sifma
Invested in America

November 30, 2015

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Attention: Mr. Brent J. Fields, Secretary

Re: Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant

Dear Secretary Fields:

The Securities Industry and Financial Markets Association ("SIFMA") is writing to respond to the invitation of the Securities and Exchange Commission ("Commission") for public comment on the effectiveness of financial disclosures about entities other than the registrant required to be included in registration statements filed under the Securities Act of 1933, as amended (the "Securities Act") and in periodic and current reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We appreciate the opportunity to provide comments to the Commission with respect to this initiative.

In this letter, we offer suggestions for changes to Regulation S-X that we believe would improve the quality of disclosure for investors while making the registration process less burdensome for the Commission and registrants. Accordingly, our suggestions reflect what additional or different information we believe would be meaningful and what existing disclosure we believe is not meaningful or is unduly burdensome to produce or review relative to its informational value to investors.

I. S-X Rule 1-02(w)

Currently, the three alternative tests used to determine significance under Regulation S-X are based on (1) the income of an acquiree as compared to the income of the registrant, (2) the assets of an acquiree as compared to the assets of the registrant and (3) the size of the investment in the acquiree as compared to the assets of the registrant. The Commission should consider revising the income, asset and investment tests as follows and for the reasons set forth below:

- *Replacing the income test with a test based on the revenues of each entity*. We believe the income test – essentially because it is based on a net amount – often results in counterintuitive and unintended results. We believe a revenue test would provide a better reflection of the significance of an acquired company's operating results to those of the registrant acquirer because it generally would not reflect the nonrecurring or unusual items that often factor into a net income determination, and in the relatively few instances where such items affect revenue, they will have a smaller proportionate impact. Further, when a registrant's net income is at or near zero, a very small acquisition may nonetheless exceed 20% under the income test and thus be "significant." We note that registrants frequently request that the Commission staff consider whether anomalous significance test results based on the income test should result in financial disclosure obligations under Regulation S-X, as the Commission recognized in its request for comment.

- *Eliminating the asset test*. We believe there are few cases where the asset test would demonstrate the materiality of an acquisition where the alternative two tests, as currently in effect or as proposed to be amended by us, would not. The most likely circumstance where this could be the case is where the acquiree is much more leveraged than the acquirer. But even in this case, where the investment test may not show significance, it is difficult to imagine the acquisition would be significant to the acquirer if the revenue test were not met. We further believe that, in some industries, the asset test results in acquisitions exceeding the significance thresholds in cases where an investor would not consider the acquisition to be significant to the acquirer. Accordingly, we believe the asset test imposes a far greater burden than its informational value to investors. In the rare case where an acquisition would not be significant under the other two tests but is nevertheless considered material based on a consideration of the totality of the circumstances, a registrant could include pro forma financial information and one year of acquiree audited historical financial statements to disclose the impact of the acquisition on the balance sheet and results of operations of the registrant.

- *For certain public company registrants, replacing the investment test with a test based on the purchase price as a percentage of the market capitalization of the registrant*. If a registrant acquirer's shares of common stock are "actively-traded securities" under Regulation M[1] (and thus have a relatively liquid market), instead of the existing investment test, we believe it would be more meaningful for the registrant to compare the purchase price to its own market capitalization – where market capitalization is equal to the product of (1) total outstanding common shares on any date within 30 days of initial filing times (2) the average price of the common stock over the 60-day period ending on the tenth trading day before filing, calculated using the closing price of the shares on each trading day during that 60-day period. If the registrant qualifies for the market capitalization test in lieu of the purchase price test at the time of its initial filing, the registrant would not be required to rerun this test at any time prior to effectiveness. We believe using market capitalization of the registrant acquirer instead of assets where the registrant's shares of common stock are actively-traded securities would eliminate the potential for false positive significance

[1] Actively-traded securities under Regulation M are those that have ADTV of at least $1 million and are issued by an issuer whose common equity securities have a public float of at least $150 million. See Rule 101(c)(i) of Regulation M.

calculations due to the mismatch between the fair value of acquiree, as reflected in the purchase price, versus the book value of acquirer, as reflected in the GAAP measure of its assets. Where a registrant acquirer's shares of common stock are not actively-traded securities, it would remain subject to the existing investment test in Rule 1-02(w).

