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Revisiting (Again) “Truth in Securities Revisited”: The SEC Disclosure Regime in the New Millennium

Abstract: The system of disclosure for public companies no longer meets the needs of investors and other stakeholders. Largely put in place by the Securities and Exchange Commission in 1982, the principles underlying the system have failed to keep pace with shifts in the market and dramatic changes in technology. The system requires a paradigm shift and fundamental alterations in the principles underlying the approach to disclosure. The shift must include the integration of comparative data, the expansion of the categories subject to mandatory disclosure, and the disaggregation of financial statements. Failure to update the system of disclosure will result in investors increasingly relying on sources of information outside of the periodic reporting process, reducing the importance of required disclosure and the role of the Securities and Exchange Commission.

Keywords: Periodic reports, climate change, mandatory disclosure, index investors, permanent capital, financial statement disaggregation, materiality

I. Introduction

Public companies file reports with the Securities and Exchange Commission (SEC or Commission) that are meant to keep investors in the capital markets informed. The contents of these reports were largely fixed in 1982 with the adoption of the system of integrated disclosure (the 1982 System).¹ Integrated disclosure reflected a paradigm shift that replaced an emphasis on public offerings with one favoring the informational needs of investors in the secondary markets.

The intellectual underpinning for the shift appeared in “Truth in Securities Revisited,” a seminal article written in 1966 by Milton Cohen.² Cohen recognized that the principles underlying the SEC’s

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¹ The system of integrated disclosure was adopted in Adoption of Integrated Disclosure System, Exchange Act Release No. 12264 (Mar. 3, 1982).

² Cohen worked for the SEC and led the “Special Study of Securities Markets,” something William Cary, then the Chair of the SEC, described as “unquestionably the most ambitious and comprehensive study [of the securities markets] since the passage of the securities acts thirty years ago” (Cary 1964, 557). Commissioners described him “as one of the seminal figures in the history of the S.E.C.” (Donaldson et al. 2004).

disclosure regime could become outmoded and result in a system that no longer met the needs of investors (Cohen 1966, 1340). Despite the growth in the secondary markets, the SEC continued to emphasize primary offerings over continuous disclosure. Cohen challenged the approach, calling on the Commission to elevate the importance of periodic reports and thoroughly integrate the disclosure requirements of the two relevant securities laws.

Over the next decade, the SEC rebuilt the disclosure regime mostly along the lines suggested by Cohen. The frequency of periodic reports increased, with quarterly disclosure mandated in 1970. The reporting regime was extended to additional industries, particularly after Congress filled in gaps in SEC oversight left over from the 1930s.³ The Commission developed a uniform set of instructions that aligned the requirements for periodic reports and primary offerings, culminating in the adoption of the system of integrated disclosure in 1982.⁴

In putting the regime in place, the Commission opted for a “principles-based” approach that placed materiality at the center. Whether discussing a company’s business operations, physical assets, or legal proceedings, disclosure was mostly required only for information important to a reasonable investor (Cohen 1985). The emphasis on materiality, however, came with a critical limitation. Materiality was to be company-specific and a matter of judgment.⁵ Managers were expected to “evaluate the significance of the information” and “tailor” the disclosure to fit their unique operations and circumstances.⁶ Under the approach, there was no obligation to treat identical transactions identically. Nor was there any need for comparative information, either as a means of reducing managerial discretion or as a means of facilitating cross-company comparisons.⁷

Almost as the ink dried, the 1982 System came under pressure. The tailored approach essentially treated investment decisions as binary, a significant limitation in an era of portfolio theory and comparative analysis. Institutions replaced individuals as the most common class of investors. Investment strategies changed. For large segments of the market, buy and hold replaced buy and sell,

³ The Exchange Act exempted certain industries from the periodic reporting process (Brown 2023a, 321–40). Congress repealed the language in 1976. Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31, 56–57.

⁴ Cohen himself viewed the article as seminal, describing it as being “widely regarded as having provided the initial impetus to what we now call the integrated disclosure system” (Cohen 1985, 987).

⁵ “Judgment” in the determination of materiality is explicitly incorporated into the required reporting regime. See Item 303(b)(2) of Regulation S-K (providing that disclosure of “results of operations” would need to include “any other significant component” that in the company’s “judgment, would be material”). Auditors likewise rely on “professional judgment” in assessing materiality. See *In re Avis*, Exchange Act Release No. 95071 (June 3, 2022) (“[t]he accountant should use his or her professional judgment in evaluating the materiality of any likely misstatements that the entity has not corrected”) (quoting PCAOB Auditing Standard 4105.26).

⁶ The SEC explained that “emphasizing principles-based disclosure may allow a registrant to more effectively tailor its disclosure to provide the information about its specific business and financial condition that is material to an investment decision and in turn may reduce the amount of disclosure that may be irrelevant, outdated or immaterial” and that “[p]rinciples-based rules rely on a registrant’s management to evaluate the significance of information in the context of the registrant’s overall business and financial circumstances and to determine whether disclosure is necessary.” Exchange Act Release No. 86614 (Aug. 8, 2019).

⁷ Indeed, as one scholar noted, to have done so would have been “looked upon by the SEC’s examiners with great concern” (Kripke 1975, 306). Professor Kripke observed: “[W]e run immediately into the fact that disclosure under the Securities Acts deals with each single company, separately. Any specific statements about the reporting company’s competitors or its place in the industry would be looked upon by the SEC’s examiners with great concern; but comparison of availabilities, investments, expected returns and risks is the heart of securities selection realistically, despite the mythology” (ibid. at 305–06). Professor Kripke was described by Mary Beach, a former SEC official, as “somewhat of a legend already in the academic community” (Beach 2002).

making engagement with management, rather than the Wall Street Walk, the primary means of affecting share values. Technological developments profoundly altered the ability of corporations to provide, and the market to absorb, more detailed and granular financial disclosure.

Despite these shifts, the underlying principles of the 1982 System remain firmly in place. As Cohen recognized, however, a regime that does not keep up with developments in the market can cease to meet the needs of investors and fail in its intended purpose. To avoid this, the SEC's disclosure system needs to incorporate at least three broad and interrelated principles.⁸

First, the approach to materiality, the foundation of the entire regime, should take into account the needs of reasonable investors for comparative information, both to facilitate cross-company analysis and to better understand the company making the disclosure. Second, the system of mandatory disclosure should better address the informational needs of investors who buy and hold rather than buy and sell. Finally, the Commission should fundamentally alter the approach to financial disclosure by increasing the degree of disaggregation in, and comparability of, financial statements.

The failure to update the system will have significant consequences. Demand for the information will not go away. Technology will continue to develop. As the divergence between the needs of investors and principles underlying the system of mandatory disclosure grow, the importance of the periodic reporting process and the role of the SEC will decline.⁹ Reforms will not, however, be easy. The protracted opposition to the SEC's efforts to add climate disclosure to the periodic reporting process illustrates the challenges that will confront any effort at fundamental change.

This article will first revisit Cohen's seminal work and the resulting transformation of the SEC's disclosure regime, a process that resulted in the adoption of the system of integrated disclosure in 1982. It will examine the shifts in the market that have occurred since then and the resulting pressure on the periodic reporting process. The article will consider fundamental reforms that need to take place to ensure that the SEC's disclosure regime continues to meet the needs of investors.

II. Truth in Securities Revisited

The system of disclosure that existed in 1966 when Milton Cohen wrote his seminal piece emphasized public offerings over periodic reporting. Path dependency explained some of the approach. After all, the Securities Act of 1933 (1933 Act) came first.¹⁰ The 1933 Act also had some structural advantages. Allowing shareholders to recover under a theory of strict liability, Section 11 incentivized accurate disclosure.¹¹ Information in public offerings was also more readily available. In an era when

⁸ The need for comparability, for example, arose at least in part from the demands emerging from portfolio theory. Similarly, index funds and the development of permanent capital are related to portfolio theory (Gilson and Gordon 2013, 884–86) (discussing the impact of portfolio theory on the growth in index funds).

⁹ The importance of financial statements had declined (Lev and Gu 2016). Investors also increasingly rely on information outside the mandatory disclosure regime, whether non-GAAP metrics (Audit Analytics 2018), or key performance indicators. Exchange Act Release No. 77599 (Apr. 13, 2016). The need for climate-change disclosure gave rise to a voluntary system of disclosure largely outside the oversight of the SEC (Brown 2023a). For a discussion of the strengths and weaknesses of voluntary disclosure regimes, see Fairfax (2022, 336).

¹⁰ As Cohen viewed it, the disclosure regimes would have been “quite different” had the two laws “been enacted in opposite order, or . . . been enacted as a single, integrated statute” (Cohen 1966, 1341).

¹¹ Liability under the Securities Exchange Act of 1934 in return required proof of actual reliance and “something more than negligence.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n.28 (1976). Cohen described the 1933 Act as “a narrowly

information filed with the SEC was logistically difficult to obtain, prospectus delivery requirements at least sometimes ensured actual receipt of the relevant disclosure.

The requirement in the Securities Exchange Act of 1934 (Exchange Act) for periodic reporting received less emphasis. In some ways, the approach amounted to a path of least resistance. The Commission had a regulatory monopoly on public offerings but not periodic reports. Since the 1930s, the NYSE had required listed companies to make quarterly disclosure (Cohen 1966, 1363) (“The major stock exchanges require all issuers of listed stocks, and the National Association of Securities Dealers generally requires issuers of stocks included in its over-the-counter quotations lists, to publish quarterly earnings figures through financial news media.”).¹² With the adoption of the Exchange Act, the Commission mandated annual reports with audited financial statements but would wait another forty years before requiring quarterly disclosure.¹³

Cohen made the case that the SEC’s approach was not meeting the needs of most investors. Registration statements, whatever their quality, had a short shelf life and eventually became stale. Periodic reporting required by the NYSE lacked consistency¹⁴ and raised qualitative concerns.¹⁵ Applicable only to listed companies, the standards did not extend to the roughly five thousand companies in the over-the-counter (OTC) market.¹⁶

A. Cohen’s Insight

Writing with the views and nuance arising out of extensive experience with, and understanding of, both regulatory regimes, Cohen made the case that the SEC’s disclosure regime no longer met the needs of investors. For registration statements, staff reviews were conducted with “remarkable zeal and efficiency.” The Commission also had leverage, with the authority to issue stop orders described by Cohen as a “death warrant.” Disclosure under the 1933 Act was as a result taken more “seriously”¹⁷

focused but high-powered effort to assure full and fair disclosure on the special occasion of a public offering” (Cohen 1966, 1340).

¹² The NYSE did so in the 1930s. The American Stock Exchange, however, only imposed the requirement in 1962 (Park 2020, 998). Nasdaq mandated actual distribution of quarterly reports to shareholders, a requirement that was repealed in 1988. See Exchange Act Release No. 25993 (Aug. 12, 1988) (eliminating requirement that issuers distribute “interim reports to shareholders”).

¹³ Exchange Act Release No. 9004 (Oct. 28, 1970). Some quarterly reporting had been required as a wartime measure. See Exchange Act Release No. 3718 (July 23, 1945). At the time Cohen wrote, in 1966, “most but not all registrants” were required to file reports semiannually (Cohen 1966, 1357).

¹⁴ As Cohen described, however, “[t]he contents of such interim reports are not prescribed in any detail, and the full disclosure standards of the federal securities laws do not apply” (Cohen 1966, 1363). Or, as another scholar put it, “Prior to 1970, many public companies listed on exchanges provided quarterly reports to investors. The NYSE had required such disclosure of all listed companies since the 1930s, though it gave companies significant discretion in what they would report” (Park 2020, 998).

¹⁵ Although some companies provided quarterly disclosure, the information was often not “trustworthy” (Park 2020, 998).

¹⁶ The companies became subject to the periodic reporting process with amendments to the Exchange Act adopted in 1964 (Brown 2004, 337). Disclosure in the OTC market among the largest companies was viewed as deficient, with the Commission reporting that “the financial data in 21 percent of the annual reports of the 588 [unlisted] firms then not subject to the continuous disclosure provisions of the 1934 Act were found to be materially deficient under the standard of the Commission’s accounting regulations” (Seligman 1983, 38).

¹⁷ “Yet, as a broad generalization, the disclosure process under the 1934 Act (apart from proxy solicitations) appears never to have been taken quite as seriously as under the 1933 Act, very likely because of differences in the attendant liabilities and sanctions and in Commission procedures” (Cohen 1966, 1361).

both by practitioners and by the Commission.¹⁸ Periodic reports in contrast were “less coherent and readable”¹⁹ and less available.²⁰ As others described, as a result of developing separately, the disclosure regimes from the two Acts were “overlapping, inconsistent, and, in some instances” contained “gaps” (D’Alimonte 2001, 55).

Cohen sought improvements in the quality of continuous disclosure. His primary goal wasn’t to weaken the 1933 Act regime, although he identified “unneeded fat” that could be cut, but to elevate the role of periodic reports. That meant better “quality, currency [timeliness], and accessibility of filed data.” The ultimate goal was disclosure that was “substantially equivalent to a current 1933 prospectus” (Cohen 1966, 1368).

Cohen called on the staff at the SEC to devote more attention to periodic reports through increased review and enforcement. He argued for greater coordination between the two Acts. His suggestions on coordination ranged from the broad, including routine use of incorporation by reference from one filing to another, to the narrow, including a uniform system of numbering the disclosure requirements across filings.

