August 10, 2016

Brent J. Fields
Secretary, U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: RIN 3235-AL78; File Number S7-06-16; Business and Financial Disclosure Required by Reg S-K

Dear Mr. Fields:

Americans for Financial Reform ("AFR") appreciates this opportunity to comment on the above-referenced concept release (the "Concept Release") by the Securities and Exchange Commission (the "Commission" or "SEC"). AFR is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. AFR includes consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1]

This extensive concept release poses many questions concerning technical and detailed issues of disclosure. It is also part of a larger set of efforts relevant to financial disclosures, including the Disclosure Effectiveness Initiative, the Reg S-K study mandated by the JOBS Act, the recent proposed changes to materiality standards by the Financial Accounting Standards Board (FASB), and the lengthy and highly technical proposed rule on Disclosure Update and Simplification released on July 13th.

In light of this multitude of initiatives, we join the call by the Investor Advisory Committee (IAC) to hold more public round tables, focus groups, and other opportunities for public input. This would permit SEC staff to both ask questions directly and provide a clearer overview of the current issues in play surrounding financial disclosure. Financial disclosure is a crucial area of financial regulation and one that is at the heart of the SEC's responsibilities. It is also in many ways a highly technical area. All too often, only a small set of accounting experts with commercial ties to reporting companies have full insight into all of the complexities involved.[2] By putting forward such a variety of requests for public comment and such a range of possible changes, the Commission and FASB are in danger of only receiving full commentary from this small set of experts, rather than the broader public for whom financial disclosures are a critical mechanism for both personal investment decisions and understanding the activities of the corporate sector.

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[1] A list of AFR member organizations is available at http://ourfinancialsecurity.org/about/our-coalition/.

[2] Ramanna, Karthik, Political Standards: Corporate Interest, Ideology, and Leadership in the Shaping of Accounting Rules for a Market Economy, University of Chicago Press, November 9, 2015.

We would also call the Commission's attention to concerns about disclosure in areas that go beyond Reg S-K, specifically disclosure issues related to private funds. Numerous commenters and investors have criticized the lack of transparency of private funds, and the Commission has found major issues in its own examinations.[3] Such lack of transparency has been found to conceal conflicts of interest with private fund investors and possibly violations of SEC rules. Financial strategies pursued by private funds also have a profound impact on outcomes at companies in which they invest. Private funds do not report directly under Reg S-K (although beneficial owner disclosures in Item 403 are relevant to such funds). But any comprehensive review of the SEC disclosure regime must include the question of private fund transparency.

Below, we lay out broad views concerning some of the conceptual issues raised in the Concept Release and some of the specific areas of disclosure on which the Commission has raised questions. We are especially concerned regarding the issue of materiality and potential weakening in the materiality standard, which as we argue below could significantly undermine disclosures across a range of areas.

<u>Conceptual Issues</u>

Audience for Disclosure: AFR believes that in considering disclosure requirements the Commission must prioritize the investor community, including all segments from retail to sophisticated investors. We also believe that the Commission must provide disclosures that serve the needs of all investors, including those who invest in companies for reasons that go beyond short-term financial returns, such as environmental, social, and governance (ESG) criteria. As pointed out in the comment letter by the U.S. Social Investment Forum, professionally managed investments influenced by ESG criteria have grown to $6.5 trillion and represent one in every six dollars of professionally managed investments in U.S. financial markets. In considering disclosure requirements, the Commission must not ignore the needs of this large segment of investors.

