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November 2, 2016

Re: **Disclosure Update and Simplification**
Release No. 33-10110; 34-78310; IC-32175
File No. S7-15-16

VIA E-MAIL: rule-comments@sec.gov

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Mr. Fields:

We are submitting this letter in response to the request by the Securities and Exchange Commission for comment on the proposed amendments to certain Commission disclosure requirements that may have become duplicative, overlapping, obsolete or superseded, as detailed in the above-referenced release (the "**Release**"). We appreciate the opportunity to comment on the Release.

Overview

We support the Commission's broad-based review of public-company disclosure requirements under the Disclosure Effectiveness Initiative of which the Release is a part. In our July 22, 2016 comment letter[1] regarding the Business and Financial Disclosure Required by Regulation S-K (Release No. 33-10064; 34-77599; File No. S7-06-16) we made recommendations relating to general principles in respect of the overall disclosure framework in the context of improvements to Regulation S-K. Those general principles also apply here and inform our recommendations in this letter.

As an overall matter, we endorse the Commission's endeavors in the Release to remove duplicative disclosure requirements in Commission rules and are supportive of most of the proposals except as noted below. In this letter, we offer some general observations regarding the proposed amendments where incremental requirements of Commission rules are proposed to be

[1] Available at https://www.sec.gov/comments/s7-06-16/s70616-313.pdf

deleted or referred to the Financial Accounting Standards Board ("**FASB**"). We share our specific concerns about proposed FASB referrals with respect to legal proceedings.

Taking a Materiality-Centered, Principles-Based Approach to Amendments

The Release states that the proposed amendments intend to accomplish three related objectives: (i) facilitating information disclosure to investors, (ii) simplifying compliance efforts and (iii) preserving the total mix of information provided to investors without significant alterations.

As an overall matter, eliminating redundant, duplicative, overlapping, outdated or superseded disclosure requirements is welcome and noncontroversial. Redundant requirements result in repetitive and boilerplate disclosure of little use to investors.

The Release identifies overlapping requirements where Commission rules call for items that are related to, but not the same as, U.S. generally accepted accounting principles ("**GAAP**"), International Financial Reporting Standards or other disclosure requirements. In cases where the Commission believes that the overlapping requirements are "reasonably similar" or are incremental but may no longer be useful to investors, the Release seeks comments on whether to delete or integrate the overlapping requirements.[2] For certain other overlapping requirements, the Release asks whether Commission rules should be retained, modified or referred to FASB for potential incorporation into U.S. GAAP.[3]

As we discussed in our July 22, 2016 comment letter, we believe that disclosure requirements should embody a materiality-centered, principles-based disclosure framework. To support such an approach, we recommend that two core principles inform and guide proposed changes to disclosure requirements:

- disclosure requirements should be designed to solicit material information needed by reasonable investors to make informed investment and voting decisions; and

- the benefits of disclosure requirements should outweigh the associated costs to registrants.

We believe that taking this approach will encourage disclosure that is relevant and useful for a reasonable investor to make informed investment and voting decisions and avoids boilerplate and repetition by allowing a registrant flexibility in crafting disclosure that is not one-size-fits all.

A Materiality-Centered, Principles-Based Disclosure Framework Requires Understanding the Objectives of the Disclosure

Financial statements are a distinct component of the Commission's integrated disclosure framework. FASB has been designated by the Commission as the private-sector accounting standard setter for U.S. reporting purposes. FASB has stated that the purpose of financial reporting is to provide financial information that is useful to existing and potential investors,

[2] Release at 29.

[3] *Id.*

lenders and other creditors in making decisions about providing resources to the entity.[4] The notes to the financial statements supplement or further explain the information on the face of the financial statements.[5] The primary users of financial statements are a wider group than reasonable investors and individuals within this group of primary users have different, and according to FASB, "possibly conflicting information needs and desires."[6]

Financial statements are only one component of the Commission's integrated disclosure system. Other principal disclosure components include narrative information with respect to a registrant's business, risk factors, and a management's discussion and analysis of financial condition and results of operations ("**MD&A**"). Each disclosure component serves distinct but related purposes. Disclosure about a registrant's business seeks to lay the groundwork for understanding and assessing the registrant. The MD&A provides a narrative explanation of the registrant's financial statements that is designed to enable investors to see the registrant through the eyes of management, provides context for analysis of the registrant's financial information and provides information about the quality of, and potential variability of, the registrant's earnings and cash flows. Risk factor disclosure aims to provide investors with specific and meaningful information about material risks faced by the registrant.

As a result of these separate disclosure requirements, related topical information may appear in several locations in an SEC disclosure document. However, we do not believe that compliance with these requirements means that a registrant must repeat the same information verbatim in each location where a topic is discussed. To enable a registrant to avoid excessive repetition while fulfilling disclosure obligations, we recommend that the Commission continue to encourage registrants to use cross-references and hyperlinks in their disclosure documents, and we would welcome an explicit statement by the Commission to the effect that cross-referencing and hyperlinking to relevant information satisfies line-item disclosure requirements calling for such information. The use of cross-references and hyperlinks to improve disclosure is an integral part of the recently adopted rules that allow registrants to include a Form 10-K summary section, and undergirds proposed amendments to include hyperlinks in exhibit tables in a registrant's SEC reports and registration statements.

Further, as part of the Disclosure Effectiveness Initiative, including with respect to proposals in the Release, we encourage the Commission to provide disclosure objectives in the case of disclosure requirements where no explicit objective has been articulated. We believe a clear understanding of why disclosure is required will help registrants and their advisers prepare more pointed and useful disclosure.

Disclosure Location Considerations – Prominence

The Release asks for comment on disclosure prominence, i.e., the relative location of specific information and the context of that information in an SEC filing. As a general matter, we do not believe that a reasonable investor would attribute much significance to where in an SEC filing a

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[4] Fin. Acct. Standards Board, *Conceptual Framework for Financial Reporting – Chapter 1, The Objective of General Purpose Financial Reporting*, September 2010 Statement of Financial Accounting Concepts No. 8 ¶ OB2 [hereinafter FASB *Conceptual Framework*].

[5] Fin. Acct. Standards Board, *Conceptual Framework for Financial Reporting – Chapter 8: Notes to Financial Statements,* Proposed Statement of Financial Accounting Concepts ¶ S2 (Mar. 4, 2014) [hereinafter FASB *Proposed Conceptual Framework Notes to Financial Statements*].

[6] FASB *Conceptual Framework at* ¶ OB8.

disclosure appears – whether it be at the beginning or the end. In our own experience reviewing lengthy SEC filings, we seldom start on page 1 and read straight through to the final page. What is important to us is understanding where in the filing information that we are interested in will be presented (whether physically or via a cross-reference). Once there, we believe that a reasonable investor would evaluate the prominence of a disclosure within its specific context, by how it is discussed within a particular section of the SEC filing. A materiality-centered, principles-based disclosure framework would offer a better method to guide prominence: registrants should be encouraged to discuss first the information that they believe is most important, although it must be made clear that a registrant's voluntary ordering of its disclosures in this manner will not create liability when (as is inevitable) information discussed later in the document ends up in hindsight being more significant to an investment than information discussed earlier.

The Release proposes a number of amendments where disclosure would be removed from the business section of a filing because it duplicates information called for by other disclosure requirements, such as U.S. GAAP for financial statements and Items 303 and 503 of Regulation S-K. In cases where there is a duplicative disclosure requirement in the financial statements due to U.S. GAAP, or in Item 303 or Item 503 of Regulation S-K, we agree that the specific requirement can be removed from Item 101 of Regulation S-K. Such proposed amendments to Item 101 of Regulation S-K are consistent with the recommendations in our July 22, 2016 comment letter to streamline the requirements in the disclosure for the description of business by removing the specific disclosure factors in Item 101(c) of Regulation S-K.

Disclosure Location Considerations – Financial Statements

The Release identifies a number of disclosure items in Regulation S-K that are repetitive or substantively similar to U.S. GAAP requirements, and proposes to eliminate such requirements in Regulation S-K, which would result in such disclosure being located only in the financial statements. These disclosures would continue to be subject to annual audit and/or interim review, internal control over financial reporting and XBRL tagging requirements.

We believe that the elimination of duplicative disclosure requirements is appropriate, but because forward-looking statements appearing in U.S. GAAP financial statements are not covered by the safe harbor under the Private Securities Litigation Reform Act of 1995 ("**PSLRA**"), we think registrants should have the flexibility to maintain forward-looking discussions in the body of the narrative disclosure and not in the financial statements, which we believe will encourage more such disclosure. In addition, some forward-looking disclosure that may be meaningful or desirable to investors may not be consistent with the scope of financial statement disclosure. FASB has described the content of financial statements to generally include information about past events and current conditions and circumstances that affect an entity's cash flows.[7] Broader forward-looking disclosure would certainly be welcomed by investors, but for a registrant, the risks of litigation should the forward-looking statements turn out to be inaccurate weigh heavily against providing such disclosure in financial statements. We emphasize, therefore, that registrants should not be compelled to include forward-looking information in the notes to the financial statements. Any new requirements for compulsory forward-looking information should benefit from protections that are consistent with those afforded under the PSLRA and existing law.

[7] FASB *Proposed Conceptual Framework Notes to Financial Statements* at ¶ D32.

Bright-Line Thresholds

We generally support the elimination of bright-line disclosure thresholds in favor of disclosure standards based on materiality. Although a bright-line disclosure threshold may be easier to apply than a disclosure standard based on materiality, where the threshold is set too low, it can result in disclosure that is immaterial to investors and of needless expense to registrants. Excess information serves no investor-protection purpose and should be weighed against the cost of providing the disclosure, which is borne by the registrant and its shareholders. We also note that other commenters have advised that the elimination of bright-line disclosure is consistent with FASB's proposal to eliminate "at a minimum provide" disclosures in the Proposed ASU 2015-310 Notes to Financial Statements (Topic 235).[8]

As the Release notes, while U.S. GAAP and Item 101 of Regulation S-K have some overlapping disclosure requirements concerning major customers, Regulation S-K requires additional disclosure of the name of any customer that represents 10 percent or more of the issuer's revenues and whose loss would have a material adverse effect on the issuer. While we believe that referral of this rule to FASB is appropriate, we believe that principles-based methods should mandate whether a customer need be named. A threshold of 10 percent of revenues may not be material for all registrants (in certain commodity industries, for example).