B. *Cohen’s Effect*

Cohen’s case was compelling and, for the next fifteen years, the Commission revised the disclosure regime largely along his suggested lines. Reporting became more frequent, with disclosure required on a quarterly rather than a semiannual basis. Although not entirely displacing the stock exchanges,²¹ quarterly reports required by the Commission were more comprehensive²² and uniform.²³

¹⁸ “The quality (in the sense of completeness, accuracy, and reliability) of disclosures under the 1933 Act is undoubtedly higher, on the average, than that under the 1934 Act, perhaps excepting disclosures contained in proxy soliciting material” (Cohen 1966, 1391).

¹⁹ Later, Cohen would write that “[b]efore the integration program was undertaken, the quality of 1934 Act disclosures was clearly inferior to that of 1933 Act disclosures even though both disclosure systems had existed about the same length of time” (Cohen 1985, 987).

²⁰ Cohen recognized the growing importance of technology and speculated that issuers could find themselves able to provide investors with disclosure of information increasingly stored on “computers” (Cohen 1966, 1377).

²¹ There were places where the Commission left the disclosure requirements to the exchanges. See Exchange Act Release No. 8683 (Sept. 15, 1969) (“The Commission considered requiring prompt reporting of an event within a few days of its occurrence. However, this appears difficult to administer and unduly burdensome and duplicative of the timely disclosure policies of the major stock exchanges and otherwise pursued by many companies.”).

²² The SEC described the standards for quarterly reports at the stock exchanges as “minimal.” Exchange Act Release No. 8684 (Sept. 15, 1969).

²³ Exchange Act Release No. 8683 (Sept. 15, 1969) (proposing to require “uniform standards” for quarterly reports). Or as others described, “After an extensive study of the disclosure practices of public companies by SEC Commissioner Francis Wheat found that the quality of the quarterly reports mandated by stock exchanges was not uniform, the SEC promptly moved to take control of quarterly disclosure” (Park 2020, 1001).

The categories of public companies subject to continuous reporting expanded.²⁴ Quarterly reporting gradually extended to a wider array of businesses, including insurance²⁵ and developmental stage²⁶ companies. Amendments adopted in 1976 to the Exchange Act brought public utilities, common carriers, and pipeline companies into the mandatory reporting regime (Brown 2023a). By the end of the decade, operating companies trading in the public markets were collectively subject to the SEC's continuous disclosure regime.

The Commission also integrated the disclosure requirements of the two Acts. Embracing the efficient market theory (Prozan and Fatale 1992, 702),²⁷ the SEC adopted Regulation S-K, “a new, integrated disclosure regulation.”²⁸ The 1982 System included a “significantly expanded and reorganized” version that served as “the repository for the uniform non-financial statement disclosure regulation requirements under both the Securities Act and Exchange Act.”²⁹ While Cohen spoke about the need for equivalency with respect to the two disclosure regimes, his approach actually laid the groundwork for replacement. The system of periodic reporting would ultimately consign the public offering process mostly to a peripheral role.³⁰

²⁴ When the SEC implemented mandatory reporting on a semiannual basis, some industries were exempted. See Exchange Act Release No. 5189 (June 23, 1955) (semiannual reports excluded “(1) banks and bank holding companies; (2) investment companies; (3) insurance companies, other than title insurance; . . . (5) companies engaged in the seasonal production and seasonal sale of a single-crop agricultural commodity; (6) companies in the promotional or development stage . . . ; (7) foreign issuers other than private issuers domiciled in a North American country or Cuba”). With the adoption of quarterly reports, some of the industries exempt from semiannual reporting were added, including banks. See Exchange Act Release No. 8683 (Sept. 15, 1969) (“Certain categories of registrants now exempt from filing Semi-Annual financial Reports on Form 9-K would not be exempt from filing Part II of proposed Form 10-Q. For example, the Commission believes the trading markets should have the benefit of quarterly financial information concerning bank holding companies and those banks required to file Annual Reports on Form 10-K.”).

²⁵ Insurance companies were initially exempted “because of the difficulty these companies had in determining quarterly results.” Exchange Act Release No. 12203 (Mar. 15, 1976) (“This decision was based primarily on the assertion that the majority of companies in this industry had neither the data processing capability nor the actuarial information necessary to compute deferred acquisition costs and reserve valuations at interim dates.”). Insurance companies became subject to the quarterly report regime in 1977. Exchange Act Release No. 13156 (Jan. 13, 1977).

²⁶ See Exchange Act Release No. 10180 (June 1, 1973); see also Exchange Act Release No. 9673 (July 26, 1972) (“Testimony by venture capitalists and underwriters in connection with the Commission’s study of hot issues markets has disclosed that current financial information of companies in the promotional or development stage is of material importance, since even day to day business events such as the signing of a contract, receipt of an order, or the closing of an office may have significant impact on the financial condition of the company.”).

²⁷ Others recognized the connection to the efficient market theory. As Professor Seligman wrote, “[t]he SEC’s ‘integrated disclosure system’ . . . coordinates required disclosures under the 1933 Act and the 1934 Act, in light of an assumption of the efficient market hypothesis that information effectively disseminated to the public will be rapidly reflected in share prices regardless of the source of the data” (Seligman 1995, 683).

²⁸ Securities Act Release No. 5893 (Dec. 23, 1977). See also Securities and Exchange Commission (2013, 10) (“This marked the first time that the principal disclosure items were made uniform for both registration statements and periodic reports.”).

²⁹ Exchange Act Release No. 77599 (Apr. 13, 2016) (“Over thirty years ago, the Commission expanded and reorganized Regulation S-K to be the central repository for its non-financial statement disclosure requirements.”). For a history of Regulation S-K, see Securities and Exchange Commission (2013).

³⁰ “[T]he balance between the primary market and the secondary market has shifted even more dramatically in the direction of secondary trading. . . . Increasingly, the ’33 Act is becoming peripheral, not central, to modern securities regulation” (Coffee 1995, 1149). “Cohen’s argument was simply the commonsense notion that disclosure obligations should be made consistent for the two markets. The implication of the efficient capital market hypothesis, however, is that disclosure particular to securities offerings might be largely redundant” (Pritchard 2013).

III. The 1982 Regime and Materiality

Cohen's article paid only modest attention to the actual content of required reports. He viewed the two regimes as largely identical.³¹ Both included a description of:

the issuer's business and property, its recent history, its controlling and controlled persons, its management and their compensation and interests, its material contracts, its capital structure and options, the terms of its outstanding securities, and, perhaps most important of all, its financial condition and results of operations.³² (Cohen 1966, 1340)

Focused on structure, he opted to "put aside the question" of content, observing only that the SEC had "no lack of statutory authority" to impose disclosure requirements and had shown no "reluctance . . . to exercise its powers" (Cohen 1966, 1368).

The version of Regulation S-K adopted in 1982 mostly aligned with Cohen's description. Disclosure would extend to a number of traditional categories, including a description of the company's business, properties, and legal proceedings. Risk factors were initially required for registration statements, but eventually extended to periodic reports.³³ Over time, the SEC would add additional topics,³⁴ sometimes when told to do so by Congress,³⁵ and occasionally adopt modest or clarifying changes.³⁶ But the fundamental framework of the system put in place in 1982 largely remained unchanged.

A. Materiality

Although it set out specific topics, the 1982 System was premised on materiality.³⁷ A small number of exceptions aside,³⁸ the explicit disclosure requirements came with a materiality qualifier. Reports needed to contain "information material to an understanding" of the development of a business, a description of principal physical properties "[t]o the extent material," and pending legal proceedings

³¹ Cohen did make at least one specific suggestion, that "[p]erhaps the most significant deficiency in the 1934 Act's continuous coverage is with respect to an issuer's sales and purchases of its own securities, but this is primarily a question of currency of information and is discussed under that heading below" (Cohen 1966, 1340).

³² The required financial statements included "a (relatively) recent certified balance sheet, certified profit and loss and surplus statements for three years, and an earnings summary for those three years and two earlier ones; and, where the certified figures are not recent enough, uncertified figures as of a more recent date" (Cohen 1966, 1345).

³³ They were originally included in Item 503(c) of Regulation S-K. Exchange Act Release No. 12264 (Mar. 3, 1982).

³⁴ Exchange Act Release No. 97989 (July 26, 2023) (adopting Item 106 of Regulation S-K to require cybersecurity disclosure).

³⁵ Exchange Act Release No. 66019 (Dec. 21, 2011) (adopting Item 104 of Regulation S-K, requiring mine safety disclosure).

³⁶ Exchange Act Release No. 89670 (Aug. 26, 2020) (amendments to Items 101, 103, and 105 of Regulation S-K).

³⁷ The 1982 adopting release did not actually use the term "principles based." This description, however, has become widely accepted, to the point where the Commission observed that "[t]hese disclosure requirements are often referred to as 'principles-based' because they articulate a disclosure concept rather than a specific line-item requirement." Exchange Act Release No. 86614 (Aug. 8, 2019).

³⁸ A small number of provisions relied on "objective, quantitative thresholds"—see Release No. 77599 (Apr. 13, 2016) ("Some of our rules employ objective, quantitative thresholds to identify when disclosure is required, or require registrants to disclose information in all cases.")—including environmental proceedings under Item 103, 17 C.F.R. § 229.103, and related party transactions under Item 404(a), 17 C.F.R. § 229.404(a) (defining as not de minimis any transaction where "the amount involved exceeds \$120,000").

if “material.”³⁹ Other material information was required to the extent necessary to make the disclosure accurate and complete.⁴⁰

The 1982 System embraced a narrow approach to materiality. Management was expected to “evaluate the significance of the information” and “tailor” the disclosure to meet the company’s unique circumstances. The approach gave corporate officials “considerable latitude” on what to disclose⁴¹ and even “whether disclosure [was] necessary.”⁴² The approach did not for the most part take into account the importance of comparative information to reasonable investors or the possibility that, at least in some cases, a reduction in managerial discretion could yield a more accurate understanding of a company’s operations and business.⁴³ There was no obligation to treat identical transactions identically.

Under the system, investors had to “trust” that management would get the analysis right.⁴⁴ This was the case despite differences in how investors and managers viewed the importance of information,⁴⁵ the risk of erroneous determinations,⁴⁶ and the incentives for opportunist disclosure, particularly with respect to adverse developments (Brown and Wald 2023, 600–01).

The wide discretion and management-centric nature of the approach was not derived from the Supreme Court’s interpretation of materiality.⁴⁷ *TSC Industries, Inc. v. Northway*, 426 U.S. 438 (1976), and *Basic, Inc. v. Levinson*, 485 U.S. 225 (1988), both stressed the importance of the information to reasonable investors, a flexible and objective standard not limited to information related to each company’s unique circumstances. Moreover, the Court explicitly counseled against determinations “based on management concerns.” *Basic*, 485 U.S. at 233.

³⁹ See Items 101, 102, and 103 of Regulation S-K, 17 C.F.R. 229.101–03. See also Exchange Act Release No. 12264 (Mar. 3, 1982) (describing the focus of Regulation S-K as “a comprehensive evaluation of the disclosure policies and procedures under both Acts to identify the information which is material to security holders and investors”).

⁴⁰ Rule 12b-20, 17 C.F.R. 240.12b-20 (“E]xcept for certain detailed affirmative statutory requirements, information must be furnished only if material.”) (SEC 1976, 21).

⁴¹ “While the SEC’s mandatory disclosure requirements provide a basic framework and minimum standard for many financial disclosures, considerable latitude remains in determining what information is actually provided” (Lang and Lundholm 1993, 246).

⁴² Exchange Act Release No. 86614 (Aug. 8, 2019).

⁴³ “[S]ince the process of disclosing information is costly to the issuer, the issuer’s obligation to disclose should be focused on the information as to which it does have a comparative advantage—value-relevant information about the issuer’s own business” (Kitch 1995, 775). The need for “firm-oriented information” was discussed in the Report of the Advisory Committee on Corporate Disclosure. Committee on Interstate and Foreign Commerce, 95th Cong., *Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission: Evolution of SEC Policies and Practices Regarding Projections* (Comm. Print 1977).

⁴⁴ As one commissioner at the SEC put it, “Investors are asked to trust that each individual company has gauged materiality on these complex issues with flawless precision and objectivity” (Lee 2020b).

⁴⁵ See SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150 (Aug. 19, 1999) (providing issuers and auditors with examples of information that may be material to investors on a qualitative basis).

⁴⁶ As the Commission has noted, “shifting to a more principles-based approach may result in the elimination of disclosure material to an investment decision if issuers misjudge what information is material.” Exchange Act Release No. 86614 (Aug. 8, 2019).

⁴⁷ See Exchange Act Release No. 12264 (Mar. 3, 1982) (“Since the proposed definition is based on the definition as set forth by the Supreme Court in *TSC Industries, Inc. v. Northway*, the Commission has determined to adopt the definition of the term ‘material’ as proposed.”). The Commission has previously used the “average prudent investor” standard for materiality. See *In re Winnebago Distilling Co.*, Securities Release No. 2188 (Feb. 24, 1940); *In re Charles A. Howard*, 18 F.T.C. 626, 629 (1934).

B. *Principles-Based Disclosure and MD&A*

An example of the concerns raised by a management-centric approach to materiality could be seen through the disclosure required in management's discussion and analysis (MD&A), Item 303 of Regulation S-K, 17 C.F.R. § 229.303, the narrative accompanying financial statements used in periodic reports and registration statements. Principles-based, with an emphasis on materiality,⁴⁸ and relying on a company-specific approach,⁴⁹ the requirements were expected by the SEC to reveal management's perspective on the company's operations.⁵⁰ MD&A disclosure did not, however, yield the desired results.