"Disclosure Overload", Modern Information Technology, and Financial Disclosures: The SEC must prioritize taking full advantage of the power of modern information technology to transform financial disclosure. AFR believes that concerns about "excessive disclosure" or "disclosure overload" are profoundly misplaced. While the amount of verbiage in financial disclosures may have increased, risk factor disclosures have become increasingly generic and

[3] AFL-CIO, "Comments on Disclosure Effectiveness Initiative", November 20th, 2015, available at https://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness-65.pdf . Ceresney, Andrew, "Private Equity Enforcement", Keynote Speech at Securities Enforcement Forum West, San Francisco, CA, May 12, 2016. Available at https://www.sec.gov/news/speech/private-equity-enforcement.html

non-specific in ways that do not provide actionable information to investors.[4] Basic economics tells us that since the cost of data analysis has declined massively thanks to improvements in computer technology, investors should now be motivated to use greater amounts of data, not less – so long as that data is made properly accessible. A concern that an increase in disclosure may "bury shareholders" in "an avalanche of trivial information" is only relevant in a world of paper-based disclosures that has long since disappeared. *TSC Industries vs. Northway*, the case in which the Supreme Court raised this concern, was decided in 1976, a time at which the most powerful supercomputer on earth had far less computing power than a modern consumer cell phone. Modern computing technologies allow enormous amounts of information to be processed, analyzed, and presented in ways that are easily understood by even less sophisticated investors and which highlight salient issues for decision making.

The proper emphasis is not on the questionable and unproven hypothesis of so-called "disclosure overload", but on the format, utility, and availability of disclosure. The extensive use of information technology permits the same set of data disclosures to be presented in ways that are comprehensible and useful to a wide variety of investor constituencies through the use of different software front ends. Taking full advantage of this could allow the Commission to simultaneously serve many different constituencies. However, in order to fully realize the potential of modern technology the Commission must take several steps. First, all disclosures should be made available in usable open data formats. Second, disclosures should be clear, consistent, and comparable between different firms and over time, so that computer analysis can track trends and make comparisons that will better inform investors. In pursuing these goals, we suggest that the Commission draw on the expertise of trade associations such as the Data Transparency Coalition, which represents private sector businesses specializing in the use of open data disclosures to serve consumers and investors.

Principles-Based Vs Prescriptive Disclosures: The Concept Release asks questions at several points concerning the use of a principles-based vs a prescriptive standard for disclosure. An effective disclosure standard requires the proper balance between principles and prescriptive rules. If well enforced, a principles-based standard is a vital backstop to rules-based disclosures. Through a general statement, a principles-based standard can provide broad coverage of all information that is important to investors. For example, the broad principles-based statement in Rule 12b-20 is a crucial backstop in order to capture cases in which purely rules-based disclosures may omit information in a manner that is effectively misleading to investors.

However, excessively principles based standards carry the risk that disclosure decisions will be dependent on discretionary judgements made differently by each company, resulting in

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[4] Mirakur, Yatin, "Risk Disclosures in SEC Corporate Filings", Wharton Research Scholars Journal, April 22, 2011. Available at http://repository.upenn.edu/cgi/viewcontent.cgi?article=1088&context=wharton_research_scholars

disclosures that are not comparable across companies, possibly not comparable at a single company across time, and have a basis that is opaque to investors. Rules-based requirements that a core set of important information be disclosed uniformly and universally are crucial in creating consistent and comparable disclosures. Such prescriptive disclosure standards may not impose greater compliance costs on companies. Indeed, the clarity of prescriptive disclosure standards may save companies time and effort in determining whether a disclosure is necessary. For these reasons, we believe that it is important to keep a strong and comprehensive core of rules-based disclosures at the heart of Reg S-K.

Materiality: As this Concept Release states, materiality can be seen as a "cornerstone" of the entire disclosure framework. It is crucial to note, however, that materiality – while it is the core element in this disclosure regime – should not be seen as defining the maximum limit of corporate disclosure. It is, instead, the lower limit, the floor below which reporting becomes fraudulent. The SEC has a broad mandate to require disclosures to protect investors, among other things. Materiality should not be treated as the sole driver of the disclosure framework.

The fraud standard of materiality laid out by the Supreme Court in TSC vs. Northway states that a fact is material for disclosure when the "fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." A version of this legal standard has also been adopted by the Commission. It is important that this standard of materiality places the onus on management to determine what information would be broadly useful to a reasonable investor, which tends to create a starting point presumption favorable to disclosure. We believe an investor-focused definition of materiality, in which management is obliged to provide all information that a reasonable investor could view as useful or important, is essential to ensuring that needed disclosures are made.

