Draft Coalition Letter ~~v4~~v5 – 7/~~16~~18/16

July ~~19~~20, 2016

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: **Concept Release on Business and Financial Disclosure Required by Regulation S-K; 17 CFR Parts 210, 229, 230, 232, 239, 240 and 249; Release Nos. 33-10064, 34-77599; File No. S7-06-16; RIN 3235-AL78**

Dear Mr. Fields:

The Corporate Governance Coalition for Investor Value (the "Coalition") has been formed to provide a forum for the discussion of issues of common interest among its members to advocate for strong corporate governance policies and the federal securities laws that promote long-term value creation for investors and the firms in which they invest. Coalition members represent American businesses of all sizes, from every industry sector and geographic region. These businesses produce the goods and services that drive the American economy, employing and creating opportunities for millions of Americans and serving the countless communities nation-wide in which they operate. The Coalition believes that strong corporate governance policies are important to provide investors with a return on investment and businesses with the capital needed to grow and operate.

The Coalition welcomes the opportunity to comment on the concept release issued by the Securities and Exchange Commission ("SEC" or "Commission") on April 13, 2016, entitled Business and Financial Disclosure Required by Regulation S-K (the "Concept Release"), which seeks public comment on modernizing certain business and financial disclosure requirements in Regulation S-K .

By statute, the mission of the Commission is to facilitate capital formation, protect investors, and maintain fair, orderly, and efficient markets. One of the ways in which the Commission accomplishes these goals is to require individuals and businesses subject to the Commission's jurisdiction to disclose certain data and information. Sometimes these disclosure schemes are principles-based, in which the

filer is provided guidance on how and what to file. In other circumstances, like Regulation S-K, the Commission prescribes specific items that a business must disclose. In either case, disclosure is the measure of transparency a company must give investors if it wishes to access the deepest, most liquid, and most diverse capital markets the world has ever known. Private companies are not subject to Regulation S-K.

For the past eight decades or more, federal securities laws have required registrants to disclose "material" information to the Commission and to investors. Failure to do so carries penalties under the Securities Act of 1933 and the Securities Exchange Act of 1934. This duty predates and exists *even without* the Commission's adoption of Regulation S-K or the proposals for changes thereto outlined in the Concept Release. So while the Commission should strive to limit the set of specific disclosures it mandates to those that are material, it is critically important to highlight the difference between a Commission-imposed duty to disclose a piece of information and the duty to disclose information that would be considered "material" under the securities laws. The former is not conclusive of the latter.

The judicial branch of government has produced a long history of jurisprudence on the concept of materiality, which companies have relied upon in determining what must be disclosed and what does not have to be disclosed to avoid liability under the federal securities laws. Forty years ago, the U.S. Supreme Court in the landmark case of *TSC Industries v. Northway* refused to find that a fact is material just because an investor "might" find it important. A fact is material, the Court held, if "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[1] The Supreme Court again addressed materiality in 1988 with *Basic Inc. v. Levinson*, where it made clear that the *TSC* materiality construct applies not only to voting decisions as were at issue in *TSC*, but also to decisions to buy, sell, or hold a security.[2] The *TSC-Basic* formulation has guided federal securities regulation ever since.

Under our jurisprudence, materiality is a conclusion of law, not of a democratic process. To be sure, there are disclosures that special interest groups want the Commission to force businesses to make under Regulation S-K for which these groups claim there is "broad public support." Broad public support, however, is not the test for materiality because it does not necessarily make a disclosure decision-

[1] 426 U.S. 438, 449 (1976).
[2] 485 U.S. 224 (1988).

useful to the reasonable investor, the crux of the materiality definition that has served our capital markets so well for so long. Our longstanding, disciplined approach to materiality reduces the risk that disclosures will become too voluminous—at great expense to the company *and* its investors—by trying to be all things to all people. It also helps the SEC, in developing disclosure regulation, to focus on what is best for investors overall so the agency can more faithfully carry out its role as the regulator of capital markets.

Considering whether information would be decision-useful to a reasonable investor is central to the Supreme Court's materiality test. The courts have told us a great deal about the reasonable investor. According to the Supreme Court, one should not ascribe "child-like simplicity" to the reasonable investor.[3] To the contrary, lower courts have said that reasonable investors are presumed to be able to complete basic mathematical calculations, to comprehend the basic operation of a securities margin account, to understand the time value of money and basic principles of diversification, to know that free cash and securities may be used to earn interest, to be able to read and understand risk factors and other disclosures plainly presented in a prospectus, and generally to be aware of macroeconomic conditions.[4] The fact that courts have referenced these characteristics of a reasonable investor further indicates that materiality centers on the financial and operational performance of companies and on investment returns for investors.

