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Via Electronic Submission to: rules-comments@sec.gov

December 15, 2017

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attention: Brent J. Fields, Secretary

Re: *Business and Financial Disclosure Required by Regulation S-K*
Release No. 33-10064; 34-77599; File No. S7-06-16

Ladies and Gentlemen:

This letter is submitted on behalf of the Disclosure Effectiveness Working Group (the "Working Group") of the Federal Regulation of Securities Committee and the Law and Accounting Committee (together, the "Committees") of the Section of Business Law (the "Section") of the American Bar Association (the "ABA") with respect to the Commission's concept release and request for comment on the business and financial disclosure requirements in Regulation S-K.[1]

The comments set forth in this letter represent the views of the Committees and have been prepared by members of the Working Group. These comments have not been approved by the ABA's House of Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, these comments do not represent the official position of the Section.

We appreciate the opportunity to comment on the Release. This comment letter follows three comment letters previously submitted to the SEC by the Working Group in response to the Commission's invitation for public comment on ways to improve the content and presentation

[1] *Business and Financial Disclosure Required by Regulation S-K*, Release No. 33-10064; 34-77599; File No. S7-06-16 (Apr. 13, 2016) [81 FR 23916 (Apr. 22, 2016)] (the "Release").

of business and financial information in SEC filings in connection with its Disclosure Effectiveness Initiative.[2] We reiterate the views expressed in those letters and hereby incorporate them by reference.

We also note that the Commission has recently proposed amendments to Regulation S-K and other rules and forms based on the recommendations made in the staff's Report on Modernization and Simplification of Regulation S-K, as required by Section 72003 of the Fixing America's Surface Transportation Act.[3] The Committees intend to submit a separate comment letter in response to those proposals.

Materiality. The concept of materiality is, of course, the cornerstone of the disclosure system (and its related liability regime) established by the federal securities laws. In the Release, the Commission recognizes that it has "adopted different approaches to guide registrants in evaluating materiality for purposes of disclosure, including in some cases using quantitative thresholds to address uncertainty in the application of materiality."[4] In some cases, such as Item 303(a)(2), Regulation S-K is "principles-based" in that it directs the registrant to apply the materiality standard directly to the facts at hand. The Release notes that principles-based requirements "rely on a registrant's management to evaluate the significance of information in the context of the registrant's overall business and financial circumstances" and to "exercise judgment" in determining whether disclosure is required.[5] In other cases, such as Item 101(c)(1)(i), Regulation S-K employs "objective, quantitative thresholds to identify when disclosure is required," which the Release refers to as "prescriptive" or "rules-based" because they "rely on bright-line tests rather than management's judgment to determine when disclosure is required."[6]

In other words, the differences in the types of legal directives contained in Regulation S-K (rules v. standards) reflect the degree to which the SEC aims to confine

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[2] Letter from Catherine T. Dixon, Chair, Federal Regulation of Securities Committee et al., Section of Business Law, American Bar Association (Nov. 14, 2014)(addressing Regulation S-X), available at https://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness-23.pdf (the "S-X Comment Letter"); Letter from Catherine T. Dixon, Chair, Federal Regulation of Securities Committee et al., Section of Business Law, American Bar Association (Mar. 6, 2015)(addressing Regulation S-K), available at https://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness-32.pdf (the "S-K Comment Letter"); Letter from David M. Lynn, Chair, Federal Regulation of Securities Committee et al., Section of Business Law, American Bar Association (Feb. 15, 2016)(addressing EDGAR), available at https://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness-69.pdf (the "EDGAR Comment Letter").

[3] *FAST Act Modernization and Simplification of Regulation S-K*, Release No. 33-10425; 34-81851; IA-4791; IC-32858; File No. S7-08-17 (Oct. 11, 2017) [82 FR 50988 (Nov. 1, 2017)].

[4] Release at 23924-5.

[5] Id. at 23925.

[6] Id.

or constrain management's judgments about disclosure. While materiality remains the cornerstone of disclosure, in some instances Regulation S-K allows management to make decisions about what is material, and in others, it does not. The reason for prescriptive disclosure requirements may be because of "uncertainty"[7] in the application of materiality, or potential conflicts of interest if the disclosure involves directors and officers, but unavoidably, by their very nature, prescriptive disclosure requirements will elicit information that is material for some registrants and meaningless for others.

