April 28, 2020

Via email (rule-comments@sec.gov)

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
Attention: Vanessa A. Countryman, Secretary

Re: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information (File Number S7-01-20)

Dear Ms. Countryman:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is writing in response to the amendments proposed by the Securities and Exchange Commission (the "Commission") to certain financial disclosure requirements in Regulation S-K and to Item 303 of Regulation S-K (the "Proposal").[2] We appreciate the opportunity to provide comments to the Commission on the Proposal. Consistent with our comment letter in response to the Commission's request for comment on a concept release on modernizing certain requirements in Regulation S-K (the "Concept Release"),[3] we support the Commission's overall approach in the Proposal of replacing prescriptive disclosure requirements with a principles-based approach. We believe this shift will reduce boilerplate, irrelevant and immaterial disclosure in favor of thoughtful disclosure that is tailored to registrants' specific circumstances.

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly one million employees, we advocate for legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. With offices in New York and Washington, D.C., SIFMA is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, 85 Fed. Reg. 12068 (proposed Feb. 28, 2020) (the "Proposal").

[3] *Business and Financial Disclosure Required by Regulation S-K*, 81 Fed. Reg. 23915 (Apr. 22, 2016) (the "Concept Release").

The Proposal reflects consideration of our and others' suggestions, and we are generally supportive of the proposed amendments, including those that will eliminate certain redundant and duplicative disclosure requirements. However, we are concerned about the expanded requirements to disclose forward-looking information and the corresponding increased liability risk faced by registrants and other offering participants, as well as the burdensome nature of certain aspects of the proposed new critical accounting estimates requirement. In this letter, we reiterate our support for certain proposals, suggest that the Commission provide certain clarifications that we believe would aid registrants and other offering participants in complying with the Proposal, suggest certain modifications to the critical accounting estimates requirement and recommend that the Commission provide explicit and robust safe harbor protection for forward-looking information required to be disclosed under the Proposal.

1. Elimination of Item 301 and Item 302(a) of Regulation S-K

SIFMA supports the proposal to eliminate Item 301 and Item 302(a) of Regulation S-K. As noted in our comment letter on the Concept Release, this information is generally readily available elsewhere on EDGAR (or, in the case of fourth quarter information, easily calculable), and to the extent it is not (such as, in the case of Item 301, a newly public registrant), the material trend disclosure requirement pursuant to Item 303 would require tailored disclosure as necessary.

2. Item 303(b) Requirement to Disclose "Underlying Reasons" for Material Changes

The Proposal would replace the existing Item 303 requirement to disclose "causes" for material changes with a requirement to disclose the "underlying reasons" for material changes. The two concepts appear on their face to be interchangeable, but we assume that in proposing this change the Commission believes there is a distinction between the two, and different disclosure will be elicited. To reduce possible confusion, SIFMA suggests the Commission clarify why this change is necessary and what, if anything, the difference is between disclosing the "causes" for a material change and the "underlying reasons" for a material change.

3. Item 303(a)(2) Discussion of Material Cash Requirements

The Proposal would replace the current requirement to disclose material commitments for capital expenditures with a requirement to disclose "material cash requirements, including commitments for capital expenditures." We are concerned that without further clarification, this could be interpreted as broader than the requirements under current Item 303(a)(2)(i). Because working capital always includes cash to fund current operations, we suggest that the

Commission confirm that the proposed change would not require a discussion of working capital cash requirements if a registrant believes it has sufficient working capital to fund its operations over the customary working capital time horizon of 12 months.[4] We believe this confirmation would avoid registrants interpreting the new rule as requiring a detailed discussion of various working capital cash requirements (e.g., for compensation and day-to-day operations), which would not provide material information for investors. Of course, if a registrant believes its working capital is not sufficient for present requirements, the proposed rule (and existing Commission guidance) would require disclosure to the extent material.