II. S-X Rule 3-05

Rule 3-05 of Regulation S-X requires a registrant to provide one, two or three years (depending on the level of significance) of audited historical financial statements, along with unaudited interim financial statements, for an acquired business (and, in certain cases, a probable acquisition) that is at least 20% significant. Significance is determined based on the tests set forth in S-X Rule 1-02(w), which we suggest revising as set forth above.

We believe the burden of preparing audited historical financial statements of an acquiree frequently outweighs the benefit of those financial statements to investors, particularly in the case of (1) a private acquiree either without audited historical financial statements or, more likely, with audited statements that are based on GAAP for private companies or that have not been audited in accordance with GAAS, or (2) an acquisition of less than the entirety of another entity, where carve-out historical financial statements need to be prepared. We acknowledge investors' need for at least one year of financial information about a significant acquiree to be able to understand the impact the acquisition will have on the registrant, and we do not propose changing the 20% threshold above which registrants must provide at least one year of acquiree historical audited financial statements (or the corresponding requirement in S-X Article 11 to provide pro forma financial information).

With respect to the requirements to provide either two or three years of historical audited financial statements of an acquiree, while we appreciate that providing multiple years allows investors to make comparisons and identify trends, we believe the benefit to investors of additional years of financial statements that need to be prepared and audited frequently does not outweigh the cost and burden to the registrant of that preparation and audit. We also believe the pro forma financial information required by S-X Article 11, reflecting the ongoing post-acquisition reporting entity and taking into account the effects of purchase accounting adjustments, generally is more valuable to investors than an additional year or years of historical audited financial statements. Accordingly, the Commission should consider adjusting the significance thresholds that determine the number of required historical years of financial statements of an acquiree as set forth below.

- Maintaining the 20% significance threshold requiring one audited year of acquiree financial statements.

- Raising the 40% significance threshold requiring two audited years of acquiree financial statements to 50%.

- Raising the 50% significance threshold requiring three audited years of acquiree financial statements to 80%.

- For acquisitions of related businesses, the Commission should consider applying the same rule that applies to individually insignificant acquisitions. Currently, registrants are required to treat related business acquirees[2] as a single business for purposes of determining significance and, if significant, must provide historical financial statements for each business in the group. On the other hand, financial statements of individually insignificant *unrelated* businesses are required only if their aggregate significance is above 50%, and in that case registrants must only provide financial statements for a substantial majority of the businesses in the group. We do not believe information about related individually insignificant businesses is more important or necessary for investors than information about unrelated individually insignificant businesses. Further, the burden to registrants of obtaining or preparing

[2] Businesses are deemed to be related where they are under common control or management; where the acquisition of one is conditional on the acquisition of the other; or where each acquisition is conditioned on a single common event.

historical financial statements for related businesses can be just as significant as it is for unrelated businesses, even if under common control.

- For probable acquisitions, the Commission should consider eliminating the requirement that audited historical financial statements and pro forma financial information be provided for probable acquisitions exceeding 50% significance if a registrant is eligible to register securities on Form S-3 or Form F-3 but does not have an effective S-3 or F-3 on file with the Commission. Companies with effective S-3 or F-3 shelf registration statements on file with the Commission are permitted to offer securities under those registration statements without providing investors audited historical financial statements of a probable acquiree, or pro forma financial information reflecting the probable acquisition, regardless of significance, unless the acquisition would represent a fundamental change to the registrant.[3] We do not believe there is any reason investors need additional information from companies that are qualified to use, but do not have on file, registration statements on Form S-3 or F-3 than they do from companies with effective shelf registration statements on file.

III. S-X Rule 3-09

Rule 3-09 of Regulation S-X requires separate historical financial statements of equity method investees that are significant above the 20% threshold (determined based on the investment and income tests set forth in S-X Rule 1-02(w)). These financial statements must be audited only for the years in which significance exceeds 20%.

We believe registrants incur significant costs and face significant obstacles in obtaining financial statements of companies they do not control. Further, contractual arrangements governing an investment may make it difficult for a registrant to obtain or make public an investee's financial statements. As a result, registrants may choose not to make investments in

[3] We note that if a probable acquisition were to represent a "fundamental change," these companies would be required to include information related to the acquisition pursuant to the undertaking in S-K 512.

entities where the burden of obtaining and providing the information required by S-X Rule 3-09 would be too great.

We suggest below the two significance tests that we believe should apply to disclosure about equity method investees under S-X Rule 3-09 and that we believe would limit the requirement to provide historical financial statements of equity method investees only to those circumstances where the investees are truly significant to the registrant.