Criticism of the quality of the disclosure has been widespread. Officials at the SEC expressed "great concerns" with the quality of disclosure (Quinn 2002), describing the contents as "quite troubling" (Walter 2010) or sometimes "essentially useless" (Glassman 2003). In "too many companies," MD&A was viewed as "difficult to understand and confusing."⁵¹ A former division director of the Division of Corporation Finance in the new millennium described the disclosure as "too much elevator music" and not enough "useful analysis" (Beller 2002).⁵²

The Commission deployed a host of mechanisms designed to improve the quality of MD&A disclosure, including guidance,⁵³ enforcement actions,⁵⁴ and amendments⁵⁵ to the provision, with little success.⁵⁶ What the Commission did not do to improve disclosure quality was embrace a less principles-based and more comparative approach that would limit the discretion of management.

⁴⁸ Trend disclosure required a test that did not precisely rely on materiality. See Item 303, 17 C.F.R. 229.303. Nonetheless, materiality was described as the "primary consideration" of the requirement. Exchange Act Release No. 85381 (Mar. 20, 2019); see also Exchange Act Release No. 77599 (Apr. 13, 2016) ("Commission guidance has continued to stress the importance of materiality in MD&A and stated that disclosure should emphasize material information and de-emphasize or, if appropriate, delete immaterial information.").

⁴⁹ "Rather than focusing on prescriptive, line-item disclosure requirements, MD&A requirements were intended to function as principles-based requirements, in order to elicit meaningful, company-specific disclosure" (Securities and Exchange Commission 2013). As a result, "the vagueness of the mandate to describe 'trends or uncertainties' means that companies will differ with respect to the information that they provide" (Park 2020, 1027).

⁵⁰ Exchange Act Release No. 90459 (Feb. 10, 2021).

⁵¹ Exchange Act Release No. 48960 (Dec. 19, 2003).

⁵² Beller served as Director of the Division of Corporation Finance from 2002 to 2006.

⁵³ See Exchange Act Release No. 61649 (Feb. 8, 2010) (Commission Guidance Regarding Disclosure Related to Climate Change). The use of guidance was unsuccessful in significantly improving the quality of climate-change disclosure. As one study concluded, "[r]esults show that more companies are saying something about climate in their 10-K filings but, of those that are disclosing something, they are not reporting more useful information. In fact, their disclosures appear to be getting briefer and less specific" (Coburn and Cook 2014, 12).

⁵⁴ The cases are discussed in Brown (2024a, chap. 5).

⁵⁵ Exchange Act Release No. 90459 (Feb. 10, 2021).

⁵⁶ "Empirical MD&A reviews, which are regularly conducted by the SEC's enforcement division, the Division of Corporation Finance, have always pointed out the systematic shortcomings of MD&As published by U.S. companies" (Hüfner 2007, 59). Concerns over the quality and content of MD&A have been echoed by public commentators (Kelleher 2016, 14) (noting that "the lack of analysis in the MD&A is a matter of real concern"), and academics (Brown and Tucker 2011, 312).

C. *The Effects*

The 1982 System established a disclosure framework that remained in place for the next four decades. Some changes occurred in the aftermath. Periodic reports became easier to access.⁵⁷ A few additional topics were added, including mine safety and cybersecurity. The approach to materiality was, however, unchanged. Remaining a matter of judgment, the 1982 System ensured that disclosure decisions would be examined through the prism of “management concerns.” The approach did not simply “filter out disclosure of insignificant details,” but resulted in the omission of information important to reasonable investors.⁵⁸

IV. Comparable Disclosure

The concept of materiality employed in the 1982 System entirely omitted the need for comparative disclosure.⁵⁹ Comparative disclosure contemplates requirements applicable to all relevant issuers, irrespective of the unique importance to their particular business, and relies on common approaches and standardized definitions (Fink 2020; Public Company Accounting Oversight Board 2024). Application does not generally depend on the judgment of management.⁶⁰

A. *The Importance of Comparability*

The approach provides a variety of benefits. Comparability enhances transparency and reduces informational asymmetries.⁶¹ For issuers, transparency can improve the efficiency of the acquisition process (Chen et al. 2018), result in more cost-effective borrowing (Hill et al. 2024), and reduce disclosure risks (Drake 2019). Comparative disclosure can also lower costs. Where management already collects the relevant information, mandatory disclosure eliminates the need for, and costs of, a separate materiality assessment and reduces the risks associated with an incorrect determination.⁶²

Comparative information also benefits investors. Increased transparency can improve an understanding of a company’s operations, reducing asymmetries between managers and users (Blanco

⁵⁷ “The pilot program for the Electronic Data Gathering, Analysis and Retrieval (‘EDGAR’) was established in 1983 pursuant to a Congressional mandate, and the system was fully effective on January 30, 1995” (Securities and Exchange Commission 2013, 13n31).

⁵⁸ Exchange Act Release No. 47264 (Jan. 28, 2003).

⁵⁹ The growing importance of comparable disclosure was not unknown when the SEC implemented the 1982 System. As Professor Kripke described, “Portfolio theory teaches that investments should be appraised not by the particular security, but by the overall portfolio and its overall risks. The suitability of a particular investment should be considered not on its individual merits alone, but on its contribution to the diversification and the risk of the total portfolio. There is no reflection of that kind of thinking in the securities legislation to date” (Kripke 1975, 306). Or as the Financial Accounting Standards Board (FASB) put it, “investing and lending decisions essentially involve evaluations of alternative opportunities, and they cannot be made rationally if comparative information is not available” (Financial Accounting Standards Board 1980).

⁶⁰ “[S]ome line-item requirements in Regulation S-K employ bright-line, quantitative thresholds to specify when disclosure is required, or require all registrants to disclose the same type of information. These requirements . . . do not rely on management’s judgment to determine when disclosure is required.” Exchange Act Release No. 86614 (Aug. 8, 2019).

⁶¹ “To the extent that prescriptive requirements result in more complete disclosures, such requirements could benefit investors by reducing information asymmetry.” Exchange Act Release No. 86614 (Aug. 8, 2019).

⁶² The costs of nondisclosure would have to be weighed against the risks of false or misleading statements where disclosure was made.

et al. 2023),⁶³ and facilitate an assessment of performance across firms (Campbell and Young 2017), including peers (Blanco et al. 2023). Greater comparability can result in an increase in analyst coverage and improvements in forecasts (De Franco et al. 2011). Comparability can also facilitate fraud detection (Blanco et al. 2023).

The benefits of comparative data explain some of the opposition. The approach increases transparency for competitors, acquirers, and regulators (Blanco et al. 2023). The accompanying reduction in the application of judgment also reduces the ability of companies to consider disclosure through a filter of “management concerns.” The reduced discretion can result in increased disclosure of negative developments and potentially shorten a CEO’s tenure.⁶⁴

B. *Case Studies of Comparability: Executive Compensation and Climate Change*

Outside of the financial statements, the 1982 System did not take into account the need for comparability. In at least two circumstances, however, alterations to the 1982 System were required to add comparable information. This occurred with respect to executive compensation and climate change disclosure, generating very different outcomes.

1. Executive Compensation and Comparability

Executive compensation provides information that, in the absence of comparability, has limited use. Without a common approach to calculating amounts paid to the CEO and other top officers, relative comparisons of similarly situated officials in peer companies will often not be possible. Moreover, changes over time in the method used by management to calculate compensation can limit longitudinal comparisons within the same company.⁶⁵

The Commission has long required compensation disclosure. Almost immediately after the adoption of the securities laws,⁶⁶ some form of compensation disclosure was included in registration statements,⁶⁷ proxy statements,⁶⁸ and annual reports.⁶⁹ The Commission did so despite objections that disclosure could cause competitive harm⁷⁰ or facilitate “criminal curiosity.”⁷¹

⁶³ As some commentators described, “accounting comparability does not only facilitate understanding of firms’ financial statements but also facilitates understanding of the mosaic of firm disclosures (e.g., earnings announcements, Form 8-K disclosures, EPA and ESG reporting) issued throughout the financial year” (Chircop et al. 2023, 3).

⁶⁴ CEOs generally control the information provided to the board of directors. In those circumstances, they have an incentive to avoid matters that reflect unfavorably on their position (Brown 2015).

⁶⁵ Exchange Act Release No. 95607 (Aug. 25, 2022) (“We have elected not to pursue a wholly principles-based approach because, among other reasons, such a route would limit comparability across issuers and within issuers’ filings over time, as well as increasing the possibility that some issuers would choose to report only the most favorable information.”).

⁶⁶ Exchange Act Release No. 54302A (Sept. 8, 2006) (“Executive and director compensation disclosure has been required since 1933, and the Commission has had disclosure rules in this area applicable to proxy statements since 1938.”).

⁶⁷ Securities Act Release No. 714 (Mar. 25, 1936). See also Release No. 54302A (Sept. 8, 2006).

⁶⁸ Exchange Act Release No. 1823 (Aug. 11, 1938) (Item 6 of Schedule 14A).

⁶⁹ Exchange Act Release No. 445 (Dec. 20, 1935).

⁷⁰ *In re Torrington Co.*, 19 S.E.C. 39 (May 1, 1945) (“A representative of the management has expressed the fear that if the compensation of officers and directors is shown in proxy statements, neighboring industries might offer ‘competition for personnel.’”).

⁷¹ “Applicants for confidential treatment have, however, been dissatisfied even with this compromise and have claimed that any interest in salaries is ‘criminal curiosity’ and that publicity will make the rank and file seethe with discontent” (Confidential Treatment 1938, 790).

The calculation of compensation was mostly left to management and did not have comparability as a goal.⁷² That changed in the early 1990s when the Commission explicitly identified comparability as a guiding principle.⁷³ Initial efforts, however, were not effective. Only with changes made in 2006 was the approach more completely integrated into the disclosure regime.⁷⁴ The changes were also accompanied by a significant and sustained effort at enforcement, particularly with respect to perks.⁷⁵

Item 402 of Regulation S-K achieved comparability by setting out mandatory methods for calculating compensation, significantly reducing managerial discretion. The increased transparency in, and ability to compare, aspects of compensation such as perks allowed for the identification of outliers (Francis and Stamm 2024), and likely altered the approach to compensation.⁷⁶ Subsequent changes in the compensation area⁷⁷ continued to reject a “wholly principles-based approach” and emphasize the importance of comparability.⁷⁸

2. Climate Change Disclosure and Comparability

Investors have increasingly sought disclosure related to climate change. Public corporations reacted by providing voluntary disclosure largely unsupervised by the SEC.⁷⁹ With little government oversight, the disclosure raised concerns over reliability, consistency, and comparability.⁸⁰

⁷² The use of a single metric was viewed as “difficult to quantify.” Exchange Act Release No. 16758 (May 6, 1980). The approach was criticized (Finneran 1983, 219) (“The current SEC disclosure requirements have failed to inform public investors in a meaningful and understandable way about the remuneration received by corporate executives. This failure results principally from the SEC’s flawed attempts at identifying and quantifying perks.”).

⁷³ Exchange Act Release No. 30851 (June 23, 1992) (“A new Summary Table also would provide an overview of each compensatory item paid to, or earned or received by the Chief Executive Officer . . . and the four other most highly paid executive officers over each of the preceding three years, enabling shareholders to discern clearly any trends in the registrant’s approach to compensating its executives, and to compare the registrant’s executive pay practices with those of other registrants.”).

⁷⁴ Release No. 54302A (Sept. 8, 2006) (“A presentation facilitating the comparability of different elements of compensation in different companies should make it easier for investors to analyze both the manner of compensation across companies and the quality of compensation disclosure across companies. . . . We nevertheless believe improving the clarity and completeness of disclosure regarding executive and director compensation and related person transactions requires a high degree of comparability between all issuers.”). At the same time, however, the accompanying narrative explanation was made principles based (ibid.) (“As described in the Proposing Release and as adopted, the Compensation Discussion and Analysis requirement is principles-based, in that it identifies the disclosure concept and provides several illustrative examples.”).

⁷⁵ The cases brought by the Commission concerning perks are discussed in Brown (2024a, sec. 2.07[F]).

⁷⁶ Payment of country club memberships that CEOs can use for personal reasons has apparently declined. Compare Goldman Sachs (2023) (disclosing that 7 percent of CEOs received country club membership benefits), with Schwab and Thomas (2006, 265) (noting that 24.53 percent of 375 CEO employment contracts provided for country/social club membership).

⁷⁷ Exchange Act Release No. 61175 (Dec. 16, 2009) (“A number of commenters responded to our request for comment by indicating that they would prefer disclosure of the aggregate grant date fair value of equity awards granted for services in the relevant fiscal year, even if granted after fiscal year end. . . . we are concerned that changing the approach to reporting could result in inconsistencies that would erode comparability.”).

⁷⁸ Exchange Act Release No. 95607 (Aug. 25, 2022).

⁷⁹ Exchange Act Release No. 94478 (Mar. 21, 2022) (“We agree with the many commenters that indicated that GHG emissions disclosure could provide important information for investors to help them evaluate the climate-related risks faced by registrants and to understand better how registrants are planning to mitigate or adapt to those risks.”).