But some recent statements on materiality raise concerns that this key element of a materiality standard may be weakened. In a recent speech, SEC Chair White characterized Commission disclosure policy as follows: "Our rules and guidance are clear that, to the extent issues about sustainability are material to a company's financial condition or results of operations, they must be disclosed".[5] There is no acknowledgement or prioritization of a reasonable investor standard in this statement. Instead, it leaves the door open to a disclosure standard which would rely solely on management's judgement as to the company's financial condition and the factors relevant to that condition. Since management can face serious conflicts of interest with outside investors concerning disclosure of information, this would be highly inappropriate.

A materiality standard must prioritize the investor by making a clear statement that all matters which a reasonable investor would find important should be included, rather than placing

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[5] White, Mary Jo, "Focusing the Lens on Disclosure", Keynote Address, International Corporate Governance Network Annual Convention, June 27, 2016. Available at https://www.sec.gov/news/speech/chair-white-icgn-speech.html

management's judgement of what is material to the company at the center of the determination. Besides permitting management to manipulate the disclosure process in inappropriate ways, it is also significant that a management-focused materiality standard would gravely impact the ability to compare disclosures between companies, as it is likely that each management team would have different assessments of what issues are material to the company's financial condition.

Specific Areas of Disclosure Information

Stock Buybacks: Stock buybacks have increased at a rapid pace in recent years and have major impact on both short-term stock performance and long-term company growth prospects by diverting funds that could be used for investments.[6] Stock buyback information is highly material and significant to investors. The SEC has required some significant disclosures in Item 703, but these disclosures are not reported with sufficient frequency and detail. Specifically, we favor the following changes:

1) **Changing the timing and increasing the frequency of disclosures**. Stock buybacks should be disclosed immediately, at the time the buyback actually occurs, as this is the time that any price manipulation would be occurring.
2) **More granular disclosures on the sources of funds for buybacks**. This will allow investors to better understand whether the long-term growth of the company is being endangered, either through increased debt or reduced re-investment, in order to fund stock buybacks.
3) **Disclosures on how stock buybacks fit within the company's overall capital allocation strategy**. This would include, for example, comparisons of funds expended and authorized to be expended on stock buybacks as compared to funds expended and expected to be expended on reinvestment in the company's long-term growth. Such a requirement could be limited to cases where stock buybacks are significant compared to overall cash flow.

International Tax And Regulatory Issues: A recent report by Americans for Tax Fairness found that offshore profits of U.S. corporations were $2.4 trillion in 2015, up from $434 billion a decade ago.[7] The high level of offshore profits, combined with the possibility of changes in both foreign and U.S. tax rules governing the taxation of these profits, means that disclosure of foreign revenues, profits and subsidiaries is directly and significantly material to the profits of

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[6] Lazonick, William, "Profits Without Prosperity", Harvard Business Review, September, 2014. Available at https://hbr.org/2014/09/profits-without-prosperity

[7] Americans for Tax Fairness, Offshore Corporate Taxes, Profits & the Competitiveness of the U.S. Tax System, May 2016, available at http://www.americansfortaxfairness.org/files/ATF-Chartbook-Offshore-Corporate-Taxes-Corporate-Profits-Competitiveness-of-US-Tax-System-May-2016-5-5-16-1.pdf. See also Citizens for Tax Justice, *Fortune 500 Companies Hold a Record $2.4 Trillion Offshore*, Mar. 3, 2016, available at http://ctj.org/pdf/pre0316.pdf.

American companies. In addition to this direct and significant financial exposure, the use of offshore tax havens can be an important part of social and governance criteria for investment, which as discussed above drives a significant proportion of investment.

While exposure to changes in tax rules is the most directly salient exposure to foreign regulations, there are other important elements of exposure to foreign laws and regulation that could well be material to firm profits. Financial, health, and privacy regulations can all affect the businesses of U.S. firms with global operations.