In recent years, however, there have been efforts to erode this longstanding approach to materiality. Some activists and special interest groups with narrow, parochial agendas have encouraged the Commission to mandate new disclosures, even if shareholders have consistently and overwhelmingly rejected shareholder proposals for such disclosures. Others have used the vernacular of "*today's* reasonable investor," as if the mere passage of time has changed the basic investor incentives that form the bedrock of American corporation law. Indeed, some activists have prevailed on Congress to use corporate disclosures to resolve foreign affairs issues—to the detriment of corporations, their investors and even the intended beneficiaries of those efforts. These developments have threatened to confuse materiality by implying an identity convergence between disclosure and materiality, *i.e.* "if it is disclosed, it *must*

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[3] *Id.* at 234.

[4] *See, e.g., In re Merck & Co., Inc. Securities Litigation*, 432 F.3d 261 (3d Cir. 2005); *Levitin v. PaineWebber, Inc.*, 159 F.3d 698, 702 (2d Cir. 1997); *In re Donald J. Trump Casino Securities Litigation*, 7 F.3d 357 (3d Cir. 1993); *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346 (2d Cir. 1993); *Flamm v. Eberstadt*, 814 F.2d 1169 (7th Cir. 1987); *Zerman v. Ball*, 735 F.2d 15 (2d Cir. 1984).

by its nature be material." These efforts should be rejected by the Commission, which serves an important disclosure "gatekeeping" function. If these efforts are permitted to succeed, they will further overload investors with decision-*useless* information. The guiding principle for public company disclosure is, and should remain, materiality as viewed by a reasonable investor.

The Coalition supports a system of securities regulation in which investors are provided with decision-useful information to deploy capital efficiently and for businesses to raise the financial resources needed to grow and expand. The concept of "materiality" has played the central role in our American capital markets for decades and has contributed to the formation of the deepest, most diverse, most liquid markets the world has ever known. The ability of businesses of all sizes—from young Main Street entrepreneurs to more mature companies that have employed millions of Americans for generations—to seek appropriate forms of investment from investors of all walks of life within our disclosure-based regulatory system is the hallmark of American free enterprise.

Our comments on the Concept Release are based on four over-arching principles. In seeking to improve the effectiveness of SEC disclosure documents, the Commission should:

1. Focus on materiality to improve Regulation S-K disclosure;

2. Not expand special-interest disclosure;

3. Make greater use of scaled disclosure to encourage capital formation; and

4. Consider additional techniques for modernizing the format of disclosure documents.

## A. The Commission Should Focus on Materiality to Improve Regulation S-K Disclosure

Since the federal securities laws first were enacted, and especially in more recent years, the disclosure documents that companies file with the SEC have continued to expand, as reflected, for example, by the lengthy annual reports on Form 10-K and proxy statements provided to investors. As many commentators have

pointed out, disclosure documents are laden with too much information that is obsolete, unnecessarily repetitive, or otherwise not useful to investors.

Requiring public companies to disclose only information that is material to investment decisions promotes capital formation and the efficient allocation of capital. Excessive disclosure mandates, whether under Regulation S-K or other regulations, have the tendency to obfuscate rather than inform. A 2015 study conducted by Stanford University concluded that "55% of investors believe that a typical proxy statement is too long," and a full 48% believe that it is difficult to read and understand. Improving the effectiveness of the Commission's disclosure regime requires us to rethink what information should be disclosed—as well as how it should be disclosed—with this in mind.

In reimagining the disclosure regime, the guiding principle should be materiality. The Commission should strive to develop a Regulation S-K that is no broader than what a court would consider material under the federal securities laws. In addition to the risk of overloading investors with non-decision-useful information, requiring disclosures of non-material information risks politicizing the Commission as it chooses which special interest disclosures to mandate or not. Against this backdrop, outlined below are some recommendations for improving the effectiveness of a number of items from Regulation S-K as identified in the Concept Release.

1. **General Development of Business (Item 101(a)(1))**

We believe the information included under this requirement is generally material. However, in the case of a company that is already subject to the reporting requirements of the Securities Exchange Act, information regarding material acquisitions, dispositions, or bankruptcies should already be disclosed in a Form 8-K or other filing given its materiality to the company's business. Redundant disclosure in reports subsequent to the Form 8-K should not be required. The SEC could choose to make a distinction under this S-K item between new registrants (who may be disclosing the general development of their business, including prior mergers or bankruptcies, for the first time in a registration statement) and established registrants (who would have disclosed such information in a previous filing). As a general matter, we do not believe companies should be required to disclose the same or substantially similar information in multiple filings.