⁸⁰ Exchange Act Release No. 94478 (Mar. 21, 2022) (“One of those commenters stated that GHG emissions information serves as the starting point for transition risk analysis because it is quantifiable and comparable across companies and industries. The commenter, an institutional investor, indicated that it uses GHG emissions data to rank companies within

The Commission eventually proposed amendments to Regulation S-K that would require public companies to include climate change–related disclosure in periodic reports. Reflecting investor concerns, the proposal made clear that comparability was an essential goal.⁸¹ Disclosure of greenhouse gas (GHG) emissions would not depend on judgment, but would be mandatory and subject to a mostly standardized method of calculation.⁸² Investors would be able to compare emissions across companies and industries and track changes in a company’s data over time.

The approach received strong support,⁸³ particularly with respect to GHG emissions,⁸⁴ with investors viewing mandatory disclosure as “table stakes.”⁸⁵ Indeed, some aspects of the proposal were not supported because of the lack of sufficient comparability.⁸⁶ The final rule, however, almost entirely abandoned the goal of comparability.⁸⁷ First, the Commission excluded entire categories of companies

industries based on their GHG emissions intensity to better assess transition risk exposure of companies in its portfolio and make informed investment decisions.”)

⁸¹ The term “comparability” appeared in the proposing release fifty-one times. The phrase “consistent, comparable, and reliable” appeared nineteen times. Exchange Act Release No. 94478.

⁸² Exchange Act Release No. 94478 (“The proposed rules would require a registrant to disclose its total Scope 1 emissions separately from its total Scope 2 emissions after calculating them from all sources that are included in the registrant’s organizational and operational boundaries.”). Only Scope 3 was subject to a materiality threshold (see *ibid.*) (“A registrant would also be required to disclose separately its total Scope 3 emissions for the fiscal year if those emissions are material, or if it has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.”).

⁸³ “[W]e also write to express our strong support for the Commission’s goal of implementing a framework for public issuers to provide investors with more comparable and consistent climate-related disclosures” (BlackRock 2022). Others expressed similar views, including State Street (2022) (“Increased standardization will also benefit U.S. companies that are currently navigating a myriad of requirements and expectations from a broad range of stakeholders.”); Vanguard (2022) (“[C]lear, comparable disclosures inform the investment decisions of portfolio managers on our actively managed funds, support the design and management of our products, and inform the engagement efforts and proxy voting decisions of our investment stewardship team.”); Council of Institutional Investors (2022) (“CII generally supports the Proposed Rule’s requirement that a registrant disclose its total Scope 1 and Scope 2 emissions separately for its most recently completed fiscal year.”); Investment Company Institute (2022) (“We support key components of the proposal, including that a company be required to disclose Scopes 1 and 2 emissions.”); and California State Teachers’ Retirement System (2022) (“The Commission’s proposal responds directly to our requests for more reliable, consistent, and comparable information to assess the risk to our portfolio companies from climate change, so that we can act to protect plan assets for the benefit of California’s teachers.”).

⁸⁴ “We support the SEC’s efforts to require all issuers to report quantitative GHG emissions estimates as soon as such estimates can be reported with appropriate accuracy and consistency” (BlackRock 2022). Similar views were expressed by Fidelity Investments (2022) (“[W]e support the SEC’s required disclosures of Scope 1 and Scope 2 emissions data which we agree is information that is financially material and useful to investor decision-making.”); Vanguard (2022) (“We appreciate that the Proposal would ensure public companies provide clear, consistent, and comparable foundational climate-related information, including uniform reporting of Scope 1 and Scope 2 greenhouse gas (GHG) emissions.”); and State Street (2022) (“We fully agree with the Commission’s proposal to require registrants to publish Scope 1 and Scope 2 GHG emissions in line with the TCFD and the GHG Protocol. For investors, these disclosures will be most effective if they enhance and standardize material climate information flows across the investment chain.”).

⁸⁵ “We believe that Scope 1 and 2 emissions data are now table stakes and part of investors’ fundamental expectations of companies” (Fidelity Investments 2022).

⁸⁶ “We recommend, however, that the SEC not require companies to disclose Scope 3 emissions at this time because of significant data gaps and the absence of agreed-upon measurement methodologies.” Investment Company Institute (2022). “We do not believe that Scope 3 emissions—by definition—meet the materiality threshold for disclosure since this information is speculative, nascent, unreliable, and there are no current standards to ensure consistent and comparable data, resulting in the potential for investor confusion” (Fidelity Investments 2022).

⁸⁷ The rule did retain the requirement that emissions be reported using a standardized metric. The Commission viewed the approach as enhancing comparability “across registrants with different types of GHG emissions.” Nonetheless, management retained significant judgement over aspects of the metric. Organizational boundaries and methodologies could vary. See Exchange Act Release No. 99678 (Mar. 6, 2024) (“Rather than potentially requiring a lengthy explanation

from the obligation to report emissions.⁸⁸ For those still subject to the requirement, the rule added a materiality qualifier,⁸⁹ allowing management to assess the relative importance of the information on a company-specific basis.⁹⁰ The final rule also eliminated a number of provisions that would have standardized some aspects of GHG calculations.⁹¹

The approach not only avoided comparable disclosure but also effectively assured that disclosure of GHG emissions would in many cases remain outside the system of mandatory reporting. Companies had significant latitude to characterize GHG emissions as immaterial, avoiding inclusion in periodic reports. At the same time, any concern about materiality under the antifraud provisions could be avoided through disclosure in sustainability reports or other informal avenues. While the Commission could bring an action based on the geography of the disclosure, doing so would potentially be viewed as a poor use of resources.⁹²

of the calculation approach used, this provision will require a registrant to disclose whether it calculated its GHG emissions metrics using an approach pursuant to the GHG Protocol's Corporate Accounting and Reporting Standard, an EPA regulation, an applicable ISO standard, or another standard.”)

⁸⁸ Exchange Act Release No. 99678 (Mar. 6, 2024) (“In balancing these considerations, we are not mandating Scopes 1 and/or 2 emissions disclosures from all registrants. Rather, under the final rule, if either or both of those categories of GHG emissions are material, and the registrant is an LAF or an AF other than an SRC or EGC, it must disclose its Scopes 1 and/or 2 emissions metrics.”).

⁸⁹ Exchange Act Release No. 99678 (Mar. 6, 2024) (“[W]e intend that a registrant apply traditional notions of materiality under the Federal securities laws when evaluating whether its Scopes 1 and/or 2 emissions are material.”).

⁹⁰ Exchange Act Release No. 99678 (Mar. 6, 2024) (“A registrant’s Scopes 1 and/or 2 emissions may be material because their calculation and disclosure are necessary to allow investors to understand whether those emissions are significant enough to subject the registrant to a transition risk that will or is reasonably likely to materially impact its business, results of operations, or financial condition in the short- or long-term.”).

⁹¹ Emissions for constituent gases were only required if “material.” Exchange Act Release No. 99678 (Mar. 6, 2024) (“if a registrant is required to disclose its Scope 1 and/or Scope 2 emissions, and any constituent gas of the disclosed emissions is individually material, it must also disclose such constituent gas disaggregated from the other gases.”). Management was given wide discretion to determine the organizational boundaries used in calculating emissions (*ibid.*) (“Unlike the rule proposal, however, which would have required a registrant to use the same scope of entities and other assets included in its consolidated financial statements when determining the organizational boundaries for its GHG emissions calculation, the final rule provides that the registrant must disclose the method used to determine the organizational boundaries.”).

⁹² The SEC, but not private parties, can bring actions based on the failure to include the information in a periodic report, even when it is disclosed elsewhere. Given the limited enforcement resources of the SEC, these types of actions would likely be rare. See *In re Shared Medical Systems Corp.*, Exchange Act Release No. 33632 (Feb. 17, 1994) (alleged violation of Item 303 where trend was disclosed in press release but not in SEC filing).

The decision to abandon comparability was deliberate.⁹³ The Commission justified the approach as necessary to lower costs⁹⁴ and reduce “compliance burdens.”⁹⁵ The purported savings, however, were never quantified, a particularly important omission given that, in many cases, companies would already have collected the relevant emissions data and would have avoided the costs and risks associated with a materiality determination. Nor were the purported cost savings balanced against the benefits of comparability.⁹⁶

C. *Comparability and the Revised Disclosure Regime*

Comparability remains an area of significant investor interest.⁹⁷ In an era of portfolio theory, investments frequently involve a comparative process. Comparability also reduces the use of judgment, which at least in some cases would produce a more accurate understanding of a company’s business.

Providing increased comparability will often necessitate the inclusion of metrics calculated on the basis of a common formula. SEC filings already require at least two key performance indicators (KPIs) but lack standardized definitions.⁹⁸ The Public Company Accounting Oversight Board (PCAOB) proposed (but later withdrew) metrics designed to facilitate comparison across accounting firms. The audit regulator recognized that the lack of standardized metrics resulted in disclosure “inconsistent across firms” with no ability to make “consistent comparisons” (Public Company Accounting Oversight Board 2024).

⁹³ The Commission acknowledged the impact on comparability. Exchange Act Release No. 99678 (Mar. 6, 2024) (“While the final GHG emissions disclosure provision will not apply to as many registrants or achieve the same level of comparability as may have been achieved under the proposed rules, on balance, we believe that . . . investors will have sufficient information to assess the operational and financial impact of transition risks and strategies on registrants and compare such impacts across registrants.”).

⁹⁴ Exchange Act Release No. 99678 (Mar. 6, 2024) (recognizing “commenters’ concerns about the potentially high cost of compliance associated with the proposed GHG emissions disclosure requirement”).

⁹⁵ Exchange Act Release No. 99678 (Mar. 6, 2024) (“We have made this change to address widely shared concerns about the compliance burden and associated costs of the more prescriptive aspects of the rule proposal.”).

⁹⁶ Exchange Act Release No. 99678 (Mar. 6, 2024) (“We acknowledge, however, that registrants could incur costs to assess and monitor the materiality of their emissions, even in situations in which they ultimately determine that they do not need to provide disclosure, and that for some registrants these costs could be significant, especially if firms are not already tracking this information for internal purposes.”).

⁹⁷ “Investors increasingly seek decision-useful, comparable and reliable information about sustainability performance in corporate disclosures in order to better understand how nonfinancial metrics can impact business and profitability” (Council of Institutional Investors 2022).

⁹⁸ The SEC, for example, requires disclosure of the number of employees. 17 C.F.R. 229.101. Backlog, previously an explicit requirement, was deleted from Regulation S-K in 2020. The information still must be disclosed, however, if material. See Exchange Act Release No. 89670 (Aug. 26, 2020) (deleting requirement to disclose “amount of backlog orders” from Item 101 but noting that backlog information would be required where “material to an understanding of the business and not otherwise disclosed”). See also *In re GT Advanced Techs.*, Exchange Act Release No. 85767 (May 3, 2019) (alleging company misstated backlog and that “disclosure was material given that several analysts . . . specifically referenced the backlog disclosure as a positive factor”). Nor has the Commission provided definitions of the terms “employee” or “backlog.”

Metrics integrated into the system of mandatory disclosure could reflect those already in common use,⁹⁹ sometimes within an industry,¹⁰⁰ sometimes as a result of regulatory requirements.¹⁰¹ These types of metrics occasionally appear in periodic reports on a voluntary basis (Public Company Accounting Oversight Board 2024). The Commission could also use metrics developed or defined by third parties. GHG emissions are expected to be calculated on the basis of existing standards or protocols.¹⁰²

Metrics designed to increase comparability will need to address concerns over reliability. In the climate change rule, the Commission required assurance for GHG emissions, the first time the SEC did so outside of the financial statements.¹⁰³ The provision defined the level of assurance and mandated that providers be independent of the company receiving the services.¹⁰⁴ The increased inclusion of comparative data will require a more systemic approach to reliability, including the need for systems of quality control, including recordkeeping requirements.¹⁰⁵

The SEC will also have to deal with the need for a more streamlined system of revising and updating metrics to avoid locking into the system a set of stale requirements. Such a process exists for EDGAR and the XBRL (eXtensible Business Reporting Language) taxonomy (Securities and Exchange Commission 2024). The rules may also be able to provide mechanisms for updating that do not require notice and comment.¹⁰⁶

⁹⁹ See Securities and Exchange Commission (2008, sec. 8120.3). See also Exchange Act Release No. 47226 (Jan. 22, 2003) (“Examples of ratios and measures that would not be non-GAAP financial measures would include sales per square foot (assuming that the sales figure was calculated in accordance with GAAP) or same store sales (again assuming the sales figures for the stores were calculated in accordance with GAAP).”).

¹⁰⁰ REITs often rely on “funds from operations,” an industry-determined metric. See *In re Vereit, Inc.*, Exchange Act Release No. 89133 (June 23, 2020) (National Association of Real Estate Investment Trusts “defines FFO as: GAAP net income or loss ‘excluding gains or losses from sales of property, and adding back real estate depreciation.’”).

¹⁰¹ “We expect to see this information broken down by industry-relevant employment categories or levels of seniority, for all full-time employees. In the US, companies are expected to at least use the disclosure framework set forth by the US Equal Employment Opportunity Commission’s EEO-1 Survey” (State Street 2023).

¹⁰² *In re Vereit, Inc.*, Exchange Act Release No. 89133 (June 23, 2020) (“[M]any REITs, including ARCP, report supplemental non-GAAP financial measures utilized by Company management, investors, and analysts in understanding and assessing operating results. One such key measure typically reported by REITs, AFFO, is an ‘adjusted’ version of a standardized metric of REIT operating performance, Funds From Operations (‘FFO’), as defined by the National Association of Real Estate Investment Trusts.”).

