research. Most individual investors rely on newsletters, magazines, mutual fund web sites or third-party financial web sites such as Yahoo! Finance. There was a consensus that institutional investors utilize EDGAR only indirectly by subscribing to third-party data processors that reformat EDGAR filings for ease of use. Panelists agreed that EDGAR too often hides useful information within lengthy disclosure documents, creating barriers for institutional and individual investors alike. In addition, lengthy disclosure documents result in the duplication of data among disclosure forms filed by reporting companies.

The panel also discussed positive and negative aspects of XBRL tagging. The SEC's voluntary XBRL tagging program was seen as a successful proof-of-concept for providing interactive data. However, application of XBRL data tags to non-financial information was seen as difficult and tagging of financial data was susceptible to missing key information contained in footnotes. In closing remarks, panelists recommended that the SEC continue its application of XBRL tagging — and several

asked the SEC to consider consolidating the number of financial reporting forms currently filed on EDGAR.

The second panel focused on the new IDEA-based disclosure system. The panel began with a description of the SEC's proposal for a "company file system" that would serve as a single repository of disclosure information for each reporting issuer, in contrast to the current EDGAR system where reporting companies make multiple filings of multiple forms, often duplicating information. The company filing system would utilize tags, whether in XBRL or another format, to mark all of the data within a single file so investors could retrieve easily the information they desired. The tagging also would facilitate data comparisons between different companies.

The panel was also presented with the concept of a "questionnaire-based approach" for collecting disclosure information. Under this approach, the SEC would replace the majority of its current disclosure forms with an online questionnaire to be completed on a schedule pre-determined by the SEC. Panelists discussed advantages of the system, which include automatic tagging of responses based on the question answered and flagging of new information filed. Unchanged information would not be resubmitted, saving compliance costs.

Panelists agreed that the company file system and the questionnaire-based approach each provided the type of technologically advanced and flexible

disclosure system envisioned for IDEA. They disagreed, however, over whether the SEC should retain the current periodic disclosure schedule or adopt a continuous approach.

To maximize IDEA's usefulness to investors, panelists suggested that the information within the company file would have to be updated continuously. Other panelists argued that reporting companies would resist modifying the periodic disclosure system for liability reasons, as continuous disclosure would increase the likelihood that issuers might disclose incorrect information. Changes to the liability scheme for disclosure would require Congressional action, something the SEC wishes to avoid.

The next stage of this process is the preparation, by year end, of a report that will describe the modernized disclosure system and recommend future SEC action. Because of the need for quality, accessible disclosure, the 21<sup>st</sup> Century Disclosure Initiative has taken on renewed importance and should be followed carefully by public filers and investors.

## Endnotes

- <sup>1</sup> Interactive Data to Improve Financial Reporting, SEC Release No. 33-8924 (May 30, 2008), 73 Fed. Reg. 32794 (June 10, 2008). For a detailed discussion of this proposed rule, see Mayer Brown's Update, "SEC Proposes New Rules That Would Mandate Use of Interactive Data to Improve Financial Reporting," available at <http://www.mayerbrown.com/broker.asp?id=4938>
- <sup>2</sup> Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, SEC Release No. IC-28064 (Nov 21, 2007), 72 Fed. Reg. 67790 (Nov. 30, 2007).

<sup>3</sup> Agendas and transcripts of prior SEC roundtables on interactive data can be found at: <http://www.sec.gov/spotlight/xbnl/xbnl-meetings.shtml>

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