2. **Narrative Description of Business (Item 101(c))**

Generally, Item 101(c) should be limited to a brief summary of background information on a business. Some of the more substantive information currently required to be disclosed here, such as working capital practices and compliance with environmental laws, would be better addressed in other sections, such as MD&A. Additionally, items that are no longer applicable to most registrants, such as dollar amount of backlog orders believed to be firm, should be eliminated.

3. **Technology and Intellectual Property Rights (Item 101(c)(1)(iv))**

We do not believe the SEC should mandate prescriptive quantitative disclosure about intellectual property, such as requiring registrants to disclose the number of patents they hold. Merely providing the number of patents or a catalog of other details of an intellectual property portfolio is not particularly useful for investors and is not material information. Because the role that intellectual property may play in a registrant's operations can vary widely, focusing on materiality allows registrants to disclose information about technology and intellectual property that is important to their business in a way that is beneficial for their investors. Indeed, this item is properly couched in terms of making disclosure "to the extent material to an understanding of the registrant's business taken as a whole," which we support as the appropriate screen against immaterial disclosure.

4. **Government Contracts and Regulation, including Environmental Laws (Items 101(c)(1)(ix) and (c)(1)(xii))**

The current disclosure requirements related to government contracts and regulation are sufficient. This item as it currently exists with its focus on materiality has been effective in eliciting useful information from registrants. Changing this item to include additional detailed requirements would likely lead to an abundance of immaterial information, which would run counter to the goal of improving disclosure. In fact, we believe this item, with its emphasis on materiality as the disclosure threshold, should be a model for other Regulation S-K items.

5. **Number of Employees (Item 101(c)(1)(xiii))**

We question whether disclosing the number of a company's employees provides material information to investors, particularly as many companies rely on a large seasonal or part-time workforce, as well as consultants, independent contractors and others who do not neatly fit into the traditional "employee" definition. Nevertheless, to the extent this item remains qualified by the phrase "to the extent material to an understanding of the registrant's business taken as a whole," we do not object to its continued disclosure, except that in light of ongoing confusion over who

counts as an employee due to recent positions taken by federal and state labor authorities, the SEC should clarify its expectations for this disclosure item. But in any event, Item 101(c)(1)(xiii) should not be expanded to require additional disclosure related to employees, such as distinguishing between unionized and non-unionized employees or actual employees and independent contractors, unless those distinctions are material to the registrant's business.

6. **Description of Property (Item 102)**

We ~~do not oppose~~believe the ~~retention~~Commission should consider eliminating this disclosure except to the extent disclosure of ~~Item 102, as it can provide~~property provides material information for investors ~~and asks registrants to focus on materially important property. However~~or is necessary to make other disclosures not misleading. If this disclosure is retained, however, Item 102 should not be expanded to include additional disclosure, and the SEC should clarify that for registrants who do not have material physical properties, disclosure about their corporate headquarters, office space, and other facilities is optional, not required.

7. **Selected Financial Data (Item 301)**

In order to simplify the time periods used in disclosure, Item 301 should be amended to only require financial data for the past three fiscal years instead of the past five fiscal years, unless additional years are necessary to not be misleading. Given the availability of data online and in previous filings, information beyond three years is easily obtainable for investors. Investors would still receive necessary information, but the change would bring more consistency to the required disclosure.

Moreover, we do not believe that the SEC should require auditor involvement (e.g., audit, review, or specified procedures) for this disclosure. We note that extant Public Company Accounting Oversight Board auditing standards (AS 2710) provide guidance for an auditor to read and consider other information in documents containing audited financial statements for material inconsistencies with information appearing in the financial statements and material misstatement of facts.

Item 301 should not be modified to be more prescriptive. Mandating use of additional metrics would force many registrants to make disclosures that are immaterial to their business. This would result in bogging down investors with irrelevant information, which would perpetuate some of the current pitfalls of the existing Regulation S-K disclosure regime. We believe that retaining the current requirements while allowing registrants to provide additional information that is material to their business is the best approach.

8. **Supplementary Financial Information (Item 302)**

Because the disclosure required by Item 302(a) is required in prior quarterly reports, we believe Item 302(a) can safely be eliminated. Thus, the disclosure required under Item 302(a) is yet another example of duplicative information that unnecessarily complicates and lengthens disclosure documents, while increasing burdens for registrants and offering little value to investors. As with Item 301, we do not believe that the SEC should require auditor involvement for this disclosure.

9. **MD&A (Item 303)**

We support a more principles-based approach to Item 303 that emphasizes materiality as seen through the eyes of a reasonable investor. Currently, Item 303 is often duplicative of other required disclosure, and should be revised to eliminate redundancy. For example, the discussion of "off-balance sheet arrangements" and "contractual obligations" is required in a registrant's financial statements under GAAP, and thus, should be removed from Item 303. We also believe that the required tabular disclosure of contractual obligations should be removed for similar reasons. We agree that consolidating the various Commission and Staff guidance on MD&A into a single place would be helpful to preparers of MD&A disclosure.