In its Report on Regulation S-K, published in December 2013, the Staff recommended that any revisions "emphasize a principles-based approach as an overarching component of the disclosure framework," and yet "while preserving the benefits of a rules-based system affording consistency, completeness and comparability of information across registrants."[8] One way to implement what would otherwise seem to be an objective at odds with itself would be to subject Regulation S-K requirements to a materiality standard. Registrants would be required to evaluate each Item in Regulation S-K – thereby preserving the rigor of a rules-based system – but would be permitted to omit information, even if disclosure would otherwise be specifically required, if such information is not material and the inclusion of the information is not necessary to make any required statements not materially misleading. We note that there may be limited instances in which this principle should not apply in light of the self-interest that may adversely affect a disclosure decision, such as with respect to related party transactions (Item 404) and executive compensation (Item 402).

Specifically, as we also stated in the S-K Comment Letter, we recommend that the Commission amend Item 10 of Regulation S-K to include the following text as subsection (g):

> (g) In addition to the information expressly required to be disclosed, the registrant shall disclose such additional material information, if any, as may be necessary to make the required statements in the light of the circumstances under which they are made not misleading. Issuers may omit information otherwise called for by a line item, except for Items 402 and 404, if such information is not material, as long as the effect of omitting the information would not be materially misleading. It shall be presumed, in the absence of facts to the contrary, that the omission of any disclosure called for by a Regulation S-K line item was an intentional

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[7] Id.

[8] *Report on Review of Disclosure Requirements in Regulation S-K*, Dec. 2013, available at https://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf (the "Staff Report") at 98.

omission by the registrant in reliance upon this sub-section (g) and not a failure to provide the disclosure called for by such line item.

Adopting an overarching application of materiality to most of the items of Regulation S-K would go a long way, in our view, to promoting the effective and efficient disclosure of material information to investors.[9]

Known Trends or Uncertainties. Items 303(a)(1), (a)(2)(ii) and (a)(3)(ii) require a registrant to describe known trends or uncertainties that have had or the registrant reasonably expects will have a material effect, either positive or negative, on its liquidity, capital resources or results of operations. These requirements are intended to generate forward-looking information that is particularly relevant to an analysis of a registrant's future performance, and we believe that they are very helpful and should be retained.

We have concerns, however, about how the Commission has interpreted these requirements. In an interpretive release issued in 1989,[10] one year after the Supreme Court decided *Basic, Inc. v. Levinson*,[11] the Commission asserted that "The probability/magnitude test for materiality approved by the Supreme Court in *Basic, Inc., v. Levinson*, 108 S.Ct. 978 (1988), is inapposite to Item 303 disclosure."[12] Instead, the Commission stated that where a trend, demand, commitment, event or uncertainty is known (collectively, "trend"), management must make two assessments:

- First, is the trend reasonably likely to come to fruition? If management determines that the trend is not reasonably likely to occur, then disclosure is not required.

- Second, if management cannot determine that the trend is not reasonably likely to occur, then management must evaluate the consequences of the trend on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operation is not reasonably likely to occur.

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[9] We also recommend that the Commission conducted a holistic review of its and the Staff's interpretations of materiality, including Staff Accounting Bulletin No. 99.

[10] *SEC Interpretation: Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures*, Release No. 33-6835 (May 18, 1989) (the "Interpretive Release").

[11] 485 U.S. 224 (1988).

[12] Interpretive Release at note 27.

We believe that the second step in this two-step analysis should be revisited, as it effectively requires a registrant to prove a negative. Disclosure is required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur. Not only is this step difficult to apply, it creates a broader disclosure mandate than is indicated by the actual words of Item 303(a), which require disclosure of a trend or uncertainty when it is "reasonably likely to result in" a material effect on the registrant's liquidity, capital resources or results of operations.

