

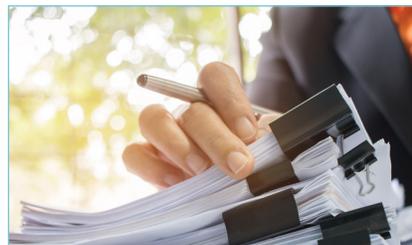
# DIMENSIONS

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## The SEC's use of Big Data in the next decade: Where are we now?

By Elizabeth P. Gray and Catherine E. Fata, Willkie Farr & Gallagher LLP, Washington DC



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### Expanding the use of data analytics and corraling big data

Structured data has become a powerful and ever-growing tool for the securities markets and regulators alike. The use of data analytics and the harnessing of big data by the SEC—according to Chairman Jay Clayton and his predecessor chair, Mary Jo White—is critical to maximizing the SEC's limited resources and developing a more effective and efficient enforcement program. In November 2016, Chair White spoke about a new “bold and unrelenting” model for SEC enforcement.<sup>1</sup> In particular, she highlighted the “transformative” effect of the increasing use of data analytics by the Commission. Three years later, Chairman Clayton cited the importance of data analytics to the SEC's efficient, effective use of its limited resources.<sup>2</sup>

1 Mary Jo White, Chairman, Securities and Exchange Comm'n, speech at the New York University School of Law Program on Corporate Compliance and Enforcement: *A New Model for SEC Enforcement: Producing Bold and Unrelenting Results* (Nov. 18, 2016).

2 Jay Clayton, Chairman, Securities and Exchange Comm'n, *keynote speech* at the Mid-Atlantic Regional Conference (June 4, 2019).

Data analytics has progressed while the SEC's access to data is improving, particularly with the SEC's recent amendments mandating the use of Inline XBRL in disclosure documents. Big data has become fully integrated into the enforcement program, even as the SEC has expanded its use of data analytics beyond that. For example, as described below, OCIE (Office of Compliance Inspections and Examinations) is now using proprietary analytics in the examination program to identify trends and problematic behavior by regulated entities and individuals such as investment advisors and broker-dealers.

As part of his initiative to protect retail investors, Chairman Clayton created the Retail Strategy Task Force. One of the RSTF's primary objectives is to "develop data-driven, analytical strategies for identifying practices in the securities markets that harm retail investors and generating enforcement matters in these areas."<sup>3</sup> Thanks to its use of data analytics, the RSTF has undertaken a number of lead-generating initiatives, which allows swift enforcement action.

Prior to the advent of big data, the client had the informational advantage—but now the SEC can view a company's public statements against the backdrop of all its other public filings. From this vantage point, the regulators can have insight into issues that the client might not, in good faith, even be aware of yet.

### Data analytics allows proactive enforcement

Data analytics has allowed the SEC to take an increasingly proactive approach to enforcement, even with fewer staffers. The SEC's in-house analytic tools have provided the regulators with the capacity to originate more cases in-house, rather than relying on traditional referral sources such as whistleblowers, other SEC divisions, and self-regulatory organizations.

The increasing use of data analytics may be responsible for the dramatic rise in enforcement actions over the past decade. In 2016, the SEC brought 868 enforcement actions, many of which originated in-house. By contrast, the SEC had brought just 630 and 574 enforcement actions in 2005 and 2006, respectively.<sup>4</sup> While the total number of enforcement actions fell slightly in the last few years, to 821 in 2018 and 754 in 2017,<sup>5</sup> this trend has reversed course. Enforcement activity increased dramatically during the second half of fiscal year 2018; by November 2019, the SEC had brought 862 enforcement actions, including 526 standalone actions, in fiscal year 2019.<sup>6</sup>

It is worth noting that the enforcement approach under Chairman Clayton differs from the "broken windows" approach followed under his predecessor. As SEC Commissioner Hester Peirce noted, the SEC "is making a more concerted effort to bring only meaningful enforcement actions."<sup>7</sup>

3 Clayton, note 2 above; see also *2019 Division of Enforcement Annual Report*.

4 *Year by Year SEC Enforcement Statistics*, Securities and Exchange Commission.

5 Division of Enforcement Annual Report, *2018* and *2017*.

6 See *SEC Enforcement Activity: Public Companies and Subsidiaries—Fiscal Year 2018 Update*, Harvard Law School Forum on Corporate Governance and Financial Regulation (December 19, 2018); see also *2019 Division of Enforcement Annual Report*.

7 Hester M. Peirce, *The Why Behind the No*, remarks at the 50th Annual Rocky Mountain Securities Conference, May 11, 2018.



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## Big data: “kind of like old age”

Data analysis and data analytics are being used now by SEC attorneys in all offices and divisions. Still, the nerve center for big data is undoubtedly DERA (Division of Economic and Risk Analysis), which was founded in 2009 to “integrate financial economics and rigorous data analytics into the core mission of the SEC.”<sup>8</sup> DERA employs attorneys, economists, analysts, statisticians, and computer programmers, all of whom are charged with developing and providing economic and statistical analyses that are used throughout the agency. It is also responsible for developing analytical approaches, methods, and models to identify issues, trends, risks, and potential securities violations.

S.P. Kothari, DERA’s Chief Economist and Director, has said of big data: “I think it is kind of like old age: anyone older than me is old, and any data set bigger than my computer system can process is big.”<sup>9</sup> What constitutes “big” is ever-changing, but it is best understood as any quantity of data that approaches our current computational limits on analysis.

More specifically, Kothari said, big data can be characterized by the “3 Vs”: volume, velocity, and variety. *Volume* is the quantity of the data. *Velocity* is the speed at which the data are created and stored. *Variety* is the heterogeneity of the data in terms of data type and format. Some, according to Kothari, would add a fourth V: *veracity*, or the quality and accuracy of the data.

## XBRL takes a major leap forward

The introduction of XBRL in 2009 was a significant development in the SEC’s use of data. Information provided as part of mandatory public disclosures is a major source of data for the SEC. The EDGAR system receives and processes about 2 million filings a year, Kothari noted in his speech, and every filing consists of numerous pages and attachments, containing thousands of pieces of information.

Structured data involves the use of tags that embed data into the HTML disclosures of a filing. These tags standardize the various numeric and narrative-based disclosure elements of financial statements and risk/return summaries. The result is that disclosure documents can be immediately grouped and processed. The information contained therein is also instantly available to any regulator with access to these systems.

The SEC’s ability to manage structured data took a major leap forward with the three-year phasing in of mandatory Inline XBRL,<sup>10</sup> allowing the user of the data to employ advanced computing power and read the document simultaneously.

8 SEC Division of Economic and Risk Analysis, <https://www.sec.gov/dera/about>.

9 S.P. Kothari, Chief Economist and Director, Division of Economic and Risk Analysis, [presentation](#) (*Policy Challenges and Research Opportunities in the Era of Big Data*) at the National Bureau of Economic Research Conference on Big Data and High Performance Computing for Financial Economics (July 13, 2019).

10 Large accelerated filers had to comply with iXBRL rules beginning in June 2019; accelerated filers that use US GAAP must comply beginning with the fiscal period ending on or after June 15, 2020; and all other filers start with the fiscal period ending on or after June 15, 2021.



INFORMATION PROVIDED  
AS PART OF MANDATORY  
PUBLIC DISCLOSURES IS A  
MAJOR SOURCE OF DATA  
FOR THE SEC.

Inline XBRL addresses each of the issues posed by Kothari—volume, variety, velocity, and veracity. In particular, the standardization created by XBRL allows the SEC to receive the same *volume* of data while greatly decreasing the *variety*. This addresses what Kothari has called “a perennial challenge of the SEC ... [finding] cost-effective ways to reduce the variety of financial data without loss of substantive information.”<sup>11</sup>

Inline XBRL also speaks to the issue of *velocity*. Forms are entered when filed, and data processing happens automatically and immediately. This leaves SEC staff with more time to review and analyze the disclosure documents for quality and consistency. Additionally, there will be minimal spikes around quarterly reporting periods due to the automation of filing and processing disclosure documents.

Inline XBRL deals as well with the fourth V, *veracity*. The human- and machine-readable format allows for easier analysis of disclosure documents by regulators. Standardizing the structure allows for aggregation, comparison, and statistical analyses that would be otherwise impossible.

