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

3 December 2018

Re: Request for Comment on Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities (Release No. 33-10526; 34-83701; File No. S7-19-18)

Dear Mr. Fields:

Ernst & Young LLP is pleased to provide comments to the Securities and Exchange Commission (SEC or Commission) on its proposal to simplify and streamline the financial disclosure requirements for registrants that conduct registered debt offerings involving either subsidiaries as issuers or guarantors¹ or pledges of the securities of affiliates as collateral.²

We support the Commission's efforts to enhance the information provided to investors and promote capital formation. We believe the proposed amendments to Rules 3-10 and 3-16 of Regulation S-X would advance these efforts and benefit both investors and registrants, as well as the public capital markets. Investors would receive information critical to making informed decisions in a simpler format. Registrants would benefit from reduced costs and burdens of providing the disclosures, which would encourage more registered debt offerings with such credit enhancements.

The proposed amendments incorporate several of our previous recommendations to the Commission,³ and we strongly support the principle underlying the proposal – investors primarily rely on the consolidated financial statements of the parent company when evaluating investments in these debt securities. However, we recommend that the Commission take additional steps, as described below, to help both investors and registrants benefit from the rule changes.

¹ Rule 3-10 of Regulation S-X, Financial statements of guarantors and issuers of guaranteed securities registered or being registered.

² Rule 3-16 of Regulation S-X, Financial statements of affiliates whose securities collateralize an issue registered or being registered.

³ [Refer to our comment letter on Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Registrant \(Release No. 33-9929; 34-75985; IC-31849\).](#)

Materiality

We generally believe that the primary consideration for providing any disclosure should be materiality, and we strongly support the Commission's effort to integrate materiality considerations within Regulation S-X. We believe this will allow registrants to tailor disclosures to their specific facts and circumstances, which will provide investors with more focused information. However, we believe the recommendations discussed in the following paragraphs would enhance the final rules and help achieve the SEC's stated goals for this rulemaking.

Disclosure objectives

We believe that the rules should state explicit objectives related to assessing the credit enhancement provided by the guarantee(s) or collateral. For example, the Commission should consider adding objectives to Rule 13-01(a) indicating that the disclosures are intended to provide investors with the material information necessary to understand (1) the potential effect of the guarantee on future payments to holders of the securities and (2) the nature and amount of the assets, liabilities and results of operations of the obligated group of entities. We believe registrants will be more likely to tailor their disclosures if they can be evaluated against clear objectives.

Additional information

We recommend that the Commission not move forward with the proposed open-ended requirements⁴ to provide additional information that would be material to making an investment decision. While it is unclear what disclosures would be necessary to meet the rules' objectives beyond the requirements of proposed Rules 13-01(a)(1) through (4) and 13-02(a)(1) through (4), we believe that sufficient investor protections are already provided by Securities Act Rule 408, Exchange Act Rule 12b-20 and S-X Rule 4-01(a).⁵ We are concerned that the proposed open-ended requirements would introduce substantial uncertainty for registrants and their auditors in assessing the sufficiency of the related financial disclosures. We fear such uncertainty would be operationally challenging, could substantially increase the compliance burden and might undermine the SEC's goal for this rulemaking. We are not aware of any similar open-ended disclosure requirements in the accounting standards or the SEC's rules and regulations with respect to financial statements and related disclosures.

Immaterial information

We support the Commission's approach of requiring disclosure only to the extent material, but we do not believe a registrant should have to state that it has omitted immaterial information and explain the reasons, as proposed in Rules 13-01(a)(4) and 13-02(a)(4). We are not aware of any precedent for these types of disclosures. Rather, elsewhere in SEC rules and in the accounting standards, preparers can apply judgment in determining whether specified disclosures may be omitted because they are not material without disclosing the basis for those judgments. Ultimately, requiring such disclosures could discourage registrants from tailoring their disclosures to focus investors on information that is material given their specific facts and circumstances, which would be inconsistent with the objectives of the proposed rules.

⁴ Proposed Rules 13-01(a)(5) and 13-02(a)(5).

⁵ These rules prohibit registrants from omitting material information that is necessary in order to make the required information not misleading.

Interim disclosures

The proposed amendments would require registrants to make disclosures for both the most recent fiscal year and interim period included in the parent company's consolidated financial statements. While registrants currently provide annual and interim financial disclosures under S-X Rule 3-10, interim financial information is not currently required by S-X Rule 3-16.

Consistent with our prior recommendations, we believe a registrant should not be required to provide the disclosures in its interim financial statements unless there has been a material adverse change in the financial condition of the obligated group (or the collateralized affiliate) since the most recently reported annual information.

When interim disclosures are necessary, we recommend that the Commission clarify proposed Rules 13-01(a)(4) and 13-02(a)(4) to state that the disclosures are required only for the "year-to-date" interim period for both Form 10-Q and registration statements.

Audit requirement

We recognize that the SEC's proposal to allow the disclosures to be unaudited at the time of offering and to remain unaudited during the fiscal year that includes the initial sale is rooted in its desire to promote capital formation. We believe investors and registrants are best positioned to provide feedback to the Commission about whether this approach is appropriate. When considering that feedback, however, the Commission should also consider that the quantitative disclosures, despite being unaudited, may often be subject to limited procedures performed by auditors when issuing comfort letters to underwriters in connection with registration statements and will be within the scope of registrants' disclosure controls and procedures with respect to Exchange Act reports.