These factors argue for increased disclosure of overseas operations. Specifically, the Commission should require:

1) **Disclosure of corporate structure**: Corporations should be required to disclose their subsidiary structure, including the name, location, and Legal Entity Identifier (LEI) number of each subsidiary entity, as well as its relation to the parent company. Without this disclosure, investors will not have a clear understanding of the company's corporate structure, activities, and potential risks due to legal or political changes overseas. While companies voluntarily disclose information about a subset of subsidiaries today, this disclosure is far from complete and often omits significant entities.[8]
2) **Disclosure of country by country operations:** Corporations should be required to disclose employees, revenues, profits, tax rates, and taxes paid on a country by country basis. Without this data, investors will not be able to assess risks due to potential future changes in tax liabilities.

Item 305 and Market Risk: The Concept Release asks at CFR 23959-23960 about the market risk disclosures required in Item 305. Market risk disclosures have been improved in recent years by changes in FASB rules. For example, FASB Statement 161 in 2008 substantially improved derivatives disclosures, and FASB has also proposed to update liquidity and interest rate risk disclosures. The analysis and disclosure of market risk is also being re-examined by banking regulators in the form of significantly enhanced Pillar 3 disclosures under Basel rules and other efforts by national regulators.[9]

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[8] Americans for Tax Fairness, *The Walmart Web: How the World's Biggest Corporation Secretly Uses Tax Havens to Dodge Taxes*, June 2015, available at http://www.americansfortaxfairness.org/files/TheWalmartWeb-June-2015-FINAL1.pdf.

[9] Basel Committee on Banking Supervision, "Pillar 3 Disclosure Requirements: Consolidated and Enhanced Framework", Bank of International Settlements, March, 2016. Available at http://www.bis.org/bcbs/publ/d356.htm

We strongly support the separation of specific market risk disclosures in Item 305 from other risk factor disclosures, which have become increasingly generic.[10]

In a broad conceptual sense, the Item 305 disclosures are well organized and have value, requiring companies to report quantitative information on total market risk sensitive exposures divided into a reasonable range of market risk types. However, we believe current Item 305 disclosures fall short in the areas of sensitivity analyses and also counterparty risk concentration. Sensitivity analyses are overly reliant on discredited Value at Risk methods and also permit too much discretion to companies in terms of how sensitivity is measured or whether it is reported at all. Item 305 disclosures are also lacking in the area of counterparty risk concentration for market sensitive instruments, particularly for derivatives. This is apparently not required to be reported, despite its significance during the financial crisis.

Given the major developments that have occurred in risk analysis since the financial crisis, we suggest that the Commission reach out to banking regulators and to academic economists to discuss updating Item 305 disclosures to improve their scope and specificity. Such outreach should be conducted in forums accessible to the public such as public round tables. For an example of important rethinking of market risk disclosures that could be utilized by the Commission, see the post-crisis analysis of flaws in derivatives risk disclosures by Viral Acharya of New York University.[11] This work includes recommendations that have not been fully absorbed in new accounting requirements for derivatives disclosures. Other examples may be found in enhanced Basel Pillar 3 disclosures.

More specific and extensive Item 305 disclosures could be limited to companies that exceed specified thresholds in terms of their holdings of market risk sensitive instruments. However, such disclosures should not be limited purely on an industry classification basis, since commercial firms such as energy companies often engage in extensive market trading.

Thank you for the opportunity to comment on these Proposed Rules. Should you have any questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,

Americans for Financial Reform

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[10] Mirakur, Yatin, "Risk Disclosures in SEC Corporate Filings", Wharton Research Scholars Journal, April 22, 2011. Available at http://repository.upenn.edu/cgi/viewcontent.cgi?article=1088&context=wharton_research_scholars

[11] Acharya, Viral, "A Transparency Standard For Derivatives", New York University Stern School of Business, 2011. Available at http://pages.stern.nyu.edu/~sternfin/vacharya/public_html/Acharya_Proposal_Disclosure_Standard_v3.pdf