We note that we are not suggesting that the Commission mirror with respect to domestic registrants the existing requirement in Form 20-F to state an opinion as to whether working capital is sufficient for present requirements. Rather, consistent with the overall goal of minimizing prescriptive disclosure requirements, we suggest that the Commission clarify that the proposed change is not intended to broaden the requirements under current Item 303(a)(2)(i) and existing Commission guidance.

4. Meaning of "Reasonably Likely"

While the probability threshold for disclosure under several existing and proposed MD&A requirements is that a result is "reasonably likely," the Commission has never explicitly defined the term. The Commission has made it clear that an event that is "reasonably likely" has a higher degree of probability than one that is "reasonably possible,"[5] which in turn is defined in ASC 450 as merely being more than "remote."[6] The Commission has also stated that "reasonably likely" is a lower disclosure threshold than "more likely than not."[7] This guidance

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[4] Although there is Commission guidance that makes it clear that a discussion of working capital cash requirements is only required where there are material trends or uncertainties relating to the sufficiency of cash funding sources through working capital, that guidance should be restated in the adopting release to make it more readily available to registrants. *See Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, 68 Fed. Reg. 75055, at 75063 (Dec. 29, 2003) ("2003 MD&A Guidance")

[5] See *Disclosure in Management's Discussion and Analysis About Off-Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments*, 67 Fed. Reg. 68054, at 68060 (proposed Nov. 8, 2002) (proposing to require disclosure of off-balance sheet obligations unless management determines that the occurrence of an event and the materiality of its effect is "outside of the realm of reasonable possibility") and *Disclosure in Management's Discussion and Analysis About Off-Balance Sheet Arrangements and Aggregate Contractual Obligations*, 68 Fed. Reg. 5981, at 5985 (Feb. 5, 2003) (adopting a final rule including a "reasonably likely" standard due to concern that the proposed standard would, among other things, result in voluminous disclosure).

[6] ASC 450-20-20.

[7] *Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations*, 67 Fed. Reg. 3746, at 3748 (Jan. 25, 2002).

appears in various sources.[8] Now that the Commission is proposing to codify additional requirements for which the disclosure threshold is "reasonably likely,"[9] we suggest consolidating the existing guidance in a footnote in the adopting release, both for ease of reference and to provide registrants and other offering participants clarity about the threshold for disclosure under the various new requirements.

5. Off-Balance Sheet Arrangements and Contractual Obligations

As stated in our comment letter on the Concept Release, we believe existing Items 303(a)(4) and 303(a)(5) of Regulation S-K require information duplicative of that in other filings or in the registrant's financial statements, and that their elimination would reduce redundancies in filings. We support the proposal to eliminate these requirements in favor of a holistic presentation of liquidity and capital resources disclosure that includes, where material, a discussion of off-balance sheet arrangements and contractual obligations information.

6. Critical Accounting Estimates

We agree that disclosure relating to critical accounting estimates can provide investors with important information. As a general matter, we support the proposed requirement that registrants include disclosure regarding estimates that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on a registrant's financial condition or results of operations, as well as the Commission's instruction that such disclosure should supplement, but not duplicate, descriptions already included in the registrant's financial statements. However, we have two serious concerns with the Commission's proposed approach, which we believe would represent a significant change from current practice.

Quantitative Sensitivity Analysis

Developing good disclosure on critical accounting estimates will be challenging, and by far the most difficult part will be addressing sensitivity. Although we agree the MD&A discussion should address the sensitivity of a critical accounting estimate to the methods, assumptions and estimates underlying its calculation, we believe a requirement to provide this sensitivity analysis

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[8] SEC. & EXCH. COMM'N, FIN. REPORTING MANUAL § 9220.11 (2008) ("Note that 'reasonably likely' is a lower threshold than 'more likely than not' but a higher threshold than 'remote'. The concept of 'reasonably likely' is used in the context of disclosure for MD&A purposes and is not intended to mirror the tests in SFAS 5 [ASC 450] established to determine when accrual is necessary, or when disclosure in the footnotes to the financial statements is required.").