In addition to removing duplicative disclosure, the SEC should also consider revising the time periods required to be discussed as part of a registrant's MD&A. The disclosure should only include information from the most recently completed quarterly or annual period. Information about prior periods can easily be obtained by investors in previous filings. Repetition of previously disclosed information can distract investors from new data and lead to confusion. We do not believe that the SEC should require auditor involvement for this disclosure.

As suggested in the Concept Release, providing an executive-level overview to MD&A that emphasizes the most important information would be helpful for investors and allow registrants to highlight material information so it does not get buried among a large volume of required disclosure. However, we would oppose the addition of industry-specific prescriptive disclosure to MD&A, because such a requirement could quickly lead to unwieldy disclosure requirements across industries and potentially impose an additional burden on registrants within a particular industry by adding mandatory metrics that are not required for other registrants. We believe that registrants should be encouraged to provide relevant industry information, provided that it is material. In contrast, rigid requirements would add unnecessary disclosure that is of limited use to investors.

Although registrants receive the benefit of a forward looking statement disclaimer for information included in MD&A, this is not necessarily the case for similar information provided in the financial statements, including any footnotes. We urge the Commission to explore ways in which it can harmonize the treatment of forward looking statements in MD&A and financial statements, perhaps using its rulemaking or exemptive authority.

### 10. **Risk Factors (Item 503(c)) and Consolidating Risk-Related Disclosure**

We support the consolidation of disclosure related to risk, legal proceedings, and risk management so that it is discussed in a single item, as opposed to the current practice of piecemeal discussion of risk in various items throughout a filing. This would eliminate duplicate discussions of risk and eliminate the need for cross-referencing entire sections of filings~~.~~ and provide investors with succinct information in one location.

~~Because risk disclosure is one of most useful areas for investors, we believe that it would be helpful for registrants to enumerate only company-specific risks (as opposed to risks that affect an entire industry or geography) and to highlight the most important risks by listing them at the beginning of the risk disclosure section with relevant subheadings to convey their importance to investors. This would allow most material risks to be easily distinguished from the more generic risks that registrants are more likely to include out of an abundance of caution. This practice could help alleviate the SEC's concerns that important risk factors are becoming more difficult for investors to identify, and hopefully, it could encourage registrants to refocus discussions of risk on those items that are material and eliminate superfluous, boilerplate disclosure.~~ While the Commission appears concerned by the possibility that registrants include some risk factors out of an abundance of caution, we do not believe that the Commission should amend this requirement in a way that makes disclosure of risk factors any more prescriptive. Presently, the Regulation S-K instruction requires the registrant to disclose the "most significant factors that make the offering speculative or risky." The risk factors must also be "organized logically." Risks vary from company to company and industry to industry; registrants should be afforded flexibility in the manner in which they communicate company-specific, material risk factors to investors. Neither do we favor revising the disclosure rules to require registrants to discuss how they intend to address or remediate individual risks, as doing so may not be possible in certain cases and could reveal competition-sensitive information. The way a company manages risk it typically discussed in a more holistic fashion in other disclosures.

11. **Disclosure of Approach to Risk Management and Risk Management Process**

With regard to risk management, information about a registrant's risk management process may be useful for investors to know how the identified risk factors are being addressed. However, because the details of a registrant's risk management process may be confidential, required disclosure of such information runs the risk of placing registrants at a competitive disadvantage. Thus, we support encouraging registrants to voluntarily disclose risk management information that is material, but only to the extent that it does not require them to disclose competitively sensitive information.

12. **Number of Equity Holders (Item 201(b))**

Because most investors now hold equity securities in street name through nominees or other intermediaries, providing the number of holders of a class of common equity does not provide meaningful information to investors. Thus, this item can safely be eliminated.

13. **Description of Capital Stock (Item 202)**

Item 202 disclosure should not be expanded to be included in periodic reports on Form 10-Q or Form 10-K. Investors can easily look to a registrant's organizational documents or registration statement to determine the terms and conditions of particular securities, and the current practice of reporting changes on Form 8-K and Schedule 14A is sufficient to keep investors informed. Repeating this information in other periodic filings is therefore unnecessary.

14. **Recent Sales of Unregistered Securities (Items 701(a)-(e))**

We believe this requirement has become less useful to investors because substantially the same disclosure appears elsewhere in a company's SEC filings. Specifically, if a company completes a material sale of securities to investors, companies typically discuss the transaction as part of MD&A liquidity and capital resources disclosures, if material. In addition, for a company subject to Securities Exchange Act reporting requirements, Form 8-K generally requires prompt disclosure of unregistered sales of equity securities, thus requiring the same basic disclosure as currently is separately required to be included in a company's Forms 10-Q and 10-K.

The information in Item 701 is already disclosed elsewhere, in MD&A and on Form 8-K. We do not believe there is a compelling reason to require repetition of

this disclosure. Therefore, Item 701 should be eliminated as duplicative of these other disclosure requirements. In connection with the elimination of Item 701, the SEC should also increase the one percent threshold (five percent for smaller reporting companies) in Item 3.02 of Form 8-K, or better still, key it off of what is material to a given company.

### 15. Purchases of Equity Securities by the Issuer and Affiliated Purchasers (Item 703)

We believe current disclosure requirements under Item 703 are sufficient and should not be modified to be more granular or to require more frequent disclosure. The current quarterly disclosure is sufficient to provide material information to investors. Requiring disclosure more frequently, such as on a monthly basis, would impose an additional burden on registrants without providing investors with decision-useful information.

### 16. Exhibits (Item 601)

Item 601 of Regulation S-K could be improved through the greater use of materiality filters. Along these lines, the Commission should review the item and eliminate all categories of documents that are presumptively material in favor of a materiality test that is dependent on each registrant's unique facts and circumstances under the *TSC-Basic* test.

For example, under Item 601(b)(10)(ii)(c), the Commission should not presume that any contract calling for the acquisition or sale of any property, plant or equipment is material when such contract exceeds 15 percent of consolidated fixed assets. A 15 percent threshold is both overinclusive for some companies and underinclusive for others. Instead, the Commission should only require that such acquisition contracts be filed as exhibits to the extent material to an understanding of a particular registrant's business taken as a whole.

Similarly, with regard to the requirement under Item 601(b)(10)(ii) to file contracts upon which the registrant's business is substantially dependent, we generally oppose any absolute qualitative or quantitative disclosure thresholds for "substantial dependence." Modifications to Regulation S-K and requirements for exhibits should move away from one-size-fits all disclosure and emphasize materiality. Use of standardized qualitative or quantitative thresholds runs counter to the goals of modernization of Regulation S-K by leading to immaterial disclosure that is unhelpful to investors and burdensome to registrants.

Item 601(b)(21), which requires lists of subsidiaries, is another provision that produces little useful information for investors. Whether a particular registrant elects to conduct its business through one or a thousand subsidiaries is largely irrelevant to investors insofar as the registrant reports its results on a consolidated basis. Yet companies expend a great deal of effort each year to update the list as organizational structures change. We believe Item 601(b)(21) should be eliminated.

As a more general proposition, the SEC should explicitly allow registrants to omit personal confidential information in exhibits without applying for confidential treatment of information. Personal confidential information should be defined to include a specific list of items that may be automatically omitted, such as social security numbers and bank account numbers.

Finally, we also note that we support the use of hyperlinks for ease of finding exhibits incorporated by reference.

17. **Critical Accounting Estimates**

We believe the existing discussion of accounting policies provided by registrants in MD&A is sufficient. Accordingly, Item 303 should not be revised to require additional disclosure about critical accounting estimates. If the SEC has found that registrants merely repeat the discussion of accounting policies contained in the notes to the financial statements, then it should provide illustrative guidance regarding the type of disclosure it is seeking in MD&A. However, we would oppose the addition of strict definitions of "critical accounting estimates". We believe that clarification on the part of the SEC, such as through a revised interpretive release, should be sufficient to provide more meaningful disclosure related to accounting policies.

18. **Industry Guides**

We do not object in principle to the modernization of the industry guides to the extent doing so focuses on the disclosure of material information. We would oppose any effort to use the industry guides to expand special interest disclosure of one kind or another.[5] We also urge the Commission to better coordinate its industry-specific disclosures with other accounting standard-setters and other regulators who oversee those industries. For example, Guide 3 concerning bank holding companies

[5] We were surprised that the Commission would propose the substantive revision of the mining industry guide while it also seeks comment on this broader issue in the Concept Release.

has begun to diverge from requirements of the Federal Reserve Board, and Guide 6 concerning insurance companies includes tabular disclosure rendered duplicative by recent amendments to US GAAP by the Financial Accounting Standards Board.

**B. The Commission Should Not Expand Special-Interest Disclosure**

In recent years, various special interests increasingly have pressured public companies to provide information about topics other than their financial performance, operations, and strategy. These efforts effectively seek to reorient corporations away from their legal and fiduciary duties to maximize value for their shareholders and press them into service as agents of cultural, social, and political change. For example, special interest groups continue to call for public companies to disclose more concerning climate change, environmental impacts, political spending, social policy, and management of their internal affairs. These topics are often referred to by the acronym "ESG" for environmental, social, and governance issues; sometimes they are referred to as "sustainability" or "socially-oriented investing" issues.