Specifically, the SEC can easily aggregate filing data to compare that data across companies or to compare one company’s disclosures across timeframes. This will allow regulators to more easily spot inconsistencies or abnormalities in disclosure documents, which could lead to regulators’ inquiries. Mike Willis of the SEC’s Office of Structured Disclosure has referred to XBRL disclosures as “the first stop for an enforcement investigation of financial statements.”<sup>12</sup>

### Big data in SEC examinations and enforcement investigations

In addition to the resources in DERA, the Division of Enforcement has developed its own data analytic capabilities, which have been integrated into the SEC’s enforcement program. CIRA (Corporate Issuer Risk Assessment) helps the enforcement staff identify trends and aberrational reporting by public company filers. In 2019, Enforcement filed numerous, significant actions against public companies, showing the Commission’s focus on “financial statement integrity, the accuracy of issuer disclosures, and the willingness to punish significant corporate wrongdoing.”<sup>13</sup> The staff’s use of data analytics was undoubtedly critical in many of those cases.

In the past few years, the Commission has also brought significant trading-related cases that may not have been possible without its ability to analyze voluminous amounts of data, including trading data and communications metadata. One prime example is *SEC v. Ieremenko*,<sup>14</sup> which the SEC filed in January 2019. In that case, the Commission filed charges against nine

THE SEC CAN EASILY AGGREGATE FILING DATA TO COMPARE IT ACROSS COMPANIES OR TO COMPARE ONE COMPANY’S DISCLOSURES ACROSS TIMEFRAMES.

<sup>11</sup> Kothari, note 8 above.

<sup>12</sup> *Still think XBRL use is limited? Experts discuss how XBRL is transforming the SEC and investors are reading your financial disclosures*, DIMENSIONS, November/December 2019.

<sup>13</sup> *2019 Division of Enforcement Annual Report*.

<sup>14</sup> Press Release 2019-1, *SEC Brings Charges in EDGAR Hacking Case* (Jan. 15, 2019); available at [www.sec.gov/news/press-release/2019-1](http://www.sec.gov/news/press-release/2019-1).

defendants—many of them overseas—for their alleged roles in a scheme to hack into the SEC’s EDGAR system and extract nonpublic information for use in illegal trading.

As Enforcement noted in its 2019 Annual Report, the case required:

... painstaking analysis of numerous events in which the defendants allegedly traded during the window between when the material nonpublic information was extracted and when it was disseminated to the public, and it showcased a number of [the SEC’s] complex analytic tools and capabilities. Market and trading specialists, using proprietary systems, identified suspicious trading in advance of more than 150 announcements. Through statistical analyses, staff determined that the odds the defendants would have randomly chosen to trade in front of these disparate events ranged from less than 7 in 10 million to less than 1 in 1 trillion.<sup>15</sup>

The staff also analyzed IP addresses that accessed various communications and systems to help establish the connections among seemingly unrelated participants in the alleged scheme.

Chairman Clayton has highlighted the expanded use of big data by OCIE, which conducts the SEC’s National Examination Program of registered firms such as registered investment advisors and broker-dealers. The examination staff uses a risk-based strategy in its examination program.

OCIE is now using two proprietary tools—NEAT (National Exam Analytics Tool) and HAL (High-Frequency Analytics Lab)—to analyze data in support of the examination program. As Chairman Clayton explained in his June 2019 keynote address,<sup>16</sup> NEAT “allows examiners to collect and analyze large datasets of trading records to identify potentially problematic activity and better understand a firm’s business during examinations.” HAL enhances the SEC’s capabilities in examinations and oversight of market microstructure, including high-frequency trading. The lab creates “reports on SEC registrant and market behavior at relevant time resolutions, down to microseconds,” which helps the regulators to “identify registrants engaging in potentially unfair market practices and to shed light on major market events.”

Given the close working relationship between OCIE and the Division of Enforcement, which frequently harnesses OCIE examination records to open enforcement investigations, OCIE’s increased use of big data provides additional, significant information for the SEC’s enforcement program.

### Risks of big data

In 2019, following well-publicized data breaches and hacking incidents, the public has become more aware of the potential cybersecurity risks posed by large amounts of sensitive data, for both the SEC and issuers. This appears to be a current priority of the SEC. Chairman Clayton, who has acknowledged



OCIE’S INCREASED USE OF BIG DATA PROVIDES ADDITIONAL, SIGNIFICANT INFORMATION FOR THE SEC’S ENFORCEMENT PROGRAM.

<sup>15</sup> 2019 *Division of Enforcement Annual Report*.

<sup>16</sup> Clayton, note 2 above.



COMPANIES SHOULD BE EXTREMELY CAREFUL IN THEIR XBRL REPORTING PROCESSES, SINCE ERRORS, HOWEVER INNOCENT, ARE NOW INSTANTLY OBVIOUS TO REGULATORS.

that no system can be 100% safe from cyber intrusion, has spoken about the importance of maintaining data security in the current environment. In 2016, following an intrusion into the EDGAR system, the SEC instituted enhancements to protect its data. Chairman Clayton highlighted steps taken by the SEC to that end, which included appointing a Chief Risk Officer and a Senior Advisor for Cybersecurity Policy.

### **Practice takeaway: Filers are responsible for their data**

Inline XBRL is likely, over time, to reduce both the time and cost of XBRL filings while increasing accuracy. It will also increase the focus on data quality. Companies should be aware that poor quality or otherwise problematic XBRL disclosure documents will send a signal not just to analysts and investors, but also to the SEC and other regulators.

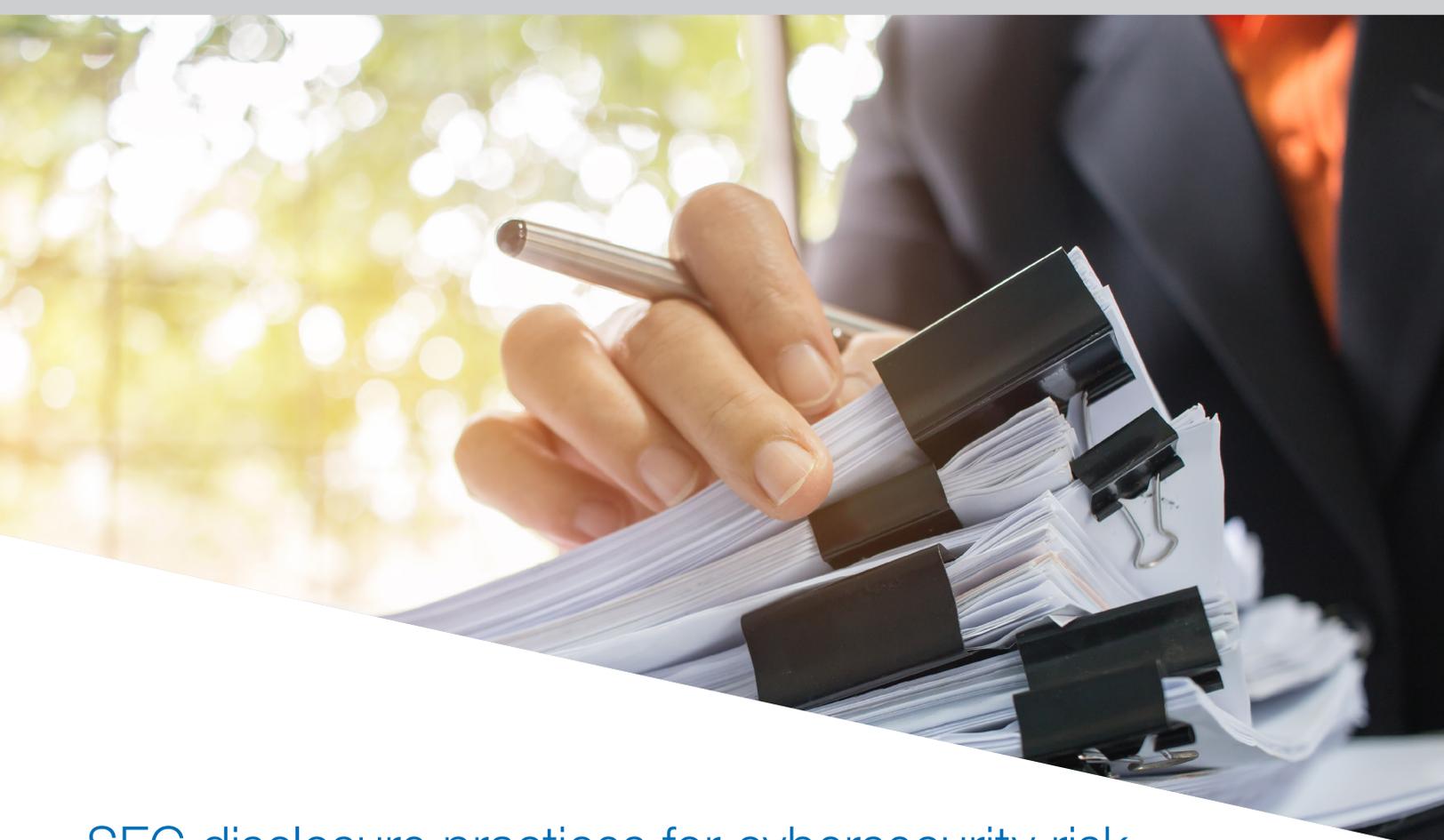
According to a *DIMENSIONS* interview<sup>17</sup> with Mike Willis of the SEC's Office of Structured Disclosure, common errors include negative values, scaling problems (e.g., companies reporting a value in the "quadrillions"), company-specific extensions for basic concepts such as cash and cash equivalents, lack of structured disclosure where required, use of improper dates, and inappropriate use of axis extensions when suitable options exist.

