

THE SIMPLICITY IN MODERNIZING FINANCIAL DISCLOSURE

*Tyler Jacobs**

INTRODUCTION

The government, specifically agencies in the executive branch, is often criticized for being inefficient.¹ These challenges can be the result of a variety of inadequacies, including outdated technology, understaffed agencies, and old-fashioned organizational constructs and processes.² Resolving these inefficiencies is exceptionally difficult with the U.S. government facing the challenge of serving the diverse and growing needs of over 330 million people.³ Even so, improvements begin with addressing the core issues. A primary way to increase efficiency, as displayed by the innovations adopted in the private sector during the 1990s, is through academic research regarding human behavior and modern technological advancements.⁴

However, case studies into specific agencies demonstrate the government suffers from an inability to solve ongoing problems, leading

* Sandra Day O'Connor College of Law, Arizona State University, J.D. 2020.

¹ Executive branch officials and agencies have addressed this problem and continue to work on bipartisan solutions. *See* OFF. MGMT. & BUDGET, DELIVERING GOVERNMENT SOLUTIONS IN THE 21ST CENTURY: REFORM PLAN AND REORGANIZATION RECOMMENDATIONS (2018), <https://www.performance.gov/GovReform/index.html>.

² *Id.*

³ U.S. CENSUS BUREAU, U.S. AND WORLD POPULATION CLOCK (Dec. 26, 2019), <https://www.census.gov/popclock/>.

⁴ Linda Gorman, *Technology and Productivity Growth*, THE NAT'L BUREAU OF ECON. DEV., <https://www.nber.org/digest/oct01/w8359.html> (last visited Sept. 29, 2020) ("The strong performance of productivity growth in the second half of the 1990s was in fact attributable to accelerating technical change, not to poor measurement or to temporary factors . . . [c]hanges in technology are the only source of permanent increases in productivity . . ."). This article, and related academic study, echo the basic economic principle of technological advancements increasing efficiency.

to a waste of financial resources.⁵ The media has covered several examples of these problems perfectly illustrating this phenomenon. A Veteran Disability Claim appeal results in an average wait time of over four years, which is disturbingly long given the major health and financial implications of the decision.⁶ Also, the Department of Transportation implemented a regulation requiring rearview cameras for certain automobiles.⁷ This regulation took seven years to implement and costs approximately \$20 million per life saved.⁸ Also, misaligned incentives created through the privatization of security clearances resulted in rushed background investigations, a federal investigation, over twenty-seven guilty pleas related to false representations, and, ultimately, a broken system.⁹ Multiple

⁵ Steve Vogel, *Veterans Face Another Backlog a Quarter-million Appeal Disability Claims*, WASH. POST (Sept. 8 2013), https://www.washingtonpost.com/politics/veterans-face-another-backlog-as-a-quarter-million-appeal-disability-claims/2013/09/10/0078154a-15ba-11e3-804b-d3a1a3a18f2c_story.html (“A veteran who takes an appeal through all available administrative steps faces an average wait of 1,598 days, according to [Veteran Affairs (“VA”)] figures for 2012. If the veteran pursues the case outside VA to the U.S. Court of Appeals for Veterans Claims, it takes an additional 321 days on average, according to court documents . . . But VA officials acknowledge that the appeals system must be transformed. Though VA is converting the claims process into an electronic, paperless system, the great majority of appeals remain paper-bound . . . To prepare for the influx of appeals, the Board of Veterans Appeals has hired 100 new lawyers in recent months and has begun a push to handle more cases by video teleconference, a step that can cut 100 days off the process, said Laura Eskenazi, vice chairman of the board”).

⁶ *Id.*

⁷ See Federal Motor Vehicle Safety Standards, 49 C.F.R. § 571.111 (2014).

⁸ NAT’L HIGHWAY TRAFFIC SAFETY ADMIN., DEP’T OF TRANSP., RIN 2127-AK43, FEDERAL MOTOR VEHICLE SAFETY STANDARD, REARVIEW MIRRORS; FEDERAL MOTOR VEHICLE SAFETY STANDARD, LOW-SPEED VEHICLES PHASE-IN REPORTING REQUIREMENTS (2010).

⁹ Jason Miller, *Justice Obtains 27th Guilty Plea in Background Investigations ‘Flushing’ Case*, FED. NEWS NET. (July 19, 2018, 3:59 PM), <https://federalnewsnetwork.com/agency-oversight/2018/07/justice-obtains-27th-guilty-plea-in-background-investigations-flushing-case/> (While discussing the current delegation of background investigations: “[t]he Trump administration announced in June that it would transfer the entire governmentwide security clearance portfolio, currently housed within OPM’s National Background Investigations Bureau (NBIB), to the Pentagon.”); Dion Nissenbaum, *Bottom Line Drove Security Clearance at USIS*, WALL ST. J., (Oct. 25, 2013, 6:43 PM), <https://www.wsj.com/articles/SB10001424052702304330904579137443326694158> (“Grove City had an incentive to rush cases, former USIS officials say, because of its contract terms: It (sic) would get the bulk of its payment, they say, when it sent a case to a federal agency and the final payment when the agency closed the case. One of those officials says the upfront payment was 90% for a period starting in 2008 . . . [s]ome

attempts to eliminate the misaligned incentives did not fix the problem.¹⁰ Lastly, conflicting objectives and a communication failure between agencies delayed and severely weakened the impact of the Volcker Rule in the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).¹¹ These are just a few examples of government inefficiencies causing taxpayer frustration and disdain.¹² Of course, each agency and regulation is unique. To address the major inefficiency

workers protested in writing but were told that they would be fired if they didn't do what they were told, they say.”).

¹⁰ Christian Davenport, *Even After Snowden, Quota System on Background Checks May Be Imperiling U.S. Secrets*, WASH. POST (June 14, 2015), https://www.washingtonpost.com/business/economy/security-clearance-contractors-still-stress-speed-over-thoroughness-workers-say/2015/06/14/00d1bd80-09fa-11e5-95fd-d580f1c5d44e_story.html (“Despite the congressional outcry, the contracts’ payment system is still structured so that the faster the contractors turn over the cases to the federal government, the quicker they get paid. And the federal government imposes a financial penalty if the companies miss their deadline . . . [it was] alleged that the company had submitted 665,000 cases that were incomplete, saying it was interested in clearing out the shelves in order to hit revenue.”).

¹¹ Justin Baer & Julie Steinberg, *Bank Rule Challenges Wall Street*, WALL ST. J., Dec. 11, 2013, at A1 (“The Volcker rule limits banks' ability to trade with their own cash, restricts them from investing in risky hedge and private-equity funds and imposes rigorous compliance requirements on the firms.”); Emily Flitter & Alan Rappaport, *Big Banks in Line for Looser Curbs on Risky Trades*, N.Y. TIMES, May 31, 2018, at A1N (“[Dodd-Frank] took five agencies three years to write it and has been criticized by Wall Street as too onerous and harmful to the proper functioning of financial markets. On Wednesday, the Federal Reserve proposed easing several parts of the rule, and four other regulators are expected to soon follow suit”); Scott Patterson & Deborah Solomon, *A Simple Bank Rule Proves Difficult to Write*, WALL ST. J., Sept. 11, 2013, at A1 (“[The delay] concerns the differing missions of the agencies, sometimes pitting the bank regulators—the Fed, Federal Deposit Insurance Corp. and Office of the Comptroller of the Currency—against the SEC . . . SEC officials grew concerned the bank regulators weren't sharing their work. Lawmakers began calling SEC officials to ask why the securities agency was stalling the process There sometimes were squabbles over where to hold [meetings between the agencies]. Bank-regulator staffers balked at traveling across Washington to the SEC's offices near Union Station. Treasury officials at one point promised a side trip to a Bojangles fried-chicken restaurant at Union Station as an incentive to make the trip, winning the round. Negotiations became so difficult the SEC and some banking regulators began to consider writing their own sets of trading regulations. Others warned this could create chaos for banks.”).

¹² See, e.g., Brian Riedl, *50 Examples of Government Waste*, THE HERITAGE FOUND. WEBMEMO 2642 (Oct. 2009), <https://www.heritage.org/budget-and-spending/report/50-examples-government-waste.2009>.

concerns within executive branch agencies and offer a workable solution, it is necessary to narrow the issue to one agency and regulatory regime. Thus, this paper will focus on increasing the efficiency of the U.S. Securities and Exchange Commission's ("SEC") financial disclosure regulations—primarily through simplification and modernization.

A basic argument supporting a completely free market economy suggests disclosure, in general, is inefficient.¹³ However, the substantial history of securities fraud proves disclosure is critical; unregulated markets have historically resulted in tremendous deception and a weakened economy.¹⁴ Thus, for the purposes of this paper, it is assumed financial disclosure serves a highly valuable government interest. Interestingly, numerous academics, corporate lawyers, economists, and industry participants argue that the current financial disclosure requirements could be minimized and still remain effective—each offering a variety of explanations as to how and why.¹⁵ This discussion has gone on for years and continues into today's political dialogue.¹⁶

Financial disclosure protects investors from fraud, provides the information allowing investors to make educated decisions, and facilitates capital formation.¹⁷ In proposing ideas to increase the efficiency and effectiveness of the current financial disclosure regulatory regime, this paper attempts to answer two primary questions: 1) Should a simplified form of financial disclosure be introduced?; and 2) How can financial disclosure, and the related body of regulations, be modernized via current technology? Academic studies focused on investor behavior and mental

¹³ LIBR. OF ECON. & LIBERTY, *Supply and Demand, Markets and Prices*, <https://www.econlib.org/library/Topics/College/supplyanddemand.html> (last visited Sept. 26, 2020).

¹⁴ See Larry Bumgardner, *A Brief History of the 1930s Securities Laws in the United States and the Potential Lesson for Today*, <http://www.jgbm.org/page/5%20Larry%20Bumgardner.pdf> (last visited Sept. 26, 2020).

¹⁵ This statement is supported throughout the paper by expert statements, past regulations and related materials, industry comment letters, and other materials that demonstrate how various market players have advocated for reduced financial disclosure.

¹⁶ See, e.g., Peter J. Henning, *Companies are Pushing for Less Disclosure. Is that Good for Investors?*, N.Y. TIMES (Sept. 14, 2018), <https://www.nytimes.com/2018/09/14/business/dealbook/sec-disclosure-investors.html> ("What is the best protection for shareholders? The SEC does not review whether an investment is a good one, only whether enough information is available to judge the potential risks and rewards.")

¹⁷ Financial disclosure is the act of making a company's financial information available to investors through filing and/or sending a document or group of documents.

capacity will provide guidance in answering Question One. To answer Question Two, the paper will propose ideas resulting in increased accessibility and user-friendliness for investors, as well as the potential for reduced compliance costs for U.S. corporations in the long-term. In doing so, the paper will analyze relevant actions taken by the SEC, as well as address implementation barriers and globalization concerns. The paper is focused on the inefficiencies and opportunities for improvement within the SEC's disclosure regulations, so the paper will only examine approaches for simplification and modernization without contradicting the policy reasons behind existing laws and regulations.

I. CURRENT REGULATORY REGIME

Disclosure regimes exist in numerous industries, including, but not limited to, medical, food and drug, motor vehicle, consumer protection, and financial industries.¹⁸ The SEC, the agency in charge of regulating the securities industry and enforcing federal securities laws, imposes mandatory periodic and continuous disclosure requirements.¹⁹ In order to be traded on a U.S. stock exchange, such as the New York Stock Exchange ("NYSE") or NASDAQ, a company must file a registration statement with the SEC such as a Form S-1.²⁰ Continuous disclosure generally includes annual and quarterly reports such as 10-K's and 10-Q's, but these can vary based on the type of company.²¹ Periodic disclosure requirements such as

¹⁸ See, e.g., 15 U.S.C. §§ 78a–qq (2018); 15 U.S.C. §§ 2051–2084 (2018); 12 C.F.R. § 1026.40 (2020).

¹⁹ See generally 15 U.S.C. § 78a–qq (2018); 15 U.S.C. §§ 80a-1–80b-21 (2018); Eva Su, CONG. RES. SERV., IF 11256, SEC SECURITIES DISCLOSURE: BACKGROUND AND POLICY ISSUES (2019).

²⁰ Fraser Sherman, *How to Get Listed on the Stock Market*, CHRON (Mar. 21, 2019), <https://smallbusiness.chron.com/listed-stock-market-3394.html> ("The main function of a stock exchange is to facilitate the transactions associated with both buying and selling of securities. Buyers and sellers of shares and stocks can track the price changes of securities from the stock markets (derivatives, equity etc.) in which they operate."); BankBazaar, *How Does a Stock Exchange Function?*, REDIFF (Sept. 25, 2009), <https://business.rediff.com/report/2009/sep/25/perfin-how-does-a-stock-exchange-function.htm>.

²¹ See Eva Su, *supra* note 19 (showing a 10-Q contains similar information as a 10-K but has fewer requirements and is filed quarterly); Will Kenton, *10-K*, INVESTOPEDIA: INVESTING (Mar. 16, 2020), <https://www.investopedia.com/terms/1/10-k.asp> ("A 10-K is a comprehensive report filed annually by a publicly-traded company about its financial performance and is required by the U.S. Securities and Exchange Commission (SEC). The report contains much more detail than a company's annual report, which is

an 8-K, Schedule 13K, Proxy Statements, and Forms 3, 4, and 5 also exist.²² These types of filings are mandatory upon a certain event—a merger, bankruptcy, or a resignation of a director all prompt a version of periodic disclosure.²³

The financial disclosure requirements vary significantly depending on a variety of factors. For example, investment companies must comply with the Securities Act of 1933 (“33 Act”), the Securities Exchange Act of 1934 (“34 Act”), and the Investment Company Act of 1940 (“40 Act”).²⁴ Small businesses face fewer disclosure regulations than large corporations because the SEC understands the significant burden high compliance costs pose to small entities.²⁵ In general, financial disclosure provides a wide range of fiscal data and additional information helping investors evaluate a company when making investment decisions.²⁶

Financial disclosure regulations are extremely complex given the various industry participants and types of corporations. Several other securities laws intermingle with the financial disclosure requirements. For

sent to its shareholders before an annual meeting to elect company directors. Some of the information a company is required to document in the 10-K includes its history, organizational structure, financial statements, earnings per share, subsidiaries, executive compensation, and any other relevant data.”).

²² See generally 15 U.S.C. § 78a–qq (2018); 15 U.S.C. §§ 80a-1–80b-21 (2018); see also Will Kenton, 8-K, INVESTOPEDIA: LAWS & REGULATIONS (July 23, 2020), <https://www.investopedia.com/terms/1/8-k.asp> (“An 8-K is a report of unscheduled material events or corporate changes at a company that could be of importance to the shareholders or the Securities and Exchange Commission (SEC). Also known as a Form 8K, the report notifies the public of events, including acquisitions, bankruptcy, the resignation of directors, or changes in the fiscal year.”).

²³ Kenton, *supra* note 21.

²⁴ See 15 U.S.C. §§ 80a-1–80b-21; see generally James Chen, *What Is an Investment Company?*, INVESTOPEDIA: INVESTING (May 12, 2020), <https://www.investopedia.com/terms/i/investmentcompany.asp> (defining investment company).

²⁵ See SEC, *Small Business and the SEC: A Guide for Small Businesses on Raising Capital and Complying with the Federal Securities Laws*, SEC: INVESTOR PUBLICATIONS (Feb 27, 2014), <https://www.sec.gov/reportspubs/investor-publications/infosmallbusqasbschtm.html>. The term smaller reporting company, and other specific types of small business that receive special treatment, are defined by federal securities laws, rules, and regulations. See *id.*

²⁶ E.g., Apple, Inc., Annual Report (Form 10-K) (Nov. 3, 2017). Disclosure documents, such as the 10-K referenced above, are filed with the SEC through the EDGAR system and are available to the public. Filings & Forms, SEC (Jan. 9, 2017), <https://www.sec.gov/edgar.shtml>.

example, there is a law requiring the delivery of a prospectus, which is a form of financial disclosure, to all shareholders via mail.²⁷ Additionally, a company selling securities through interstate commerce must be registered with the SEC and must file the financial disclosure through the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system.²⁸

Importantly, the SEC's practices over the last decade reflect a desire for progress – evidenced by the time, money, and resources its staff invested in improving its financial disclosure regime.²⁹ The investment company industry, as suggested by the research of the Investment Company Institute ("ICI"), has also been a consistent advocate for more efficient and modernized financial disclosure.³⁰ The willingness of the SEC, ICI, Financial Industry Regulatory Authority ("FINRA"), and the investors themselves, to seek increased efficiency and embrace the resulting modifications is encouraging.³¹ The internet has transformed the

²⁷ SEC, FINAL RULE: DELIVERY OF DISCLOSURE DOCUMENTS TO HOUSEHOLDS (1999), <https://www.sec.gov/rules/final/33-7766.htm>.

²⁸ *Filing a Registration Statement*, SEC: SMALL BUSINESS (Sept. 18, 2018), <https://www.sec.gov/smallbusiness/goingpublic/howtofile>. The EDGAR system is open to the public. The system can be used to locate filings and access the current and historic financial disclosure documents of the companies registered with the SEC. *See* EDGAR: Company Filings, SEC, <https://www.sec.gov/edgar/searchedgar/companysearch.html>.

²⁹ *See, e.g.*, Investment Company Reporting Modernization, 83 Fed. Reg. 27279 (proposed June 12, 2015); SEC, *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies* (Jan. 13, 2009); SEC, *Investment Company Reporting Modernization* (Oct. 13, 2016); SEC, *Optional Internet Availability of Investment Company Shareholder Reports* (June 5, 2018). These regulations, among other things, modernized the information made available in financial disclosure and created an optional new delivery mechanism under certain circumstances.

³⁰ *See, e.g.*, Inv. Co. Inst., *The Profile Prospectus: An Assessment by Mutual Fund Shareholders—Summary of Research Findings* (1996), https://www.ici.org/pdf/rpt_profprspctus3.pdf; Inv. Co. Inst., *The Profile Prospectus: An Assessment by Mutual Fund Shareholders (Volume II)* (1996), https://www.ici.org/pdf/rpt_profprspctus2.pdf; Inv. Co. Inst., *Understanding Investor Preferences for Mutual Fund Information* (2006), https://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf. These reports include the evaluation of financial disclosure regulation, surveys of fund owners, academic studies, estimates of disclosure costs, and more.

