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June 29, 2018

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

Re: File Reference No. S7-10-18; Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships (SEC Rel. Nos. 33-10491; 34-83157; IC-33091; IA-4904)

Dear Mr. Fields:

We are pleased to respond to the request for public comment from the Securities and Exchange Commission (the "SEC" or the "Commission") on the proposed rule, *Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships* (the "proposal").

We support the Commission's longstanding view that auditor independence is essential to the public's trust in financial reporting and is critical for effective and functioning capital markets. We acknowledge and support the conceptual underpinnings of the auditor independence rules, which provide a basis for investors to have confidence that the auditor is capable of exercising objective and impartial judgment.

We appreciate the SEC's continued efforts to re-evaluate and address the current challenges presented by Rule 2-01(c)(1)(ii)(A) of Regulation S-X (the "Loan Provision"). We agree with the Commission's proposal to update the application of the Loan Provision by taking into account the evolution of the capital markets, and refocusing the rule to align with its original intent of restricting relationships between the accounting firm and those shareholders of the audit client who have a "special and influential role" with the audit client. We value the Commission's efforts in addressing the practical challenges the Loan Provision has presented. We believe the proposal strikes the right balance of enhancing efficiency and effectiveness in implementing the requirements and reducing compliance burdens and unintended consequences, while continuing to foster robust auditor independence rules.

We appreciate the opportunity to comment on the proposal and have set out below observations and recommendations on specific areas of the proposal, as well as on other matters we believe can benefit from similar analysis and consideration by the Commission in relation to the auditor independence rules.

PROPOSED AMENDMENTS TO THE LOAN PROVISION

We agree with the Commission that in today's capital markets, there are certain circumstances in which the Loan Provision is not functioning as it was originally intended. We are aware of certain circumstances where we believe an accounting firm's objectivity and impartiality was not impaired by practical challenges in addressing the specific requirements of the Loan Provision. We also agree with the Commission's observation that a high volume of audit committee communications regarding such relationships may dilute the impact of other communications that may be more likely to bear on the accounting firm's objectivity and impartiality.

Therefore, we support the Commission's proposal to refocus the Loan Provision on those lending relationships that could bear on an accounting firm's independence whether in fact or in appearance, while excluding lending relationships that are unlikely to present an actual threat to an accounting firm's objectivity and impartiality.

Limiting the Loan Provision's Scope to Beneficial Ownership

We support the Commission's proposal to exclude record owners from the scope of the Loan Provision. The evolution of the capital markets has led to the creation of a network of financial intermediaries (e.g., broker-dealers, financial institutions, insurance companies, and third-party retirement plan administrators) that act as record owners for their customers, who in turn are the beneficial owners of the issuer's equity securities. Although these financial intermediaries are commonplace in today's capital markets, they do not possess the characteristics of a shareholder that has a "special and influential role" with an audit client, which was the original focus of the Loan Provision. Under the existing provision, an accounting firm is not in compliance with the independence rules if the accounting firm has a lending relationship with an entity that is a record owner of more than 10% of an audit client's equity securities, even though the record owner typically lacks the ability or the financial incentive to exert influence over the audit client. The inclusion of record owners in the Loan Provision has led to practical challenges, even though there is no perceived or actual impact on the accounting firm's objectivity and impartiality in such circumstances. We therefore support the Commission's proposal to focus the Loan Provision solely on beneficial owners, and agree that this is the appropriate scope and threshold for the Loan Provision, because only the beneficial owners are in a position to benefit from financial gains (or suffer from financial losses) that are tied to the performance of their investment.