Companies should be extremely careful in their XBRL reporting processes, since errors, however innocent, are now instantly obvious to regulators. SEC staff may reach out to a company, Mr. Willis noted, if they become aware of XBRL reporting errors. The SEC may also provide feedback on XBRL quality in comment letters. However, a company should not rely on the SEC or solely on third-party vendors to identify quality issues that exist in the company's own reporting.

Remember: Filers, not third parties, are liable for the accuracy of their XBRL data. As Mr. Willis observes: "Filers...should understand that they are personally liable for structured-disclosure errors in the same manner that they are liable for their traditionally reported disclosures."<sup>18</sup>

<sup>17</sup> *The SEC's increasingly sophisticated use of XBRL-tagged data, interview with Mike Willis, SEC Office of Structured Disclosure; DIMENSIONS* Special Edition, December 2015.

<sup>18</sup> *Ten years of XBRL: Financial-reporting experts reflect on benefits, successes, and remaining challenges (Part 2), DIMENSIONS*, August/September 2019.



## SEC disclosure practices for cybersecurity risk

Abstracted from: *What Companies Are Sharing About Cybersecurity Risk And Oversight*

By Jamie Smith, Bridget Neill, and Stephen Klemash

Ernst & Young Americas, Denver CO (JS); Washington DC (BN); Pittsburgh PA (SK)

*Ernst & Young Americas Center for Board Matters*, Oct. 1, 2019; 7 pages

**The SEC tried to map out disclosure.** Cyberattacks are now among the most serious risks to business. After the SEC issued [Commission-level guidance](#) in 2018 (augmenting the staff's 2011 guidance), Jamie Smith, Bridget Neill, and Stephen Klemash from the Ernst & Young Americas Center for Board Matters analyzed cybersecurity disclosure by public companies. Aiming to help investors, the SEC clarified registrants' duties to disclose the risks, any material breaches of security, and the possible effects of breaches on finances and operations. It reminded companies that several existing disclosure requirements (e.g., business description, MD&A, and risk factors) might call for cybersecurity disclosure.

One new subject in the 2018 guidance was an emphasis on robust disclosure controls and processes; another was a ban on insider trading linked to cybersecurity breaches. Disclosures that might weaken cybersecurity were not required. The staff said it would not second-guess disclosure decisions made in good faith about breaches but would bring enforcement actions when disclosure is seriously deficient; in fact, it had already done so once.

**A small hike in reporting.** The authors analyzed cybersecurity disclosure in the proxy statements and 10-Ks of the 82 companies in the 2019 Fortune 100 that had filed both documents in 2018 and by September 5th in 2019. Concluding that numerous companies had improved their disclosure, the analysis focused on disclosure in three areas: cybersecurity, board oversight, and risk management. All 82 companies identified cybersecurity as a risk factor in both 2018 and 2019. In the other two areas, board oversight and risk management, there were slight year-to-year increases in most disclosure, although differing greatly in depth and specificity. The key year-to-year changes concerned board oversight. The filers that disclosed a concentration on cybersecurity in their proxy statement's risk-oversight section rose from 80% in 2018 to 89% in 2019. Those disclosing that their boards had delegated cybersecurity oversight to a board-level committee rose from 78% to 84%.

**Boards needed experts and point persons to boot.** The number of sampled companies increased (from 40% in 2018 to 54% in 2019) that said they were looking for directors with cybersecurity expertise, cited such expertise in one or more director's biography, or did both. The companies that charged one or more point persons in management (the chief information security officer or the chief information officer, for example) with informing directors about cybersecurity grew from 26% to 33%. While there was a rise from 39% to 43% in companies that addressed the frequency with which management informed the directors, the frequency was rarely quantified. Most filers employed words such as "regularly" or "periodically." Only 16% in 2019 (up from 12% in 2018) disclosed that management did so annually or quarterly at a minimum.