ESG special interest groups have tried to shoehorn their respective preferred disclosures into the concept of materiality, straining it beyond its longstanding jurisprudential contours, usually by proposing to consider disclosure from the viewpoint of a wide range of stakeholders other than the reasonable investor. Their common goal is to use Commission-mandated disclosure to advance social or political goals. Often, these proposed disclosures are designed for the putative benefit of society at large, not investors; their intended "beneficiaries" may own no securities at all. Whatever each ESG proponent's exact purpose and intentions might be, we believe the effect would be to cause disclosure to stray beyond materiality. We further submit that forcing registrants to disclose nonmaterial information—especially information that costs a great deal to gather and report, like information concerning so-called "conflict minerals"—increases compliance costs, which ultimately are passed on to the registrant's business counterparties.

While public companies are always free to disclose ESG information on a voluntary basis, some policymakers, non-governmental organizations, and private-sector groups have focused in on public company disclosure documents filed with the SEC as the preferred place to include new mandatory disclosures on a wide range of ESG topics. Whether these proposed new disclosures seek to reveal material information to the reasonable investor for purposes of the federal securities laws and are consistent with the SEC's mission is very much a matter of debate. No matter the topic or the merit of the proposed disclosure's objective, the Supreme Court's

traditional materiality standard should be the benchmark as the SEC and other policymakers consider whether to impose new disclosure obligations on reporting companies. Regulation S-K should not be used to require public companies to disclose information that does not pass this test.

We do not believe that SEC-mandated disclosures should be used to further social or political motivations that the federal securities laws were not designed to advance. Shareholders who believe the firm they own should make such disclosures are free to pursue their strategies through the internal business governance structure.[6] The SEC disclosure regime should not be an avenue for special interests to impose their agenda on shareholders at large, particularly when doing so does not maximize long-term value creation at a company. The objective of many calling for new public company ESG disclosures is not the enhancement of shareholder value, but rather to achieve some social impact or political goal. These goals, if met, would in many cases contribute to an environment that makes it more difficult for businesses to innovate, compete, and grow.

Moreover, special interest disclosures risk politicizing the federal securities laws and the SEC while fostering regulatory uncertainty that is detrimental to investors and businesses alike. To the extent securities regulation becomes an instrument of social or political change, it becomes unmoored from its longstanding purposes as reflected in the SEC's mission. In turn, the bounds within which securities regulation is fashioned become porous, which in turn facilitates political and other types of opportunism. The federal securities laws – and thus the SEC as the agency that crafts, administers, and enforces the regulatory regime – become fair game to be used however those with the most influence would like.

The SEC's expertise centers on the operation, practices, and regulation of securities markets. The agency is not an expert about topics outside its mission, such as how to resolve difficult issues of a social or political nature. The SEC is not well-positioned, for example, to address concerns relating to things like supply chain management, the environment, labor relations, the political process, and foreign affairs. While the agency's eighty-plus years as a capital markets regulator does well-position it to address emerging and persistent issues in that arena, the SEC understandably struggles when asked to craft disclosures that are designed to achieve

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[6] We note that the overwhelming majority of investors regularly reject proxy proposals to make such disclosures. The average percentage vote for environment-related shareholder proposals, for example, has generally held constant between 11 and 21% over the last decade, according to a recent study by the Manhattan Institute. http://www.proxymonitor.org/Forms/2016Finding2.aspx

goals other than protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.

Likewise, the SEC's expertise is not implicated simply because disclosure is involved. The SEC's expertise is only implicated when the goals of the disclosure are within the scope of the SEC's mission. The Coalition believes that goals outside the SEC's mission should be left to other governmental bodies, civil society organizations, and the private sector to address by means other than the federal securities laws. Thus, we believe the SEC should tread lightly when it comes to compelling so-called sustainability disclosure.

## C. The Commission Should Make Greater Use of Scaled Disclosure to Encourage Capital Formation

Registrants of different sizes, longevity as filers, and industries face disparate burdens in complying with the Commission's many disclosure obligations. A growing body of economic research demonstrates that young, dynamic companies spur a disproportionate amount of job creation in the United States. While these companies often need growth capital in the form of equity investments, an overly burdensome disclosure regime (particularly under Regulations S-K and S-X) can serve to discourage capital formation for these companies in the public markets. Likewise, even mature companies can be hamstrung if the costs and burdens of compliance outweigh the benefits of a public listing.

When investment does not occur because of these regulatory burdens, a wide range of stakeholders is impacted beyond the individual managers and shareholders of a particular company. Potential employees are affected because new employment opportunities will not be created. Additionally, consumers may not see new products brought to market, and new firms may not enter markets to create competition. As a result, growth will slow, harming not just investors but also the broader economy.