¹⁰³ Exchange Act Release No. 99678 (Mar. 6, 2024) (“obtaining assurance over GHG emissions disclosure provides investors with an additional degree of reliability regarding not only the figures that are disclosed, but also the key assumptions, methodologies, and data sources the registrant used to arrive at those figures”).

¹⁰⁴ Exchange Act Release No. 99678 (Mar. 6, 2024) (“Adopting a principles-based approach inherently involves some uncertainty, but we believe registrants would be better served by such flexibility than an approach that, for example, identifies a static list of qualified providers.”). To the extent there was a requirement for the inclusion of any other category considered material, however, the list would not be static.

¹⁰⁵ Exchange Act Release No. 99678 (Mar. 6, 2024) (“[S]ome commenters recommended that the Commission require the GHG emissions attestation provider to be subject to additional minimum quality control requirements. We have determined not to impose such requirements at this time.”).

¹⁰⁶ See Rule 501(a), 17 C.F.R. 230.501(a) (allowing Commission to designate professional certifications or designations that qualify as accredited investors).

V. Disclosure, Permanent Capital, and Engagement¹⁰⁷

When Cohen wrote in 1966, individuals dominated the markets.¹⁰⁸ Unhappy with management, they mostly demonstrated displeasure through the Wall Street Walk.¹⁰⁹ The disclosure system, therefore, largely focused on investors who “bought and sold” rather than those who “bought and held.”

A. *The Rise of Permanent Capital*

Following adoption of the 1982 System, institutions became the most common category of investors.¹¹⁰

Investment strategies also evolved. Asset managers advising index funds emerged as the dominant investors in the equity markets, with three holding more than 20 percent of the shares of the largest public companies.¹¹¹ The advisors managed funds for others and, as a result, did not bear the economic risks associated with the investments. In making investments, they relied on an index, algorithm, or formula.¹¹² Once set, investment decisions no longer depended on the attributes of the particular company or the competency of management.¹¹³ For the most part, the investors lost the ability to exit

¹⁰⁷ This section is informed in part by discussions with a number of institutional investors with significant equity holdings. With respect to the three largest index investors, representatives from the stewardship offices at Vanguard and BlackRock agreed to an interview; those at State Street did not.

¹⁰⁸ This was still the case in 1982 when the Commission adopted the system of integrated disclosure. As Professor Karmel noted, “In 1980, institutions held 33 percent of all publicly quoted American shares. Today, they are believed to own 45 percent” (Karmel 1991, 68).

¹⁰⁹ As a former commissioner of the SEC described, “Considering the number of institutions holding equity securities, and reviewing the institutions involved in aggressive exercise of powers appurtenant to shareholdings, it is fair to conclude that the number of institutions actively involved in corporate governance matters is small and that most institutions still express dissatisfaction with the management of portfolio companies through the ‘Wall Street walk’—the sale of the securities” (Sommer 1990, 367). Institutional investors were described as willing to “abandon ship . . . at the slightest sign of malaise” (Lowenstein 1983, 260).

¹¹⁰ “Institutional investors today collectively own 70–80% of the entire U.S. capital market, and a small number of money managers hold significant stakes at each public company” (Hamdani 2019, 973).

¹¹¹ “[T]he ‘Big Three’ index fund managers—Vanguard, BlackRock, and State Street—control a sizable portion of the overall stock market: they manage more than 20.5% of outstanding shares for S&P 500 companies, and they cast more than 25% of the votes at these companies” (Griffin 2023, 693). With respect to voting power, “the Big Three’s stock portfolios and voting power have ballooned. It is estimated that the Big Three will cast 34% of the votes at S&P 500 companies by the end of this decade and 41% by the end of the next” (Bratton 2024, 439). The four largest asset managers—Blackrock, Vanguard, Fidelity, and State Street—dominate the passive investment process. They do not, however, have all of their assets in index funds (Thinking Ahead Institute 2023). Vanguard has apparently sometimes managed funds on an active basis (Tower 2011) while Fidelity relies less on index investing than the other three large asset managers (Fichtner et al. 2017).

¹¹² Index funds were first offered in the mid-1970s, a creation of John Bogle at Vanguard. “They were, however, nicknamed ‘Bogle’s folly’” and “denounced as ‘un-American’ and ‘a sure path to mediocrity’” (Christie 2021, 886).

¹¹³ “The Big Three combined are the ‘largest holder’ in at least 88% of the S&P 500” (Hamdani 2019, 981–82). They have also undergone significant growth in the US, with passive investment accounting “for approximately 40% of stock assets in 2017, twice the share observed 10 years before” (Bas et al. 2023, 9). Not all passive investment occurs through mutual or other funds. Instead, “some institutional investors invest[] through large separate accounts . . . retain[ing] their voting rights” but according to Bebchuk et al., the approach “applied to a relatively small minority of the shares held by the Big Three” (2022, 1558). At least one institutional investor interviewed for this article confirmed the approach.

(Bebchuk 2019)¹¹⁴ even when companies were underperforming (Mitts 2023, 174).¹¹⁵ The approach earned index investors the sobriquet of “permanent” capital (Platt 2020, 1480).

Index funds mostly employed a long-term investment horizon, an approach shared with other types of institutional investors. Impact and other investors often employed a “buy and hold” approach¹¹⁶ in an effort to maximize influence¹¹⁷ and maintain a “voice” at the company.¹¹⁸ These investors recognized that the ability to shift corporate behavior and increase share values could “take time” to materialize.¹¹⁹

Unlike “permanent capital,” however, the decision to retain ownership for most long-term investors could be more fairly characterized as a preference or choice rather than a requirement.¹²⁰ To the extent they were displeased with management, they retained the ability to sell the shares. Permanent capital, by comparison, could not exit from a particular company absent a change in the relevant formula or index.

B. *The Importance of Engagement*

With permanent capital having no meaningful exit strategy, asset managers primarily rely on engagement with management as a means of improving share values. The need for, and benefits from, engagement may not seem intuitively obvious.¹²¹ After all, engagement is a cost. Moreover, the inability to exit means that companies could ignore any advice without concern that these investors would sell their shares and push down prices.

¹¹⁴ Funds may, however, have some discretion to depart from a relevant index. Some flexibility to exit does exist. “[F]unds face no legal requirement to hold any particular constituent of a tracked index, let alone with the same weight as the index. Empirically, funds regularly exercise this discretion. An index fund could, therefore, underweight a company, decline to hold it at all, or even short it (thereby giving it a negative portfolio weight). Any of these three approaches constitutes exercising a right to exit” (Molk and Robertson 2024, 299).

¹¹⁵ This is not to say that an exit strategy is impossible. Companies can be removed from the index or the weight of a particular stock altered. “An index provider periodically adds or drops stocks from the index and adjusts the weights of the component stocks. In doing so, the index provider often exercises discretion, which affects fund returns” (Mahoney and Robertson 2021, 313).

¹¹⁶ “ESG-aware investors are single-objective and incorporate ESG information into their stock screening process to achieve the best risk-adjusted financial performance. They are also typically passive shareholders. Socially responsible investment (SRI) funds traditionally employ negative screen process to either eschew investing in certain industries (for example, tobacco, gambling, weapon manufacturing, and alcohol) or divest from others (for example, oil and gas). These funds meet the needs of ethically motivated investors who would derive negative utility from investing in these so-called ‘sin’ stocks and wish to avoid the loss of utility” (Yasuda 2025, 4).

¹¹⁷ “[D]isclosure regulation can induce real effects through market mechanisms by allowing stakeholders to make informed decisions and exert public pressure on treated firms” (She 2022, 401).

¹¹⁸ “An investor who is dissatisfied with a company’s performance, including its net-zero alignment, has three choices: a. Sell their position. b. Hold their position and engage with the company. c. Hold their position and not engage with the company” (MSCI ESG Research LLC 2023).

¹¹⁹ “Long-term oriented owners might be more supportive of investment in innovative activities and human capital-intensive projects, the benefits of which take time to materialise” (Bas et al. 2023, 12).

¹²⁰ “For many institutional investors, engagement is preferable to divestment for all but the most polluting industries, such as thermal coal. It enables large investors to retain some power of influence, guiding capital to encourage a low-carbon transformation of the organizations in which they invest” (Warren 2021).

¹²¹ The importance of engagement is not limited to permanent capital. “The concentration of ownership and the growth of passive assets are now so great that corporate engagement is far more practical than divestment for the largest institutional investors. Liquidity constraints have increased the cost of exit while the relative cost of engagement has fallen, as it can now be spread across a larger asset base” (Jahnke 2017).

Engagement, however, has a number of potential benefits. Although not bearing the underlying economic risks,¹²² permanent capital has incentives to use the process to improve share values.¹²³ Increased returns, while spread among all shareholders, may be disproportionately beneficial depending on the particular index or formula used by a fund (Sahu 2023).¹²⁴ Even for widely employed benchmarks, improved share values increase a fund's return, helping to attract additional investors or forestall withdrawals (Hamdani 2019, 981–82). Engagement can also fulfill legal duties, including obligations as a fiduciary (Fink 2020),¹²⁵ or arise from soft obligations, including those set out in stewardship codes (discussed in Brown 2024b, 880–83). Clients also presumably expect that asset managers will engage on their behalf with portfolio companies.¹²⁶

Management has incentives to listen to, and take advice from, permanent capital.¹²⁷ For one thing, failing to do so may result in investor dissatisfaction,¹²⁸ something that can attract activists.¹²⁹ In addition, asset managers may be aware of “best practices” and have other insights as a result of their widespread holdings and participation in industry organizations.¹³⁰ Permanent capital may also serve as a sounding board for possible changes to a company's governance.

Permanent capital has the capacity to provide unique input that will not necessarily comport with the views of management. These investors often have a longer-term horizon than executive management and may favor expenditures and other strategies that, while involving short-term costs, can generate

¹²² “Coates recognized but did not highlight that the people who make decisions on behalf of the large institutional investors do not themselves hold the economic stakes in the companies that they control but instead exercise that power on behalf of dispersed individual fund shareholders” (Fisch 2022, 1844).

¹²³ “Asset managers that work hard to improve shareholder value may stand out as loyal stewards. Recognition of these faithful efforts by the public may attract additional investments” (Hamdani 2019, 981–82).

¹²⁴ An index fund can capture gains by “overweight[ing] the target of governance improvements” (Molk and Robertson 2024, 301).

¹²⁵ Investment advisors have fiduciary obligations to their clients, something that extends to some types of engagement, including voting. See Investment Advisers Act Release No. 33605 (Aug. 21, 2019) (“To satisfy its fiduciary duty in making any voting determination, the investment adviser must make the determination in the best interest of the client and must not place the investment adviser's own interests ahead of the interests of the client.”).

¹²⁶ “We recognize the importance of being accountable to our clients on how we fulfill our duties as responsible fiduciaries on their behalf” (State Street 2023).

¹²⁷ “[B]oards and management have powerful incentives to communicate with their largest investors. First, management has an interest in learning what its investors, and especially the large ones, think about the company's performance and its management strategy. After all, managers who lose their investors' support increase their chances not only of being targeted by an activist, but also of losing the fight. The same logic applies to managers of activist hedge funds, because to secure the backing of the large money managers, it is wise to engage with them in advance” (Bachmann et al. 2022). “[I]t is management that has an incentive to learn about money managers' view of the company's strategy. Thus, management might use this channel to initiate discussions about the company's business plan” (Hamdani 2019, 1000).

¹²⁸ “If corporate managers do not respond to money managers' concerns, money managers' dissatisfaction could become louder, thereby reaching the ears of activist hedge funds. Large money managers' dissatisfaction may serve as a fertile ground for the operation of hedge funds” (Hamdani 2019, 988).

¹²⁹ “But asset managers have the expertise to sense problems in company performance and are the ones who, once an activist arises, analyze solutions offered by the portfolio companies' managers. In fact, the matters that may cause an activist hedge fund to enter the arena and launch an activist campaign are the same matters that may be discussed in these engagements, whether or not any activism campaign is in sight” (Hamdani 2019, 1000).

¹³⁰ “[W]e have joined various industry groups and industry initiatives . . . to participate in conversations and information sharing about issues that impact global and local markets and may affect the long-term value of our clients' assets” (State Street 2023). Others have observed: “Equity owners can help improve a firm's performance through governance by providing better guidance and/or specialised knowledge of the sector in which the firm operates, steering the firm towards new managerial techniques, and easing access to additional funds” (Bas et al. 2023, 12).

returns further into the future or otherwise promote sustainability.¹³¹ Nor are boards likely to provide the same perspective. Although some boards include directors with a lengthy tenure,¹³² they can lack incentives to provide views contrary to those expressed by management (Brown 2015).

C. *The Nature of Engagement*

Engagement represents a “continuum of responses to company performance.”¹³³ Engagement can involve face-to-face meetings, letters, emails, or other forms of direct interactions¹³⁴ and can be initiated by either the asset manager or the company.¹³⁵ With the goal of creating a “long-term” relationships,¹³⁶ permanent capital generally does not rely on the more confrontational means of interaction, including shareholder proposals and director nominations.¹³⁷ Large asset managers seeking to escalate concerns do so through additional interaction with the company or through the exercise of voting rights, sometimes accompanied by public explanations of their decision.¹³⁸

Engagement by permanent capital has increasingly focused on interaction with members of the board,¹³⁹ a shift from earlier periods when participation was limited by concern over legal restrictions¹⁴⁰ and CEO control over the information flow to directors (Brown 2015). Engagement commonly

¹³¹ The CEOs in the S&P 500 have an average tenure of 4.8 years, down from six in 2013, with almost 40 percent serving terms of one to five years (Jerotich 2024). Permanent capital will remain invested in the company indefinitely.

