Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

Updated August 20, 2024

SEC Securities Disclosure: Background and Policy Issues

Disclosure requirements are the cornerstone of federal securities regulation. One of the key federal securities laws, the Securities Act of 1933 (P.L. 73-22), is often referred to as the "truth in securities" law. As this name suggests, the 1933 act focuses on disclosure, specifically requiring companies offering securities, such as stocks or bonds for public sale, to provide truthful information about these securities and the risks associated with investing in them. Similarly, the Securities Exchange Act of 1934 (P.L. 73-291), requires companies with publicly traded securities to periodically report certain information on an ongoing basis. The disclosure-based regulatory philosophy is consistent with Supreme Court Justice Louis Brandeis's famous quote that "sunlight is said to be the best of disinfectants; electric light the most efficient policeman." In practice, transparency through disclosure seeks to inform investors and policymakers and enables market mechanisms to price risk and deter fraud. This In Focus discusses the current disclosure regime and analyzes relevant policy issues.

Background

The Securities and Exchange Commission (SEC) is the primary regulator overseeing the securities markets, including enforcing securities disclosure requirements. The SEC requires issuers offering and selling securities to either register with the SEC and comply with applicable disclosure requirements (i.e., *public offerings*) or obtain an exemption from certain registration requirements (i.e., *private offerings*). The SEC also requires issuers to make certain nonpublic disclosures. For more details, see CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

Public Disclosure

Public disclosures are publicly accessible through the SEC's online portals. When companies fundraise through public securities offerings, the SEC requires that the companies disclose certain information, including financial statements, business risks and prospects, a description of the stock to be offered for sale, and the management team and their compensation. **Table 1** lists three types of forms that the SEC requires publicly traded companies to file periodically and as major events occur.

Table 1. Examples of Public Company Disclosure

Form	Content
10-K	*Annual reports* of a company's business and financial conditions and audited financial statements.
10-Q	*Quarterly reports* for the first three fiscal quarters of the year that include a company's unaudited financial statements and financial conditions.
8-K	*Current reports* to announce major events shareholders should know about.

Source: CRS using information from the SEC.

Nonpublic SEC-Only Disclosure

The SEC also requires companies to make certain nonpublic, SEC-only disclosures, which allow the SEC to monitor risks and inform certain research while keeping the information confidential. The SEC normally does not make nonpublic information identifiable to any particular registrant, although it could release certain information in the aggregate and use the information during enforcement.

Principles of SEC Disclosure Requirements

A former SEC chair summarized several principles in which the SEC's disclosure requirements must be rooted:

- **Materiality**—In 1976, the Supreme Court in *TSC Industries, Inc. v. Northway, Inc*. defined information as material if "there is a substantial likelihood that a reasonable shareholder would consider [the information] important in deciding how to vote."
- **Comparability**—standardized financial reporting requirements.
- **Flexibility**—the view that requirements that are too rigid can lead to "superfluous, and in some cases, misleading disclosure."
- **Efficiency**—generally, finding the rule that is "most effective with the least cost."
- **Responsibility** (or liability)—the view that rules have little long-term value if they cannot be effectively enforced.

Materiality is one of the most important principles governing public securities disclosure. In general, federal securities laws require that issuers disclose to investors all material information they need to make sound investment decisions. Federal securities laws provide that investors harmed by misleading statements or the omission of material facts can seek remedy through litigation. The SEC affords some discretion to companies through a principles-based approach to materiality, which provides some flexibility for companies to make decisions on what to disclose on a case-by-case basis.

Policy Issues

To be effective, securities disclosures would neither be so restrictive that they omit essential information nor be so voluminous that they create information overload or exhaust resources with irrelevant information. Some observers characterize the central issue regarding securities disclosure as striking a balance between requiring disclosure that is consistently material and/or useful on the one hand and can be provided in a cost-effective and justified manner for its intended audience on the other.

Disclosure content. Policy attention in the 118th Congress has been focused on what types of disclosures companies should make related to national security or environmental, social, and governance (ESG) concerns, including climate risk, human rights, workers' rights, and diversity. Some proposals would require new disclosure associated with certain foreign countries of concern (e.g., S. 3286, S. 854, and H.R. 747). Multiple proposals address diversity issues through the disclosure of specific diversity, equity, and inclusion programs (e.g., H.R. 6776) and board and executive officer composition (e.g., H.R. 4177 and S. 2007). Other proposals would require new disclosure on workforce management policies and practices (e.g., H.R. 4578 and S. 2751) and forced labor activities in production and supply chain (e.g., H.R. 4840 and S. 1770). While some proposals call for more ESG disclosure (e.g., H.R. 4759), other proposals would prohibit the SEC from requiring certain climate information (e.g., H.R. 1018 and S. 391). Furthermore, the Mandatory Materiality Requirement Act (H.R. 4168 and S. 2005) would require the SEC to limit issuer disclosure to information that is material to a vote or investment decision-making. Proponents of new disclosures view their proposals as having positive impacts on publicly traded companies' operations and as aligning disclosures with stakeholders' interests. They contend that a standardized framework for such disclosures would help companies comply with their obligations and enable investors and regulators to monitor specific activities and cross-compare the risks at different companies. Critics of increased disclosure requirements question the usefulness of the information to investors and the increased costs for publicly traded companies. Some critics also believe that the existing regime of disclosing material information is sufficiently flexible to account for the disclosure needs.

Disclosure quality and information overload. As disclosure requirements and related costs have generally increased over time, questions have arisen over whether disclosed information is readable and understandable to investors. For example, Walmart's initial public offering (IPO) prospectus in 1970 totaled fewer than 30 pages, compared with Airbnb's 2020 IPO filing of more than 400 pages. 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. The SEC once launched initiatives to simplify disclosure—for example, issuing a final rule regarding "Disclosure Update and Simplification." It also published a Plain English Handbook that aims to promote more informative filings.

Disclosure frequency. 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. Some bills were introduced that would have directed the SEC to study the costs and benefits of 10-Q quarterly reporting, especially to smaller issuers (e.g., H.R. 5970 in 115th Congress). Proponents of reducing the frequency of quarterly reporting argue that in addition to the costs involved, it distracts from companies' longer-term strategies. Opponents of reduction are concerned about potential negative effects on financial transparency and investor protection. The SEC once issued a request for public comment on the nature and timing of 10-Q reporting.

Disclosure requirements for smaller firms. Some question whether disclosure requirements should be the same or different for firms of different sizes and with varying capabilities to absorb compliance costs. Some research indicates that the cost is high for SEC disclosure and other IPO compliance requirements, and the issuers also face annual ongoing compliance costs. Reports suggest that such high costs disadvantage smaller companies. The Jumpstart Our Business Startups Act (JOBS Act; P.L. 112-106), enacted in 2012, reduced disclosure requirements for certain securities offerings, but concerns exist that smaller companies continue to face fundraising challenges. To address these concerns, Congress has considered numerous legislative proposals to further customize registration and disclosure requirements for offerings of different sizes and purposes, with some proposals building on existing JOBS Act provisions. The most notable of these proposals include the JOBS and Investor Confidence Act of 2018 (JOBS Act 3.0; House amended S. 488 in 115th Congress) and the Expanding Access to Capital Act (H.R. 2799 in 118th Congress) that proposes to adjust certain registration and disclosure exemptions for smaller firms.

Disclosure style and format. Investors' preferences for disclosure may differ depending on whether they are retail or institutional investors. One important trend in the asset management industry relates to how investors have shifted from investing directly for themselves to investing indirectly through the use of institutional money managers. Because the current investor base is mostly institutional, some argue that the SEC's disclosure requirements should move toward data standardization and machine readability. Others argue that public disclosure should be in plain English for retail investors. The SEC Disclosure Effectiveness Testing Act (H.R. 8462 in 117th Congress) would have required the SEC, when developing rules about disclosures to retail investors, to conduct investor testing, including a survey and interviews of retail investors.

Disclosure delivery method. Some observers question whether securities disclosure materials should be distributed digitally or on paper by default. After a long policy debate, in 2018, the SEC adopted Rule 30e-3 to allow certain investment funds to transmit shareholder reports digitally as the default option. Opponents, including the paper industry, voiced concerns that the rule disadvantages elderly and rural investors, whom they argue are more accustomed to paper reading and may have less access to the internet. Supporters highlighted the environmental and economic benefits, including that the Investment Company Institute estimated that the move would save $2 billion in printing and mail costs over a 10-year period, and they would like to see such digital-first options applied more broadly. The Improving Disclosure for Investors Act (H.R. 1807 and S. 3815 in 118th Congress) would require the SEC to promulgate rules relating to electronic delivery.

Eva Su, Specialist in Financial Economics

Disclaimer