Too Big to Disclose:
Firm Size and Materiality Blindspots in Securities Regulation

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ABSTRACT

This Article argues that the securities disclosure regime contains previously unexamined structural deficiencies that pertain to the information provided by the largest public companies. These deficiencies arise from the operation of the materiality standard, a core element of the disclosure regime that is used in a number of SEC disclosure rules. The materiality standard is designed to limit firms' disclosure to information that would be of importance to investors, and to prevent the overproduction of information. I suggest, however, that in the case of large firms the materiality standard can also lead to the underdisclosure of information—or to "materiality blindspots." The materiality standard determines whether firm-specific information must be disclosed by assessing its importance relative to the size of the firm and the "total mix of information" about that firm. Since the threshold for what is material increases as firms get bigger, however, at the very largest firms even matters that are significant or sizeable in absolute terms may be deemed immaterial and remain undisclosed. Such firms are "too big to disclose" and, in a perfectly legal manner, take advantage of the materiality standard to avoid disclosure of important matters.

To illustrate the existence of materiality blindspots, I analyze the SEC rules in three key disclosure areas (material contracts, material legal proceedings, and material business spending) and then present original case studies and survey evidence based on the disclosure practices of large firms. After revisiting generally accepted theories on disclosure regulation through the prism of firm size and analyzing examples from the case studies, I identify two sets of potential harms. First, materiality blindspots may undermine investor protection and corporate governance, including by diminishing the accuracy of security prices and by making inside and outside monitoring for fraud or suboptimal management practices more difficult. Second, the operation of the materiality standard may give systematic advantages to large firms relative to smaller firms by enabling large firms to minimize the interfirm costs of disclosure; this can lead to market distortions and in effect serve as a regulatory subsidy for bigness. To remedy these problems, I propose that certain disclosure requirements that currently rely only on the principles-based materiality standard should be supplemented with targeted rules employing quantitative thresholds for disclosure. This would provide a safety net against materiality blindspots by requiring large firms to disclose additional information that is not captured by the existing materiality standard, but that is nonetheless significant or sizeable in absolute terms.

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