Indeed, with this second step, the Commission has divided the future into two categories: (1) reasonably likely to occur, and (2) not reasonably likely to occur. If not the latter, then reflexively, it must be the former. However, this either/or construct ignores a separate category of the future – (3) neither "reasonably likely" nor "not reasonably likely" to occur – thereby broadening the scope of the known trends and uncertainties requirement by collapsing this third category into "reasonably likely." As a result, registrants may be required to disclose information pursuant to Item 303 that is neither material nor reasonably likely to result in a material effect on liquidity, capital resources or results of operations. Not surprisingly, as the Commission observes in the Release, "Although the courts are divided on the issue of whether Item 303 requirements create a general duty to disclose in the Rule 10b-5 context, these courts have agreed that the Supreme Court's standard in *Basic v. Levinson* is the appropriate standard for determining liability under Rule 10b-5 rather than the Commission's two-step test."[13]

In our view, this two-step test should be replaced with the probability versus magnitude test adopted by the Supreme Court in *Basic v. Levinson:*

> "Under such circumstances, materiality 'will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'"[14]

We believe that the probability versus magnitude test would be more helpful to registrants than the two-step test in analyzing known trends and uncertainties, while achieving the appropriate and necessary objective of providing to investors information about known trends or uncertainties that are reasonably expected to affect a registrant's liquidity, capital resources or results of operations.

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[13] Release at 23944.

[14] *Basic*, 485 U.S. at 238 (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968)).

We also reiterate our suggestion in our S-K Comment Letter that the SEC consolidate the currently effective guidance of the Commission and its Staff with respect to the MD&A. To the extent that guidance is Staff guidance as opposed to Commission guidance, we suggest that the consolidated information make this distinction clear.

Further, we recommend that, now that the U.S. Supreme Court will not review the U.S. Court of Appeals for the Second Circuit's decision in *Indiana Public Retirement System v. SAIC, Inc.*, 818 F.3d 85 (2d Cir. 2016), the Commission consider addressing in a new rule applicable to all of the SEC's disclosure rules the current uncertainty created by the split among the Second Circuit and the Third and Ninth Circuits, by clarifying that omission of a disclosure required by an SEC rule does not, per se, constitute a violation of a duty to disclose under Section 10(b) or Rule 10b-5. Rather, whether it does or does not depends on the facts and circumstances of the situation.

<u>Critical Accounting Estimates</u>. As we also stated in our S-X Comment Letter, we recommend that the Commission consider amending Item 303 to specifically require a discussion about the judgments and assumptions that management must make in order to prepare its financial statements and that have the most significant impact on such financial statements. In addition, we suggest that the Commission specifically state in Item 303 that the disclosure in the MD&A is meant to supplement, and not duplicate, the information about such judgments and assumptions included in the footnotes to the financial statements. Although interpretations and guidance issued by the Commission and the Division of Corporation Finance with respect to the appropriate MD&A disclosures indicate that the MD&A should include a discussion about critical accounting estimates or policies, Item 303 does not specifically require this discussion or define its parameters, particularly with respect to the significant accounting policies footnote to the financial statements. Accordingly, registrants often simply repeat the information in the financial statement footnotes about significant accounting judgments and assumptions.

Accounting is not precise, and accounting measurements include varying degrees of uncertainty and are susceptible to fluctuation. We think that disclosure about the significant judgments and assumptions underlying significant accounting decisions is necessary so that investors understand that the financial statements could differ significantly depending on the breadth of the range of reasonable judgments and assumptions and where the registrant's accounting judgments lie within those ranges. In addition, we believe that investors' assessment of the predictive nature of historical financial statements would be enhanced by an understanding of the critical judgments and assumptions.

Because the statutory safe harbors for forward-looking statements do not apply to the financial statements, including the footnotes thereto, whereas such safe harbors

do apply to MD&A, we recommend that enhanced disclosure about critical accounting estimates and judgments be required to be included in MD&A.

Strategy. Item 101(a)(1) does not require disclosure of a registrant's business strategy. However, many registrants already include a stand-alone section in the business section discussing the registrant's business strategy. This suggests that many registrants believe that describing their strategy in a stand-alone section is useful to investors and that providing such disclosure is appropriate in the business section. We also note that in connection with IPOs, it is market practice and likely a requisite to a successful IPO marketing effort that the IPO prospectus include a stand-alone strategy discussion. Accordingly, we suggest that Item 101(a)(1) be revised to include business strategy among its list of required disclosure items. We do not, however, believe that "business strategy" should be defined. We submit that there is a generally accepted understanding in the market as to what such disclosure should convey, and companies should have the ability to respond to any such disclosure requirement through the lens of their business.

Intellectual Property Rights. We believe that the Commission should retain the current scope of Item 101(c)(1)(iv), and not amend the item to require that all that all "intellectual property" be disclosed. We believe that expanding the scope of the disclosure requirement could require the identification of and at least partial disclosure of trade secrets. By definition, the disclosure of a secret deprives it of protection under trade secret laws. Even disclosure that a trade secret exists, without specific or partial disclosure of the trade secret, creates potential irreparable harm and risk to the trade secret owner. Unnecessary administrative expense, uncertainty, and challenges to security of the trade secret owner are all risks that flow from a requirement or implication that trade secret information must be disclosed.

Any expansion of the current disclosure requirements regarding intellectual property would cause problems beyond those associated with trade secret protection. For example, copyright protection automatically springs into existence upon the reduction of a creative work to tangible form. When such works are created by regular employees of a company, the company becomes the owner of the copyrights covering those works, regardless of whether those copyrights are registered or even whether the company is aware of them. The average registrant likely owns tens of thousands of unregistered copyrights covering the routine work product of its employees, making the required identification and disclosure of those copyrights an insurmountable task that is additionally unlikely to yield information that investors will consider material.

An expansion of the disclosure requirement regarding intellectual property would cause similar problems in the trademark context. There are some categories of trademarks, service marks, and trade dress that cannot be protected immediately upon their adoption because they lack distinctiveness. Over time, however, they can

acquire distinctiveness, but the acquired-distinctiveness inquiry is an intensively factual one that turns on a number of considerations and is not subject to bright-line rules. Requiring a registrant to evaluate whether each unregistered non-inherently distinctive mark it potentially owns has become protectable since the registrant's last filing would impose significant costs on registrants.

Congress quickly responded to reports that companies are being victimized by trade secret theft by passing legislation to establish a federal right of action to strengthen the U.S. trade secret laws, the Defend Trade Secrets Act of 2016. The Senate Judiciary Committee noted that trade secret theft causes an estimated $300 billion in annual losses to the American economy and costs the U.S. more than two million jobs annually.[15] Technological advances have made trade secret theft a growing problem. We believe that the competitive costs of trade secret information could adversely affect a registrant's value by removing the competitive advantage provided by the trade secret. Any requirement that trade secret information be disclosed under Item 101(c)(1)(iv) would potentially render the business vulnerable to extensive losses arising from the theft of trade secrets. For these reasons, we do not believe that the Commission should expand the scope of Item 101(c)(1)(iv).

<u>Sustainability</u>. We support the Commission's efforts to examine the importance of sustainability and public policy matters (we refer to these broadly, together with other environmental, social and governance matters, as "ESG" matters) to investment and voting decisions and to determine which disclosures might be important to an understanding of a particular registrant's business and financial condition.

The U.S. capital markets and the profile of investors in U.S. public companies has changed significantly since the Commission last comprehensively addressed potential ESG requirements in 1975. We agree with the Commission's conclusion that the role of sustainability and public policy information in investors' voting and investment decisions is evolving as some investors are increasingly engaged on ESG matters. We also agree with the Commission's long-standing position that disclosure relating to environmental and other matters of similar concern should not be required of all registrants unless, under the particular facts and circumstances, such matters are important to the reasonable investor (*i.e.*, material information). We believe this is a sound policy that should be modified, as necessary, in an evolutionary and incremental manner.

Under the current framework, ESG disclosure requirements are largely principles-based, arising under items such as S-K Item 303(a) "known trends and uncertainties" and Item 503(c) "significant risks." The Commission has explicitly acknowledged that in certain cases, information with respect to social and environmental performance, while not a line-item disclosure requirement, may be necessary in order to make the

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[15] Senate Judiciary Committee, *Report on the Defend Trade Secrets Act of 2016*, 114th Congress, S. Rep. 114-220, at 2 (2016).

statements in the filing not misleading or otherwise complete. In addition, the Commission has issued guidance on specific disclosure topics such as the 2010 interpretive release regarding climate change.[16] This primarily principles-based disclosure approach provides important flexibility to registrants in determining what should be disclosed in their filings with the SEC. However, we note that this approach has also been strongly criticized by those who believe that the disclosure requirements are neither adequately adhered to by registrants (either addressed in boilerplate disclosures or ignored altogether) nor adequately enforced by the SEC.

We believe that ESG issues encompass a wide and diverse range of issues from climate change to sustainable business practices to human capital management. Even with a particular topic, such as the impacts of climate change, the issues will vary significantly from industry to industry and from registrant to registrant. We acknowledge that such ESG issues may not always necessarily be material for all registrants. As a result, line-item requirements may result in a significant number of registrants being required to make immaterial disclosure that is costly to prepare and not necessarily helpful to investors. A principles-based approach is more flexible, but does have limitations. For these reasons, we believe that the Commission should carefully consider, where appropriate, a model for ESG disclosures that integrates both principles-based and prescriptive disclosure elements.

We agree with the Commission's observation that any future rulemaking should be informed by a careful, balanced analysis of the investment and voting information needs of a diverse investor population, characterized by varying levels of financial sophistication and interest. Investor needs are evolving and these will inform both the content of the disclosure, as well as its manner of presentation and delivery. A materiality-focused disclosure system puts significant pressure on both the Commission and registrants to determine what is important to the "reasonable investor" assessing the "total mix" of public information regarding the issuer and its securities. However, this does not necessarily mean that the role of the SEC and the U.S. securities laws should be expanded to require information that is important or interesting to investors, but not fundamentally material with respect to their investment decisions. It should be noted that investors and registrants continue to have other avenues of dialogue on ESG matters, including stand-alone sustainability reports and website-based disclosures. It is important however for registrants to understand that to the extent they are voluntarily disclosing "material" information as defined by the SEC rules and regulations in such reports or platforms, such information must be captured in their filings with the SEC.

We believe that the Commission and the Commission's Staff have been effective in the past with providing guidance regarding how existing disclosure requirements may

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[16] *Commission Guidance Regarding Disclosure Related to Climate Change*, Release No. 33-9106 (Feb. 8, 2010) [75 FR 6290 (Feb. 8, 2010)]

need to be considered in the context of developing areas of interest, such as climate change and cybersecurity risks. Further, the Staff of the Division of Corporation Finance regularly reviews and comments on the disclosures that registrants include in their annual and periodic reports. Before considering any rulemaking initiatives, we believe that the Commission should consider the interpretive and operational avenues that it has to address any concerns about the adequacy of disclosure regarding particular topics that are the subject of public or investor attention.

Litigation. Item 103 requires disclosure of material pending legal proceedings and certain other specified pending or contemplated legal proceedings to which an issuer or its property is subject. Legal proceedings for which disclosure is required include both private litigation and governmental proceedings. Significantly, legal proceedings also can be the subject of disclosure under several other line items, including risk factors, MD&A and the notes to the financial statements in accordance with ASC 450-20 relating to loss contingencies. Legal proceedings sometimes also may be disclosed in the description of the business. These various line item and accounting requirements have resulted in duplicative disclosures. Moreover, in our experience, little more than disclosure of "name, rank and serial number" factual information about proceedings is provided in response to Item 103 in many filings. In contrast, the description of legal proceedings in risk factors typically puts the litigation in the context of risks to the enterprise, and the description in MD&A (and sometimes in the financial statement notes) indicates the effect an adverse determination can have on the future earnings and liquidity of an issuer. As a result, these other disclosures are more likely to provide useful information for investors.

Item 103 can serve a useful purpose by collecting in one place information about material legal proceedings. However, it too often results in just a listing of matters with descriptions that are not important to investors and without the context that provides meaningful disclosure. We believe it is desirable to minimize duplication and to encourage disclosure of legal proceedings in context so the disclosure is meaningful for investors. This can be accomplished by permitting Item 103 disclosures to be treated as a cataloguing of legal proceedings, but without unnecessary detail, and by building in flexibility through expressly recognizing in Item 103 the ability of an issuer to cross refer or hyperlink to the identified disclosure of legal proceedings elsewhere in the disclosure document where the matters are discussed in context, such as risks of the enterprise or matters potentially affecting earnings or liquidity.

In addition to recognizing in Item 103 the ability, and frequently the desirability, of referencing disclosure elsewhere, we believe Item 103 can be updated and modernized in the following ways:

- The need to separately call out and establish different disclosure criteria for environmental matters should be revisited in view of the passage of time since environmental matters were separately provided for. Because of improvements in disclosure, there no longer is the same need to treat

environmental matters separately from other matters that are material to an issuer and subject them to a different disclosure standard.

- The level of detail called for by Item 103 does not serve a useful purpose. Instead, an issuer should be required to provide disclosure necessary to identify the nature of the proceeding, its alleged basis and the relief sought.

- The requirement to disclose proceedings known to be "contemplated" by governmental authorities should be reevaluated. This is a difficult standard to apply. A better standard, more in line with ASC 450-20, would be to require disclosure of material claims that have been asserted or are probable of assertion by a governmental authority.

In suggesting that Item 103 expressly recognize an issuer's ability to cross refer to disclosure of legal proceedings discussed in risk factors, we are not addressing the broader question whether or not there should be a consolidated discussion of risk and risk management. Instead, we are suggesting that flexibility be recognized in Item 103 so that an issuer can choose where and in what context to best discuss particular matters in greater detail.

We believe that Item 103 disclosure of legal proceedings and ASC 405-20 disclosure of loss contingencies serve different purposes which justify their being treated differently. ASC 450-20 loss contingency disclosure is derived from the accounting standards and thus is focused on quantitative impact to the income statement. Item 103 legal proceedings disclosure, while it has quantitative aspects, is principally qualitatively oriented to provide an understanding of the potential effect of legal proceedings on the enterprise, including with respect to risk, business operations and future performance. Accordingly, we think it is not desirable to include Item 103 disclosure in the financial statements or, correspondingly, to replace Item 103 disclosure with ASC 450-20 disclosure (except to modernize and streamline Item 103 disclosure as we suggest above). Moreover, we think it is not desirable to have FASB revisit loss contingency disclosure under ASC 450-20, which is carefully balanced to provide necessary disclosure to investors while protecting the interests of issuers and shareholders in the difficult and uncertain area of litigation. We believe that through recent efforts of the Staff in the comment letter process, the quality of required ASC 450-20 disclosure has improved. In addition, when FASB last revisited ASC 450-20, the difficulties in revising it became evident, and FASB appropriately determined not to proceed with the project. Part of this difficulty is attributable to the audit process, which presents challenges to preserving an issuer's attorney-client privilege and work product protections. Thus, maintaining existing ASC 450-20 disclosure requirements, with its associated auditing procedures, and focusing separately on improving Item 103 disclosure, is a better approach in our view.

Risk Factors. We recognize that the current, principles-based risk factor disclosure called for by Item 503(c) raises a number of difficult issues for registrants and investors

alike, both as to the scope of the disclosure and the manner of its presentation. As to the scope of disclosure, many issuers feel compelled to include a large number of risk factors for various reasons, including the potential to avoid liability based on "bespeaks caution" concepts and to preserve their ability to invoke the statutory safe harbors provided by the Private Securities Litigation Reform Act of 1995 from liability for certain forward-looking information; concern that the omission of risk factors disclosed by other companies in the same industry or business sector could be viewed as suggesting that these risks are inapplicable to the registrant; and Staff comments. The presentation of risk factors also poses issues. As the Commission observed in the Release, suggestions to limit the number of risk factor disclosures, or to order these disclosures in terms of management's view of their priority or assessment of probability and magnitude of the potential impact, have been considered in the past and have met with opposition from issuers, often based on considerations of potential liability arising from omitting or miscalculating the likelihood or severity of risks.[17]

Notwithstanding these difficult issues, we believe there are a number of ways in which the Commission can improve risk factor disclosure without jettisoning the current materiality-centered, risk-based analytical approach required by Item 503(c), as well as other line-item requirements that call for management's risk identification, assessment and disclosure. This flexible approach, as informed and refined by updated Commission or staff interpretive guidance, is readily adaptable to the evolutionary nature of internal and external risks facing a particular company and its investors.

Length and Number of Risks. Critics have aptly observed that risk factor disclosure by many issuers has become so lengthy, unfocused and generic so as not to be helpful to a potential investor. Registrants and their counsel are appropriately concerned about mitigating the risk of future litigation and respond to such concerns by disclosing numerous risks that may affect the registrants' businesses and financial results, including some generic risks. In weighing the need for enhanced disclosure of more focused, registrant-specific risk assessments against the prospect of potential litigation exposure, many registrants and their counsel choose to over-disclose. To some extent, the Commission's position on the inappropriateness of risk-mitigation disclosure in the Risk Factors section may inadvertently have contributed to "boilerplate" risk factors. While some commenters may observe that the length of risk factors or the number of risk factors does not pose a concern for potential investors, we believe that the disclosures may become so lengthy that a retail investor may have difficulty identifying those risks that are truly significant and that should be taken into account before making an investment decision. That being said, we do not favor establishing an arbitrary or specific numeric limit on the risk factors that may be included in a filing – an idea that, as noted above, the Commission has considered and rejected in the past. Instead, we would encourage the Commission to undertake further inquiry, perhaps through the use of focus groups, regarding investors' reactions to "right-sizing"

[17] Release at 23956, note 493.

risk factor disclosures. Such measures might assist the Commission in evaluating the merit of academic studies indicating that "risk factor disclosure is informative and … decreases information asymmetry among investors."[18]

To improve the quality of risk factor disclosures, the Commission may wish to refine and build on the concept now embedded in the relevant instruction to Form 20-F, which also underpins Item 503(c): "Companies are encouraged, but not required, to list the risk factors in the order of their priority to the company." For example, the Commission might consider whether prioritizing risks should be mandatory for all registrants. In addition, we suggest that the Commission allow issuers the flexibility to include disclosure of their risk management or mitigation measures without being considered as detracting from the severity of the risk (which would not be helpful to the issuer in invoking the statutory safe harbors in the event the risk eventually materializes).

Generic Risk Disclosures. We also encourage the Commission to consider a specific requirement that registrants omit generic risk factors that describe risks that would affect any public company (e.g,. risks associated with additional issuances of securities, stock price fluctuations, macroeconomic conditions, etc.). We understand that practitioners may be reluctant to advise their corporate clients to omit generic risks; so, in order to encourage a move toward a more focused presentation of material risks, we suggest that the Commission either consider the presentation of a check-box grid where a registrant could indicate from a list of identified generic risks those applicable to its business, or maintain a set of "generic risks" associated with particular types of companies (e.g., risks associated with emerging growth companies, risks associated with foreign private issuers, etc.) within its investor education materials and those risks could be referred to, and incorporated by reference into, a registrant's filings. Either approach should have the effect of cutting down pages of disclosure that might otherwise obscure a discussion of material and distinctive risks specific to the company. Alternatively, the Commission should consider adoption of a specific safe harbor from liability relating to the omission of generic risks common to public companies.

The Commission or its Staff also should provide interpretive guidance, as it has in the past, to assist issuers in analyzing and disclosing such emerging risks as cybersecurity breach or climate change, although experience shows that this approach alone is likely to be less effective in assuaging concerns regarding non-disclosure of even generic risks. Such interpretative guidance might be helpful in reiterating the applicability of a principles-based approach to disclosure of risks, as well as providing registrants and counsel with best practice recommendations regarding the grouping of related risks, the need to disclose issuer-specific risks and the use of descriptive captions for risks. In addition, the Commission could update the list of examples now contained in Item 503(c).

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[18] Release, text accompanying note 492.

Probability of Occurrence and Steps to Mitigate Risks. We believe that it would not be helpful to require registrants to disclose the probability of occurrence of any of the facts set out in its risk disclosures. We do agree, however, that such probability/magnitude assessments are relevant to the company's decision-making process, as explained, for example, in the Staff's Disclosure Guidance Topic No. 2, Cybersecurity (2011). As the Staff noted, companies should not be forced to disclose proprietary or confidential business information company management often takes into account in weighing the need for disclosure of the "most significant factors that make investment in a registrant's securities speculative or risky …." In our view, it is unlikely that the details of management's probability/magnitude analysis would result in meaningful disclosure for the reasonable investor, since, necessarily, any assessment of probability would be accompanied by statements of assumptions as well as by disclaimers (which are now disfavored in risk factors). We believe that this would result in disclosures that would confuse investors rather than focusing investors on the factors that are likely to have an effect on the registrant's performance, and also jeopardize the confidentiality of sensitive, proprietary company information. Similarly, we believe it would not be helpful to require a specific discussion regarding the ways in which the registrant proposes to address each risk, although such disclosure should be permitted if the issuer so chooses. Moreover, it should be clear from an issuer's business description, as well as from the issuer's MD&A, especially the overview or executive summary and the discussion of trends, how the issuer has fared in addressing risks and changing market or competitive conditions.

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We appreciate the opportunity to comment on the Commission's concept release on Regulation S-K and respectfully request that the Commission and the Staff consider our recommendations and suggestions. We are available to meet and discuss these matters with the Commission and/or the Staff and to respond to any questions.

Very truly yours,

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