- A test based on the size of the registrant's investment in the investee, but using the market capitalization-based test proposed above under "Rule 1-02(w)" where the registrant's shares of common stock are actively-traded securities. If the registrant's shares of common stock are actively-traded securities, instead of the existing investment test, a registrant would compare the size of its investment in the investee to its own market capitalization as described above under "Rule 1-02(w)".

- An income test, but revising existing Rule 1-02(w) to require a registrant to compare its share of an equity investee's total income to the registrant's total income, excluding income from that investee. We believe the current test, requiring a comparison of the investee's total income to the registrant's total income, is misfocused because using the investee's total net income overstates the amount of an investee's income reported by the registrant. We propose to exclude income from the investee from the registrant's total income in the denominator to be consistent with the significance tests for acquirees, where the acquiree's income does not factor into the registrant's total income. Under the existing test, where a registrant with $200 million of net income has a 20% interest in an investee with $100 million of net income, significance equals 100/200, or 50%. Under the proposed new test, significance would equal 100x0.2/200-100, or 20%, which we believe is a more realistic measure of significance.

The Commission should consider adjusting the significance thresholds that determine the number of required historical years of financial statements of an investee as set forth below.

- Maintaining the 20% significance threshold requiring one audited year of investee financial statements.
- Raising the 40% significance threshold requiring two audited years of investee financial statements to 50%.
- Raising the 50% significance threshold requiring three audited years of investee financial statements to 80%.

IV. S-X Rule 3-10

Rule 3-10 of Regulation S-X generally provides that subsidiary issuers and guarantors of registered securities must file separate financial statements. If certain conditions in Rule 3-10 are met, however, more limited information, either in the form of condensed consolidating financial information or narrative disclosure, can be presented in the parent company's financial statements instead.

In our experience, the costs of providing audited historical financial statements of a guarantor where the accommodations provided by Rule 3-10 of Regulation S-X permitting more limited information are unavailable can be significant. We note that in debt offerings under Rule 144A under the Securities Act, issuers that would not meet the technical requirements for providing more limited financial disclosure about subsidiary issuers and guarantors under Rule 3-10 nonetheless frequently provide condensed consolidating financial information or other more limited disclosure about them, rather than providing their separate historical financial statements. We believe the robust nature of the Rule 144A debt markets should be indicative of what investors need and are willing to accept with respect to financial disclosure about guarantors. Accordingly, the Commission should consider expanding the accommodations provided by the rule and limiting the information that is required as follows:

- Permitting condensed consolidating disclosure for any majority-owned guarantor subsidiary. While we understand that performance risk related to a guarantee may be greater where a subsidiary is not 100% owned because a minority investor could attempt to block the performance of a guarantee, we believe that risk should be addressed in risk factors or other qualitative disclosure. Condensed consolidating financial information is sufficient to provide investors with an understanding of the various sources of credit on which they are being asked to rely.

- Eliminating the requirement that a guarantee be full and unconditional for reliance on the accommodations provided by Rule 3-10. Where a guarantee is not full and unconditional, investors will necessarily place less reliance on that guarantee as a source of credit. Accordingly, financial statements of a guarantor in those instances are even less important to an investor and should not be required. Instead, a registrant should be permitted to present condensed consolidating financial information even for subsidiaries that give lesser guarantees. In these cases, the registrant should be required to present in separate columns the financial information of subsidiaries providing full and unconditional guarantees and the financial information of subsidiaries providing lesser guarantees.

- Eliminating the requirement in Rule 3-10(g) that full historical financial statements be provided for a recently acquired subsidiary guarantor until that subsidiary has been included in the company's consolidated audited results for nine months of the most recent fiscal year where the purchase price or net book value of the acquired guarantor exceeds 20% of principal amount of debt being guaranteed. The ability to rely on the accommodations provided by Rule 3-10 should not be different for existing subsidiary guarantors and newly acquired subsidiary guarantors. Further, where the recently acquired subsidiary is significant, Rule 3-05 will separately require financial statements of that subsidiary. This threshold for disclosure should be sufficient for investors.

- Expanding the accommodation provided in the Notes to Paragraph (f) of Rule 3-10 by changing the definition of "minor" in Rule 3-10(h)(6). Currently, (i) where the parent has no independent assets or operations and any non-guarantor subsidiaries are "minor," the registrant may include narrative disclosure rather than condensed consolidating financial information about the guaranteeing subsidiaries, and (ii) if the parent does have independent assets or operations, the parent can omit the column for any non-guaranteeing subsidiaries in the condensed consolidating financial information if those subsidiaries are “minor.” “Minor” is defined as each of total assets, stockholders’ equity, revenues, income and cash flows amounting to less than 3% of the corresponding consolidated amount. The Commission should consider changing 3% to 20% in the definition of minor. Changing 3% to 20% would significantly reduce the burden on registrants of having to break out financial information with respect to subsidiaries providing non-material guarantees, and is more consistent with the measure of material, separate financial information used elsewhere in Regulation S-X (e.g., Rules 3-05 and 3-09).

- In filings under the Exchange Act, permitting the accommodations below. We believe registrants weigh the costs and burdens of ongoing reporting obligations under the Exchange Act with respect to subsidiary guarantors against the benefits of registration when determining whether to conduct offerings on an exempt or registered basis and when evaluating the potential advantages of providing subsidiary guarantees.

    - If stand-alone financial statements of subsidiary guarantors are required, large accelerated and accelerated filers should be permitted to file this information by amendment within 45 days after quarter-end and 90 days after year-end, rather than by the earlier deadline for their 10-Qs and 10-Ks. We note that Rule 3-09 permits this accommodation for financial statements of equity-method investees.

    - Allowing voluntary filers to provide the condensed consolidating financial information permitted by the accommodations under Rule 3-10 even if they don't meet the requirements for doing so.

    - Eliminating the requirement that registrants continue to provide Rule 3-10 disclosure about subsidiary guarantors even after the debt security guaranteed has been deregistered. Currently, guarantors that separately file full financial statements under Rule 3-10 are no longer obligated to do so upon deregistration of the debt security they guarantee. Guarantors that provide more limited financial information by virtue of the accommodations provided by Rule 3-10, however, are exempt from reporting under Rule 12h-5, and Commission guidance under Rule 12h-5 requires a parent to continue to include the more limited information in its financial statements so long as the debt securities are outstanding (and the guarantee remains in place), regardless of whether they have been deregistered.[4] The disparate treatment is illogical, and should be harmonized by expressly allowing registrants to cease providing the information called for by the Rule 3-10 accommodations when the guaranteed security is deregistered pursuant to Section 15(d) of the Exchange Act.

V. S-X Rule 3-16

Rule 3-16 of Regulation S-X requires historical financial statements of affiliates whose securities collateralize those of a registrant. Because the costs and burdens associated with preparing or obtaining those financial statements are often significant for the reasons noted under "S-X Rule 3-09 and S-X Rule 3-10" above, we suggest that the Commission consider revising Rule 3-16 as set forth below:

- Raising from 20% to 50% (collateral value/principal amount outstanding) threshold for financial statements of pledgors. We note that the introduction to Rule 3-16(a) states that the rule shall apply to affiliates whose securities constitute a "substantial" portion of the collateral and, in other contexts, "substantial" is understood to be well above 20%.

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[4] See Release No. 33-7878 (2000) ("The parent company periodic reports must contain this information for as long as the subject securities are outstanding.")

- Permitting registrants to include majority-owned subsidiary pledgor financial information in a condensed consolidating footnote like the accommodations we suggest be provided under Rule 3-10.

We note that in Rule 144A offerings issuers frequently omit the information that would have been required by Rule 3-16 for a registered offering in cases where they do not believe the information is material to investors.

VI. S-X Rule 11-01

We do not propose changing the circumstances set forth in Rule 11-01(a) that determine when pro forma financial information is required. For purposes of Rule 11-01(b), we suggest that significance be determined based on the revised significance tests we propose above under "S-X Rule 1-02(w)" and, in the case of equity-method investees, the revised tests we set forth above under "S-X Rule 3-09."

With respect to the definition of what constitutes a "business" in Rule 11-01(d) for, among other items, determining whether Rule 3-05 historical financial statements of an acquiree are required and for determining when pro forma financial information is required under Article 11 for dispositions, the Commission should confirm that the facts and circumstances test for determining whether a lesser component of an entity constitutes a business also can serve to rebut the presumption that a separate entity, subsidiary or division is a business.

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If you have any questions regarding SIFMA's views or require additional information, please do not hesitate to contact the undersigned at [redacted], or our counsel on this matter, Leslie N. Silverman of Cleary Gottlieb Steen & Hamilton at [redacted].

Very truly yours,

Sean Davy, Managing Director, Capital Markets Division
Securities Industry and Financial Markets Association