We recommend the Commission clarify what constitutes a beneficial owner for purposes of the Loan Provision. We appreciate that Rule 240.13d-3 outlines the voting authority/investment authority tests for beneficial ownership in other securities law contexts. However, we do not believe that focusing on voting authority/investment authority as outlined in Rule 13d-3 is necessarily the right focus for beneficial ownership in relation to the Loan Provision. For example, a large financial institution that holds an investment in an operating company should not be viewed as the beneficial owner for purposes of the Loan Provision if that investment is solely through a mutual fund that is managed by the financial institution because the fund manager is acting as an agent/fiduciary of the fund shareholders. Instead, for purposes of the Loan Provision, we believe the beneficial owner determination should also focus on whether a shareholder has an actual economic interest in the audit client. Thus, in the scenario above, we believe the beneficial owners are the shareholders who have the actual economic interest in mutual fund shares, and not the financial institution that manages the mutual fund.

Further, we recommend the Commission include in the text of the Loan Provision the concepts outlined in footnote 22 of the proposal, describing the beneficial owners that are within the scope of the Loan Provision (i.e., beneficial owners that are lenders or downstream affiliates of the lender to the accounting firm or covered person are included in the scope; entities that are under common control with or controlled by the beneficial owner are excluded from the scope). We believe this will help provide certainty as to which beneficial owners are covered by the Loan Provision.

Significant Influence Test

We agree with the Commission that the 10% bright-line threshold is no longer suitable for achieving the intent of the Loan Provision and agree that a significant influence test is a more appropriate basis for evaluating whether a lender to the accounting firm is a beneficial owner that has the ability to exert a special and influential role over the audit client's operation and financing policies. Significant influence is a well-established concept in the Financial Accounting Standards Board's Accounting Standards Codification Topic 323, *Investments—Equity Method and Joint Ventures*, as well as in other parts of the Commission's independence rules. Therefore, we believe significant influence is the appropriate framework to utilize in the application of the Loan Provision.

We are supportive of adding the concept of evaluating "portfolio management processes" to the significant influence test for investment companies. We agree with the Commission that the first step in the significant influence assessment should be an evaluation of the investment adviser's portfolio management process, including the nature of the services provided by the investment adviser pursuant to the terms of its advisory contract with the fund. We agree that in circumstances in which the advisory contract or limited partnership agreement grants the investment adviser or general partner significant discretion with respect to the fund's portfolio management processes, it is unlikely that a shareholder will have the ability to influence those portfolio management processes and, therefore, significant influence by the shareholder generally would not exist. We encourage the Commission to include this concept in the adopting release as it will help clarify how significant influence should be evaluated in the investment management industry.

We encourage the Commission to clarify that in the investment company context, participation on an advisory committee does not create a presumption of significant influence. For example, many private funds that are organized as limited partnerships and limited liability companies have advisory committees. A limited partner's or member's participation on an advisory committee is not typically analogous to participation on a board of directors at an operating company because private fund advisory committees have a different objective and a different type of authority. Their purpose generally is to provide suggestions to the investment adviser or general partner; they do not oversee the investment adviser nor the general partner and typically do not participate in the portfolio management process. Therefore, although we believe participation on an advisory committee is one factor to consider when evaluating significant influence, such participation alone should not lead to the presumption of significant influence. The responsibilities of the advisory committee can vary, and thus an analysis, based on the facts and circumstances, is needed to establish whether a limited partner/member has significant influence.

Additionally, many private fund limited partnership agreements include the right for the limited partners to remove the general partner ("kick-out rights"). We believe these rights are typically protective rights, in that the rights only allow for removal of the general partner, but they do not allow for the appointment of the successor general partner or any action that would be viewed as a special or influential role; thus, these rights, standing alone, should not be viewed to indicate that a limited partner has significant influence over the general partner or investment adviser.

Exchange-traded funds (“ETFs”) introduce unique financial intermediaries into the Loan Provision analysis. We believe authorized participants act similarly to record owners, and should not be viewed as beneficial owners of the ETFs and would not have significant influence. Authorized participants are typically large financial institutions that enter into legal contracts with ETF distributors and are the only investors allowed to interact directly with the ETFs. Market makers are generally considered financial intermediaries that provide liquidity to ETFs; their objective is not to influence the fund or the portfolio management process. We recommend the Commission clarify that typically market makers would not be considered to have significant influence for purposes of the Loan Provision.

We agree with the Commission that maintaining independence is a shared responsibility between the accounting firm and the audit client and recommend the Commission consider referencing that concept in the final adopting release. We believe the audit client and accounting firm both have a shared responsibility to evaluate the portfolio management and governance processes, and determine whether there are beneficial shareholders that may have significant influence. The audit client is generally aware if there are shareholders that may have significant influence over its decisions. The accounting firm alone will not have all the information needed to evaluate and conclude on these matters.

“Known Through Reasonable Inquiry” Standard

We support adding the concept of “known through reasonable inquiry” to the Loan Provision. The “known through reasonable inquiry” standard will help address compliance challenges and concerns with respect to the accessibility of information regarding beneficial owners. We agree with the Commission that if an accounting firm, in coordination with its audit client, does not know after reasonable inquiry that one of the accounting firm’s lenders is also a beneficial owner of the audit client’s equity securities, it is unlikely the accounting firm’s objectivity and impartiality could be impacted by its lending relationship with the beneficial owner.

Excluding Other Funds That Would be Considered Affiliates of the Audit Client

As noted in the proposal, the term “audit client” currently encompasses entities that are “affiliates of the audit client,” including entities that control, are controlled by, or are under common control with the audit client, as well as entities in the same investment company complex (“ICC”), even if the accounting firm does not audit those entities. We agree that investors in a fund typically do not possess the ability to influence the policies or management of another fund in the same fund complex. Therefore, we believe it is reasonable to modify the scope of the Loan Provision to exclude other funds that would be considered affiliates of the fund audit client.

Additionally, we believe this concept should be expanded to apply not only to other funds in the same ICC, but also to other affiliates of the entity under audit, because the same analysis and rationale noted by the Commission applies to such other affiliates of the audit client. Therefore, we believe the Loan Provision should apply only to the entity under audit and not to the affiliates of the entity under audit.

In the investment company context, we do not believe a beneficial owner of an affiliate would have the ability to influence the policies or management of the audit client, and thus, the accounting firm's objectivity and impartiality would not be impaired. For example, a beneficial owner of a commonly controlled broker-dealer in the same ICC as a fund entity under audit usually would neither have significant influence nor would it possess the ability to influence the policies and management of the fund entity under audit. Furthermore, if an accounting firm audits a private fund, and that fund controls a private portfolio company that has other beneficial owners, there is only a remote likelihood that such other beneficial owners of that portfolio company would be in a position to exercise significant influence and possess the ability to influence the policies and management of the private fund that is the audit client.

We also do not believe that in an operating company context, a beneficial owner with significant influence over a downstream affiliate would necessarily have the ability to influence the operating company that is the entity under audit, and therefore, the accounting firm's objectivity and impartiality would not be compromised. For example, we do not believe that a beneficial owner of an immaterial subsidiary of the operating company could have a special and influential role at the operating company that is the audit client.

OTHER POTENTIAL CHANGES TO THE LOAN PROVISION OR RULE 2-01 OF REGULATION S-X

Materiality Threshold

Although the proposal does not include a materiality concept, we recommend the Commission consider adding a materiality threshold as one of the factors to be considered in determining whether lending relationship with a beneficial owner that has significant influence over an audit client would impair the accounting firm's independence. We believe that if the accounting firm and audit client determine that a beneficial owner of the audit client's equity securities has significant influence over the audit client, it would also be appropriate to evaluate whether the accounting firm's lending relationship with the beneficial owner is material to the accounting firm.

Covered Person and Immediate Family Members

While the current Loan Provision also applies to a covered person (or his or her immediate family member) who has a borrowing relationship with a beneficial owner of an audit client, we believe that the existence of certain types of covered persons who have a borrowing relationship with the audit client's beneficial owner would not impact the accounting firm's impartiality and objectivity. Specifically, we recommend the Commission amend the covered person definition to exclude from the scope of the Loan Provision partners and principals who are located in an office of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit, where such persons are not on the audit engagement team or in the chain of command.

We also recommend the Commission consider adding to the existing list of immaterial and/or collateralized lending relationships that should be excluded from the scope of the Loan Provision. *See, e.g.,* Rule 2-01(c)(1)(ii)(A)(1)-(4). Specifically, we recommend excluding all loans that are obtained under normal lending procedures, terms, and requirements, where such loans are collateralized by property or securities (e.g., mortgages on investment properties, margin loans collateralized by the securities in the brokerage account), or are clearly inconsequential, such as mobile phone financing arrangements. These types of loans are similar to other loans already excluded from the scope of the Loan Provision (e.g., a mortgage loan collateralized by a primary residence, an automobile loan).

We also encourage the Commission to consider excluding partner capital loans with a beneficial owner of an audit client from the scope of the Loan Provision. Partner capital loans are typically negotiated at a program level by the accounting firm and various lenders to the accounting firm. The partner is not involved in negotiating the terms and conditions of these lending arrangements. The accounting firm will generally indicate which lending institution is available to a partner to provide financing of his or her partnership capital. The lack of involvement by the partner in negotiating the contractual terms of the partner capital loan would lead a reasonable person to conclude that there is a remote likelihood of a threat to the accounting firm's objectivity and impartiality.

Evaluation of Compliance

We believe it is appropriate for the accounting firm to use professional judgment to evaluate and determine the frequency, timing, and extent of any ongoing monitoring that is needed to maintain compliance with the Loan Provision. We do not believe the Loan Provision should be amended to include a prescriptive method for determining the frequency, timing, and extent of any such monitoring because the facts and circumstances for each audit client and its beneficial owners may be different. A reasonable approach could be one that includes a re-evaluation of the portfolio management process and any publicly available information during the fiscal year-end audit, unless the audit client or accounting firm becomes aware of a material change in the investment adviser's or general partner's portfolio management process or other information comes to the attention of the accounting firm or audit client that may impact the analysis.

Additionally, we recommend the Commission consider adding a reasonable transition period to the Loan Provision to address situations in which the accounting firm becomes aware of a beneficial owner that has significant influence over an audit client and that is also a lender to the accounting firm or a covered person. The accounting firm does not have visibility into when a lender to the accounting firm or covered person decides to invest in an audit client to such a degree that it may have significant influence over the audit client. As a result, the accounting firm or covered person may not be in a position to prevent an independence matter from occurring. Accordingly, we believe that a reasonable transition period will allow the accounting firm to promptly address the independence matter.

Secondary Market Purchase of Debt

We recommend that purchasers who acquire an accounting firm's private placement notes on the secondary market, thereby becoming lenders to the accounting firm, should be excluded from the scope of the Loan Provision. In such circumstances, the accounting firm would not typically be involved in negotiating the terms and conditions of the subsequent sale on the secondary market, and therefore, the accounting firm's objectivity and impartiality is unlikely to be impacted.

Other Suggested Changes to the Commission's Auditor Independence Rules

We would again like to thank the Commission for the opportunity to comment on other aspects of the Commission's auditor independence rules. We have carefully considered the Commission's analysis and rationale behind the proposed changes included within the proposal on the Loan Provision, and believe a similar rationale could be applied elsewhere. We believe there are other areas within the auditor independence rules that either have unintended consequences, or as a result of changing market conditions, involve significant practical challenges, and yet do not present any actual or perceived threat to maintaining objectivity and impartiality in the performance of an audit. In addition, auditors and audit committees may feel obligated to devote substantial resources to evaluating potential issues with certain aspects of the existing rules, which could distract auditors' and audit committees' attention from matters that may be more likely to bear on the auditor's objectivity and impartiality. We reiterate our firm commitment to auditor independence as essential to the public's trust in financial reporting, and suggest that the following areas be considered in the spirit of strengthening and modernizing the application of the existing general standard of auditor independence embodied in Rule 2-01(b).

Affiliate of the Audit Client Definition

As noted above and in the proposal, the definition of "affiliate of the audit client" includes entities that control, are controlled by, or are under common control with the audit client as well as entities in the same ICC as the audit client even when the accounting firm does not audit those entities.

While the current "affiliate of the audit client" definition generally functions well in traditional corporate structures, that definition does not appear to have been designed to address the intricate, interrelated, and fast-changing nature of certain other entity structures and relationships in today's global business environment, particularly the rapid movement of capital within the private equity industry. We believe the focus of the independence rules should be on the entity being audited. The requirement for the accounting firm also to be independent of affiliates of the audit client, as defined, sweeps too broadly, and, in certain respects, creates impractical and unintended results. The "affiliate of the audit client" definition can artificially limit the extent to which entities that are only indirectly or tangentially related to the entity being audited may enter into relationships with an accounting firm, even where there is no reasonable likelihood that such relationships could impact the audit client, its financial statements, or the objectivity and impartiality of the accounting firm. This leads to practical challenges for issuers and accounting firms, including with respect to obtaining data for evaluating affiliate status on a real-time basis.

As the Commission identified in the proposal, an overly broad definition of "audit client" can give rise to results that are out of step with the purpose and intent of the auditor independence rules. We encourage the Commission to revisit the scope of the current definition of affiliate of the audit client in the context of the complex structures that exist in today's business environment, bearing in mind the challenges that certain aspects of the definition present to registrants and accounting firms. With respect to private equity complexes and other pooled investment vehicles, the current affiliate definition connects relationships between the accounting firm and all of the other controlled portfolio investments without regard to whether any other controlled portfolio company is subject to audit by that firm, or whether there are potential, actual, or perceived threats to that firm's objectivity and impartiality in performing the audit. Within the proposal, the Commission has appropriately recognized that there are certain fact patterns where an accounting firm's objectivity and impartiality is not impaired.

A re-evaluation of the affiliate definition also warrants consideration because that definition raises issues similar to those identified by the Commission in its analysis of the lack of influence by investors in funds within an ICC that an accounting firm does not audit. In this regard, we agree with the Commission's position that independence issues under the existing rules that do not implicate an accounting firm's objectivity and impartiality in fact or appearance could desensitize market participants to other independence concerns. For these reasons, we encourage the Commission to reconsider the scope and application of the "affiliate of the audit client" definition.

Business Relationships

Similar to the Loan Provision, we believe that the Commission's current auditor independence rule governing business relationships (Rule 2-01(c)(3) of Regulation S-X) may not be functioning as originally intended under current market conditions. The existing rule provides that an accounting firm is not independent if the accounting firm has a business relationship with an audit client, or with persons associated with the audit client in a decision-making capacity, such as an audit client's officers, directors, or substantial stockholders. We believe the concept of substantial shareholders in a decision-making capacity is analogous to the concept of a beneficial owner that has significant influence over an audit client. In our view, the Commission has put forth a sound, reasoned position for the use of "significant influence" as the standard for evaluating a beneficial owner's ability to have a "special and influential role" over an audit client; we believe the same standard should be used within the business relationship rule to identify substantial stockholders in a decision-making capacity. The significant influence standard outlined in the Loan Provision proposal appears to be similar in concept to the substantial stockholder in a decision-making capacity principle outlined in the business relationship rule.

The nature of activities that might be considered under the current rule to be impermissible business relationships also should be reassessed in light of current developments in the use of technology, shared intellectual property, and multiparty arrangements. It is increasingly common for organizations to form multiparty "ecosystems" or consortia, combining a multitude of capabilities possessed by different companies in order to compete in a rapidly innovating, technology-driven economy. These arrangements may take a variety of different forms. Given the rapidly expanding evolution of these types of arrangements, we encourage the Commission to consider interpretive guidance on considerations that should be evaluated to determine whether the accounting firm's independence is actually impacted in fact or appearance in these types of situations.

Transition Period and Safe Harbor Provisions

In certain circumstances, because of a corporate action outside the control of the accounting firm, the immediate application of an auditor independence requirement can unexpectedly be triggered. Broadly, we believe the Commission should consider adopting transition periods for marketplace events that have a potential impact on the independence of an accounting firm, such as the transition measures that are included in the International Ethics Standards Board for Accountants' auditor independence standards. Corporate events, such as mergers, acquisitions, and dispositions, regularly occur outside the accounting firm's control and yet the rules do not provide practical approaches for resolving the independence issues that arise from these corporate events. These sudden auditor independence issues can have an adverse impact on the ability to perform the audit or cause substantial cost and disruption to the parties to the transaction. The result is that accounting firms and audit clients may be required to resolve the issue by halting audit work midstream until such time as the nonaudit service or business relationship at issue can be terminated or modified or delaying the transaction. This is applied universally, even in situations where it is unlikely that an investor, apprised of all relevant facts and circumstances, would believe that the independence of the accounting firm would be impaired if the relationship were permitted to continue for some appropriate transition period. The adoption of a transition period to address corporate events during the audit and professional engagement period would allow accounting firms to transition out of the relationship in an orderly manner.

We also encourage the Commission to provide guidance for resolving independence issues that may arise when a private company decides to access the public markets through an initial public offering. The accounting firm is required to be independent under the Commission's independence rules for all financial statement periods included in the registration statement. Given the number of fiscal periods required to be included in registration statements, it is not always the case that private companies will have planned sufficiently in advance such that the auditor is independent for all prior years under SEC independence requirements. If these anticipatory steps have not been taken, it can pose an obstacle for a company's ability to access the capital markets if the accounting firm has not maintained this level of independence and a new auditor must, therefore, be identified. The adoption of a transition period that permits the inclusion of audited financial statements in a registration statement where the accounting firm was independent under the professional standards applicable at the time the audit was performed would allow additional flexibility for private companies in accessing capital markets.

A similar issue arises with respect to the application of the independence rules to the audit and professional engagement period. We believe it is appropriate to have restrictions during the audit period that prevent the accounting firm from being in a position to audit its own work; it also is appropriate that financial, employment, and other relationships, including services that would involve management functions, advocacy, or a conflict or mutuality of interest with the audit client, should not be permitted during the professional engagement period. In considering a change in auditors, however, the operation of the current rules requires that any relationships between the proposed auditor and the client extending into the first audit period must be permissible under the Commission's independence rules, even if they are resolved prior to appointment and the commencement of the professional engagement period. In these circumstances, we believe that independence restrictions prior to the appointment of the auditor during the first audit period should be focused on prohibiting the auditor from auditing its own work, and beyond this, the accounting firm and potential client should be able to make a reasonable assessment of whether any other pre-existing services or relationships impact on the accounting firm's impartiality and objectivity.

The Commission's current auditor independence rules provide a "safe harbor" in Rule 2-01(d), which recognizes that in certain situations involving financial interests an individual may inadvertently and unknowingly impair his or her independence. Under the safe harbor provision, when an accounting firm has in place a system of quality control to prevent and identify potential noncompliance with the rule and violations are resolved in a timely manner, the accounting firm's independence is not considered to be impaired. We believe the addition of a similar safe harbor applicable to activities prohibited in Rule 2-01(c)(3) and Rule 2-01(c)(4) would be consistent with the Commission's desire to identify those relationships that truly could impair the accounting firm's objectivity and impartiality.

Any transition or safe harbor relief in such circumstances should be based on a careful assessment of the impact on the accounting firm's impartiality and objectivity in the circumstances, a plan to resolve the matter in a timely fashion, the use of appropriate safeguards in the intervening period, and should be subject to review by the audit committee.

We encourage the Commission to consider these matters in its continued evaluation of the practical challenges of the independence rules.

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We appreciate the opportunity to provide our perspectives on the current proposal. If you have any questions or would like to discuss our views further, please contact Mr. Paul J. Reszutek, Director of Independence, at [redacted].

Sincerely,

Deloitte LLP

Deloitte LLP

cc: Jay Clayton, Chair
Robert Jackson Jr., Commissioner
Hester Peirce, Commissioner
Michael Piwowar, Commissioner
Kara Stein, Commissioner
Wesley Bricker, Chief Accountant