American Federation of Labor and Congress of Industrial Organizations
815 16th St., NW
Washington, DC 20006
202-637-5000
aflcio.org

AFL-CIO
AMERICA'S UNIONS

October 22, 2019

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Modernization of Regulation S-K items 101, 103, and 105 [File No. S7-11-19]

Dear Ms. Countryman:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I am writing to provide comments on the Securities and Exchange Commission's proposed amendments to Regulation S-K items 101, 103, and 105. The AFL-CIO is a voluntary federation of 55 national and international labor unions that represent 12.5 million working people. Union members participate in the capital markets as individual investors as well as participants in pension and retirement savings plans. In our view, the Commission should maintain and preserve its longstanding use of rules-based Regulation S-K disclosure requirements as a complement to principles-based disclosure.

A hybrid system of rules-based and principles-based disclosure requirements has long been a source of strength for the U.S. capital markets. Principles-based disclosure gives broad flexibility to corporate management to decide what needs to be disclosed. However, corporate management may misjudge what information should be disclosed or even intentionally withhold information that is unfavorable to management. In contrast, a rules-based approach to disclosure provides investors with uniform and consistent presentation of information by all companies. For this reason, the Commission has historically required bright-line Regulation S-K disclosure rules as a complement to principles-based disclosure to help investors compare companies when making investment and proxy voting decisions.

We are concerned that modifying the Commission's Regulation S-K rules to only require disclosure of information that companies deem to be "material" to investors will effectively eliminate the Commission's rules-based disclosure requirements. If adopted, the proposed rulemaking will require the disclosure of information that meets the U.S. Supreme Court's legal definition of materiality to investors that was first stated in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976):

"Information is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision" (Note 14). This legal definition of materiality defines the minimum required disclosure to avoid false and misleading proxy solicitations under Rule 14a-9, and defines materiality for securities fraud cases under Rule 10b-5 as stated in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). The *TSC Industries, Inc. v. Northway, Inc.* legal definition of materiality does not define the optimal level of disclosure that would benefit investors after taking into account the costs of disclosure to companies.

Using the *TSC Industries, Inc. v. Northway, Inc.* legal definition of materiality as the standard for Regulation S-K disclosure requirements undermines the entire purpose of having bright-line rules. In theory, public companies are already required to disclose all material information to avoid Rule 14a-9 and Rule 10b-5 liability. Why have any Regulation S-K rules at all if these rules are going to be defined by the minimum legally required standard for disclosure? Instead, the Commission should determine which disclosure rules are likely to benefit investors more than the cost of compliance by companies. The economically optimal level of disclosure is far higher than the minimum level of disclosure that is required under *TSC Industries, Inc. v. Northway, Inc*.

The informational needs of investors have changed significantly since the U.S. Supreme Court first adopted the *TSC Industries, Inc. v. Northway, Inc.* definition of materiality in 1976. The idea that too much disclosure by companies can overwhelm investors by providing irrelevant information is an outdated concept based on a bygone era when investors received paper copies of annual reports by mail. Today, thanks to the Internet availability of SEC filings and advances in computer technology, investors can quickly and effortlessly search for the specific information that is most relevant to their investment decision-making. For this reason, the Commission should not use a four-decade-old definition of materiality to guide today's disclosure requirements.

For these reasons, we oppose revising Regulation S-K Item 101(a) to permit principles-based disclosure of company's development of the business. We question the Commission's assertion that investors are burdened by inclusion of company business strategies in annual reports on Form 10-K even if this information is repetitive from year-to-year. Moreover, we believe that annual disclosure of a company's business strategy should be a required disclosure rule for all companies. Most companies already provide this disclosure on an annual basis, and we are concerned that limiting disclosure to only "material" changes in business strategy from year-to-year will reduce the amount of business strategy information that companies disclose to their investors.

The Commission's proposed changes to Regulation S-K Item 101(c) also illustrate the downsides of principles-based disclosure. For example, the Commission proposes to replace the current rule that companies disclose the number of employees with a principles-based description of companies' "human capital resources." The Commission asserts that "Item 101(c)(1)(xiii) dates back to a time when companies relied significantly on plant, property , and equipment to drive value." It is certainly true that today, the contributions of employees create more value than ever before in our knowledge-based economy. However, for this reason the number of employees is more material than ever and should be retained as a required disclosure rule.

While we welcome the Commission's recognition that improved human capital disclosure is needed, we believe that Regulation S-K Item 101(c)(1)(xiii) should be strengthened with additional quantitative, bright-line disclosure rules. For example, companies should be required to disclose quantitative data on the geographic locations of employees, the percentage of full-time vs. part-time employees, the use of temporary employees and independent contractors, employee average tenure and turnover rates, unionization rates, and employee diversity information. We note that many companies voluntarily disclose aspects of this data in supplemental sustainability reports or in a narrative discussion to provide context for their Item 402 pay ratio disclosures. Uniform rules-based disclosure will greatly aid investors in comparing and analyzing companies.

We also believe the Commission should require improved disclosure of legal proceedings under Regulation S-K Item 103. Legal proceedings are of great interest to investors because they can significantly impact a company's business model in ways that go far beyond the materiality of any monetary liabilities. To help remedy this information deficiency, we support the greater use of bright-line disclosure rules such as those required by Item 103 for environmental matters. Rather than require hyperlinks to disclosure that the company has provide elsewhere, the Commission should require companies to provide hyperlinks to the dockets of the actual legal proceedings or at least require disclosure of the venues, parties, and dates that litigation commenced.

In our view, the Commission should retain its existing requirement that companies disclose their "most significant" risk factors under Regulation S-K Item 105. Replacing the "most significant" standard for risk disclosure with "material" risks will reduce the amount of risk factor information that companies will disclose to investors. While the amount of risk factor disclosure has increased in recent years, investors are readily able to digest this information. The Commission's proposal to require a summary of risk factors for discussion that exceeds 15 pages and the proposal to require an organization of risk factors under relevant headings adequately addresses the increase in risk factor disclosure without needing to adopt a "material" disclosure standard.

Finally, the Regulation S-K rules should be expanded to require disclosure of topics that investors have long sought on environmental, social, and governance issues. As noted by the SEC Investor Advisory Committee in its comment letter to the Commission on disclosure effectiveness:

> *It is clear that a significant, and growing number, of investors utilize sustainability and other public policy disclosures to better understand a company's long-term risk profile. The Committee believes that environmental, social and governance issues should be subject to the same materiality standards as other sources of risk and return under the Commission's rules. Like other sources of business risk and return, environmental, social and governance issues can be material based on a quantitative measure such as the expenditures required or the effect on earnings. Such issues can be material when considered in the context of qualitative factors such as the effect on a company's reputation or the impact on the purchasing decisions of the issuer' customers. Likewise these matters can impact voting decisions by shareholders.* [1]

[1] Letter from the SEC Investor Advisory Committee to the Division of Corporation Finance, U.S. Securities and Exchange Commission, 7-8 (June 15, 2016) (citations omitted), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-approved-letter-reg-sk-comment-letter-062016.pdf.

In conclusion, we respectfully urge the Commission to withdraw and reconsider its proposed rulemaking on Regulation S-K items 101, 103, and 105. Rather than eliminate rules-based Regulation S-K disclosure requirements, Commission should instead maintain and strengthen its longstanding hybrid approach of combining bright-line rules and principles-based disclosure. Thank you for taking the AFL-CIO's views into consideration regarding this matter. If the AFL-CIO can be of further assistance, please contact me at [redacted] or [redacted].

Sincerely,

Brandon J. Rees
Deputy Director, Corporations and Capital Markets