³¹ FINRA is a private self-regulatory agency that works alongside the SEC. They oversee brokerage firms and provide regulatory assistance. "FINRA plays a critical role in ensuring the integrity of America's financial system—all at no cost to taxpayers. Working under the supervision of the Securities and Exchange Commission, we: write and enforce rules governing the ethical activities of all registered broker-dealer firms and

ability of an individual to gather information and technology continues to progress at an alarming rate.³² Now, it is time for financial disclosure regulations to meet the needs of the modern investor.

All securities market players, including the major regulatory bodies, small businesses, large corporations, investment companies, and individual investors, have an incentive to support making disclosure more efficient, modern, and user-friendly.³³ However, a challenge arises in finding a balance between reducing regulatory requirements and ensuring investor education and protection. Unsurprisingly, the current financial disclosure regulation has failed to find the perfect middle ground; major inadequacies currently hinder efficiency and effectiveness.³⁴ A few regulatory changes

registered brokers in the U.S.; examine firms for compliance with those rules; foster market transparency; and educate investors.” FIN. INDUS. REG. AUTH., *What We Do*, <https://www.finra.org/about/what-we-do>.

³² See generally Max Rosser & Hannah Ritchie, *Technological Progress*, OUR WORLD IN DATA (2019), <https://ourworldindata.org/technological-progress#citation> (“The exponential growth rates that we have observed over the last decades seem to promise more exciting technological advances in the future. Many other types of technology have seen exponential growth rates A couple of exceptionally promising examples are: Butters’ Law of Photonics and Rose’s Law. Butters’ Law says the amount of data one can transmit using optical fiber is doubling every nine months, which you can convert and say that the cost of transmission by optical fiber is halving every nine months. Rose’s Law describes the exponential growth of the number of qubits of quantum computers. If this growth rate should remain constant, it leads to some mind-bending opportunities.”).

³³ The SEC mission statement is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. A user-friendly interface certainly protects investors and in theory would promote a stronger market as investors have a better platform to educate themselves. FINRA has the same interests as the SEC. Investors receive the benefit of avoiding information overload and attention capacity issues discussed later in this paper. This will let them make better investment decisions in a quicker amount of time. Larger companies can use the user-friendly platform to attract investors and lobby for deregulation once some of the new disclosure platforms and strategies prove effective. This could decrease compliance cost in the future which will be great for small businesses and investment companies and their clients. In general, a more user-friendly platform could jumpstart a process that includes the SEC considering modifying other disclosure regulations based off industry comments and investor satisfaction. See SEC, *What We Do*, <https://www.sec.gov/Article/whatwedo.html>.

³⁴ Clearly, this is a question of degree. The research referenced later will provide a basis for this statement. It would be extremely unlikely that any research would conclude that disclosure regulation is currently, or ever can be, at the perfect balance. This paper will focus on providing a few examples of the most current and relevant inadequacies

will provide examples of how minor adjustments and an openness to experimentation can improve the efficiency and effectiveness of financial disclosure regulations. The result could mean a major leap in reaching the pareto-efficient point in financial disclosure regulation, instead of the minor steps we have observed over the past several years.³⁵

II. ACADEMIC RESEARCH: THE BENEFITS OF SIMPLIFICATION

An entire subsection of behavioral economic and cognitive psychology academic research suggests simplifying disclosure could be beneficial, as investors often ignore the filings or are misled by their personal interpretation of the data.³⁶ The most current academic research suggests that too much information forces the reader to simplify the information on their own, which leads to poor decision-making.³⁷ For

and solutions to fix, or improve, these issues.

³⁵ “Pareto efficiency, or Pareto optimality, is an economic state where resources cannot be reallocated to make one individual better off without making at least one individual worse off. Pareto efficiency implies that resources are allocated in the most economically efficient manner . . . An economy is said to be in a Pareto optimum state when no economic changes can make one individual better off without making at least one other individual worse off . . . In neoclassical economics, alongside the theoretical construct of perfect competition, [sic] is used as a benchmark to judge the efficiency of real markets—though neither perfectly efficient nor perfectly competitive markets occur outside of economic theory.” Jim Chappelow, *Pareto Efficiency*, INVESTOPEDIA (Sept. 25, 2019), <https://www.investopedia.com/terms/p/pareto-efficiency.asp>. The minor steps that I am referring to include the SEC regulations referenced in footnote 28 and the body of research related to improving financial disclosure.

³⁶ E.g., Stephen Choi & Adam Pritchard, *Behavioral Economics and the SEC*, U. MICH. L. SCH. SCHOLARSHIP REPOSITORY (2003) (“[I]nvestors will have limited attention spans, [so] requiring more disclosure may cause them to ignore more important information. Indeed, armed with an overconfident sense of his ability to digest mountains of disclosure, an investor may miss important aspects of disclosure.”). Additional citations throughout this section of the paper will add further support for this statement.

³⁷ Tony Paredas, *Blinded by Light: Information Overload and Its Consequences for Securities Regulation*, WASH. U. L. REV., Paper No. 03-02-02, (2003) (“[B]ecause of bounded rationality . . . people can only process a finite amount of information during any particular period of time . . . [S]tudies show that when faced with complicated tasks that involve vast quantities of information, people tend to adopt simplifying decision strategies that require less cognitive effort, but that are less accurate than more complex decision strategies.”); Herbert A. Simon, *Rationality as Process and as Product of Thought*, 68 AM. ECON. REV. 1, 9–14 (1978); Herbert A. Simon, *Theories of Decision-Making in Economics and Behavioral Science*, 49 AM. ECON. REV. 253, 272–73 (1959); Petra Persson, *Attention Manipulation and Information Overload*, Cambridge Univ. Press, Working Paper No. 17-024, (2017) (“Cronqvist and Thaler (2004) study the retirement savings plan introduced in

example, an investor may decide to purchase stock based on the first five pages of a 150-page document because they are incapable of properly processing the information beyond the first few pages. Also, an investor may make a financial decision based on a personal simplification of data—the data provided may be very complex, but the investor may internally summarize the perceived takeaways in an attempt to process all the information in the document.

This concept is referred to as “information overload,” which implies that a reader has a set capacity for the amount of information that can be processed and ultimately reaches a point where receiving more information has negative consequences.³⁸ The relevance and concern regarding information overload have both grown as the disclosure requirements have generally increased over time.³⁹ For example, Walmart’s initial public offering (“IPO”) prospectus in 1970 was less than 30 pages, while Uber’s IPO prospectus in 2019 was over 415 pages.⁴⁰

Sweden in 1993. Eligible Swedes were encouraged to choose five out of 456 funds, to which their savings would be allocated. The study reports that one third did not make any active choice; their savings were instead allocated to a default fund.”). Information overload seems a likely reason that so many Swedes rely on the default choice: comparing hundreds of funds is a Herculean task for ordinary households, and one might expect many of them to resort to the default or make superficial active decisions. Indeed, studying the same Swedish reform, [research] shows that funds that (for exogenous reasons) were better represented in the fund catalogue—that is, have better “menu exposure”—received more active contributions. Similarly, a study of retirement savings plan in the United States showed that making the decision problem less complex—by collapsing a multidimensional problem into a binary choice—increases enrollment in the plan.

³⁸ Paredas, *supra* note 37, at 419.

³⁹ Eva Su, *supra* note 19 (“As disclosure requirements and related costs have generally increased over time, questions have arisen over whether disclosed information is readable and understandable to investors . . . Current policy debates question whether the current disclosure regime leads to information overload—that is, whether the high volume of disclosure makes it difficult for investors to find the most relevant information.”).

⁴⁰ *Id.*; Adam Hayes, *Initial Public Offering (IPO)*, INVESTOPEDIA, <https://www.investopedia.com/terms/i/ipo.asp> (last updated Sep. 4, 2020) (“[An IPO] refers to the process of offering shares of a private corporation to the public in a new stock issuance. Public share issuance allows a company to raise capital from public investors . . . [I]t also allows public investors to participate in the offering. A company planning an IPO will typically select an underwriter . . . they will also choose an exchange in which the shares will be issued and subsequently traded publicly.”).

Additionally, academics have coined the term “attention capacity” to represent the amount of information an individual can remember.⁴¹ A study of brand recognition has shown that a typical consumer can remember 12 bits of information per brand.⁴² This is significantly less than the amount of information in one section of a Registration Statement, 10-K, or 8-K. Critically, studies have concluded that investors, more often than not, do not even read financial disclosures.⁴³ This body of research suggests financial disclosure would be more effective if it was simplified and shortened, made more user-friendly, and made more accessible.

Although some investors do not read financial disclosure, and still may not even if it is simplified and modernized, critical information must be made available to those wanting to make educated financial decisions. Research suggests current disclosure regimes may not be effective at enabling a reader to make an educated decision.⁴⁴ This exemplifies a major inconsistency requiring immediate redress. The Federal Trade Commission (“FTC”) faced challenges regarding the effectiveness of its disclosure regulations, so it conducted research in an attempt to solve these problems.⁴⁵ The FTC concluded that its disclosure regime was not as effective as the agency desired, but there were various opportunities for

⁴¹ See J. Jacoby et al., *Time Spent Acquiring Product Information as a Function of Information Load and Organization*, 8 PROC. ANN. CONVENTION AM. PSYCH. ASS'N, 813 (1973).