¹³² In the S&P 500, the average tenure of directors is between nine and ten years. More than 15 percent have served for at least sixteen years (Tonello 2020).

¹³³ “Engagement is the investor’s voice, and it can be defined as the continuum of responses to company performance available to investors” (MSCI ESG Research LLC 2023).

¹³⁴ “The term ‘engagement’ is used by money managers to describe various types of communications and discussion with portfolio companies, including meetings, e-mails, and phone conversations” (Hamdani 2019, 986–87).

¹³⁵ “We may initiate these engagements, or they may be held at the request of the portfolio company” (State Street 2023).

¹³⁶ “Through engagement, we aim to build long-term relationships with the issuers in which we invest on behalf of our clients and to address a broad range of topics relating to the promotion of long-term shareholder value creation” (State Street 2023). “BlackRock’s corporate governance framework is a set of principles, guidelines and practices that support sustainable financial performance and value creation for our shareholders over the long-term” (BlackRock n.d.).

¹³⁷ Vanguard has stated: “nor do we nominate board members or submit shareholder proposals” (Vanguard 2023). BlackRock has been explicit on the point, noting that the manager “does not engage in shareholder activism” (BlackRock 2023b, 80).

¹³⁸ One asset manager described escalation as “[w]riting to the company” to formalize concerns, further engagement with “the board and company” and various use of voting authority, including support of “shareholder resolutions,” voting against (or abstaining) from “management resolutions,” and “[v]oting against relevant board members” (State Street 2023).

¹³⁹ According to one source, “93 percent of Fortune 100 companies disclosed information regarding their shareholder engagement programs . . . according to proxy disclosure data based on the 69 companies on the 2022 Fortune 100 list that filed proxies as of May 25. Furthermore, 67 percent disclosed that select board members (most often the lead independent director or compensation committee chair) directly participate in those discussions as appropriate, up from 51 percent in 2020” (Pederson 2023). Others have noted that “[c]ompany-investor engagement on governance topics—and disclosure of these efforts in the proxy statement—also continues to grow. The portion of S&P 500 companies disclosing engagement has grown from 6% in 2010 to 72% in 2017. And directors are getting increasingly involved in this engagement. This year, 29% of companies that disclosed engagement with investors noted director involvement. This is up from 25% last year” (Manoff and Klemash 2017).

¹⁴⁰ So, for example, “Back in 2014, 42% of directors very much agreed that shareholder engagement presented too great a risk of disclosing non-public information and violating Regulation FD (Fair Disclosure). By 2018, that figure had dropped to 19%. And only 6% very much agreed that directors don’t have time to meet with investors—down from 19% in 2014” (Moats et al. 2023).

involves those on the board who serve in influential positions, including lead directors or chairs of relevant committees.¹⁴¹

Engagement topics may include board composition and practices, executive compensation, and governance rights for shareholders.¹⁴² A significant portion of the engagement process, however, involves assessment of risk oversight by the board. Risks can relate to business models, including sustainability.¹⁴³ While “sustainability” is often used synonymously with environmental, social and governance (ESG) matters,¹⁴⁴ the term is broader and can encompass risks associated with the continuation of a business or business line.¹⁴⁵

Risks addressed in the engagement process may be identified through public sources,¹⁴⁶ macroeconomic changes,¹⁴⁷ and shifts in technology.¹⁴⁸ Permanent capital also may be made aware through disclosure in periodic reports and other disclosures mandated by the SEC.

D. *Engagement and the Revised Disclosure Regime*

The 1982 System was designed around those buying and selling rather than those buying and holding, an approach that no longer reflects the actual dynamics of the market.¹⁴⁹ A key area of reform would be to more systematically reflect disclosure of corporate risks and means of risk oversight, particularly at the board level. Disclosure will need to go significantly beyond the existing requirement for risk factors, a provision that produces overbroad and generic disclosure.¹⁵⁰

¹⁴¹ Proxy statements in 2022 for the S&P 100 disclosed that 67 percent of “select board members (most often the lead independent director or compensation committee chair) directly participate[d]” in discussions with investors, “from 51 percent in 2020” (Pederson 2023). For a discussion of some of the types of nonpublic information obtained through individual meetings with management, see Vanguard (2023, 22–55) (case studies and insights).

¹⁴² “Our estimates imply that The Big Three’s campaigns increased female directorships. . . . Our findings show that indexed investors can and do meaningfully influence firms’ governance structures” (Gormley et al. 2023, 7).

¹⁴³ BlackRock listed as one of its five priorities “[s]trategy, purpose, and financial resilience” (BlackRock 2024). Larry Fink has stressed the importance of addressing sustainability concerns. “We believe that all investors, along with regulators, insurers, and the public, need a clearer picture of how companies are managing sustainability-related questions” (Fink 2020). Similarly, Vanguard’s engagement practices are grounded in “four pillars of good corporate governance: board composition and effectiveness, board oversight of strategy and risk, executive pay, and shareholder rights” (Vanguard 2023).

¹⁴⁴ “‘Sustainability Risk’ is an inclusive term to designate an investment risk (probability or uncertainty of occurrence of material losses relative to the expected return of an investment) that relates to environmental, social and/or governance issues” (Blackrock 2023a, 2).

¹⁴⁵ “Sustainability is closely related to ESG, but we believe it is also meaningfully distinct. In practical terms, sustainability is a term that describes running a business—at the highest governance level—to make it more likely to survive and prosper in the long run. Sustainability ensures that the company is taking the proper steps to have reliable and continued access to essential resources and the support of key stakeholders” (Lubrano and Volynets 2022, 42).

¹⁴⁶ For example, one asset manager discussed the approach to engagement that occurred in connection with the collapse of Silicon Valley Bank “and the subsequent banking crisis” (State Street 2023).

¹⁴⁷ “[W]e engaged with portfolio companies in the banking and insurance sectors to better understand how they are responding to the uncertain interest rate environment” (State Street 2023).

¹⁴⁸ “[W]e engaged with technology companies to understand the steps they are taking to manage risks and opportunities related to emerging technologies such as artificial intelligence” (State Street 2023).

¹⁴⁹ With board oversight a key component of interaction, permanent capital could also benefit from better disclosure concerning board attendance. Item 407 only requires disclosure of those directors who attended fewer than 75 percent of the “aggregate” of board and committee meetings. Item 407(b) of Regulation S-K, 17 C.F.R. 229.407(b).

¹⁵⁰ Item 105 of Regulation S-K, 17 C.F.R. 229.105. “Investor comments on the SEC’s 2016 Regulation S-K Concept Release with respect to risk factor disclosures indicated that over 80% did not believe that Item 105 is ‘effective for capturing emerging risks . . . such as those associated with cybersecurity [or] climate change’” (Ho 2022, 336).

By providing “a richer picture of the company’s strategy,” including the accompanying risks, in periodic reports (Park 2020, 1027), investors can better prepare for engagement with management, particularly in addressing the effectiveness of oversight (Brown 2019).

Sustainability disclosure commonly addresses risks to an issuer’s business model. The disclosure may be about immediate concerns, whether stranded assets, reserves affected by changing weather patterns, or escalating energy costs. They may also address concerns to the issuer’s longer term business model. (Ibid.).

Disclosure, properly structured, would also potentially lower costs (MSCI ESG Research LLC 2023) by facilitating the identification of outliers (Gormley et al. 2023). Adding topics to the engagement process can also affect corporate behavior. When Congress mandated the inclusion of mine safety data in periodic reports, safety improved.¹⁵¹

Climate change¹⁵² and human capital¹⁵³ are examples of topics that can relate to risk.¹⁵⁴ So are safety concerns in core areas of the business, something apparent from the crises at Boeing, *In re Boeing Co., Derivative Litig.*, C.A. No. 2019-0907-MTZ (Del. Ch. Sept. 7, 2021), and Blue Bell, *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019). Threats and risks to the supply chain are another (Fink 2020). The standards drafted by the Sustainability Accounting Standards Board represent a good place to start, but those investors focused on long-term engagement are a key source of the ultimate requirements

¹⁵¹ Dodd–Frank mandated disclosure of safety violations in periodic reports. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1804–05 (2010), § 1503 (adopting 15 U.S.C. 78m–2). In doing so, Congress did not impose a materiality qualifier, depriving management of any significant judgment about what to disclose (Karmel 2016, 799) (“The disclosure requirements adopted by the SEC apply only to mines located in the United States but apply equally to all U.S. mines regardless of their size.”). With the information already available publicly over the website of the Mine Safety and Health Administration, location in periodic reports was less about providing new information than increasing public awareness and facilitating comparability. Exchange Act Release No. 66019 (Dec. 21, 2011) (“We agree with commentators who suggested that the Commission’s provision of an example of a possible tabular presentation may encourage uniformity and comparability of disclosures.”). The approach “essentially rais[ed] the profile” of the data and “facilitat[e] comparisons across public issuers that operate mines” (Lynn 2011, 327). Enhanced public awareness created greater public disapproval for companies with inadequate safety records (Christensen et al. 2017, 284). Investors who wanted to avoid public approbation associated with ownership could divest. With permanent capital lacking the option, these investors could nonetheless mitigate the reputational concerns through improvements in the safety record of the relevant companies. This provided incentives to raise the issue during the engagement process. Indeed, data suggests that disclosure in SEC filings resulted in a significant drop in safety violations (ibid. at 284). Investor pressure was one possible explanation for the change, although the authors did not specifically identify permanent capital as the source (Karmel 2016, 800).

¹⁵² “We are conducting an engagement campaign focused on companies across segments of the food value chain—including the fertilizers and agricultural chemicals, agricultural products, and packaged food subindustries—to better understand how companies are responding to climate- and nature-related risks and opportunities and to identify best practices on these topics” (State Street 2023).

¹⁵³ “Human capital management continues to be an area of focus for our Asset Stewardship team. . . . Our conversations will focus on risks and opportunities related to human capital on the following topics: board oversight; human capital strategy; compensation strategies; employee voice; and diversity, equity, and inclusion” (State Street 2023).

¹⁵⁴ The addition of human capital disclosure to Regulation S-K shows the need for this type of information. The requirement was entirely principles based and did not include comparative metrics but was limited to information deemed “material” by management (Clayton 2020). This was true even though there were some human capital metrics in common use, including “part time vs. full time workers, workforce expenses, turnover, and diversity” (Lee 2020b). Perhaps unsurprisingly, the resulting disclosure generated mostly “positively-toned” narrative (Gibson Dunn 2023).

(Sustainability Accounting Standards Board 2018) (Industrial Machinery & Goods Sustainability Accounting Standard).

VI. Financial Disaggregation and Comparability

The 1982 System incorporated an approach to financial disclosure that developed in earlier eras when companies had less capacity to produce, and investors less ability to absorb, detailed and granular information. That changed, however, with technological developments and growing interest in comparability.

A. *The Disaggregation and Comparability Problem*

The content of financial statements filed with the SEC mostly developed at a time when preparers used manual typewriters, number 2 pencils, and carbon paper.¹⁵⁵ Providing granular, high-quality financial disclosure on a regular basis would have stretched capacity and imposed significant costs. Financial statements also developed when individuals dominated the market and relied on hard copies, requiring disclosure that was understandable and did not overwhelm.

The result was a system that included a modest number of broad items on the face of the financial statements.¹⁵⁶ Financial statements were described as a “structured summary” (International Accounting Standards Board 2014) that consisted of only a “few items” (International Accounting Standards Board 2008). Management viewed the information as proprietary that would, if disclosed, cause competitive harm (Cavanaugh 1941). When the SEC called for inclusion of the costs of goods sold, some companies contended that the disclosure would “invit[e] disaster” (Confidential Treatment 1938, 794).

Concerned primarily with the need for uniform accounting standards,¹⁵⁷ the Commission mostly relegated the presentation of the financial statements to management.¹⁵⁸ Regulation S-X¹⁵⁹ sought to

¹⁵⁵ “In the 1930s, companies had to take financial data and aggregate it into digestible bits of information that they could distribute easily and that the investing community could easily analyze” (Prohs 2002, 490). Or as Professor Kripke described, the functions were performed by “a modest clerk perched on a high stool before a ponderous ledger” (Kripke 1941, 1180).

¹⁵⁶ “IFRSs and U.S. GAAP provide little specific guidance on the presentation of line items in financial statements, such as the level of detail or number of line items that should be presented. The resulting variation and inconsistency in presentation formats create difficulties for users who want to understand and analyze an entity’s activities” (International Accounting Standards Board 2008, 23).

¹⁵⁷ “The problem with that view of comparability is that it allows an excessive degree of latitude in reporting practice. It was the dominant view during the 1930s and 1940s and did permit, or even encouraged, the proliferation of alternative accounting procedures that characterized the period, many in situations in which few significant differences in enterprises or circumstances were ever reasonably substantiated” (Storey and Storey 1998).

¹⁵⁸ Exchange Act Release No. 17116 (Sept. 2, 1980) (“Numerous commentators suggested that the proposed rules be altered to provide registrants with a greater degree of flexibility to determine whether certain information should be disclosed on the face of the balance sheet or in the accompanying notes. The Commission has concluded that those comments have substantial validity and therefore has revised the instructions to require separate disclosure of the following items either on the face of the balance sheet or in an appropriately captioned note.”).

