CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

**Re: Modernization of Regulation S-K Items 101, 103 and 105**
**17 CFR Parts 229, 239 and 240;**
**Release Nos 33-10668, 34-86614; RIN 3235-AL78**
**File No. S7-11-19**

Dear Secretary Countryman:

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness ("CCMC") appreciates the opportunity to comment on the proposed rules issued by the Securities and Exchange Commission (the "SEC" or "Commission") on August 8, 2019, entitled "Modernization of Regulation S-K Items 101, 103 and 105" (the "Proposing Release").

The Proposing Release is the latest effort in a much broader effort undertaken by the Commission over the past several years to modernize the public company disclosure regime. As we have repeatedly noted, the public company business model has become far less popular than in the past, which is reflected in the declining number of public companies overall—in the past twenty years, the number of US public companies has been cut in half. Fewer public companies means fewer investment opportunities for Main Street investors. The Chamber once again commends the Commission for its ongoing commitment to review existing regulations that affect this serious issue.

As the Commission is well aware, the guiding concept of "materiality," as laid out by the Supreme Court in seminal cases such as *TSC Industries v. Northway*[1] and *Basic*

[1] 426 U.S. 438 (1976).

*Inc. v. Levinson*,[2] has played the central role in our American capital markets for decades and has contributed to the formation of the deepest, most diverse, most liquid markets the world has ever known. Materiality has long been the dividing line for determining what should be disclosed and what should not have to be disclosed under the federal securities laws. Therefore, considering materiality through the eyes of a "reasonable investor" is a critical feature of the Supreme Court's test. Materiality does not turn on the needs of an investor that is not representative of investors more broadly or that is looking to advance some special interest.[3]

The CCMC has repeatedly expressed its concern that, in recent years, there has been a concerted effort to erode this longstanding approach to materiality. This new development has complicated and confused what materiality means and would further overload investors with information that few find to be useful when evaluating a company's financial and operational performance. Some special interests are advancing conceptions of materiality that would abandon altogether the traditional notion of materiality rooted in the Supreme Court's jurisprudence. These interest groups want to expand what businesses are mandated to disclose in order to advance the groups' own political and social agendas and to further goals that are extraneous and contrary to the SEC's mission.[4]

For the most part, the Proposing Release favors a principles-based approach to disclosure over a prescriptive one. We support the Commission's decision to follow this approach, and concur that prescriptive disclosure requirements can easily become outdated. Principles-based disclosure also assures the delivery of material information

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[2] 485 U.S. 224 (1988).

[3] This approach to materiality mitigates the risk that SEC disclosure documents will become too dense and impenetrable for investors by seeking to be all things to all people. It also helps ensure that the SEC, in fashioning and enforcing the disclosure regime under the federal securities laws, focuses on what is best for investors overall and adheres to the agency's mission as the country's capital markets regulator.

[4] We discuss materiality further in our white paper, ESSENTIAL INFORMATION: MODERNIZING OUR CORPORATE DISCLOSURE SYSTEM (Winter 2017), *available at* https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/U.S.-Chamber-Essential-Information_Materiality-Report-W_FINAL-1.pdf.

to investors. This approach is also endorsed in our previous comment letters on matters that are the subject of the Proposing Release.[5]

As a brief summary of our comments:

- We support the proposed amendments to Item 101(a) of Regulation S-K in respect of the General Development of Business.
- We also support the proposed amendments to Item 101(c) regarding the Narrative Description of Business, but urge the Commission to proceed carefully with the proposed Human Capital Resources disclosure.
- We support many of the changes to the Item 103 Legal Proceedings disclosure, but urge the Commission to scrap the presumptive materiality threshold of $300,000 for certain environmental proceedings, as such a threshold would otherwise require disclosure for many companies that is otherwise quantitatively and qualitatively immaterial.
- Finally, we generally support the proposed revisions regarding Item 105 Risk Factors disclosure, though we request that the Commission retain the "most significant" risks trigger for disclosure.

## Discussion

### I. General Development of Business (Item 101(a))

We support the proposed amendments to Item 101(a) of Regulation S-K. Notably, these amendments would eliminate a prescribed five- or three-year timeline, update the non-exclusive list of disclosure topics, and allow current period updates with cross-references to disclosures in past filings. These strike us as sensible, principles-based revisions designed to deliver material information to investors.

[5] Our letter dated July 20, 2016 is available at https://www.sec.gov/comments/s7-06-16/s70616-173.pdf, and our letter dated October 27, 2016 is available at https://www.sec.gov/comments/s7-15-16/s71516-33.pdf.

## II. Narrative Description of Business (Item 101(c))

We are generally supportive of proposed Item 101(c)'s revised disclosure topics, which seem more tailored for today's service-based economy. In particular, we support the Proposing Release's contemplated expansion of narrative regulatory disclosure under Item 101 to include the material effects of compliance with government regulations. The requirements for this disclosure in the past focused solely on environmental issues, which are immaterial for many businesses, yet did not mandate the disclosure of other material regulatory regimes.