[9] Proposal at 12076, 12080, 12101.

on a quantitative basis will entail costs, including significant management time and heightened liability exposure, that outweigh its benefits in incremental disclosure.

Quantitative insights into critical accounting estimate sensitivity could be useful to investors in certain cases, but we are concerned that in many cases this disclosure could create a problem of false precision, especially in areas that are particularly subjective. It may also result in confusion, both because investors may have a false sense of the comparability of disclosure across different companies and because they would not have meaningful information about the probability of any indicated sensitivity. The potential for data that can easily be misinterpreted by investors or that overstates the true risks involved would be significant in our view. We believe clear and concise qualitative disclosure regarding uncertainty and sensitivity should in most situations be more appropriate and helpful to investors, and that necessarily uncertain quantitative analysis may distract from such informative qualitative disclosure.

We also urge the Commission to consider the increased risk of Section 11 claims when crafting the critical accounting estimates requirement. First, requiring any additional forward-looking disclosure exposes registrants to potential Section 11 liability if the required disclosure is omitted, without regard to whether the omission makes other disclosures misleading. Second, in light of the Supreme Court's decision regarding Section 11 liability for opinions in *Omnicare, Inc. v. Laborers District Council Construction* (2015), Section 11 liability for forward-looking statements may turn on the reasonableness of the assumptions underlying such statements, and the reasonableness of these assumptions is especially vulnerable to challenge based on 20/20 hindsight. Finally, we note that because scienter is not an element of a private right of action under Section 11 and therefore the heightened pleading requirements of the Private Securities Litigation Reform Act (the "PSLRA") (Section 27A of the Securities Act and Section 21E of the Exchange Act) would provide no protection, even with the benefit of *Omnicare*, registrants would be exposed to a risk of litigation meaningfully more serious with respect to any new forward-looking disclosure requirements.

Against the doubtful benefit of the rule as proposed, the Commission should weigh both the large burden that crafting this disclosure would impose on registrants,[10] and the Commission's goal of encouraging companies to become and remain public by reducing the costs associated

[10] We understand from discussions with outside auditors that preparation of these kinds of quantitative disclosures, which are required under IFRS, is extremely burdensome on both registrants and their auditors.

with doing so, consistent with the protection of investors.[11] The quantitative critical accounting estimates requirement appears at odds both with this goal and with many of the other changes in the Proposal that seek to reduce unnecessary compliance burdens. Accordingly, we do not believe the Commission should require any quantitative disclosure. Instead, the requirement should be limited to providing sensitivity information qualitatively, with registrants of course having the option to go beyond this and provide quantitative information if they believe that is the most effective and practicable method of illustrating sensitivity.

While we strongly believe the above approach is preferable, in the event the Commission decides to retain the quantitative requirement in the final rule, we urge the Commission to clarify that "reasonably available" quantitative sensitivity information means information produced in the ordinary course of business and not simply to satisfy the disclosure requirement. The "reasonably available" provision presumably is intended to provide an appropriate counterbalance to the burdens outlined above. However, as a practical matter, it is unlikely to provide a safety net to registrants, because in the event of a lawsuit predicated on the omission of this information, a registrant would have to litigate whether it was permitted to withhold the disclosure based on the factual issue of whether it was reasonably available, rather than being able to potentially resolve the matter through a motion to dismiss or for summary judgment. Moreover, requiring quantitative disclosure only if already produced in the ordinary course—an objective test much less likely to involve disputed issues of fact—would also be consistent with the over-arching objective of MD&A disclosure as enabling investors to see a registrant "through the eyes of management": if management produces such analysis in the ordinary course and it is used as part of the registrant's ongoing decision-making process, it is much more likely to be probative than an analysis produced solely to comply with a disclosure requirement.

Forward-Looking Information

The new critical accounting estimates requirement would represent a meaningful expansion in the forward-looking disclosure included in MD&A (this is true especially if the quantitative sensitivity analysis requirement is retained, but remains a concern even if that aspect is

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[11] Jay Clayton, Chairman, Sec. & Exch. Comm'n, Remarks at the Economic Club of New York (July 12, 2017) ("While there are many factors that drive the decision of whether to be a public company, increased disclosure and other burdens may render alternatives for raising capital, such as the private markets, increasingly attractive to companies that only a decade ago would have been all but certain candidates for the public markets. And, fewer small and medium-sized public companies may mean less liquid trading markets for those that remain public. Regardless of the cause, the reduction in the number of U.S.-listed public companies is a serious issue for our markets and the country more generally. To the extent companies are eschewing our public markets, the vast majority of Main Street investors will be unable to participate in their growth. The potential lasting effects of such an outcome to the economy and society are, in two words, not good.").

removed). As highlighted in our comment letter on the Concept Release, requiring the disclosure of forward-looking information imposes a significant liability risk on registrants and other offering participants—when a contingency actually happens, its materiality naturally increases, and if a stock drop results, class action litigation challenging the original disclosure often follows. The proposed critical accounting estimates requirement will therefore expose registrants and other offering participants to an increased risk of litigation, which commentators often point to as a significant deterrent to companies going and remaining public.[12] This risk is likely to chill the production of open, thoughtful and balanced disclosure.

While the "statutory safe harbors" under the PSLRA generally cover forward-looking disclosure in MD&A (which would include any forward-looking components of the proposed critical accounting estimates requirements) and provide certain protections discussed below, these statutory safe harbors do not apply in certain situations (for example, they do not apply in initial public offerings ("IPOs")). By contrast, the "regulatory safe harbors" in Rule 175 under the Securities Act and Rule 3b-6 under the Exchange Act apply to all forward-looking statements in MD&A, including in an IPO, but provide less robust protection to registrants and other offering participants.

In the Proposal, the Commission emphasizes that the regulatory safe harbors protect eligible forward-looking statements in MD&A against private legal actions that are based on allegations of a material misstatement or omission. However, the availability of these regulatory safe harbors may raise questions of fact that would result in substantial discovery in the event of litigation. The statutory safe harbors have a significant benefit in that the factual question of whether any forward-looking statements were made with actual knowledge of their falsity is not determinative of liability, and judges seem to be prepared to decide as a matter of law whether the cautionary statements are sufficiently meaningful to qualify for the safe harbor. By contrast, the regulatory safe harbors may raise questions of fact relating to whether a statement was made or reaffirmed without a reasonable basis or other than in good faith. The reality is that if a registrant and other offering participants must litigate these issues, they are likely to settle—and settlement amounts may be significant.

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[12] *See, e.g.*, Eric L. Talley, Public Ownership, Firm Governance, and Litigation Risk, 76 U. Chi. L. Rev. 335, 336 (2009) ("According to many commentators, researchers, and the privatizing companies themselves… the private-equity wave of the last half-decade was at least partially inspired by an organizational desire to escape the (espoused) burdens of public ownership, including litigation risk.").

Because the proposed rules call for necessarily uncertain, forward-looking information, the Commission can foster the evolution of better disclosure, and promote the oft-stated Commission goal of reducing the cost to companies of going and remaining public, by providing explicit, strong safe harbor protection for forward-looking statements relating to critical accounting estimates. Specifically, we suggest that the Commission expand the PSLRA statutory safe harbors to cover any forward-looking critical accounting estimates disclosure for all types of companies and transactions (including IPOs). This would be consistent with the Commission's approach when it required quantitative and qualitative disclosures about market risk pursuant to Item 305 of Regulation S-K.[13] It also would be consistent with the Commission's goal of encouraging companies to go public, as it would reduce the risk of incurring litigation costs (including the risk of having to pay out settlements in the event they cannot succeed on a motion to dismiss or for summary judgment) attendant to requiring additional forward-looking disclosures.

Consistent with the approach under Item 305(d)(2)(i), the Commission should also provide that disclosure required under the new critical accounting estimates provision, except for historical facts such as how much each estimate has changed during the reporting period, is explicitly considered a "forward-looking statement" for purposes of the safe harbors. We believe this approach is appropriate for disclosures regarding critical accounting estimates because they involve uncertainties that are similar in nature to those underlying forward-looking statements, and in many cases are explicitly forward-looking. The Proposal would require the identification of critical accounting estimates that "involve a significant level of estimation uncertainty and have had **or are reasonably likely to have** a material impact on financial condition or results of operations" (emphasis added). While the estimate may itself be determined as of a particular date, forward-looking considerations will be implicit both in the identification of the estimate and, to a significant extent, in the assumptions underlying the estimate.

Finally, to the extent the quantitative sensitivity analysis requirement remains, the Commission should specifically provide that the meaningful cautionary statements prong of the statutory safe harbors will be deemed satisfied if a registrant meets the disclosure requirements, consistent with the existing approach to quantitative market risk disclosure in Item 305(d)(2)(ii).

[13] *Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information About Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments*, 62 Fed. Reg. 6044, at 6051-52 (Feb. 10, 1997) (the "S-K 305 Release").

7. Interim Period Discussion

SIFMA supports the proposal to allow registrants to compare their most recently completed quarter to either the corresponding quarter of the prior year (as is currently required) or the immediately preceding quarter, and believes the increased flexibility is a welcome change that would allow registrants to present information in the way they consider to be most relevant and helpful to investors.

8. Forward-Looking Statements Generally

In addition to our concerns regarding the proposed critical accounting estimates disclosure requirement discussed above, SIFMA notes that the Proposal would require other additional forward-looking information compared to what is currently required by Item 303.[14] Additionally, the Proposal would eliminate the confirmations in Item 303(c) that the statutory safe harbors apply to the disclosure of off-balance sheet arrangements and contractual obligations, given the proposed integration of these requirements into the larger MD&A. While the Commission and proposed S-K Item 303 note the availability of the regulatory safe harbors, as discussed above, we do not believe these provide meaningful protection to registrants and other offering participants.

Given the potential costs associated with additional forward-looking disclosure, the benefits of the statutory safe harbors discussed above, and the difficulty of applying a surgical approach to an integrated disclosure requirement, we believe the Commission should revisit the safe harbor landscape as it applies to MD&A more broadly. We suggest that, in light of the expanded, holistic approach to forward-looking liquidity and capital resources disclosure proposed, the Commission also take an expanded, holistic approach to PSLRA protection and expand the statutory safe harbors to apply to all forward-looking statements wherever they appear in MD&A, for all transactions and registrants. This would be consistent with the approach of extending the statutory safe harbors to all transactions and registrants for Item 305 disclosure that is not clearly historical.

SIFMA believes this approach would align with the Commission's goal of making it easier and more desirable for companies to go public (especially since the litigation risk is particularly high in the IPO context), whereas expanding the forward-looking disclosure requirements without providing the corresponding protections (and in the case of off-balance sheet and contractual

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[14] For example, the Proposal would codify a requirement that registrants include a discussion of all material cash commitments, not just those for capital expenditures. Proposal at 12093.

obligations, making the protections less explicit and easily accessible) would have the opposite impact.

9. Transition Period

In response to Question 87, SIFMA believes a longer transition period than 180 days would be appropriate for compliance with the critical accounting estimates requirement. In light of the complexity of the requirement, SIFMA suggests that registrants be given 18 months to comply. This is consistent with the time provided to registrants (other than those likely to have experience with measuring market risk) to comply with Item 305 upon adoption.[15] We do not believe most U.S. GAAP-reporting registrants have sufficient experience in the kind of sensitivity analysis being proposed, so we consider 18 months to be the appropriate transition period.

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If you have any questions regarding SIFMA's views or require additional information, please do not hesitate to contact the undersigned at [redacted], or our counsel on this matter, Leslie N. Silverman or Jeffrey D. Karpf of Cleary Gottlieb Steen & Hamilton LLP, at [redacted].

Very truly yours,

Aseel M. Rabie
Managing Director and Associate General Counsel

[15] S-K 305 Release at 6057.