¹⁵⁹ 17 C.F.R. 210.1-01, et seq. See also Exchange Act Release No. 17116 (Sept. 2, 1980) (“In 1940, there was little available authoritative accounting literature. . . . Consequently, the Commission considered it beneficial that S-X included condensed requirements contained in one authoritative source.”).

provide for “informative [financial] disclosure”¹⁶⁰ and, over issuer objection,¹⁶¹ included a few specific content requirements.¹⁶² For manufacturing and commercial companies,¹⁶³ income statements¹⁶⁴ had to include a small number of broad categories.¹⁶⁵

Otherwise, financial statements were only required to provide “reasonably detailed” information¹⁶⁶ in an “intelligible and useful fashion.”¹⁶⁷ The approach allowed “average investors” to “acquaint” themselves “with the current business condition of the company.”¹⁶⁸ While the presentation of the financial statements had to be “fair,”¹⁶⁹ there was no obligation to include all information material to investors.¹⁷⁰ Instead, fair presentation amounted to a “know it when you see it” standard.¹⁷¹

The result was reduced comparability and an “aggregation” problem.¹⁷² Financial statements could result in “oversimplified” balance sheets and produce income statements consisting of an “undigested

¹⁶⁰ Exchange Act Release No. 17116 (Sept. 2, 1980) (“The regulation did not prescribe accounting methods, but rather stated requirements which were intended to elicit informative disclosures.”). See also Accounting Series Release No. 12 (Feb. 21, 1940) (“Some new requirements have been added in the new regulation, principally with a view to obtaining more informative disclosure as to such accounting policies as depreciation, depletion, and maintenance and as to such matters as advances to and from affiliates, directors, and officers.”).

¹⁶¹ The effort to require the inclusion of “profit and loss statements” was described as “stormy” (Confidential Treatment, 1938, 793).

¹⁶² Exchange Act Release No. 75985 (Sept. 25, 2015) (“Regulation S-X contains disclosure requirements that dictate the form and content of financial statements to be included in filings with the Commission.”).

¹⁶³ The requirements applied to commercial and industrial companies. They did not apply to banks, or broker-dealers. See Item 5-03 of Regulation S-X.

¹⁶⁴ The particular importance of the income statement has long been recognized (see Kaplan and Reaugh 1939, 939) (“Accountants and investment analysts today are agreed that the income statement is much more significant and informative to the investor than the balance sheet.”).

¹⁶⁵ Item 5-03 (gross sales less discounts, returns, and allowances). In the post-FASB era, the Commission largely got out of the business of directly regulating financial statements but left in place the limited content requirements. Exchange Release No. 17116 (Sept. 2, 1980) (“A minority of the commentators have stated that certain components of the proposed amendments to S-X effectively may be pre-empting the activities of the FASB, especially its project to develop a conceptual framework for financial accounting and reporting.”).

¹⁶⁶ “Without laboring the point, which has received extended consideration from all sides, it may be well to observe that financial statements ought to be accurate, reasonably detailed, and intelligible” (Werntz 1941).

¹⁶⁷ “This raises the problem of how to present financial information to investors in an intelligible and useful fashion” (Werntz 1941).

¹⁶⁸ Disclosure was designed “to make available to the average investor honest and reliable information sufficiently complete to acquaint him with the current business condition of the company, the securities of which he may desire to buy or sell” (Kaplan and Reaugh 1939, 936, quoting Commission annual report).

¹⁶⁹ “An independent auditor’s report contains an opinion as to whether the financial statements present fairly, in all material respects, an entity’s financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.” PCAOB Auditing Standard 2815.01, The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles.” For an in-depth discussion, see DeFond et al. (2018, 91).

¹⁷⁰ “[I]t is not possible to require an entity to present a complete disaggregation of material information in the primary financial statements” and as a result “not all material information can be presented in the primary financial statements” (International Financial Reporting Standards 2023). But see Exchange Act Release No. 20657 (Feb. 15, 1984) (“In the Commission’s view, the fundamental performance standard for financial reporting is the presentation of all information material for rational investment decisions.”).

¹⁷¹ As one chief accountant at the SEC explained, “Fair presentation is hard to define, but you know it when you see it” (Sampson 1985).

¹⁷² “As is the case for most issuers, Apple’s disclosures for its income statement captions, especially expenses, are scant. . . . no disclosures or disaggregation is provided for any expense. Investors are not only in the dark regarding the definition and composition of expenses, but also as to whether the expenses are comparable to other companies’ expenses with the same captions” (Peters and Winters 2023).

mass of footnotes.”¹⁷³ Criticism over the inadequate level of detail arose almost from outset (Kaplan and Reaugh 1939).

The arrival of segment reporting in the notes to the financial statements added some additional detail and disaggregation.¹⁷⁴ Financial Accounting Standards Bureau (FASB) ostensibly opted for a “management approach”¹⁷⁵ that was intended to provide investors with an inside view of the company.¹⁷⁶ The standard, however, failed to ensure that this would occur by encouraging the disclosure of segments on a “single basis”¹⁷⁷ and by allowing a “modified” management approach.¹⁷⁸ The modified approach permitted management to aggregate segments.¹⁷⁹ And while limits on the approach existed, management had substantial discretion in structuring segments. As a result, they could be used to mask losses¹⁸⁰ or emphasize gains.¹⁸¹ Management could “hide” aspects of the business, something that that could occur for competitive or opportunistic reasons.¹⁸²

¹⁷³ “Progress made in clarifying the basic principles of accounting has been more than matched by improvement of the standards or principles of disclosure. An oversimplified balance sheet, a three-figure income statement, the statement that ‘tells all’ in an undigested mass of footnotes are becoming rarer” (Wertz 1941).

¹⁷⁴ “Segment reporting under ASC Topic 280 is one of the few required disclosures of disaggregated information in US GAAP” (Peters and Winters 2023).

¹⁷⁵ “The method for determining what information to report is referred to as the management approach. The management approach is based on the way that management organizes the segments within the public entity for making operating decisions and assessing performance.” Accounting Standards Codification 10-05-3, Segment Reporting, Financial Accounting Standards Board. The previous approach had focused on industries. See Exchange Act Release No. 40884 (Jan. 5, 1999) (“Recognizing that businesses often evaluate their operations using criteria not necessarily related to the products or services offered to the public, the FASB replaced the industry segment reporting standard with one that requires businesses to report financial information on the basis of ‘operating segments.’”). In making the change, FASB apparently believed that the management approach would provide “more disaggregated information” than the industry approach and was “therefore, preferable” (Schneider and Scholze 2011, 2).

¹⁷⁶ “The FASB’s new segment reporting standard . . . requires the management (congruent) approach to segment definition in which externally reported segments are congruent with those used internally” (Maines et al. 1997, 3).

¹⁷⁷ “A public entity could provide complete sets of financial statements that are disaggregated in several different ways, for example, by products and services, by geography, by legal entity, or by type of customer. However, it is not feasible to provide all of that information in every set of financial statements. The guidance in this Subtopic requires that general-purpose financial statements include selected information reported on a single basis of segmentation.” Accounting Standards Codification 280-10-05-3, Segment Reporting, Financial Accounting Standards Board.

¹⁷⁸ “Entities may choose to aggregate operating segments that are similar along all the following dimensions: products and services, production processes, types of customers, distribution methods, and regulatory environments. These are referred to as the aggregation criteria. Since entities may combine certain operating segments, the approach required by the standard is a ‘modified’ as opposed to ‘pure’ management approach” (Botosan et al. 2021, 4).

¹⁷⁹ “Discretion in how to aggregate information is a form of voluntary disclosure, with some important distinctions from a simple decision to disclose or remain silent” (Ebert et al. 2017, 82).

¹⁸⁰ Research has shown that management has “incentives to conceal bad performance by aggregating segments incurring losses with profitable segments” (Chen et al. 2015, 1017). The incentives to disaggregate can depend upon “the relative magnitudes of the underlying components” (Bonner et al. 2014, 2089).

¹⁸¹ “Amazon designed their segment reporting in a way that highlighted profitable segments during unprofitable years, thereby showing how close Amazon was to being profitable. By contrast, during profitable years, Amazon’s reports draw attention to overall success, thus obscuring how close Amazon might be to being unprofitable” (Ebert et al. 2017, 81).

¹⁸² “Taken together, these observations paint a picture of companies that use their discretion in aggregation in order to put their best foot forward. They emphasize overall performance in good times, thus obscuring how close they are to a neutral benchmark, such as zero profits. And they emphasize well-performing operations in bad times, highlighting how close they are to the neutral benchmark of zero losses” (Ebert et al. 2017, 82). Other studies “suggest that managers have the incentives not to report segmental information either to achieve personal benefits (agency costs) or to avoid potential competitive harm (proprietary costs)” (Aboud et al. 2023, 10).

Investors have long sought increased disaggregation of financial disclosure (Bonner et al. 2014),¹⁸³ as have others (Vakil 2019). And while FASB did require some additional disaggregation of segments, the amendments did not alter how they were determined (Financial Accounting Standards Board 2023a). The result of the “modified” management approach over time has been a decline in the number of reported segments despite the growth in the size and complexity of large public companies.¹⁸⁴

B. *The Benefits of Disaggregation and Comparability*

Studies suggest that increased disaggregation provides significant benefits.¹⁸⁵ Disaggregation can produce information “critically important in understanding an entity’s performance, assessing an entity’s prospects for future cash flows, and comparing an entity’s performance both over time and with that of other entities” (Financial Accounting Standards Board 2023b).¹⁸⁶ Disaggregation can give stakeholders a better understanding of changes in line items on the financial statement,¹⁸⁷ lower costs for analysts,¹⁸⁸ improve the accuracy of analyst forecasts (Bui et al. 2023), and reduce the need for “best guesses” (CFA 2007), facilitating better investment decisions (Bui et al. 2023).¹⁸⁹ The approach has been associated with a less aggressive use of non-GAAP disclosure (Vakil 2019).

C. *Financial Statements and the Revised Disclosure Regime*

Financial statements used in the 1982 System require two interrelated sets of reforms. First, the presentation of the financial statements should be made more uniform and standardized.¹⁹⁰ The items

¹⁸³ The interest has been longstanding. “Financial analysts have consistently over the years requested financial statement data disaggregated to a much greater degree than it is now” (Association for Investment Management and Research 1992, quoted in Peters 2023). Indeed, the concerns go back to the 1930s. As one article described, “[i]temization within these major categories of income is an essential minimum of income disclosure. An investor is not interested merely in learning the total earnings for the current year which an indivisible total gives him; his primary interest in earnings is based, to a large extent, on the ability it gives him to forecast the future. Total figures must be broken down to enable him to obtain some information as to the sources of past income in order that his guess as to the future, precarious at best, is something more than a wild shot in the dark” (Kaplan and Reaugh 1939, 944).

¹⁸⁴ “Overall, since the introduction of the FASB’s first segment disclosure requirements in 1977 to the present, the percent of U.S. traded entities providing segment data has declined” (Botosan et al. 2021, 2). The Commission added segment-related disclosure to the narrative of periodic reports. The disclosure requirements in some respect go beyond what is required by FASB. See Exchange Act Release No. 40884 (Jan. 5, 1999).

¹⁸⁵ “[M]ost studies have confirmed the superiority of disaggregated models over aggregated ones” (Khansalar and Namazi 2017, 464).

¹⁸⁶ “By reducing information asymmetry between the firm and outside investors, more transparent disclosures increase stock liquidity, reduce stock price crash risk and lower the cost of external funds” (Bui et al. 2023, 2).

¹⁸⁷ “[D]isaggregating accounting information can increase transparency and understandability by disclosing more accounting details or by showing what caused the changes in an account” (Bui et al. 2023, 2). “Insufficient disaggregation also makes it more difficult for users to understand how a line item in one financial statement relates to the other financial statements” (International Accounting Standards Board 2008, 23).

¹⁸⁸ “Financial analysts actually spend substantial time and effort disaggregating information aggregated by accountants. This disaggregation process ultimately leads to less efficient markets” (Prohs 2002, 490).

¹⁸⁹ Others have noted the negative effects of inadequate disaggregation. “Accounting standards currently permit assets and related liabilities, revenues, and expenses, as well as investing and financing cash inflows and outflows, to be reported on a highly aggregated or netted basis, causing much important information to be obscured or lost altogether. The information loss can result in misleading analyses, distorted conclusions, and suboptimal investment decisions” (CFA Institute 2007, 13).

¹⁹⁰ FASB has noted the benefits but viewed doing so as impractical. See Appendix A: Basis for Conclusions, Presenting Line Items and Subtotals in Financial Statements BC7.12, in Financial Accounting Standards Board (2021, 17) (“Specifying

on the face of the financial statements should be universally applicable among companies or at least within relevant groups of companies and have common definitions. This should extend to segment reporting. The approach would facilitate comparisons among companies.

Second, items on the financial statements should be disaggregated. The depth of the disaggregation will need to be determined, but even subcategories such as employee compensation or administrative expenses can be excessively broad and would benefit from additional breakdown.

Disaggregation and increased comparability will impose costs.¹⁹¹ Companies may need to reconfigure their internal processes¹⁹² and update information technology.¹⁹³ The additional disclosure can heighten regulatory scrutiny (Libby and Brown 2013) and increase the risk of a takeover (Bui et al. 2023). Disaggregation may also raise competitive risks, although this concern tends to be overstated. But the decision should not turn on the fear of information overload,¹⁹⁴ misinterpretation,¹⁹⁵

certain line items that all entities must present would make it easier for resource providers to locate information. However, the Board concluded that at a conceptual level no single set of line items, subtotals, and totals for the income statement would serve all entities equally well.”)