Nevertheless, issues around executive compensation have, unfortunately, become hyper-politicized in recent years, and the CCMC is wary of creating a new disclosure regime on this front. The ill-conceived pay-ratio disclosure—itself the product of a supercharged political process—has resulted in a mandatory disclosure that is wholly immaterial to investors, and is a testament to the dangers of creating compensation disclosures that serve the interests of those other than Main Street investors. Executive compensation has also become a popular subject for shareholder proposals under Rule 14a-8, and public companies must regularly consider such proposals that seek to micromanage those companies' businesses. Various special interest groups also favor expanded compensation disclosure, not because of the informational benefits it brings to them as investors, but rather to gain leverage against corporate managers and to sow disharmony in the workplace.

With these deep reservations in mind, however, the CCMC concedes that certain matters concerning human capital resources may be material to investors in certain circumstances. Accordingly, we are cautiously supportive of the Commission's proposal to require a principles-based disclosure regime around these matters. In doing so, we believe it is critical that such disclosures remain limited, as described in the Proposing Release, "to the extent material to an understanding of the registrant's business taken as a whole." In keeping this disclosure principles based, we do not see a need for the Commission to provide examples of the types of measures or objectives that management should focus on its disclosure.

Additionally, we do not believe that the Commission should retain the requirement to disclose a particular number of employees for a registrant. With the rise of employee outsourcing and leasing arrangements; greater use of outside consultants, seasonal workers and independent contractors; and the emergence of the

"gig" economy, providing the number of pure employees as of a date certain no longer reflects a meaningful statistic for many companies. In light of those developments, adjusting the disclosure to require a range or bucketing employees into arbitrary groups would not seem to provide material information to investors either, and we do not support such a requirement.

## III. Legal Proceedings (Item 103)

The Proposing Release contemplates the amendment of Item 103 to permit explicitly the use of hyperlinks and cross-references to disclosures located elsewhere in a periodic report. Many issuers already make use of these disclosure techniques, and we support the proposed amendments. Still others prepare a unified liability disclosure for purposes of the financial statement footnotes and repeat some version of this disclosure elsewhere in the periodic report to satisfy Item 103. Thus, the proposed amendments may have the added benefit of eliminating this kind of duplicative disclosure.

We question the Commission's desire to retain a presumptive materiality threshold (proposed to be increased to $300,000) in the context of environmental proceedings. Such a position seems to run counter to the principles-based disclosure philosophy that predominates all other elements of the Proposing Release, and would continue to lead to the disclosure of immaterial information.

The Proposing Release half-heartedly justifies the disclosure on the grounds that it could promote comparability. But there is no comparability between a manufacturing firm with $10 billion in revenue that discloses a $300,000 fine from an environmental regulator for conduct involving no discharge into the environment (a quantitatively and qualitatively immaterial event for such a company) and a logistics firm with $100 million in revenue that makes the same disclosure relating to an event endangering human health (which would likely be material for this much smaller company). Indeed, the Commission's original selection of a $100,000 threshold for disclosure in the 1970s was entirely arbitrary, and we see no benefit to investors in

retaining any disclosure premised on an arbitrary threshold. Accordingly, we would delete proposed Section (c)(3)(iii) of Item 103.[6]

Instead, the Commission should only require disclosure for government regulatory proceedings (environmental or otherwise) when material to an investor's understanding of the business taken as a whole. To this end, as noted above, we support the Proposing Release's contemplated expansion of narrative regulatory disclosure under Item 101 to include the material effects of compliance with government regulations on capital expenditures, earnings and competitive position. Such a step is consistent with market practice at many companies and would provide material disclosure to investors.

## IV. Risk Factors (Item 105)

We share the Commission's concern over the proliferation of risk disclosure that has grown generic and verbose. We believe that a number of the Commission's proposals to improve risk factor disclosure are sensible and appropriate. Thus, we support a summary risk factor section for disclosure over 15 pages and the reordering or risk factors under relevant headings.

The CCMC does not support, however, the proposed change in the disclosure threshold for risk factors from "most significant" to "material". In doing so, we concede that this position may at first blush seem inconsistent with our broader theme of ensuring that disclosure in Commission filings remains dedicated to material matters. But, the reality is that issuers are routinely sued over immaterial misstatements and omissions. Therefore, for any number of reasons, companies may tailor their prophylactic risk factors to address a universe of perceived risks that go beyond the ones most material to the business.

We are concerned that a migration from a "most significant" standard could create a presumption of materiality in the risk factor section, i.e., that any risk disclosed is presumptively a material one to the business. To mitigate this outcome,

[6] The CCMC is aware of the unusual circumstances involving the SEC in the 1970s that first led to the development of the environmental liability disclosure, but the passage of time and overall evolution of the Commission's disclosure regime should provide the Commission with the flexibility to depart from decisions about disclosure it made four decades ago.

some companies may choose to disclose fewer risks to investors, which would not be beneficial to investors overall. A change in the status quo could also encourage still more frivolous securities litigation. Accordingly, we urge the Commission to retain the requirement to disclose the "most significant" risks.

**Conclusion**

We again commend the Commission for its ongoing efforts to modernize the public company disclosure regime. We appreciate your consideration of these comments, and the CCMC is available to discuss them further with the Commissioners or Staff at your convenience.

Sincerely,

Tom Quaadman

cc: The Honorable Jay Clayton
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee