Council of Institutional Investors®
The voice of corporate governance

Via E-Mail

November 26, 2018

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

Re: File Number S7-19-18

Dear Mr. Secretary:

We are grateful for the opportunity to present our views on the proposed changes to the disclosure requirements in Rules 3-10 and 3-16 of Regulation S-X (Proposed Rule).[1]

The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $25 trillion in assets under management.[2]

We generally support the Securities and Exchange Commission's (Commission or SEC) goal of the Proposed Rule "to better align [the requirements of Rules 3-10 and 3-16 of Regulation S-X] with the needs of investors and to simplify and streamline the disclosure obligations of registrants."[3]

The comments included in this letter focus on certain aspects of the Proposed Rule that are expected to affect many institutional investors, including CII members.

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[1] Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities, Securities Act Release No. 10,526, Exchange Act Release No. 83,701, 83 Fed. Reg. 49,630 (proposed rule Oct. 2, 2018), *available at* https://www.gpo.gov/fdsys/pkg/FR-2018-10-02/pdf/2018-19456.pdf.

[2] For more information about the Council of Institutional Investors ("CII"), including its members, please visit CII's website at http://www.cii.org/members.

[3] 83 Fed. Reg. at 49,631.

Location of Disclosures

CII opposes the Proposed Rule provisions that permit the parent company to provide the "Proposed Alternative Disclosures" outside its financial statements.[4] Similarly, we oppose the Proposed Rule provisions that permit registrants to "provide financial and non-financial disclosures about the affiliate(s) and the collateral arrangement" outside their financial statements.[5]

As we explained in our comment letter in response to the Commission's proposed rule on Disclosure Update and Simplification:[6]

> For those topics that would result in relocation of disclosures, we generally do not support relocation of disclosures from inside to outside the financial statements. Many investors place significant value on having required disclosures subject to "annual audit and/or interim review, internal control over financial reporting, and XBRL tagging requirements." Many investors also place significant value on having required disclosures not subject to the "safe harbor under the Private Securities Litigation Reform Act of 1995."[7]

Consistent with our view, we support the alternative considered, but not adopted, that would have "require[d] that the Proposed Alternative Disclosures, or the Disclosures specified in proposed Rule 13-02, as applicable, be located *in* the audited annual and unaudited interim financial statement footnotes of the parent company, or registrant, as applicable, in all filings."[8] As the SEC appears to acknowledge, and we agree, the potential benefits to investors and the markets of the rejected alternative are many including: "enhanced reliability of information included in the financial statements;"[9] "more readily-available information in structured

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[4] *Id.* at 49,648 ("the note to proposed Rule 13-01(a) would allow the parent company to provide the Proposed Alternative Disclosures in a footnote to its consolidated financial statements or, alternatively, in management's discussion and analysis of financial condition and results of operations"); *see* Commissioner Kara M. Stein, Statement on Proposed Amendments to the Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize A Registrant's Securities (Rule 3-10 and Rule 3-16 of Regulations S-X) 2 (July 24, 2018) (commenting that the "release . . . does not provide adequate data in support" of permitting disclosure outside the financial statements), https://www.sec.gov/news/public-statement/statement-stein-072418.

[5] 83 Fed. Reg. at 49,653 (describing the requirements of proposed Rule 13-2).

[6] Disclosure Update and Simplification, Securities Act Release No. 10,110, Exchange Act Release No. 78,310, Investment Company Act Release No. 32,175, 81 Fed. Reg. 51,608 (proposed rule Aug. 4, 2016), *available at* https://www.federalregister.gov/documents/2016/08/04/2016-16964/disclosure-update-and-simplification.

[7] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Brent J. Fields, Secretary, Securities and Exchange Commission 3-4 (Sept. 22, 2016) (footnotes omitted), www.cii.org/files/issues_and_advocacy/correspondence/2016/September%2022%202016%20comment%20letter%20(final%20with%20letterhead)%20KAB.pdf*; see* CII, Policies on Other Issues, **Independence of Accounting and Auditing Standard Setters** (updated Mar. 1, 2017) ("Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions."), https://www.cii.org/policies_other_issues#indep_acct_audit_standards.

[8] 83 Fed. Reg. at 49,667 (emphasis added).

[9] *Id.* at 49,648.

formats;"[10] and increased "investor confidence in the disclosed information [that] may affect their willingness to invest."[11]

Continuous Reporting Obligation

CII opposes the Proposed Rule provisions "permitting a parent company to cease providing the Proposed Alternative Disclosures" under an expanded set of circumstances.[12]

We generally believe the Proposed Alternative Disclosures are important to investors in separately evaluating the likelihood of payment by the issuer and guarantors.[13] In part, because of the importance of that information, we also believe the Proposed Rules should "continue to require the parent company to provide the Proposed Alternative Disclosures in its periodic reports for as long as the subject securities are outstanding[]."[14] Our basis for opposing permitting a parent company to cease providing the Proposed Alternative Disclosures while the subject securities are still outstanding is generally consistent with the following comments of The Credit Roundtable:

> Issuers should not have it both ways: the ability to pay less interest via a registered bond issuance, yet retaining a mechanism that allows them to turn off financial reporting based on their own decisions regarding the percentage ownership of wholly-owned subsidiaries. Eliminating an administrative cost for issuers solely at the expense of investors does not serve the Commission's purpose of guaranteeing fair, free and open markets.
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> We urge the Commission to retain the current rules that require a parent company to continue to provide the Alternative Disclosures for as long as the guaranteed securities are outstanding. This is consistent with the Commission's overarching goal that investors rely on both the consolidated financial statements of the parent company and supplemental details about the subsidiary issuers and guarantors when making investment decisions.[15]

Foreign Private Issuers

CII opposes the Proposed Rule provisions that would eliminate the "requirement to reconcile the financial information included in the Proposed Alternative Disclosures to U.S. GAAP" for

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[10] *Id*.
[11] *Id.* at 49,668.
[12] *Id.* at 49,651.
[13] *See* Letter from James Andrus, Investment Manager, Global Governance, California Public Employees' Retirement System to Brent J. Fields, Secretary, Office of Secretary, U.S. Securities Exchange Commission 4 (Nov. 30, 2015) ("We agree with the SEC that Rule 3-10 which requires separate financial disclosures by issuers of guaranteed debt and guarantors of those securities is important to investors in separately evaluating the likelihood of payment by the issuer and guarantors."), https://www.sec.gov/comments/s7-20-15/s72015-38.pdf.
[14] 83 Fed. Reg. at 49,651.
[15] Letter from Cathy Scott, Director, Fixed Income Forum to Mr. Brent Fields, Secretary, U.S. Securities and Exchange Commission 2 (Sept. 21, 2018), https://www.sec.gov/comments/s7-19-18/s71918-4403402-175578.pdf.

foreign private issuers. As previously indicated, we believe the Proposed Alternative Disclosures are important to investors in separately evaluating the likelihood of payment by the issuer and guarantors.[16] That evaluation is likely to be more helpful if it is reconciled to U.S. GAAP.[17] We believe reconciliation imparts discipline and leads to increased rigor and reliability of the information reported.

In addition, reconciliation requirements are a key tool for educating investors and other market participants about the existence and impact of the many material differences that continue to exist between financial information prepared under U.S. GAAP and other standards. We simply disagree with the SEC's conclusion that because the parent company's consolidated financial statements are required to be reconciled to U.S. GAAP, it is not necessary to continue "to include a requirement to reconcile the financial information included in the Proposed Alternative Disclosures to U.S. GAAP."[18]

When Disclosure is Required

We generally support the Proposed Rule provisions eliminating "the existing 'substantial portion' test for determining whether disclosure is necessary and instead use a materiality standard to determine the appropriate level of disclosure[]."[19] We agree that the use of a materiality standard may be appropriate to determine when disclosure is required to the extent "material" is defined as "a substantial likelihood that disclosure of the omitted fact would have been viewed by a reasonable investor as having significantly altered the total mix of information available."[20]

We generally agree with the SEC that "if the securities of an affiliate pledged as collateral do not represent a material amount of collateral to an investor, the investor would likely not require detailed disclosures about that affiliate or the collateral arrangement because the collateral provides little, if any, credit support, and therefore such information could be omitted."[21]

However, our support for the proposed materiality standard is contingent upon the following two related Proposed Rule provisions that require (1) "disclosure of any quantitative or qualitative information that would be material to making an investment decision with respect to the

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[16] S*ee* Letter from James Andrus at 4.

[17] S*ee* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Nancy M. Morris, Secretary, Securities and Exchange Commission 2 (Sept. 24, 2007) (Commenting that "any potential elimination of the U.S. GAAP reconciliation requirement should . . . 'apply only to a foreign private issuer that files its financial statements in full compliance with the English language version of IFRS *as published by the IASB"'*), https://www.sec.gov/comments/s7-13-07/s71307-84.pdf.

[18] 83 Fed. Reg. at 49,651.

[19] *Id.* at 49,657.

[20] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission 4-5 (July 8, 2016), https://www.sec.gov/comments/s7-06-16/s70616-49.pdf. We also generally support the similar use of materiality in connection with the proposed Rule 13-01.

[21] 83 Fed. Reg. at 49,657.

collateralized security;"[22] and (2) "the registrant to disclose a statement [about] . . . those financial disclosures [that] have been omitted and the reasons why the disclosures are not material."[23]

We agree with the SEC that the second disclosure requirement would benefit investors by providing "clarity" about what disclosures were omitted and why those disclosures were omitted.[24] We believe the first disclosure requirement would also benefit investors because it would provide relevant information, not otherwise explicitly required by the Proposed Rule, which would likely render the disclosures taken as a whole to be more useful for investment decisions.

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Thank you for consideration of our views. If we can answer any questions or provide additional information on this matter, please do not hesitate to contact me at 202.822.0800 or jeff@cii.org.

Sincerely,

Jeffrey P. Mahoney
General Counsel

[22] *Id.*
[23] *Id.*
[24] *Id.*