⁴² *Id.* at 813–14 (“Evidence suggests that a point of information overload may be reached beyond which additional information would produce dysfunctional consequences. Read-in time expenditures by [thirty-two] housewives was studied as a function of the number of brands (4, 8, 12, or 16) and amount of information (4, 8, 12, or 16 bits) per brand. Results indicate increasing time expenditures up to [twelve] bits of information per brand, after which read-in time expenditures decreased.”).

⁴³ Robert Prentice, *Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for its Future*, 51 DUKE L. J. 1397, 1455–56 (2001) (“[T]hat investors typically do not read disclosure documents when investing in securities.”).

⁴⁴ Naresh K. Malhotra, *Reflections on the Information Overload Paradigm in Consumer Decision Making*, 10 J. CONSUMER RES., 436, 438 (1984) (“While consumers may employ heuristics to limit the intake of information, these heuristics may often involve a tradeoff between simplifying and optimizing.”). Additionally, the studies referenced previously reach similar conclusions. See, e.g., Su, *supra* note 19; Jacoby et al., *supra* note 41; Prentice, *supra* note 43.

⁴⁵ LORRIE CRANOR, ET AL., FED. TRADE COMM'N, PUTTING DISCLOSURE TO THE TEST (2016), <https://www.ftc.gov/system/files/documents/reports/putting-disclosures-test/disclosures-workshop-staff-summary-update.pdf>.

improvement.⁴⁶ In response to the study, the FTC made several changes to better enable readers to educate themselves.⁴⁷ These changes included listing the most important information first, avoiding repetition, and using unambiguous language.⁴⁸ The solutions all had one thing in common—simplification.⁴⁹

Simplified disclosure, if done correctly, could eliminate the practice of strategically placing unfavorable data deep within a document. Corporations, aware that investors do not generally read disclosure, have an opportunity to “hide” critical undesirable data inside an extensive and complicated document.⁵⁰ This practice was so prominent and troublesome, that a Supreme Court case addressed the issue.⁵¹ The Supreme Court attempted to eliminate this potential problem by ruling that only “material” information should be included in financial

⁴⁶ Lorrie Cranor, *FTC Disclosure Evaluation Research from the Archives*, FED. TRADE COMM’N: TECH@FTC (Sept. 12, 2016, 1:35 PM), <https://www.ftc.gov/news-events/blogs/techftc/2016/09/ftc-disclosure-evaluation-research-archives> (“[T]he FTC conducted consumer testing of consumer mortgage disclosures and found that the disclosures in use at the time were not effective at conveying mortgage costs to many consumers. Using a combination of long interviews with recent mortgage borrowers and quantitative controlled testing, these studies found that prototype disclosures developed for the study were significantly more effective. Later the Consumer Financial Protection Bureau commissioned further prototype development and testing . . .”).

⁴⁷ CRANOR, ET AL., *supra* note 45. A public workshop on improving disclosure at the FTC included groups of expert panelists that made recommendations for improving disclosure. *Id.* at 1. The improvements included, but were not limited to, using simple, unambiguous language wherever possible, having an organized structure, listing the most important or unexpected information first, presenting information that shows people why disclosure may be relevant to them, avoiding repeated disclosure that results in readers becoming habituated and thus ignoring it, and considering the timing of the disclosure releases. *Id.* at 11. These recommendations were made based off support from controlled testing and extensive interviews. *Id.* at 12.

⁴⁸ *Id.*

⁴⁹ *See id.*

⁵⁰ Corporations have been accused of placing data in certain parts of the financial disclosure that are less likely to be read or understood. For example, pages at the end of the document or words at the center of a page are less likely to be read than an earlier page or words at the beginning of a page. Certain rules determine the order of types of data, what data can be provided, and how that information is to be presented, but corporate attorneys have creative control and have used this limited discretion to benefit their company at, what could be, the expense of a potential shareholders.

⁵¹ *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

disclosure.⁵² Unfortunately, this resulted in a subjective case-by-case analysis in an attempt to determine what constitutes “material information.”⁵³

The totality of these academic studies overwhelmingly suggests that simplified disclosure can increase efficiency and effectiveness.⁵⁴ However, answering the questions of how to simplify disclosure and to what degree are no easy task. Thus, the question of what simplified disclosure would look like, as well as how modernization can contribute to the solution, must be addressed.

III. SIMPLIFIED DISCLOSURE: CASE STUDIES AND PROPOSED SOLUTIONS

Behavioral Economics Works, a Canadian think-tank, conducted a behavioral experiment in which it prepared a model simplified financial statement to research effective disclosure techniques.⁵⁵ The study compared its model annual financial statement with five annual financial statements provided by dealer member firms of The Investment Fund Institute of Canada (“IFIC”).⁵⁶ Behavioral Economics Works recruited 2,597 English-speaking Canadians from across the country to participate in the experiment and the average age of the participants was 51.⁵⁷ The participants owned a minimum of one investment product and had a

⁵² Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417, 448 (2003) (discussing *TSC Indus., Inc. v. Northway*: “[T]he Supreme Court held that a fact is ‘material’ if ‘there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote’. In adopting this standard, the Supreme Court rejected the view that a fact is material if an investor ‘might’ find it important. The Court was concerned that such a low threshold of materiality would lead to a flood of disclosures that would ultimately swamp investors: ‘Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good . . . [M]anagement’s fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decision-making.’ This relates to the concept of ‘attention manipulation,’ in which management intentionally hides negative information within the disclosure or organizes data in a confusing and manipulative way.”).

⁵³ *Id.*

⁵⁴ This statement is supported by the studies referenced in this section.

⁵⁵ KELLY PETERS, ET AL., BEHAVIORAL ECONOMICS APPLIED TO FINANCIAL DISCLOSURE 3 (Feb. 2019), <https://www.ific.ca/en/news/ific-and-beworks-release-behavioural-economics-research-report/>.

⁵⁶ *Id.* at 68.

⁵⁷ *Id.* at 13.

minimum of one-year of experience as an investor.⁵⁸ Importantly, the numbers and information included within the model simplified disclosure did not differ from the original disclosure.⁵⁹ The conclusion of the study was clear – simplified disclosure provides several benefits, the most important of which is increasing the investor’s average return on investment.⁶⁰ The study also found that the benefits of simplified financial disclosure include a higher percent of pages viewed, better information comprehension scores, and increased investor confidence in their understanding of the information.⁶¹ These benefits directly solve the problems raised from information overload and attention capacity.

The tools used in crafting the experiment’s model financial statement can be applied to traditional Registration Statements, 10-Qs, 10-Ks, and other SEC financial disclosure documents. These strategies include eliminating complicated financial data that most investors are not familiar with, emphasizing the most important data, having summary boxes on each page, and eliminating legalese and repetition.⁶² This study provides a framework for successfully simplifying disclosure, but is not exhaustive. A major takeaway from the study is that even minor changes, such as making more comprehensible graphics and using bullet points, can have a significant impact.⁶³ This indicates that technology should be used to fully realize the benefits when adopting a similar simplification framework.

⁵⁸ *Id.*

⁵⁹ *Id.* at 93.

⁶⁰ *Id.* at 14–16 (“[I]nvestors who viewed the [simplified disclosure] were more accurate when answering questions that assessed detailed comprehension. These investors were also more confident about their understanding of the statement they had viewed This suggests that investors’ detailed comprehension of complex statement components was supported by a combination of simplified text [and] chunking information thematically Given that there was no significant difference between the simple and comprehensive [disclosure], [it can be] conclude[d] that a boost to investors’ detailed comprehension was achieved by incorporating [the simplified disclosure] tactics [The study] found that across a variety of measures . . . the [simplified disclosure] further enhanced key investor outcomes. The[se] [investors] also performed better with regard to percent of pages viewed.”).

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* (concluding that, “[e]ven relatively minor changes to language and graphics have a significant and positive impact on investors’ detailed comprehension of their statements and their intentions to take action in service of achieving their goals”). BE Works recommends, among other things, simplifying the statement by reducing the

Furthermore, ICI has advocated for the SEC to implement similar changes as those used by the FTC and IFIC.⁶⁴ Recently, the ICI recommended that the SEC adopt a rule that would require registered companies to file a new “summary report.”⁶⁵ This report would contain only “key information”—internal studies indicate that only including the most relevant data would result in an increased likelihood that investors would read it and find it helpful.⁶⁶ The ICI answered the question of what specific data should be considered key information through its 2017 Mutual Fund Shareholder Tracking Survey.⁶⁷ It was determined that key information included, but was not limited to, the historical performance of the fund, the performance of the fund compared to index funds, and

amount of text and summarizing key information with bullet points presented near the top-left corner of the page.

⁶⁴ ICI is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to promote public understanding and advance the interests of funds, their shareholders, directors, and advisers. INV. CO. INST., *About ICI—Membership*, https://www.ici.org/about_ici/membership. The following citations in this paragraph support this statement.

⁶⁵ Letter from Susan Olson, General Counsel, Division of Investment Management, to Brent Fields, Secretary, SEC (Oct. 24, 2018), <https://www.sec.gov/comments/s7-12-18/s71218-4932121-178430.pdf> (“In furtherance of the Commission’s efforts to enhance the investor experience, we recommend that the Commission consider proposing a rule creating a new, optional summary shareholder report with key information in a prescribed order. Results from our investor testing of a prototype for a summary shareholder report indicate investors would be more likely to read the summary than the full-length shareholder report and find a summary helpful to compare different funds.”).

⁶⁶ *Id.*

⁶⁷ *Id.* (“ICI’s 2017 Mutual Fund Shareholder Tracking Survey included a question that asked mutual fund–owning households to rank the importance of a variety of factors when making their mutual fund purchase decisions. When asked about the information they consider when choosing a mutual fund, 92[%] of mutual fund–owning households said that they reviewed the historical performance of a fund, with 50[%] indicating a fund’s historical performance was very important when making their fund purchase decision. [87%] of mutual fund–owning households indicated that they considered a fund’s performance compared with an index, when making their purchase decision, with 35[%] saying it was very important. Fund fees and expenses were found to be a very important consideration in fund selection. About nine in [ten] mutual fund–owning households indicated they reviewed the fund’s fees and expenses, with 40[%] indicating the fund’s fees and expenses were very important when making their purchase decision.”).

fund fees and expenses.⁶⁸ This survey also found that 90% of investors agreed that ICI's prototype summary report contained enough information to make educated financial decisions and made comparing data between funds easier.⁶⁹ The real shareholder reports that were used as part of the study were seen as difficult to understand by 67% of fund owners and very difficult to understand by 24% of fund owners.⁷⁰ Not only did investors agree that a prototype summary report was effective, but this was also corroborated by the three-question survey on comprehension at the end of the report.⁷¹ These questions tested the investor's comprehension of the prototype summary report; the results demonstrated that the prototype summary report helped investors answer content-related questions correctly.⁷²

The first step in making financial disclosure more efficient is to address information overload and attention capacity concerns by implementing a rule that requires that registered companies file a one-page summary report with key information.⁷³ The counterargument is that this will increase costs and further contribute to the problem by increasing the current financial disclosure requirements. However, paired with the modernization solution, this rule will pay off by eliminating unnecessary filing requirements in the future.⁷⁴

⁶⁸ *Id.*

⁶⁹ INV. CO. INST., MUTUAL FUND INVESTORS' VIEWS ON SHAREHOLDER REPORTS: REACTIONS TO A SUMMARY SHAREHOLDER REPORT PROTOTYPE 4, 10 (October 2018), https://www.ici.org/pdf/ppr_18_summary_shareholder.pdf.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ See INV. CO. INST., *supra* note 69, at 2. The key information will be the information that investors and experts determine to be the most critical based off of the ICI research as well as forthcoming SEC and other group studies.

⁷⁴ If the summary report is successful, it could lead to eliminating summary prospectuses, research into eliminating 10-Q's, shortening the 10-K, and eliminating and shortening other reporting requirements. Additionally, investors are more likely to read a one-page report, so a primary purpose behind the disclosure regime is more likely to be realized. See *supra* note 73 and accompanying text.

IV. MODERNIZATION: PAST SEC ACTION AND PROPOSED SOLUTIONS

The SEC has already addressed several inefficiencies in its disclosure regime. For example, it has taken steps to eliminate duplicative and overlapping filing requirements imposed by multiple federal securities statutes such as the '33 Act, '34 Act, and '40 Act.⁷⁵ Additionally, the SEC has relaxed numerous requirements for small businesses so that compliance costs will not force these companies out of the market.⁷⁶ The relaxed requirements have neither increased fraud nor decreased investor satisfaction.⁷⁷ The SEC has implemented rules that seem to focus on modernizing and simplifying disclosure, but clearly, the opportunity for further improvement still exists.⁷⁸

Increasing accessibility and readability has been a common talking point among executives at the SEC.⁷⁹ An example of a recent technological improvement in the SEC's disclosure regime occurred under Item 601 in Regulation S-K.⁸⁰ This regulation requires, among other things, that certain

⁷⁵ E.g., Cam C. Hoang, *New SEC Rules Eliminates Duplicative, Overlapping, Outdated Disclosure Requirements*, GOVERNANCE & COMPLIANCE INSIDER (Aug. 19, 2018), <https://governancecomplianceinsider.com/new-sec-rules-eliminates-duplicative-overlapping-outdated-disclosure-requirements/>.

⁷⁶ See, e.g., J.D. Harrison, *SEC Finalizes Key JOBS Act Rules for Small Businesses*, WASH. POST, (Mar.25, 2015), <https://www.washingtonpost.com/news/on-small-business/wp/2015/03/25/sec-finalizes-key-jobs-act-rules-for-small-businesses/>.

⁷⁷ See *id.*

⁷⁸ Eva Su, CONG. RES. SERV., IF11256, SEC. SECURITIES DISCLOSURE: BACKGROUND AND POL'Y ISSUES (2019), <https://fas.org/sgp/crs/misc/IF11256.pdf> ("The SEC has launched recent initiatives to simplify disclosure, for example, issuing a final rule regarding "Disclosure Update and Simplification," effective November 15, 2018.").

⁷⁹ See, e.g., Laura S. Unger, Comm'r, SEC, *Rethinking Disclosure in the Information Age: Can There be Too Much of a Good Thing?*, Remarks at the Internet Securities Regulation American Conference Institute (June 26, 2000), <http://www.sec.gov/news/speech/spch387.htm> ("As the Commission pursues new ways to help democratize access to investment information, we have to remember that information can only empower investors if they understand it and can effectively apply it. Access to information isn't a substitute for knowing how to interpret it.").

⁸⁰ See 17 C.F.R. § 229.601 (2020); *Securities Law Advisory: SEC Finalizes Rules to Modernize Regulation S-K*, ALSTON & BIRD (April 3, 2019), <https://www.alston.com/en/insights/publications/2019/04/sec-finalizes-rules-on-regulation-s-k>. See generally 17 C.F.R. §§ 229, 232, 239, 248 (2020) (regulation S-K establishes reporting requirements for publicly held companies).

financial disclosure documents must provide hyperlinks to all previously-filed documents that were referenced in the current filing.⁸¹ The practice of using hyperlinks should be expanded to references to other sections within the same document. This will enable investors to easily navigate the larger disclosure documents. While this modification could be viewed as repetitive and tedious, given that Item 601 is already in place, creating new hyperlinks will take minimal additional time and effort. Since investors rarely read the entire disclosure document, having a quick reference to other sections when skimming the document could be beneficial to investors.⁸²

The next step in modernizing financial disclosures is to make them available on user-friendly platforms that incorporate interactive graphs. A past SEC Commissioner commented that financial disclosure graphs in electronic form would allow investors to interact with the disclosure and view actual data points with one click of a mouse.⁸³ A few investment companies have commented on SEC proposed regulations advocating for pilot programs to test new technology and features to make disclosure more user-friendly.⁸⁴ These new types and features of financial disclosure could be ineffective, more costly, or ignored by investors. However, the

⁸¹ 17 C.F.R. § 229.601 (2020); ALSTON & BIRD, *supra* note 80.

⁸² See Robert Prentice, *Whither Securities Regulation? Some Behavioral Observations Regarding Proposals for its Future*, 51 DUKE L. J. 1397, 1456 (2002).

⁸³ Mark Story, *Introduction to Interactive Data*, SEC, https://www.sec.gov/rss/xbrl/interactive_data1.htm (last modified May 21, 2007).

⁸⁴ See Letter from Jonathan Chiel, Executive Vice President and General Counsel, Fidelity Investments, to Brent J. Fields, Sec'y, SEC (Oct. 31, 2018), <https://www.sec.gov/comments/s7-12-18/s71218-4593694-176325.pdf> (“We strongly encourage the SEC to foster innovation by creating a pilot program for investment funds that wish to experiment with interactive disclosure technology. . . . As with almost any technology initiative, all of this takes time and resources. Accordingly, we would prefer to see the SEC set up voluntary pilot programs to allow issuers to experiment with interactive disclosures and better determine their feasibility and utility for investors. This pilot program can allow funds the ability to obtain real-time input and feedback from public testers, which designers can then incorporate and re-present to focus groups for additional input.”); Hester M. Peirce, Comm’r, SEC, Remarks at the Financial Planning Association 2018 Major Firms Symposium: Pickups and Put Downs, SEC (Oct. 2, 2018), <https://www.sec.gov/news/speech/speech-peirce-100218> (discussing the importance of flexibility, “[a]llow[ing] pilot programs, and provid[ing] a principles based approach to disclosure so that the industry can innovate”); Letter from Michael J. Woodall, CEO, Putnam Investments, to Brent J. Fields, Sec’y, SEC (Nov. 30, 2018), <https://www.sec.gov/comments/s7-12-18/s71218-4715274-176689.pdf>.

pilot program could be used to test their effectiveness on consenting investors and would be completely optional, thus minimizing such concerns.⁸⁵ Market leaders would likely want to use a pilot program to retain market share and provide customers with the same services other companies are providing. Additionally, there would be less of a learning curve if a future regulation were to require the new disclosure on user-friendly platform. The SEC should allow these pilot programs through either exemptive relief or no-action letters.⁸⁶ In the investment company sector, the pilot programs would likely be employed by market leaders such as Fidelity, Vanguard, JP Morgan, and Blackrock.⁸⁷

The pilot programs will test tailoring disclosure to user-interfaces such as iPads, laptop touch screens, smartphones, etc., so that navigating the documents is easier and more interactive than with paper form. The new user-friendly platforms would increase accessibility because the disclosure would be available any time your smart device is available.⁸⁸ Additional

⁸⁵ See Letter from Jonathan Chiel, Executive Vice President and General Counsel, Fidelity Investments, to Brent J. Fields, Sec’y, SEC (Oct. 31, 2018), <https://www.sec.gov/comments/s7-12-18/s71218-4593694-176325.pdf> (stating that Fidelity “would prefer to see the SEC set up voluntary pilot programs”).

⁸⁶ See *Definition of Exemptive Relief*, LAW INSIDER, <https://www.lawinsider.com/dictionary/exemptive-relief> (last visited October 5, 2020) (“[E]xemptive relief means any approval, decision, declaration, designation, determination, exemption, extension, order, ruling, permission, recognition, revocation, waiver or other relief sought under securities legislation or securities directions.”); *No-Action Letters*, SEC, <https://www.sec.gov/fast-answers/answersnoactionhtm.html> (last modified Mar. 23, 2017) (“An individual or entity who is not certain whether a particular product, service, or action would constitute a violation of the federal securities law may request a ‘no-action’ letter from the SEC staff. Most no-action letters describe the request, analyze the particular facts and circumstances involved, discuss applicable laws and rules, and, if the staff grants the request for no action, concludes that the SEC staff would not recommend that the Commission take enforcement action against the requester based on the facts and representations described in the individual’s or entity’s request. The SEC staff sometimes responds in the form of an interpretive letter to requests for clarifications of certain rules and regulations.”).

⁸⁷ See Mike Dunn, *Mutual Fund Company Market-share Ranking August 2019*, MUTUAL FUND DIRECTORY (Aug. 16, 2019), <https://mutualfunddirectory.org/mutual-fund-company-market-share-ranking-august-2019/> (Each of these companies listed ranks in the top 6 of assets under management (“AUM”) and have close to 3% of the market share or greater.).

⁸⁸ Providing the disclosure through email as the default rule, as suggested later, or through an app or text message, would allow the document to be viewed by an investor at his or her convenience. See discussion *infra* Part V.

benefits of pilot programs testing new technologies and features include: using QR codes for fund comparison tools that improve financial literacy; meeting the needs of those with disabilities; meeting the needs of those that speak English as a second language; considering the individual preferences of investors; and more opportunity for communication between parties.⁸⁹ The pilot programs should test a summarized interactive slideshow that simplifies financial disclosure already available on EDGAR and makes it accessible on smartphones, tablets, and laptops.⁹⁰ Unlike the SEC's Disclosure Update and Simplification Rules in 2018, the resulting regulations from these pilot programs would adequately address the concerns regarding information overload and attention capacity.⁹¹ Developing a group of pilot programs testing interactive graphs, slideshows, a more user-friendly interface, and more hyperlink utilization, is the second step in solving the inefficiencies in the current financial disclosure regime.

V. MODERNIZATION: SOLUTIONS FOR RELATED LAWS

Several laws that are still strictly adhered to have a legislative purpose that is no longer relevant given technological advancements. For example, certain funds are required to have prospectuses be delivered to each shareholder by mail.⁹² This rule is still in place even though the ICI estimated that it costs \$2 billion in printing and mail expenses over ten years.⁹³ The SEC implemented Rule 30e-3 to allow certain investment funds to use email as the default option, but the rule needs to be expanded

⁸⁹ Letter from Eric J. Johnson, President, Donnelley, to Brent J. Fields, Sec'y, SEC (Oct. 31, 2018), <https://www.sec.gov/comments/s7-12-18/s71218-4593947-176329.pdf>.

⁹⁰ Summary disclosures, such as a mutual fund summary prospectus, currently exist. See *Mutual Fund Prospectus*, INVESTOR.GOV, (<https://www.investor.gov/introduction-investing/investing-basics/glossary/mutual-fund-prospectus> (last visited Oct. 6, 2020)). However, these are still very extensive (about 30 pages in most cases) and only available in the traditional platforms. A slideshow would better captivate investor attention and help avoid information overload, especially if the slideshow used summary boxes in the top corners as proved effective by the IFIC.

⁹¹ See Su, *supra* note 78; *supra* text accompanying note 40 (explaining that even after 2018, some prospectuses were less simple than in previous years).

⁹² See Su, *supra* note 78 (explaining that after implementation of Rule 30e-3 certain investment funds are allowed to transmit prospectuses digitally by default, meaning that some are still transmitted by mail).

⁹³ *Id.*

to all securities.⁹⁴ There is an argument that this rule would harm elderly and rural investors who may not use technology and rely on mailings to gather information.⁹⁵ However, while investors could elect to get disclosure via mail by contacting the appropriate company,⁹⁶ the default rule should reflect the majority preference.⁹⁷ A study in 2017 found that 95% of mutual fund owners have internet access, compared to 68% in 2000.⁹⁸ The default rule should be that sending either an email or push notification satisfies the “delivery” rule.⁹⁹ This would lead to fewer costs, more accessibility, and a better platform for viewing the material.

Additionally, proxy voting¹⁰⁰ disclosure mailings could be eliminated entirely unless an investor were to opt-in to mailings.¹⁰¹ A voting process that took place entirely online would be streamlined, save resources, and

⁹⁴ *Id.* See generally 17 C.F.R. pt. 200 *et seq.*

⁹⁵ Su, *supra* note 78.

⁹⁶ *Optional Internet Availability of Investment Company Shareholder Reports Rules*, SEC, <https://www.sec.gov/investment/secg-optional-internet-availability-investment-company-shareholder-reports-rules> (last modified Aug. 3, 2018).

⁹⁷ 280.86 million people used the internet in 2019, and this figure is projected to increase in coming years. J. Clement, *United States: Number of Internet Users 2015-2025*, STATISTA (July 14, 2020), <https://www.statista.com/statistics/325645/usa-number-of-internet-users/> (Total internet users are “projected to grow to 296.7 million internet users in 2025. The United States are one of the biggest online markets worldwide.”). This is around eighty-six percent of the 2019 U.S. population as of January 1, 2019. *U.S. World and Population Clock*, U.S. CENSUS BUREAU, <https://www.census.gov/popclock/> (last visited Oct. 5, 2020). The number of people using the internet is likely even higher among those that own securities. Sarah Holden et al., *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet*, 23 ICI RES. PERSP. 1, 18 (2017), <https://www.ici.org/pdf/per23-07.pdf>.

⁹⁸ Sarah Holden et al., *supra* note 97, at 18.

⁹⁹ *Push Notification*, CAMBRIDGE DICTIONARY, <https://dictionary.cambridge.org/us/dictionary/english/push-notification> (last visited Sep. 27, 2020) (“[A] push notification [is] . . . a message sent to a smartphone relating to one of its apps, even when it is not running . . .”).

¹⁰⁰ A proxy vote is a ballot cast by a shareholder regarding a proposed company action. Shareholders receive a proxy ballot with a book of information in the mail regarding the upcoming vote.

¹⁰¹ Will Kenton, *Proxy Vote*, INVESTOPEDIA.COM (Apr. 14, 2020), <https://www.investopedia.com/terms/p/proxy-vote.asp> (explaining that a proxy vote is a ballot cast by a shareholder regarding a proposed company action and that shareholders receive a proxy ballot with a book of information in the mail regarding the upcoming votes).

be good for the environment.¹⁰² It would not discourage the participation of elderly and rural investors because the option to attend the stockholder annual meeting or opt-in to mailings would still be available.¹⁰³

Due to the widespread adoption of the internet, smartphones, and computers, an “access equals delivery” rule is satisfactory to achieve the original legislative purpose behind the delivery rule, which is to ensure that all investors have access to reliable information.¹⁰⁴ Ultimately, this type of rule would be good for the environment, save the industry money, reduce investor fees, and not unfairly burden elderly individuals or those living in rural areas.¹⁰⁵ Implementing the “access equals delivery” rule for all securities is a necessary step in modernizing federal securities laws.

¹⁰² See Letter from Paul F. Roye, Senior Vice President, Capital Group, to Brent J. Fields, Sec’y, SEC (Oct. 30, 2018), <https://www.sec.gov/comments/s7-12-18/s71218-4587765-176294.pdf> (“Production of paper prospectuses [including proxy voting] and shareholder reports has a significant negative impact on the environment. For the American Funds, over the 12-month period from July 2016 to June 2017, we mailed . . . [a]pproximately 5,122 tons of paper . . . [t]his resulted in the destruction of about 122,000 trees. In addition, transporting this amount of paper required approximately 395 tractor trailer truckloads, resulting in an increase in carbon emissions.”).

¹⁰³ See *id.*; *supra* notes 95 and accompanying text.