Referral of Item 103 to FASB

The Release asks for comment about the possible retention, modification or elimination of requirements in Item 103 of Regulation S-K that are incremental to U.S. GAAP or the possible integration of these incremental requirements by referral to FASB.

We believe that ASC 450 contains the appropriate level of requirements for disclosure of material legal proceedings to inform investment and voting decisions of the reasonable investor, and suggest that the Commission consider eliminating Item 103. We do not believe that it is necessary to expand the disclosure in ASC 450. We believe that the disclosure in ASC 450, together with the requirements in Items 303 and 503(c) of Regulation S-K, elicit all material information for reasonable investors regarding legal proceedings. If the Commission decides to retain Item 103, it should be modified to provide a more specific disclosure objective and to eliminate disclosure requirements based on bright-line thresholds, or expressly permit exclusion of such disclosure if not material to a registrant.

The Release highlights differences between Item 103 and ASC 450, noting that in some respects, Item 103 is more expansive. Additional disclosure areas include bankruptcy proceedings, environmental proceedings involving capital expenditures or deferred charges in excess of a 10 percent current consolidated assets threshold and an environmental proceedings $100,000 monetary sanction threshold. Because all material proceedings must be disclosed pursuant to ASC 450, any incremental disclosures beyond what ASC 450 requires are *per se* not material and should be eliminated. Some of these incremental requirements could result in disclosure that is extraneous, rather than material, such as is often the case with environmental

[8] *See* Cynthia M. Fornelli, Center for Audit Quality, Comment Letter on Disclosure Update and Simplification (Oct. 3, 2016), https://www.sec.gov/comments/s7-15-16/s71516-19.pdf; Deloitte & Touche LLP, Comment Letter on Disclosure Update and Simplification (Oct. 5, 2016), https://www.sec.gov/comments/s7-15-16/s71516-23.pdf; KPMG LLP, Comment Letter on Disclosure Update and Simplification (Oct. 19, 2016), https://www.sec.gov/comments/s7-15-16/s71516-26.pdf.

disclosures. Moving the incremental requirements of Item 103 to U.S. GAAP would increase the burden on auditors and issuers and would not provide any additional disclosure of material information.

In addition to the increased burden that would be imposed by importing Item 103 into the financial statements, we note that the disclosure of legal proceedings is an area that registrants approach with heightened sensitivity due to the nature of litigation. Preparing disclosure responsive to both Item 103 and ASC 450 implicates attorney-client and work product privileges and strategic concerns. In particular, responding to auditors' requests in connection with ASC 450 requires care due to the need to preserve attorney-client privilege and work product privileges. This disclosure is given by lawyers under the guidance of the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information. We anticipate that any revision to ASC 450 that would add new or different disclosure obligations would require a review and possible update to the American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information. Likewise, the Public Company Accounting Oversight Board (United States) may need to consider revisions and any impact on auditing standards. These additional considerations weigh against a wholesale referral to FASB of Item 103 as a way to achieve "simplified" disclosure. We also note that the continued review of the Commission Staff of disclosures required by ASC 450 focuses on improving the disclosure of loss contingencies and procedures with respect to the determination of such loss contingencies.[9] We believe that this does not support an expansion of ASC 450 but does warrant continued efforts to help guide registrants in this area.

If the Commission decides to retain Item 103, it should be modified to eliminate disclosure based on bright-line thresholds, or expressly permit exclusion of such disclosure if not material. In this connection, instruction 5 to Item 103 contains specific requirements applicable to disclosure of certain environmental legal proceedings, including a $100,000 threshold for potential monetary sanctions for proceedings involving a governmental authority. This bright-line requirement dates from 1982. Since that time, there has been a marked increase in global regulation of environmental matters and inflation has meant that $100,000 is not material in the case of substantially all SEC registrants. Using this outdated threshold causes registrants to include information in Item 103 that is not material and makes it difficult for an investor to understand what pending legal proceedings are material to the registrant. We advocate that the Commission eliminate these bright-line thresholds.

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[9] *See* Ernst & Young LLP, *2016 trends in SEC comment letters*, Technical Line SEC Comments and Trends No. 2016-22, (Sep. 29, 2016), 7. ("Specifically, the SEC staff focused on disclosures about reasonably possible losses as well as the clarity and timeliness of loss contingency disclosures and accruals when there were no early-warning disclosures.")

We appreciate the opportunity to participate in the process, and would be pleased to discuss our comments or any questions that the Commission or its staff may have, which may be directed to Derek Dostal, Joseph A. Hall, Sophia Hudson, Michael Kaplan, Shane Tintle or Nicole Green of this firm at 212-450-4000.

Very truly yours,

Davis Polk & Wardwell LLP