**The compass of mitigation efforts was wide.** In the third area analyzed, risk management, 82% of the companies in 2018 and 89% in 2019 reported attempts to reduce cybersecurity risk. Those reporting their planning of responses to cyberattacks (e.g., post-disaster recovery or business continuity) rose from 49% to 55%. In both years, 9% disclosed such preparation for attacks as simulations, tabletop exercises, and response-readiness checks. Those reporting the use of education and training to reduce risk climbed from 18% in 2018 to 26% in 2019. Eleven percent in 2019, up from 6% in 2018, indicated that they worked with peer companies, industry associations, or policymakers. A slight decrease, from 13% to 12%, said they had retained an independent outside advisor; no company revealed the extent of this advisor's assessment.

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Abstracted from *What Companies Are Sharing About Cybersecurity Risk And Oversight*, published by Ernst & Young Americas Center for Board Matters, 2100 One PPG Place, Pittsburgh PA 15222. To read the full text, visit [https://assets.ey.com/content/dam/ey-sites/ey-com/en\\_us/topics/cbm/ey-cbm-cybersecurity-risk-oversight-final-eycom.pdf](https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-cbm-cybersecurity-risk-oversight-final-eycom.pdf).

To read other publications by the EYA Center for Board Matters, visit [www.ey.com/en\\_us/board-matters](http://www.ey.com/en_us/board-matters). For a Nasdaq memorandum on S&P 100 companies' oversight practices and skill sets concerning cybersecurity, including findings on board structure and corporate governance, go to <https://www.nasdaq.com/governance-center/boards-and-cybersecurity>.

EDITOR'S NOTE: The SEC posted guidance on December 19, 2019, for international companies related to technology risks. See [www.sec.gov/corpfir/risks-technology-intellectual-property-international-business-operations](http://www.sec.gov/corpfir/risks-technology-intellectual-property-international-business-operations).

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## RECENT DEVELOPMENTS

# MD&A: Drafting today and thinking about tomorrow

By Kevin Douglas and Taylor Wirth, Bass, Berry & Sims PLC

Developments with respect to the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section of SEC disclosure documents have garnered less attention lately than other items in the SEC disclosure arena. Preparing and crafting MD&A disclosures nevertheless remains a major focus for disclosure lawyers and financial-reporting professionals. In addition, despite the importance of MD&A for certain investors and industry professionals, one area that the SEC has declined to address in rulemaking is the integration of XBRL into the MD&A section of periodic reports and other disclosure documents.

### 12 key tips and observations for drafting MD&As

The MD&A is the section of a periodic report or registration statement in which management provides its analysis of the registrant's financial condition and results of operations. It thus gives critical insight into the views of management regarding the key drivers and trends impacting a public company's financial performance. Disclosure lawyers and financial-reporting professionals should note these key tips, observations, and issues to consider when preparing or reviewing the MD&A:

1. **Layered disclosure and executive summary.**

Drafting layered disclosure—whereby the MD&A is ordered with the more important themes or highlights set at the beginning of the disclosure, while additional detail follows—has been advocated by the SEC staff (including in its [2003 MD&A interpretative release](#)). Layered disclosure enhances the readability of the MD&A. It is facilitated by including an executive summary at the beginning of the MD&A, an approach that is followed by some (but not all) registrants.

2. **Other readability techniques.**

The use of headings, bullet points, and a plain-English drafting approach may improve the readability of the MD&A. Another improvement is cross-referencing—rather than repeating—discussions that appear elsewhere in the periodic report or, in the case of disclosures in the Form 10-Q MD&A section, disclosures in the Form 10-K to the extent these disclosures do not require updating.

**3. Item 303 requirement to disclose material trends.**

A core disclosure component of [Item 303 of Regulation S-K](#) (which sets forth the SEC disclosure requirements applicable to MD&As) is the requirement to provide an analysis of known material trends, uncertainties, and other events impacting a registrant's results of operations, liquidity or capital resources. Practice varies widely among registrants on the extent to which forward-looking statements are included in the MD&A. Some registrants may be reluctant to include overly expansive forward-looking disclosure (for example, based on concerns about liability exposure if such forward-looking information is not ultimately accurate). Yet there are countervailing considerations: Inclusion may result in more useful disclosure, and failing to disclose known trends can give rise to exposure from Rule 10b-5 allegations from private parties as well as SEC civil actions.

**4. Impact of trends disclosure on future periodic reports.**

When considering how and whether to disclose material trends in the MD&A, registrants should be mindful of the impact on future periodic reports. Including such trends disclosure in the MD&A may, in certain circumstances, create the need to update and continue such disclosure in the MD&A in the registrant's next periodic report (rather than simply deleting such disclosure in the next succeeding periodic report).

**5. Location of trends disclosure.**

In deciding whether to disclose a trend in the financial statement's footnotes or in the MD&A, disclosure counsel should remember that the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act applies to disclosures in the MD&A but not to disclosures in financial statements' footnotes.

**6. Interaction between MD&A disclosure and risk-factors disclosure.**

In drafting MD&A disclosure, think about whether any disclosure included in the MD&A also gives rise to a need to make corresponding revisions to the risk-factors disclosure in the Form 10-K or potentially merits any risk-factor updates for inclusion in the Form 10-Q.

**7. Quantification of factors impacting performance.**

When providing a narrative description of factors impacting the results of operations for a registrant in the MD&A, consider not only whether particular drivers of results materially impacted performance, but also whether quantifying the impact of such trends during the applicable period would be helpful or necessary to provide a clearer picture of performance.

**8. Non-GAAP financial measures.**

Many registrants will include less extensive disclosures of non-GAAP financial measures in periodic reports than in earnings-release disclosures. This may be based on the view that it is unnecessary to include the same level of non-GAAP financial disclosure in periodic reports because analysts and investors focus less on periodic reports than on earnings-release materials. To the extent that non-GAAP financial disclosures are included in the MD&A of periodic reports, disclosure counsel should closely review SEC rules and staff guidance on non-GAAP financial disclosures to ensure compliance with legal requirements (including the requirement to give equal or greater prominence to GAAP financial information).

**9. Review the earnings-release disclosure package for consistency.**

Review the earnings release, the earnings call transcript, and (to the extent applicable) the earnings deck for the investor presentation, looking for consistency with the periodic report. In this regard, SEC staff will review not only earnings releases but also the call transcripts: any material inconsistencies between these disclosures and periodic report disclosures can be a topic of SEC comment. In addition, the question-and-answer portion of the earnings call may yield helpful insights into the most important issues and trends impacting a registrant from the perspective of analysts.

#### 10. Post-period events.

Be mindful of the potential need (given that the MD&A speaks as of the date of filing) to disclose events arising following the end of a quarter, even if such events do not impact results of operations for the quarter or do not need to be disclosed in the financial statement's footnotes included in the periodic report (except in a subsequent event footnote).

#### 11. Disclosures by peer companies.

There may be benefit in periodically reviewing the MD&A disclosure from peer companies of the registrant as well as SEC comment letters received by such peer companies, to assess areas of focus for the SEC staff that may also be relevant to the registrant.

#### 12. Critical accounting policies and estimates.

Taking into account past staff pronouncements on this issue, most registrants will disclose (either in the periodic report or, in some cases, through cross-referencing to the Form 10-K) critical accounting policies and estimates. Registrants will commonly address in the MD&A three to five critical accounting policies (which will be a subset of the accounting policies otherwise discussed in the financial statement's footnotes). When doing so, provide an analysis as to why the impact of these critical accounting policies could be material.

### MD&A disclosures and drafting for the 2020 proxy season

Looking ahead to the 2020 proxy season, disclosure lawyers should be aware of the effects of the [SEC's rules](#) implementing the Fixing America's Surface Transportation Act (the FAST Act). Among other things, the FAST Act revised Instruction 1 of Item 303(a) of Regulation S-K to permit public companies to exclude discussion of the prior three years in their MD&A. They can instead discuss just the prior two years in their MD&A if such disclosure has already been included in a prior SEC filing.

Registrants opting to omit a discussion of the earliest period must disclose, in the current SEC filing, the location of that discussion in the prior filing. Registrants may find that the flexibility provided by these revised rules is helpful in eliminating repetitive disclosure and enhancing the overall clarity of the MD&A. However, public companies must remain cautious and consider whether such omitted information is material to an investor's understanding of the company's operations.

Although the FAST Act's principal goals were to simplify and streamline disclosure as well as improve readability and navigability of reports, the SEC does not specify any particular layout or style for the MD&A. Nonetheless, public companies should keep the SEC's objectives in mind to enhance their communications to key stakeholders. Accordingly, public companies should consider updating the MD&A to organize and present such disclosure in a more investor-friendly manner, as noted in Tip 2 above (e.g., use additional tables, simplified narratives or summaries, bullet points, and bold text).

### XBRL tagging for MD&A? Not so FAST.

As public companies contend with the phase-in of the FAST Act, disclosure lawyers will undoubtedly pay close attention to the application of [rules pertaining to Inline XBRL](#). These iXBRL rules require filers to embed XBRL data directly into HTML documents on EDGAR and generally otherwise ease certain administrative issues related to XBRL. Although no rules have been proposed yet addressing how this applies to the MD&A, disclosure lawyers and financial-reporting professionals might also consider potential future changes that could impact a registrant's SEC reports, including the applicability of structured formatting for the MD&A.

Public companies are now well-attuned to the intricacies of XBRL, which has been in use for SEC documents since 2009. In this format, financial items are "tagged" using the SEC's standard taxonomy. Investors, analysts, disclosure lawyers, and other industry professionals can [download](#) from the SEC a registrant's financial information in XBRL (for example, in Excel format) to more easily view, access, and compare the information. Currently, XBRL is required for a registrant's financial statements and related footnotes included in reports and registration statements filed with the SEC but is not required for other financial or business information. For example, it is not required for the MD&A, executive compensation tables, earnings releases, or other financial, statistical, or narrative disclosures outside of the financial statements.

Since the adoption of the XBRL rules in 2009, industry professionals have from time to time submitted comments to the staff requesting that the SEC change the rules regarding XBRL, either requiring or permitting registrants to tag items in additional sections of SEC reports (including, in particular, MD&A disclosure). In the [final rule](#), however, the SEC stated that “more experience with interactive data and a greater understanding of the costs and time associated with compliance with the requirements of the SEC rules is needed before expanding the requirement to other information.”

Common concerns cited with respect to tagging additional items in XBRL format, such as the MD&A, include the cost of compliance for more tagged disclosure in SEC reports and the difficulty in applying the existing standard taxonomy due to variations in executive compensation practices among public companies. Over the last decade, the use and understanding of XBRL has expanded, but its applicability outside of the financial statements has not.

### **Interest in expanding XBRL to the MD&A section**

There has been growing discussion among the SEC and commenters regarding the expansion of XBRL requirements, as shown by the [2016 SEC concept release](#) on disclosure modernization in Regulation S-K. [Rules proposed](#) by the SEC in 2015 to implement Dodd-Frank Act Section 953(a) (regarding pay for performance in proxy or information statements) would have required a company to disclose executive pay and performance information for itself and as compared to peer-group companies in a table and to tag the information in an interactive data format such as XBRL. However, the SEC never adopted the final pay-for-performance rules, including the additional XBRL-tagging requirements.

In connection with the [proposed FAST Act rules](#) on iXBRL, the SEC asked whether any additional disclosures should be required in structured format, such as within the MD&A or disclosure related to a registrant’s properties. However, when the [final iXBRL rules](#) were adopted by the SEC in 2018, such additional tagging requirements were determined to be beyond the scope of the iXBRL rulemaking. These rules have a three-year phase-in period for registrants for fiscal periods ending on or after June 15, 2019 (for large accelerated filers); June 15, 2020 (for accelerated filers); and June 15, 2021 (for all other filers).

In addition, as recently as October 2017, the SEC’s Office of Structured Disclosure acknowledged appeals from various constituents to expand the use of XBRL to, among other things, MD&A disclosure, and it called for additional public input regarding the “market considerations for the increased or decreased use of structured data.” [See the interview in the [September 2017 issue of Dimensions](#) with Mike Willis, Assistant Director of the SEC’s Office of Structured Disclosure.]

Beyond the recent iXBRL requirements and cover page tagging for SEC filings required under the FAST Act, there has been sparse discussion and no movement regarding the expansion of XBRL to additional SEC disclosures. The staff does not currently have any observations, guidance, or trends regarding any such expansion posted publicly on the SEC website.

## About *Dimensions*

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