Scaling disclosure commensurate with an issuer's size and longetivy as a filer has proved to be an effective tool for encouraging participation in the public capital markets without denying investors access to material information. It is also wholly consistent with the congressional intent expressed in the JOBS Act and the securities law provisions of the FAST Act. Accordingly, the Commission should continue to consider additional opportunities to expand the use of scaled disclosure beyond the current classification of smaller reporting companies and emerging growth companies. We do not recommend, however, tying eligibility for scaled disclosure to a certain proportion of companies, such as a percentile of market capitalization. Such a

measure would not be as easy to determine as established metrics, and could result in difficulty and increased uncertainty regarding a particular registrant's eligibility for scaled disclosure. Moreover, the costs of preparing disclosures are often absolute, so tying the requirement to file them to a relative metric would be inappropriate.

Although we intend to comment separately on the Commission's recent proposal to increase the financial thresholds in the "smaller reporting company" definition[7], we believe such efforts are a step in the right direction. We also endorse the recent unanimous recommendations of the SEC's Advisory Committee on Small and Emerging Companies. In its report delivered to the Commission on September 23, 2015,[8] this committee made a series of very sensible suggestions, including the following:

- revising the definition of "smaller reporting company" to include companies with a public float of up to $250 million;
- providing smaller reporting companies with the same disclosure accommodations available to emerging growth companies, including:
  - exemption from the requirement to conduct "say on pay" and "say when on pay' votes;
  - exemption from rules requiring mandatory audit firm rotation;
  - exemption from pay versus performance disclosure; and
  - allow compliance with new accounting standards on the date that private companies are required to comply;
- revising the definition of "accelerated filer" to include companies with a public float of $250 million or more, but less than $700 million;[9] and

[7] Release No. 33-10107, *Amendments To Smaller Reporting Company Definition* (June 27, 2016).
[8] The full report is available at https://www.sec.gov/info/smallbus/acsec/acsec-recommendations-expanding-simplified-disclosure-for-smaller-issuers.pdf.
[9] As a result of such revision, the requirement to provide an auditor attestation report under Section 404(b) of the Sarbanes-Oxley Act would no longer apply to companies with public float between $75 million and $250 million.

- exempting smaller reporting companies from XBRL tagging and from filing immaterial attachments to material contracts.

## D. The Commission Should Consider Additional Techniques for Modernizing the Format of Disclosure Documents

Whatever the substantive content of the disclosure requirements in Regulation S-K may be, information should be disclosed in a way that makes it easier for investors to access the information and understand it. Accordingly, in evaluating disclosure effectiveness, the Commission should consider how technology can improve the way information is presented and delivered to investors.

The Commission's basic system of delivering reports on a periodic basis to investors originated decades ago in a pre-Internet era in which receiving company reports via the postal service, print media and the SEC's public reference rooms were the primary ways of obtaining detailed information about public companies. The launch of EDGAR in the early 1990s introduced the public reporting process to the computer age, but EDGAR's virtual file cabinet of documents has also become a relic of an earlier time. Both companies and investors have become far more sophisticated in their use of technology to prepare and review disclosure documents, and we believe it is the appropriate time for the Commission to begin a process for modernizing the fundamental format of document delivery.

As you know, the Commission's 21st Century Disclosure Initiative produced a detailed report on the topic of disclosure modernization,[10] and many of those recommendations are still worthy of further pursuit. The "company file" discussed at length in this report is one possible solution, but we believe the Commission should consider other alternatives that incorporate new technology as well. In the meantime, below we provide some comments on a series of stop-gap measures for improving the current document delivery system.

### 1. Cross-Referencing

Cross-referencing should be encouraged as a method of avoiding repetitious disclosure. For disclosure that contains numerous instances of cross-referencing, the

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[10] Staff Report, *Toward Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System* (Jan. 2009), available at https://www.sec.gov/spotlight/disclosureinitiative/report.pdf.

addition of a summary page including a list of cross-references with hyperlinks would be helpful for investors to more easily navigate through filings.

Despite its convenience, the use of extensive cross-referencing does highlight a problem inherent in Regulation S-K and the SEC's periodic reports, which is the requirement to disclose substantially similar information in multiple places. We recommend that the SEC work toward consolidating and eliminating duplicative disclosure requirements to decrease the need for frequent use of cross-referencing in the first place.

2. **Incorporation by Reference**

The SEC should continue to permit and encourage incorporation by reference in order to avoid repetition of information. This technique is also useful because it can draw investors' attention to those items that have not changed since the previous filing, which can be helpful in noting updated information. Incorporation by reference can be facilitated through the expanded use of hyperlinks, as discussed below.