¹⁹¹ “[C]ritics note that disaggregation provides little benefit in view of the increased costs associated with collecting, refining, and communicating such detailed information and that it may hinder investors’ ability to efficiently process a firm’s performance information” (Vakil 2019, 1). Preparers were described as lamenting “the cost and challenges of implementation, particularly with regard to inventory” (Posner 2022).

¹⁹² “[W]e believe that the Proposed Update will require significant changes to how most companies capture and summarize financial statement information. This is because the disaggregation of expenses as required by the Proposed Update will in many cases differ from how management accumulates information and analyzes operating results. These changes will add significant costs to gather, review, and audit this information considering internal control implications as well as changes to systems and processes” (Paul 2023).

¹⁹³ “Regarding the role of technology, Jens Berger observed that a big challenge facing some preparers is getting information by nature from IT systems that have been set up to report by function. . . . He observed some preparers tended to give a default ‘no’ response because they may need to adjust their sometimes very old financial systems. There were lesser concerns from those with upgraded systems as the willingness to provide certain data points is related to companies’ IT capabilities” (International Accounting Standards Board 2008).

¹⁹⁴ “We also believe the increased granularity could add to disclosure overload for investors and analysts, and require disclosure of potentially misleading information” (Fox 2023). “While disaggregating the referenced line items may provide more detailed information, it also increases the risk for misinterpretation by investors, creditors and other stakeholders. Users of the financial statements may draw correct conclusions or overemphasize certain attributes, leading to suboptimal decisions. API believes the increased granularity could overwhelm investors and analysts with too much or potentially conflicting information, for example, by making it challenging to identify relevant trends” (White 2023). See also Exchange Act Release No. 17116 (Sept. 2, 1980) (“The Commission believes that annual reports to shareholders should not be overburdened with information which, although relevant to meaningful analysis, is of little interest to the majority of users.”).

¹⁹⁵ “While disaggregating the referenced line items may provide more detailed information, it also increases the risk for misinterpretation by investors, creditors and other stakeholders. Users of the financial statements may draw incorrect conclusions or overemphasize certain attributes, leading to suboptimal decisions. API believes the increased granularity could overwhelm investors and analysts with too much or potentially conflicting information, for example, by making it challenging to identify relevant trends.” (Horton-Diaz 2023). “While disaggregating the referenced line items may provide more detailed information, it also increases the risk for misinterpretation by investors, creditors and other stakeholders. Users of the financial statements may draw incorrect conclusions or overemphasize certain attributes, leading to faulty assessment and decisions” (Fox 2023).

confusion,¹⁹⁶ or the inability to otherwise understand the disclosure.¹⁹⁷ In an era of technology and structured data (Brown 2019),¹⁹⁸ investors have greater ability to digest disaggregated information.¹⁹⁹

VII. Steps Forward

Cohen's fundamental insight was that the SEC's reporting regime could cease to meet the needs of investors. The insight remains relevant today.

The principles underlying the 1982 System have proved stubbornly unaffected by changes in the market and investor demand for more granular information, comparative data, and additional topics.²⁰⁰ The few reforms that have occurred have been made grudgingly, unaccompanied by any fundamental shift.²⁰¹ Absent a more thorough reexamination and revision of the current system of disclosure, investors will increasingly be forced to look elsewhere for the information they need, reducing the importance of periodic reports and the role of the SEC (Brown 2023a).

Nor are the dynamics discussed in this article the only source of pressure on the 1982 System. The expansion of the private markets has allowed large companies to more easily opt out of the disclosure process, reducing coverage.²⁰² Changes in technology have lowered the costs for issuers of producing, and for investors, of absorbing, information on a more rapid, even real-time, basis,²⁰³ raising questions

¹⁹⁶ “[W]e believe reporting cost incurred will create confusion for investors and other users of financial statements. Reporting costs incurred is inconsistent with existing US GAAP for capitalizable costs and does not correlate to revenue for inventoriable costs. This approach could result in confusion and questions from users of the financial statements for which there may be no clear answer” (Damico 2023).

¹⁹⁷ “RILA members do not regularly receive requests from investors or external users to provide further details on the components of inventory expense” (Brooks 2023). See also Zakrowski (2023); Holmes (2023); Johnson (2023).

¹⁹⁸ As one commissioner to the SEC stated, “The introduction of structured data requirements for financial statement and prospectus information has . . . facilitated comparison across time periods, across companies, and even between data in SEC filings and other agency filings” (Lee 2020a). The Investor Advisory Group at the PCAOB has observed that “[f]or over two decades, advances in databases and data storage have enabled the development of powerful software and hardware tools for analyzing large volumes of data. Researchers and professionals in fields like security analysis and portfolio management, whose work impacts market prices, have adopted these tools” (Investor Advisory Group Members 2023).

¹⁹⁹ Exchange Act Release No. 95607 (Aug. 25, 2022) (“[W]e believe that requiring the data to be structured will lower the cost to investors of collecting this information, permit data to be analyzed more quickly, and facilitate comparisons among public companies, all of which justify the incremental cost to registrants.”). See also Exchange Act Release No. 96159 (Nov. 28, 2022) (“Requiring Inline XBRL tagging of the compensation recovery disclosure benefits investors by making the disclosures more readily available and easily accessible to investors, market participants, and others for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine-readable data language such as ASCII or HTML.”).

²⁰⁰ As one commissioner to the SEC stated, “There must be a limit to the number of times we can credibly assert to investors that we act in their best interests by making policy choices they directly oppose” (Lee 2020c).

²⁰¹ Even assurance in the climate-change release was viewed as a one-off. Exchange Act Release No. 99678 (Mar. 6, 2024) (“We considered the view expressed by some commenters that there is no reason to treat GHG emissions disclosures differently than other disclosures located outside of the financial statements, which do not require assurance. . . . GHG emissions disclosures are unique in that many companies currently voluntarily seek third-party assurance over their climate-related disclosures, and commenters, including investors, have expressed a particular need for assurance over GHG emissions disclosures.”).

²⁰² “Relying on a hand-collected data set consisting of SEC public filings, we found that many companies have substantially more beneficial owners than their shareholder of record count would indicate” (Alon-Beck and Livingstone 2023, 71).

²⁰³ The Commission has the requisite authority to ensure more frequent reporting. Sarbanes–Oxley allowed the SEC to mandate “real time issuer disclosure” with respect to “material changes in the financial condition and operation” of the company. See Section 409 of Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (adopting 15 U.S.C. 78m(l)).

about a system focused on quarterly disclosure.²⁰⁴ Artificial intelligence has begun to impact the reporting process²⁰⁵ and to alter management's approach to disclosure.²⁰⁶

Reorienting the SEC's disclosure regime will not be easy. Nonetheless, a few things can be done in the short term.

First, the Commission should, when considering changes to the existing system, weigh the need for, and importance of, comparative disclosure, particularly when determining materiality. Reforms to Regulation S-K should explicitly assess the benefits of comparative information, both in reducing opportunistic disclosure within a company and facilitating analysis across companies. The Commission conceded the importance of comparative disclosure in the climate change proposal but mostly ignored the approach in the final rule, contrary to the preferences expressed by investors in the comment letters.

Second, the Commission should take an approach to disclosure that more fully acknowledges the sophistication of institutional investors, their ability to absorb and assimilate information, and the rising use of artificial intelligence. Concerns from earlier eras that disclosure will overburden, cause confusion, or be misinterpreted are mostly misplaced. While requirements for more granular information can impose costs, the inability to absorb and accurately assess the information is, for the most part, not one of them.²⁰⁷

Third, the Commission should reexamine its role with respect to the contents of financial statements. Although ceding to FASB the determination of accounting standards, the Commission retained

Advances in technology have reduced these costs and facilitated more frequent high-quality disclosure. As technology makes this increasingly feasible, the Commission will need to consider both the types of information that can be subject to more frequent disclosure, the policy reasons for doing so, and issues around verification and accuracy (Park 2020, 1024) (“[T]here is good reason why mandatory disclosure is periodic rather than continuous. If securities regulation reflects the results of a hypothetical bargain between investors and issuers, periodic disclosure reflects the interests of those parties. Issuers will vigorously resist continuous disclosure.”).

²⁰⁴ Quarterly disclosure has already required work-arounds. The market often does not want to wait for top-line financial disclosure to be filed with the SEC. As a result, alternative mechanisms have developed. Earnings often appear in a press release, see Exchange Act Release No. 84842 (Dec. 18, 2018) (“Some companies issue an earnings release prior to filing the associated Form 10-Q, though, as noted above, many companies now issue earnings releases concurrently with the filing of these forms.”), sometimes long before the relevant SEC filing (Brown 2021).

²⁰⁵ AI has the capacity to “learn” about particular companies, uncover anomalies that could affect earnings, and potentially identify fraud. AI has the potential to provide an effective mechanism for meeting regulatory requirements. Software may, for example, facilitate the identification of trends, uncover fraud, or resolve materiality issues. AI can be used to develop key performance indicators that are “more intelligent, adaptive, and predictive” (Schrage et al. 2024). Relevant algorithms may eventually write narrative that accompanies disclosure.

²⁰⁶ Companies are already altering their approach to disclosure in response to algorithms. In an environment of algorithmic traders and quantitative analysts, managers increasingly recognize “that their speeches need to impress bots as well as humans” (Cao et al. 2023, 3606). The approach can entail the use or avoidance of terms or approaches that impact the relevant algorithms. These efforts may provide opportunities for both improved disclosure and “manipulation and collusion” (ibid, 3636).

²⁰⁷ For those investors who do not want or need the additional disclosure, their concerns can be addressed through the use of summaries or inclusion of more complex disclosure in separate, less read, portions of a report, not through the nondisclosure of the information. Registration statements take this approach; so does mine safety disclosure. See Exchange Act Release No. 66019 (Dec. 21, 2011) (“The exhibit would include the detailed disclosure about specific violations and regulatory matters required by Section 1503(a) as implemented in the proposed rules. The Proposing Release noted our view that this approach would facilitate access to the information about detailed mine safety matters without overburdening the traditional Exchange Act reports with extensive new disclosures.”).

control over the presentation of the financial statements.²⁰⁸ Since aligning Regulation S-X with the standards adopted by FASB, however, the Commission has largely not exercised authority in the content and comparability of financial statements.²⁰⁹ The result has been financial statements that often lack standardized content and adequate detail. The Commission needs to end the deference to FASB and take a more active role in ensuring standardization and comparability of financial statements,²¹⁰ an approach necessitated by FASB's failure to adequately address the content requirements sought by investors (Brown 2023b).

Fourth, the Commission should jumpstart a discussion among relevant stakeholders about the need for more fundamental revisions to the 1982 System. Concept releases are one way to begin the conversation.²¹¹ Advisory committees that include a cross section of interested parties are another. Cohen's work was preceded by a detailed and thoughtful market study.²¹² At least two committees led by SEC commissioners provided input into the 1982 System.²¹³ The Investor Advisory Committee created by Congress in Dodd–Frank provides a ready-made organization to spearhead this type of effort (Securities and Exchange Commission n.d.).

Engaging in fundamental reform will entail a lengthy process. Moreover, the courts may throw a wrench into reform efforts, deploying the major questions doctrine and other approaches to limit the SEC (Brown 2023a). Judicial invalidation of the climate change rule could effectively deny the Commission the authority to ensure that periodic reports include what investors need to make informed decisions, an approach contrary to congressional intent.²¹⁴ Nonetheless, delay in reexamining the 1982 System will have consequences. The importance of periodic reports and the supervisory role of the SEC will continue to decline, reducing comparability and reliability of corporate disclosure and imposing unnecessary costs on the investment process.

²⁰⁸ FASB has already taken the position that the approach is “not feasible.” See Appendix A: Basis for Conclusions, Presenting Line Items and Subtotals in Financial Statements BC7.12, in Financial Accounting Standards Board (2021).

²⁰⁹ See Exchange Act Release No. 17116 (Sept. 2, 1980).

²¹⁰ In adopting the climate-change rule, the Commission specifically disagreed with commenters who asserted that the changes should have been left to FASB. The Commission reiterated its “ultimate responsibility” for accounting standards and viewed the exercise of authority as a necessary “response to the need expressed by investors for information related to the financial statement impacts of severe weather events as discussed elsewhere in this release.” Exchange Act Release No. 99678 (Mar. 6, 2024).

²¹¹ Exchange Act Release No. 50700 (Nov. 18, 2004) (concept release seeking comments on, among other things, conflicts of interest associated with self-regulatory organizations and challenges with respect to surveillance); Exchange Act Release No. 38672 (May 23, 1997) (concept release seeking comments on, among other things, standards applicable to alternative trading systems).

²¹² Committee of Interstate and Foreign Commerce, 88th Cong., *Report of the Special Study of the Securities Markets of the SEC*, H. Doc. No. 95, pt. 1 (1963). The work was done under the “supervision” of Cohen. For membership of the “study group” making the recommendations, see Securities and Exchange Commission (1961).

²¹³ The Wheat Report was chaired by SEC Commissioner Francis Wheat (Securities and Exchange Commission 1969), while a subsequent committee was chaired by Commissioner A. A. Sommer. Committee on Interstate and Foreign Commerce, 95th Cong., *Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission: Evolution of SEC Policies and Practices Regarding Projections* (Comm. Print 1977). For a discussion of some of these tensions with studies overseen by commissioners, see Cary (1964).

²¹⁴ As discussed, Congress made the SEC the singular agency responsible for disclosure by public companies.

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