¹⁰⁴ This rule refers to the idea that being able to access the document satisfies the delivery requirements laid out in the federal securities laws’ statutes and regulations. See Securities Offering Reform, Release Nos. 33-8591, 34-52056, IC-26993, 2005 WL 1692642 (Aug. 3, 2005) (to be codified at 17 C.F.R. pts. 200, 228, 229, 230, 239, 240, 243, 249, 274), available at <http://www.sec.gov/rules/final/33-8591.pdf> (stating that [u]nder such an “access equals delivery” model, investors are presumed to have access to the Internet, and issuers and intermediaries can satisfy their delivery requirements if the filings or documents are posted on a web site”). Several funds qualify for this type of rule already, but certain funds have not been permitted to switch to this method. See Letter from Jones Day to Brent J. Fields, Sec’y, SEC (Nov. 7, 2018), <https://www.sec.gov/rules/petitions/2018/petn4-734.pdf> (“In 2005, the Commission adopted an “access equals delivery” model regarding the delivery of final prospectuses, as set out in Securities Act Rules 172 and 173.”).

¹⁰⁵ See Roye, *supra* note 102; *supra* notes 93–95 and accompanying text. A company having fewer compliance costs results in fewer costs being passed on to the investor through fees. Alternatively, lower compliance costs would allow the money to be spent elsewhere which would likely increase the value of a company. See Jones Day, *supra* note 104 (discussing the compliance costs for disclosures).

VI. IMPLEMENTATION BARRIERS

The SEC would almost certainly be uncomfortable in considering eliminating current disclosure requirements without having testing periods for the new regulations. Major rule changes are unlikely to be considered without a lengthy testing process—this is another cause of the inefficiency in the financial disclosure regime. Thus, a workable solution must necessarily start with increased financial burdens on the industry, but will eventually benefit all industry players.

Problems with adding a new disclosure regulation without eliminating others include increased compliance costs, legal uncertainty, use of SEC resources, and a steep learning curve for all industry players. Extensive research, including a cost-benefit analysis, must be conducted by the SEC to determine if the adoption of these proposed financial disclosure changes would be beneficial long-term. Certain statutes and regulations also require such studies before implementing new regulations.¹⁰⁶ Although this seems burdensome and unproductive, it could lead to major benefits in the long run. For example, eventually the 10-Q could be eliminated—decreasing compliance costs, reducing information overload, and allowing companies to focus on long-term growth.¹⁰⁷ Opponents of

¹⁰⁶ See generally 15 U.S.C.A. § 80a-1 (West 2020).

¹⁰⁷ See e.g., Peter J. Henning, *Companies are Pushing for Less Disclosure. Is that Good for Investors?*, N. Y. TIMES (Sept. 14, 2018), <https://www.nytimes.com/2018/09/14/business/dealbook/sec-disclosure-investors.html> (“President Trump tweeted on Aug. 17 that ‘some of the world’s top business leaders’ want to stop reporting financial information quarterly. He said he would ask the Securities and Exchange Commission to look at requiring disclosure only every six months.”); Shivaram Rajgopal, *What Would Happen if the U.S. Stopped Requiring Quarterly Earnings Reports?*, HARV. BUS. REV. (Sept. 6, 2018), <https://hbr.org/2018/09/what-would-happen-if-the-u-s-stopped-requiring-quarterly-earnings-reports> (“In 2007, when the UK mandated the start of quarterly reporting, they left the actual format of such disclosures up to individual firms. After the start of mandatory quarterly reporting in the UK, the number of firms that issued quantitative quarterly reports, defined as those with sales and earnings numbers, declined, suggesting a decline in disclosure transparency. However, the number of firms that issued annual earnings or sales guidance increased significantly.”); SU, *supra* note 76 (“Policy debates have also focused on how frequently public companies are required to file reports with the SEC. The frequency of reporting could affect investors’ access to information as well as companies’ ongoing compliance costs. In the 115th Congress, bills were introduced that would have directed the SEC to study the costs and benefits of 10-Q quarterly reporting, especially to smaller issuers (S. 488 and H.R. 5970). Proponents of reducing the frequency of quarterly reporting argue that in addition to the costs involved, it

this change explain that frequent reporting increases analyst accuracy, which is critical given the industry is becoming increasingly institutionalized.¹⁰⁸ Currently, institutional investors own 70% of stock trading volume.¹⁰⁹ However, if 10-Q's were eliminated, all analysts, and thus all investors, would be on the same playing field; no individual or institution would be unduly burdened.¹¹⁰ Although the proposed solutions would include additional short-term burdens for the industry, investors

distracts from companies' longer-term strategies. Opponents of reduction are concerned about potential negative effects on financial transparency and investor protection.”); David Zaring, *Should Companies Abandon Quarterly Earning Reports?*, WHARTON (Aug. 27, 2018), <https://knowledge.wharton.upenn.edu/article/ending-quarterly-reporting/> (“PepsiCo CEO Indra Nooyi suggested [abandoning 10-Q’s]. Nooyi, who is set to leave PepsiCo in October, told Reuters that her comments were made in a broader context—reorienting U.S. companies to have a longer-term view of their businesses and ‘to explore the harmonization of the European system and the U.S. system of financial reporting.’ . . . Advocates of the switch point to the savings for companies in accounting, legal and other costs, and the latitude to focus on longer-term growth rather than to be dictated to by quarterly earnings expectations David Zaring, Wharton professor of legal studies and business ethics, agreed [and] said the SEC should seriously consider Trump’s proposal given the substantial push for a change in reporting frequency.”).

¹⁰⁸ Amelia Josephson, *What Is an Institutional Investor?*, SMART ASSET (July 24, 2019), <https://smartasset.com/investing/what-is-an-institutional-investor> (“Most of the trading that happens on the market is done by institutional investors. . . . The percentage of corporate shares held by institutional investors has increased dramatically in the last 60 years. Today, the volume of trades by retail investors pales in comparison to the trading activity of institutional investors.”); Rajgopal, *supra* note 107 (“Frequent reporting increases analysts’ accuracy. Analyst coverage for UK firms increased after the introduction of more frequent mandatory reporting, meaning more firms had at least one dedicated analyst following its reporting. Analyst forecast error, defined as the difference between actually reported earnings per share and forecasted earnings per share, fell for firms after the introduction of mandatory reporting. These findings suggest that frequent reporting makes it easier for sell-side analysts to cover firms.”).

¹⁰⁹ Josephson, *supra* note 108 (“By some estimates, institutional investors account for 70% of stock trading volume.”).

¹¹⁰ This is because 10-Q's would be eliminated for everyone and all individuals and institutions would still have the same amount of information for their analysis. There would not be an asymmetric information issue. *See, e.g.,* Zaring, *supra* note 107 (discussing how sophisticated investors use their vast resources to analyze quarterly reports before the average investor even has the chance to review them.).

will quickly realize the benefits.¹¹¹ Substantial long-term benefits are likely to follow for all market players.

VII. GLOBALIZATIONS CONSIDERATIONS

The U.S. capital markets are more regulated than any other market in the world.¹¹² As such, extensive simplification and modernization may allow the U.S. to continue to compete internationally. For the past few decades, seven markets have controlled most of the world's market capitalization—the United States, Canada, the United Kingdom, France, Italy, Japan, and Germany—with the U.S. being the largest market.¹¹³ As frequently echoed by economists, overregulation can negatively affect an economy; this is a vital policy discussion in today's political atmosphere.¹¹⁴ The U.S. prioritizes investor protection and has significantly less financial market fraud than other countries.¹¹⁵ Therefore, the U.S. is almost certainly

¹¹¹ See, e.g., *id.* (discussing how businesses could shift to a long-term growth mindset if quarterly reports were no longer required, which could lead to long-term benefits).

¹¹² See generally *IPO Insights: Comparing Global Stock Exchanges* 65, ERNST & YOUNG (2009), [https://www.ey.com/Publication/vwLUAssets/IPO_Insights:_Comparing_global_stock_exchanges/\\$FILE/IPO_comparingglobalstockexchanges.pdf](https://www.ey.com/Publication/vwLUAssets/IPO_Insights:_Comparing_global_stock_exchanges/$FILE/IPO_comparingglobalstockexchanges.pdf) (a guide to the United States' highly regulated IPO process showcases their position as the most regulated capital market in the world).

¹¹³ See, e.g., INT'L FIN. CORP., *Emerging Stock Markets Factbook* (1999). Consider that, since 1995, these those seven markets have accounted for 75%—and that percentage increasing—of the world's market capitalization.

¹¹⁴ See Peter J. Ferrara, *How Overregulation Is Killing The Economy*, INVESTOR'S BUS. DAILY (Apr. 27, 2016), <https://www.investors.com/politics/commentary/how-overregulation-is-killing-the-economy/>; Doug Schoen, *Yes, There Is Such A Thing As Over-Regulation*, FORBES (Dec. 2, 2015), <https://www.forbes.com/sites/dougschoen/2015/12/02/yes-there-is-such-a-thing-as-over-regulation/#6ae574754671> (regarding the annual defense policy bill: "President [Obama] also proposed 2,224 new regulations just before Thanksgiving. These rules have tremendous economic impact as 144 of them are set to cost the American economy up to \$100 million. To be sure, some of these rules are for the greater good—for instance, contractors will be entitled to paid sick leave – but we also know that there's a lot in there that's just regulation for the sake of regulation. And that's never a good thing . . . It follows that we must always be mindful of the impact that over regulation plays in our economy . . . right now as more and more businesses suffer at the hands of regulations and are forced out of business or overseas.").

¹¹⁵ See, e.g., *Corruption Perception Index*, TRANSPARENCY INTERNATIONAL, <https://www.transparency.org/cpi2018> (last visited Sept. 23, 2020). Although stock market fraud is only one factor in corruption rankings, these figures provide an insight into which countries have the resources to prevent fraud and have taken action to do so.

going to continue to rank as one of the countries that require the most financial disclosure and, therefore, have the highest compliance costs.¹¹⁶ Currently, the U.S. and Canada continue to require stricter disclosures, while Japan and Germany require less restrictive disclosures, and the United Kingdom lands somewhere in the middle.¹¹⁷

The U.S. dominates the international capital markets with a market equity cap at about \$32 trillion.¹¹⁸ Foreign stocks, such as the popular Chinese company Alibaba, are often repackaged and sold in U.S. markets.¹¹⁹ However, like any other U.S. fund, these types of investments must be accompanied by significant financial disclosures explaining, among other things, the risks of investing in foreign markets.¹²⁰ Not only could the proposed solutions in this paper modernize and simplify financial disclosure and increase the efficiency of the SEC disclosure regime, but they could also benefit the U.S. on a global level. The U.S. could be the first major capital market to take important steps in

This statement is widely held to be true, and it is part of the reason the U.S. markets are the most reliable and active markets in the world.

¹¹⁶ See generally *Cost of Compliance Expected to Hit \$181bn*, BANKING EXCH. (April 13, 2020), <https://www.bankingexchange.com/bsa-aml/item/8202-cost-of-compliance-expected-to-hit-181bn>.

¹¹⁷ See Merritt. B. Fox, *Political Economy of Statutory Reach: U.S. Disclosure Rules in a Globalizing Market for Securities*, 97 MICH. L REV. 696, 758 (Dec 1998).

¹¹⁸ U.S. *Capital Markets Deck 2018*, SIFMA (Sept. 6, 2018), <https://www.sifma.org/resources/research/us-capital-markets-deck-2018/> (“America has the largest and deepest capital markets in the world—according to the Federal Reserve, the capital markets provide approximately 80% of debt financing for businesses in the U.S. The securities industry facilitates access to those markets, creating investor opportunity, capital formation, job creation and economic growth.”).

¹¹⁹ Justin Kuepper, *Top 10 Most Popular Foreign Stocks*, THE BALANCE (Nov. 17, 2019) (“International investors have access to virtually limitless opportunities around the world, from Austria to Zambia. Buying and selling these foreign securities is easy to do through the use of exchange-traded funds (ETFs) and American Depositary Receipts (ADRs). These investment products cover the vast majority of popular companies and countries around the world ... [ADRs are] a popular way for American investors to invest in foreign companies. ADRs are created when U.S. banks purchase a bulk lot of shares from a company, bundle them into groups, and reissue them on a U.S. stock exchange. The bank then manages the ratio of U.S. ADRs to foreign shares to ensure that the ADRs are accurately priced on U.S. exchanges.”).

¹²⁰ See, e.g., *Summary Prospectus*, FIDELITY INT’L INDEX FUND (Apr. 29, 2019), <https://fundresearch.fidelity.com/mutual-funds/summary/315911727>.

transforming its disclosure regime to acknowledge modern technology and widely held views in academia.

Some jurisdictions have leveraged modern technology to make financial disclosure more efficient, less environmentally harmful, and more responsive to majority preferences.¹²¹ The European Union and Australia allow for funds to simply notify investors that financial disclosure is available on their website, and send a mailed copy upon the request of an investor.¹²² In Canada, an electronic copy of the report can be provided, with a paper copy upon request.¹²³ However, these minor discrepancies alone have not proven significant enough to have an impact on U.S. competition globally.¹²⁴

Diversity among disclosure standards between capital markets can be positive—it can drive competition and lead to the most efficient outcome; on the contrary, it could also drive the smaller market to match the regulatory regime of the larger market to remain competitive.¹²⁵ Although treaties exist so that corporations can offer securities in multiple jurisdictions, globalization concerns abound as foreign markets continue to grow.¹²⁶ The U.S. has pushed for foreign jurisdictions to adopt conforming securities legal regimes, but with limited success.¹²⁷ Nonetheless, Japan and Switzerland have adopted certain insider trading laws to reconcile with U.S. policy, but a uniform financial disclosure regime

¹²¹ This has primarily been done in foreign jurisdictions through the adoption of the “access equals delivery rule” for all securities. *See* Roye, *supra* note 102.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *See* SIFMA, *supra* note 118.

¹²⁵ *See* Cally Jordan, *Regulation of Canadian Capital Markets in the 1990s: The United States in the Driver's Seat*, 4 CA. PAC. RIM L. & POL'Y J. 577, 592 (1995) (discussing how the adoption of the Multi-Jurisdictional Disclosure System between the United States and Canada has resulted in a shift in Canada's securities regime toward that of the United States).

¹²⁶ *See, e.g.*, Stephen J. Choi & Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market*, 65 FORD. L. REV. 5 at 1890, n. 73 (1997), <http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=3361&context=flr> (“Canada and the United States also entered into a bilateral agreement in 1991, the Multijurisdictional Disclosure System, with respect to offering information disclosure requirements. Under the Multijurisdictional Disclosure System, Canadian issuers may issue securities in the United States while complying with Canadian registration and disclosure requirements so long as the issuer's financial statements conform to the United States' generally accepted accounting principles.”).

¹²⁷ *Id.*

has yet to be universally implemented.¹²⁸ It is possible that if the U.S. displays to other markets that this paper's proposed regulatory changes result in an efficient U.S. disclosure regime, other jurisdictions could conform to U.S. financial disclosure standards. This has the potential to benefit investors worldwide; furthermore, continued competition to find the efficient outcome in a disclosure regime would no longer be necessary as these changes, and future adaptations, can maximize efficiency.

The U.S. remains the leader in overall capital market size, so significant improvements to address the inefficiencies in financial disclosure regulations are likely to result from U.S. leadership.¹²⁹ However, this is not to say that foreign jurisdictions do not pose a threat to the U.S. market. Recent revelations display that a decline in U.S. IPOs and improvements in foreign markets' stability present a challenge to the U.S. in retaining its market share.¹³⁰ Thus, taking steps to increase the effectiveness and efficiency of financial disclosure can stimulate the U.S. economy while providing incentives for major corporations to remain incorporated in the United States.

¹²⁸ *Id.* Additionally, certain markets, such as Japan, have modeled their securities legal regime around the United States' laws. See James D. Cox, *Regulatory Competition in Securities Markets: An Approach for Reconciling Japanese and United States Disclosure Philosophies*, 16 HASTINGS INT'L & COMP. L. REV. 149, 151 (1993).

¹²⁹ See *U.S. Capital Markets Deck 2018*, SIFMA (Sept. 6, 2018), <https://www.sifma.org/resources/research/us-capital-markets-deck-2018/>.

¹³⁰ Richard R. Ellsworth, *Capital Markets and Competitive Decline*, HARV. BUS. REV. (Sept. 1985), <https://hbr.org/1985/09/capital-markets-and-competitive-decline> ("The growing strength of the United States' foreign competitors and our economic malaise are common topics for discussion in our country today. Yet the causes most frequently enumerated—the lack of an effective national industrial policy, shortsighted management practices, and the strong dollar—do not adequately explain the basic predicament, although they address important issues. Rather, the competitive decline afflicting many Fortune '500' companies in large part reflects management's preoccupation with capital-market conventions that divert attention from product-market needs and frustrate efforts to improve competitiveness."). Recent improvements and opportunities for growth have been observed in both the German and Japanese capital markets. *Id.*

CONCLUSION

The inefficiencies of government may be inescapable. The private sector generally has fewer levels of review and is better situated to quickly adapt to technological improvements. However, academic research and modern technology have created tools to address the inefficiencies in government, specifically within the executive branch and financial disclosure regulations. Finding the correct balance between preventing fraud by forcing the production of critical information and avoiding informational overload from overregulation is an ongoing challenge. Modernization and simplification offer techniques to increase the efficiency and effectiveness of financial disclosure, and the SEC has demonstrated that these concerns have been on its radar. However, the SEC's current actions do not go far enough given the widely held views in academia regarding information overload and attention capacity.

Academic research strongly suggests that a simplified form of financial disclosure should be introduced—thus, the answer to Question One, should a simplified form of financial disclosure be introduced, is yes. Therefore, the SEC should require a one-page summary report containing only key information. The government must modernize financial disclosure to increase the efficiency and effectiveness of the SEC financial disclosure regime. This can be done by first permitting the launching of pilot programs that make disclosure available on user-friendly platforms that incorporate interactive graphs, slideshows, and hyperlinks, and second implementing an “access equals delivery” rule for all securities. These actions provide the answer to Question Two regarding how financial disclosure, and the related body of regulations, can be modernized via current technology. Once these initial actions are completed, the resulting successes can allow for more drastic steps to be taken in the attempt to maximize the efficiency in the SEC's financial disclosure regime. The foundations behind this paper's proposed solutions provide an outline of approaches to improve efficiency within other executive branch agencies and regulations as well.

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