Disclosure location

When a registrant has publicly issued equity securities, the disclosures under Rules 13-01 and 13-02 would be intended for only a subset of its investors. Consequently, we recommend that the Commission require those disclosures to be provided in a supplemental schedule (i.e., under Article 12 of Regulation S-X) that could be filed as an exhibit to applicable SEC filings. We believe providing the proposed disclosures in a separate schedule would:

- ▶ Make the disclosures easy for the intended audience of investors to find
- ▶ Make the disclosures easier for a registrant to add to a new registration statement by avoiding the need to amend entire items of previously filed Exchange Act reports (e.g., Items 7 and 8 of Form 10-K) to allow incorporation by reference
- ▶ Allow registrants to exclude the special-purpose disclosures from annual reports to shareholders

Within the Article 12 framework, the Commission would need to allow the new schedules to include unaudited and interim information consistent with the proposed disclosure model.

Summarized financial information (SFI)

Overall, we support the Commission's proposal to replace the current financial reporting requirements in S-X Rules 3-10 and 3-16 with SFI.⁶ We believe these changes would reduce compliance costs for registrants but still provide investors with sufficient information to assess the respective credit enhancement. However, we believe the following changes would further improve the disclosures and ease compliance burdens.

Additional clarifying disclosure

To enhance the transparency of SFI related to an obligated group, we recommend that the Commission require additional disclosure of material amounts related to (1) investments held by the obligated group in non-obligated subsidiaries and (2) intercompany (or related-party) transactions between the obligated and non-obligated groups. These disclosures could appear as separate line items or in explanatory notes to the SFI presentation. We also believe that registrants should disclose when the obligated group includes variable interest entities, if any are material, and cross-reference the relevant disclosures in the consolidated financial statements.⁷ Similar disclosures regarding intercompany and related-party transactions should be required to accompany SFI when securities of affiliates are pledged as collateral.

Separate presentation of certain entities

The proposal would require registrants to present SFI separately, rather than in the aggregate, if the required qualitative disclosures differ within the group of subsidiary issuers/guarantors (or the group of affiliates whose securities are pledged as collateral). We believe this approach is overly prescriptive and that the SEC should revise proposed Rules 13-01(a)(4) and 13-02(a)(4) to allow more flexibility to address the disclosure objectives in these circumstances. In many such cases, it could be acceptable to present SFI for the aggregate group with supplemental qualitative or quantitative disclosure to inform investors about material differences with the group. Such an approach could be sufficiently informative and preferable to presenting multiple tables of SFI.

Methods of excluding non-guarantor information

Proposed Rule 13-01(a)(4) would allow a parent company to exclude the financial information of non-guarantors from the financial disclosures of an obligated group using any method that "best meets the objective" and "is reasonable in the circumstances."

While we agree that no single approach should be prescribed, we recommend limiting the allowable methods to those that have a basis in US GAAP or IFRS as issued by the International Accounting Standards Board, as applicable to the registrant. This would enhance the comparability and consistency of SFI and make it more useful for investors. It would also alleviate any debate about whether another method would be acceptable or the need to discuss that method with the SEC staff. For registrants reporting under US GAAP, we believe the available methods should be limited to the equity method (Accounting Standards Codification (ASC) 323), the fair value method (ASC 321) or the fair value practical expedient available for equity securities without a readily determinable fair value (ASC 321).

⁶ As defined under Rule 1-02(bb) of Regulation S-X.

⁷ See ASC 810.

Recently acquired subsidiary guarantors

We support the proposed amendment to rescind the requirement to provide separate audited financial statements for a recently acquired guarantor under S-X Rule 3-10(g) because we expect that recently acquired guarantors would rarely have a material effect on the financial capacity of the obligated group. However, when its effect is material (e.g., if the acquired guarantor subsidiary is an essential component of the obligated group and the associated sufficiency of the guarantees), the SEC should consider requiring SFI for the recently acquired guarantor in registration statements if its information is not already included in the SFI of the obligated group provided as of the most recent balance sheet date.

Transition issues

We recommend that the SEC address expected transition issues in any final rule. For example, the Commission could address whether a registrant could continue complying (whether indefinitely or for a limited period of time) with the existing disclosure requirements:

- ▶ In its periodic reports due after the new rules become effective (e.g., Forms 10-K, 10-Q, 20-F) or in a registration statement that is filed before the new rules become effective but that won't be declared effective until after the new rules are in effect
- ▶ If the indenture agreement for an outstanding guaranteed debt security specifically requires disclosures consistent with the existing requirements

We believe robust transition guidance will reduce the need for the Commission staff to issue separate guidance, as it has done recently when the Commission changed other rules.⁸ It will also reduce uncertainty about compliance and transition among registrants and investors.

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Yours sincerely,



Copy to:

Mr. William Hinman, Director, Division of Corporation Finance
Mr. Kyle Moffatt, Chief Accountant, Division of Corporation Finance
Mr. Wesley R. Bricker, Chief Accountant, Office of Chief Accountant

⁸ [SEC staff's guide on Amendments to the Smaller Reporting Company Definition](#) and [SEC staff's Compliance and Disclosure Interpretations: Exchange Act Forms, Section 105.09](#)