3. **Hyperlinks**

We support the current permitted use of hyperlinks to make disclosure more user-friendly for investors. It is relatively easy for registrants to utilize available technology for including hyperlinks to increase the readability of filings. The Commission should continue to encourage the use of hyperlinks to allow investors to navigate throughout a filing and to easily access other documents referenced within a filing.

We also urge the Commission to permit a greater use of hyperlinks to information outside the EDGAR system. For example, most registrants maintain websites that are very useful sources of information for investors. Indeed, several SEC rules now require registrants to post information to their websites and make the corresponding website addresses available in their SEC reports.[11] Recognizing the increasingly important role that registrants' websites play, the SEC should permit hyperlinks to additional information on those company websites. Because of the dynamic nature of websites, including changes in URLs and ongoing removal of historical information, we would not object if, as a condition to hyperlinking to a source outside EDGAR, the SEC were to require registrants to maintain separate

[11] For example, Item 407 of Regulation S-K permits or requires registrants to make various information about corporate governance available on their corporate websites.

records of hyperlinked information so that an archive would be available should SEC personnel wish to see it.

4. **Company Websites**

Consistent with our earlier comments advocating for increased ability to hyperlink to external sources, we also encourage the Commission to give registrants the option of satisfying more of their disclosure obligations through the use of incorporation by reference to company websites. We do not believe that making this accommodation would present any undue burden on investors, since SEC rules already require website disclosure of some company information and many investors have become accustomed to using company websites to obtain other company information. Permitting this practice should also produce cost savings for registrants by permitting them to avoid duplication of effort.

5. **Specific Formatting Requirements**

We support granting registrants increased flexibility with regard to the order, numbering and captioning of items so that they can tailor the overall format of their disclosure documents in a way they determine is most useful to their investors. Likewise, we request that the Commission permit the greater use of charts, tables and other graphics to satisfy individual disclosure items. In these ways, we believe registrants could then more effectively communicate information that is material to understanding their particular companies.

6. **Layered Disclosure**

We support the greater use of layered disclosure, in a method that balances providing clear information to investors with avoiding repetition. The addition of a summary introduction highlighting key events and updates from the most recent fiscal period could provide investors with a helpful overview before reviewing the details contained in lengthy disclosure. Again, we believe registrants best understand their own investor bases and should have the flexibility to provide decision-useful information to them.

However, while registrants should have the option of providing layered disclosure if they elect, we do not support requiring numerous methods of presenting information that is tailored toward different investors of varying levels of sophistication. Requiring the same information to be presented in a myriad of ways would be burdensome for registrants to prepare and would create confusion for

investors by making information more difficult to find and increasing the length of filings.

7. **Structured Disclosures**

While we understand the potential usefulness of standardized markup languages such as XBRL for investors to be able to compare data across registrants, the SEC should be mindful of the significant cost and time burden it presents for registrants. In particular, scaled requirements for emerging growth companies and smaller reporting companies should be maintained and expanded.

It would also be advisable for the SEC to examine empirically how many investors actually use this data. While XBRL tagging may seem beneficial in theory, if the data is not actually being used by a significant number of investors, then these requirements may place an undue burden on registrants. Several recent SEC pronouncements make the basic assumption that investors widely use XBRL data, but our own experience is contrary to this assumption. We do not support the further expansion of XBRL or similar requirements without a thorough study of the issue.

The SEC should also look into finding a system that is easier for registrants to use. As noted in the Concept Release, the current system involves much complexity, which involves a need for registrants to outsource the task of tagging data. Accordingly, the SEC should examine the usefulness of the current system and whether there is a better, more user-friendly system available.

**Conclusion**

The Coalition believes that Regulation S-K should be modernized in a way that streamlines disclosure and emphasizes materiality, to ensure that investors are provided with meaningful, non-repetitive information and registrants are not burdened with overwhelming disclosure requirements. In the SEC's effort to modify Regulation S-K, we caution against the use of rigid, one-size-fits-all disclosure methods, which we believe would perpetuate existing problems with lengthy disclosure that is of limited use to investors. Requiring controversial disclosures intended to satisfy the idiosyncratic needs of special-interest groups should not become a routine feature of SEC rules. Additionally, the SEC should use this opportunity to encourage registrants to eliminate boilerplate, immaterial information that has increasingly crept into filings as a result of fear of liability. Finally, we also believe that it is incumbent for the SEC to perform an analysis on how any proposed

modifications will impact capital formation and competition prior to releasing proposed rules.

We thank you for your consideration of these comments and would be happy to discuss these issues further with the Commissioners or Staff.

Sincerely,

Cc: The Honorable Mary Jo White
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar