November 30, 2015

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-20-15

Dear Mr. Fields:

We appreciate the opportunity to share our views and provide input on the areas included in the Securities and Exchange Commission's (the SEC or the "Commission") *Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Registrant*. We commend the SEC for re-examining the effectiveness of financial disclosures about entities other than the registrant that are required by Regulation S-X. We encourage the SEC to continue its outreach to investors, preparers, and other groups to obtain feedback in connection with its disclosure effectiveness initiative.

Our recommendations are based on our experiences in working with the SEC's disclosure requirements as independent auditors. In developing our observations and recommendations, we have avoided recommending quantitative thresholds or specifying the exact form and content of disclosures because we believe these determinations should be made in connection with the input of registrants, users, and investors.

Our observations and recommendations included in the Appendix should be viewed individually, as we feel any action on these suggestions would improve the existing disclosure requirements. In connection with the Request for Comment, we have responded to the following rules, which correspond to individual sections in the Appendix:

I. Financial statements of businesses acquired or to be acquired (S-X 3-05)
II. Pro forma information (S-X Article 11)
III. Financial information of equity method investees (S-X 3-09 and S-X 4-08(g))
IV. Financial statements of guarantors and issuers of guaranteed securities registered or being registered (S-X 3-10)
V. Financial statements of affiliates whose securities collateralize an issue registered or being registered (S-X 3-16)
VI. Special instructions for real estate operations to be acquired (S-X 3-14)

As possible amendments to Regulation S-X are considered, we recommend that the Commission consider the benefit of addressing possible proposed rule changes by topic and not in combination, given the challenges of proposing multiple changes in one release.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the SEC staff or the Commission may have. Please do not hesitate to contact John May [redacted] or Wayne Carnall [redacted] regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

APPENDIX

I. Financial statements of businesses acquired or to be acquired (S-X 3-05)

Rule 3-05 of Regulation S-X ("S-X 3-05") requires registrants to provide financial statements of a business acquired or to be acquired if it exceeds a defined level of significance. The benefit of providing these financial statements is to allow investors to evaluate the impact of the acquired or to be acquired business on the registrant. The costs of this regulation include the direct out of pocket costs of preparing the financial statements. Additionally, there are potential indirect costs, such as a need to delay or forgo the acquisition because the required information cannot be obtained. The delay or inability to complete the acquisition may be detrimental to investors. In evaluating the existing rule and weighing the costs and benefits of S-X 3-05, we recommend that the Commission consider the following:

Tests used to evaluate significance

We believe it is appropriate that the tests used today to determine the financial statements requirements are based on defined ratios between the registrant and the acquiree. However, in our experience there are a number of situations in which the existing tests set forth in Rule 1-02(w) of Regulation S-X ("S-X 1-02(w)") indicate that financial statements are required when it would not appear to be a significant acquisition. This is usually a result of the application of the income test to situations in which there are unusual items for the current year of the registrant or the acquiree that have the effect of distorting the impact the acquiree will have on the registrant. In many of these situations, the registrant has sought relief from providing financial statements on the basis that notwithstanding the mechanical application of the test, the acquiree was not significant. The staff has granted the requested relief on many of these occasions. However, the process of requesting relief can delay the completion of the transaction and there is an element of uncertainly in any request.

Likewise, there can be situations in which an acquiree will have a significant future impact on the registrant, but because of unusual items included in pretax income of either the acquiree or the registrant, would not be significant under the existing test and, as a result, financial statements are not deemed to be required by S-X 3-05. In addition, pretax income will be impacted by how the acquiree is capitalized. For instance, an acquiree may have historically been highly leveraged, which resulted in significant financing costs reducing pretax income. This may yield a conclusion that the acquiree is not significant, when, in fact, it could have a significant impact on future results.

Income Test
We recommend the Commission consider replacing the income test with a revenue test. We recognize that decades ago the Commission used a revenue test but replaced it with the current income test. Nonetheless, we believe a revenue test may be a better indicator of relative significance of the acquiree to the registrant than pretax income because it would eliminate the impact of unusual income and expense items for both the acquiree and the registrant, as well as eliminate the impact of the acquiree's historical capitalization.

If the Commission decides to retain the income test as currently set forth in S-X 1-02(w), we recommend considering a two-test approach to determine significance. For example, if the income test exceeds the applicable significance threshold (e.g., 20%), one of the other existing significance tests (i.e., the investment test or the asset test) also should be met at some specified lower level for the evaluated entity to be deemed significant under S-X 3-05.

To further reduce the impact that unusual income or expense items can have on the significance tests, we also recommend modifying Computational Note (2) of S-X 1-02(w) to address the following when computing average income:

- Allow loss years to be excluded from the denominator in the calculation of average income (that is, four years of profitability would be divided by four, not five), or alternatively, require the absolute value of loss years to be included in the computation of average income.
- Allow the use of average income for the tested entity to be included in the numerator (similar to what is permitted for the denominator).

Asset and Investment Tests
The existing investment test compares a fair value metric (consideration transferred) to a carrying value metric (total assets of the registrant), which may not provide the most meaningful measure of significance.

We recommend the Commission consider modifying the investment test to compare the consideration transferred for the registrant's investment in the tested entity to the registrant's market capitalization. If a registrant does not have public equity outstanding and its fair value is not readily available, the carrying value of the registrant's total assets should be used as the denominator.

As an increasing number of companies have assets that are not reflected in the historical cost accounting model, we believe that the use of market values, compared to historical cost may be a better indicator of the relative significance of an acquisition.

We recommend retaining the asset test as it is currently set forth in S-X 1-02(w) to address situations in which the registrant acquires a highly-leveraged company for which the purchase price is relatively insignificant but the acquired assets are significant.

Under our recommendation for changes to the income and investment tests, there will be significant acquisitions that would not have been significant under the existing rule, and there will be acquisitions that are significant under the existing rule, that would not be significant under our recommended alternative. We believe our recommended changes will better reflect the significance of an acquisition to the registrant and the corresponding need for financial statements.

Financial statements to be presented

Currently, the Commission has a sliding scale based on the level of significance using the tests in S-X 1-02(w) to determine the number of years of financial statements (one, two, or three) that should be provided. We believe that financial statements are more meaningful if comparative periods are presented. Accordingly, as the Commission considers if there should be changes in the level of significance to require financial statements, we believe that comparative financial statements should be required regardless of the threshold.

Additionally, we believe the number of years that are required under S-X 3-05 should not exceed the number of years that would be required if the acquired or to be acquired business were to file its own registration statement under the Securities Act of 1933[1] (the 1933 Act). Accordingly, if an acquiree could present two years of financial statements if it were to file its own registration statement, then only two years of financial statements should be required under S-X 3-05.

Enhance symmetry among filings

Under the existing rules, financial statements relating to probable acquisitions, very recent significant acquisitions, and acquisitions that are not individually significant under S-X 1-02(w) are not required to be filed unless a company is filing a registration statement or certain proxy statements. In those situations, financial statements would be required to be filed for:

- Consummated and probable acquisitions that are individually insignificant but exceed 50% significance in the aggregate;[2]
- Probable acquisitions that exceed 50% significance;
- Acquisitions consummated within the past 75 days that exceed 50% significance.

A company is required to file financial statements on Form 8-K for an acquisition that exceeds the 20% significance level 75 days after consummation. We generally believe that all investors should receive the same information at the same time about an acquired business and that the level of disclosure should not be dependent on whether the company is filing a registration statement/certain proxy statements. Given that the Commission's rules currently do not require the above financial statements to be filed in connection with the ongoing disclosure requirements of the Securities Exchange Act of 1934 (the 1934 Act), we recommend the Commission consider eliminating the incremental requirements to provide financial statements in the situations described above. In considering this recommendation, we recommend that the SEC consider whether the needs of an investor buying securities from the company are different from the needs of an investor buying the securities on the open market.

As an alternative, in lieu of providing audited financial statements about certain insignificant acquisitions, the Commission could replace the requirements in S-X 3-05(b)(2)(i) with a requirement to provide pro forma information on Form 8-K.

Additionally, as part of this analysis, we recommend the Commission consider if the disclosure needs of investors are the same when investing in companies filing initial registration statements as compared to companies that have a reporting history. For example, the Commission could consider eliminating the requirement to provide the financial statements for probable acquisitions described above if the registrant is eligible to use short-form registration or is a well-known seasoned issuer. The existing requirements could be retained for a company that is not eligible to use short-form registration or is not a well-known seasoned issuer. For a company conducting an IPO in which there is no reporting history, the Commission

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[1] For purposes of this letter, when referring to the 1933 Act we are specifically referencing registration statements on Form S-1, S-3, and S-4, as well as the foreign private issuer equivalents on Form F-1, F-3, and F-4.

[2] S-X 3-05(b)(2)(i) states: "if the aggregate impact of the individually insignificant businesses acquired since the date of the most recent audited balance sheet filed for the registrant exceeds 50%, financial statements covering at least the substantial majority of the businesses acquired shall be furnished. Such financial statements shall be for at least the most recent fiscal year and any interim periods specified in Rule 3-01 and Rule 3-02."

should consider whether it would be appropriate to lower the thresholds used for determining significance for providing financial statements of acquired and to be acquired businesses.

Another item that would enhance reporting symmetry between the 1933 Act and the 1934 Act relates to the age of financial statements included in such filings. The determination of the most recent periods that should be presented in Form 8-K is based on the age of financial statements at the time the initial filing is due. The determination of the most recent period that should be presented in a registration statement is assessed at the date of filing and on the effective date. This could mean that the financial statements filed in Form 8-K may need to be updated to a more a recent period when filing a registration statement. This can be problematic as there can be significant changes in personnel at the acquiree. We recommend that the Commission consider whether periods covered by financial statements of an acquired business filed on Form 8-K for a consummated acquisition would be sufficient for purposes of inclusion in a later registration statement.

Foreign private issuers and foreign businesses

In a cross-border transaction, financial statements of an acquired business that do not meet the definition of a foreign business must be prepared in accordance with U.S. GAAP or include a reconciliation under Item 18 of Form 20-F. Requiring financial statements to be prepared in accordance with U.S. GAAP may result in unnecessary costs and information that may not be useful to investors.

We recommend that the Commission consider permitting a foreign private issuer (FPI) that files its financial statements in accordance with IFRS as issued by the IASB (IFRS) to file financial statements under S-X 3-05 that are prepared using IFRS or reconciled to IFRS using the same methodology as Item 17 of Form 20-F, regardless of whether the acquired or to be acquired business meets the definition of a foreign business. We believe that financial statements of an acquiree that are prepared on the same basis as the registrant's financial statements will be more useful to an investor.

We also recommend that the SEC consider permitting an audit of financial statements of a foreign business filed for purposes of S-X 3-05 to be performed in accordance with International Standards on Auditing (ISAs). ISAs are high-quality auditing standards that are widely accepted worldwide. The AICPA auditing standards are largely converged with ISAs. In a number of situations, financial statements of the acquiree audited using ISA are readily available. By accepting ISA in this situation, the company will be able to file the financial statements sooner than if the audit has to be performed using AICPA standards.

Other

- The cost burdens of providing financial statements of an acquired business can be disproportionately higher for Smaller Reporting Companies (SRCs), which are also more likely to be required to include financial statements because of their relative size. We recommend the Commission evaluate if investors in SRCs need the same financial statements of an acquiree and for the same periods as a non SRC.

- S-X 3-05(b)(4)(iii) requires financial statements that have already been filed to be included in a registration statement if "the acquired business is of such significance to the registrant that omission of such financial statements would materially impair an investor's ability to understand the historical results of the registrant." This requires the registrant to incur costs to obtain a consent from an auditor who, in many cases, would not otherwise have any involvement with the registration statement. In situations where financial statements have been previously filed with the Commission and the acquired business has been included in the audited results for at least 9 months, we recommend that the Commission consider whether it is necessary to provide those financial statements in the registration statement or whether the market has had adequate time to understand the impact of the acquired business.

II. <u>Pro forma information</u>

We encourage the Commission to consider the following points with respect to pro forma information.

In lieu of financial statements of an acquired business

There can be situations in which pro forma information could provide investors with beneficial information about acquired businesses. For example, the Commission could consider increasing the significance level for which audited financial statements are required in favor of pro forma information for acquisitions that exceed a certain size. For example, if the Commission increased the significance level for which audited financial statements are required from 20% to 30%, it could require pro forma information at 20% significance or perhaps a lower level.

Permitting pro forma income statements for more than one year

Rule 11-02(c)(2)(i) of Regulation S-X requires a registrant to present a pro forma income statement for the most recent fiscal year and subsequent interim period for a business combination. We note that the Commission staff has informally indicated that they will not object if a registrant presents pro forma comparative prior year interim income statement information.[3] ASC 805-10-50-2(h) requires two years of pro forma income statement information when comparative financial statements are presented. Consistent with our recommendations below for promoting consistency between Article 11 of Regulation S-X ("S-X Article 11") and U.S. GAAP pro forma disclosures, we recommend that a registrant be permitted to present pro forma income statement information for two years if it believes the presentation would provide investors with useful information. Such presentation could also facilitate useful comparative analysis for investors if the entity elects to include them in Management's Discussion and Analysis.

Consistency with U.S. GAAP pro forma requirements

Both U.S. GAAP (ASC 805-10-50-1) and S-X Article 11 require disclosure of pro forma financial information. For various reasons, pro forma operating results giving effect to business combinations may be different under each requirement. For example:

- Nonrecurring adjustments – Pro forma income statements prepared under S-X Article 11 exclude the effects of nonrecurring charges or credits directly attributable to a transaction. A pro forma information under U.S. GAAP requires these items to be included.

[3] Division of Corporation Finance's Financial Reporting Manual Section 3230.1

- Different assumed transaction dates – S-X Article 11 requires adjustments related to a pro forma income statement to be computed assuming the transaction was consummated at the beginning of the fiscal year presented. In contrast, the assumed acquisition date used to compute pro forma operating results in accordance with U.S. GAAP is not revised as the financial statements are updated.[4] These differences cause S-X Article 11 pro forma operating results that might initially agree with the U.S. GAAP pro forma operating results to move out of alignment as time passes.

  To illustrate, assume a registrant with a December year end acquires a business in late 2015, and a significant portion of the purchase price is for an intangible asset for which an accelerated method of amortization will be used. When Article 11 pro forma information is first prepared to report the business combination (for example, in a Form 8-K reporting the acquisition), the assumed acquisition date will be the same for Article 11 and U.S. GAAP – January 1, 2014. Thus, the 2014 pro forma amortization expense will be the same in the 2014 Article 11 pro forma statement of income and the 2014 U.S. GAAP pro forma operating results reflected in the footnotes to the registrant's financial statements in its 2015 Form 10-K. If a registrant files a registration statement in late 2016, it would be required to update its Article 11 pro forma information and present a pro forma statement of income for the year ended 2015. When the registrant prepares that information, it would change the assumed acquisition date from January 1, 2014 to January 1, 2015. However, the assumed acquisition date for preparing the U.S. GAAP pro forma operating results remains January 1, 2014. As a result, the pro forma amortization expense in the 2015 Article 11 pro forma statement of income will not agree with the 2015 pro forma amortization expense reflected in the footnotes to the registrant's financial statements in its 2015 Form 10-K or its 2016 Form 10-K.

- Different earnings measures – S-X Article 11 requires pro forma income from continuing operations and related pro forma per share amounts, and it prohibits showing pro forma amounts reflecting discontinued operations. U.S. GAAP simply requires a company to present pro forma "earnings" and does not specify which "earnings" measure is to be presented.[5]

We recommend that the Commission consider aligning its requirements with U.S. GAAP to establish more consistency between the pro forma presentation requirements.

III. Financial information of equity method investees (S-X 3-09 and S-X 4-08(g))

The Codification of Financial Reporting Policies (FRP) Section 213.03.b states: "*While the Commission recognizes that GAAP [APBO] 18 calls for the presentation of either separate financial statements or summarized financial information, guidance is not provided as to when either of these alternatives may be more appropriate. The rules establish uniform standards to determine the degree of detailed information to be included in filings with the Commission.*"

Accordingly, the Commission took a U.S. GAAP concept and codified the thresholds at which disclosure would be required. The disclosures are designed to provide detailed information about financial condition and results of operations of equity method investees.

[4] ASC 805-10-50-2.h.
[5] ASC 805-10-50-2.h.3.

The financial statements of an equity investee may not be sufficiently informative to investors because the registrant's financial statements may differ with regard to reporting currency, fiscal year, accounting standards (e.g., when a registrant uses U.S. GAAP and the equity investee uses IFRS), basis, etc. Moreover, companies can incur significant incremental costs in preparing these financial statements—including for periods when they are not significant.

It has been our experience that some of the challenges registrants have in complying with Rule 3-09 of Regulation S-X ("S-X 3-09") include the following:

- Depending upon the ownership interest in the underlying investee and other factors, such as membership on the board of directors and other positions within management, the registrant's/investor's level of influence over an investee can vary. Lower levels of ownership interest and other involvement with the investee can limit the ability of registrants to obtain investee financial statements.
- There are situations in which this information is being audited (or audited in accordance with U.S. GAAS) solely for the purpose of complying with S-X 3-09.
- A company may not know if an investee is significant until close to or after year-end. Accordingly, the registrant may have difficulty obtaining the required financial statements in a short period of time to file with the SEC, or it may be required to incur costs to obtain the financial statements when they may not be required.

Additionally, the summarized information currently required by Rule 4-08(g) of Regulation S-X ("S-X 4-08(g)") that allows companies to combine unrelated entities may not provide an investor with sufficiently meaningful information when the registrant has different ownership percentages or investees with losses are combined with investees with income. For example, a company could have two equity affiliates - registrant owns 20% of Affiliate A, which has $200 of income, and 50% of affiliate B, which has a $100 loss. This company would report income of $100 in the summarized S-X 4-08(g) information when it reports a loss of $10 in the consolidated statement of income for equity affiliates.

We believe that the Commission could reduce the situations in which financial statements would be required by S-X 3-09 and change the disclosure requirements of S-X 4-08(g) in a way that would result in better information for investors and that would reduce overall compliance cost.

Changes to S-X 4-08(g)

More relevant information can be provided under S-X 4-08(g) that will allow a reader to evaluate a registrant's various investee affiliates by modifying S-X 4-08(g) as follows:

- Require summarized financial information for each investee that is individually significant to be presented separately. To better understand the information in the context of the registrant's financial statements, the information could be presented in a columnar format that reconciles the investee's net assets and net income to the amounts included in the consolidated financial statements. This reconciliation could start with the total net assets and net income for each entity and calculate the percentage attributable to the registrant based on the disclosed percentage ownership and include adjustments for differences in basis and other adjustments as necessary. The total would then represent the amount of net assets and net income attributable to the investee included in the consolidated financial statements. This reconciliation should present an amount in total for the net assets and net income for all investees not separately presented such that the amount of net assets and income would agree to the primary financial statements.

- Retain the requirement under the existing rule that the information in the notes to the financial statements be prepared using the same currency and the same accounting standards as the registrant.
- In connection with the above recommendation for expanded summarized financial information presented on a separate basis for each significant investee, consider eliminating the current requirement in S-X 4-08(g) to present combined summarized financial information of all investees when they exceed 10% significance in the aggregate. Alternatively, consider whether qualitative or narrative disclosures would provide sufficient information.
- Expand Rule 1-02(bb) of Regulation S-X ("S-X 1-02(bb)") to require disclosure of pretax income and the tax provision as these are both relevant to the determination of the amounts included in the consolidated financial statements.

Changes to S-X 3-09

In light of our recommended enhancement of disclosure under S-X 4-08(g), we recommend the Commission consider increasing the threshold for significance to require separate financial statements under S-X 3-09. While the appropriate threshold should be at the discretion of the Commission based upon input from others, we believe full separate financial statements should only be necessary when the investee is so significant that financial information that would otherwise be provided by S-X 4-08(g) does not provide sufficient information for investors to understand the consolidated results and financial condition of the registrant.

We do not recommend any changes to the tests used to determine significance under S-X 3-09 other than the changes to Computational Note (2) to S-X 1-02(w), as discussed in the Income test section on page A1.

We also recommend the Commission amend S-X 3-09 to only require financial statements for years in which the significance tests are met. While under current rules, the financial statements for insignificant years can be unaudited, the financial statements still need to be prepared and provided in a manner consistent with Regulation S-X. Companies are currently incurring significant costs to prepare financial statements of investees that, by the Commission's definition, are not significant. As indicated above, we believe comparative financial statements are more informative than those for a single year. However, the objective of the financial statements is different: financial statements provided as required by S-X 3-09 are designed to provide information about amounts included in the registrant's historical financial statements, while those prepared pursuant to S-X 3-05 provide information about how the acquired business will impact the registrant's financial statements in the future.

Lastly, we recommend that an entity not be required to provide financial statements that would otherwise by required by S-X 3-09 if it has disposed its investment prior to the reporting date.

Foreign private issuers and foreign businesses

A foreign businesses has unique issues and challenges in preparing financial statements under S-X 3-09. To address these unique issues we suggest the following:

- FPIs using IFRS are not required to comply with S-X 4-08(g). Therefore, as the SEC considers the recommendations above, it should consider amending Form 20-F to require conforming disclosure by a FPI or consider consolidating those disclosure requirements into S-X 3-09, which does apply to FPIs.
- Consistent with our recommendations regarding foreign businesses related to S-X 3-05, the Commission should consider whether a U.S. GAAP reconciliation for a significant equity investee is meaningful when the registrant itself does not provide any U.S. GAAP information.
- Further, we do not believe that the incremental benefit of having S-X 3-09 financial statements audited using U.S. GAAS exceeds the incremental cost when the financial statements have been audited in accordance with ISAs. We recommend that the Commission accept S-X 3-09 financial statements of a foreign business audited using ISAs in circumstances where the audit report does not need to refer to the standards of the PCAOB, as required by Rule 2-05 of Regulation S-X. We believe this will result in a reduction of costs without a decrease in audit quality.

Interim reporting requirements

We recommend the Commission modify current interim disclosure requirements about investees to focus on significant changes similar to Rule 10-01(a)(5) of Regulation S-X ("S-X 10-01(a)(5)"). This will allow registrants to omit detailed interim financial disclosures about investees that have not changed significantly in amount or composition since the end of the most recently completed fiscal year. Such a change would be consistent with interim disclosure principles and may reduce compliance costs without depriving investors of material information.

Investment company considerations

We are aware that until the SEC staff's interpretations published in September 2013, Business Development Companies (BDCs) prepared their financial statements and disclosures under the assumption that S-X 3-09 and S-X 4-08(g) do not apply to them. As set forth in FRP Section 213.03.b, the requirement to provide either separate financial statements or summarized financial information is related to the accounting concepts in ASC 323, *The Equity Method of Accounting for Investments in Common Stock*, which does not apply to investment companies, as they carry all investments at fair value. Additionally, application of the significance tests for purposes of S-X 3-09 and S-X 4-08(g) has been interpreted differently between the SEC's Divisions of Corporation Finance and Investment Management, resulting in complexity and confusion.

Nevertheless, we recognize that there may be situations in which financial information for investees of investment companies may be material, such as when the significant investee itself is an investment company accounted for at fair value. If the Commission concludes that such information is required, we recommend that the Commission consider requiring a significance test only for investees that exist as of the reporting date. We recommend that the measures applied to determine significance and the disclosure requirements for investment companies, particularly BDCs, be modified as follows:

Significance tests

The numerator of the income test, as set forth in S-X 1-02(w), includes the registrant's equity in the investee's income from continuing operations. For an investment company, its "income" is measured by the net increase (or decrease) in its net assets from operations, and includes investment income earned as well as its realized and unrealized gains (or losses) on its investments.

Significance should be considered from an investor's perspective. For example, investors typically invest in BDCs for income distributions. Accordingly, investment income is a key measure for users of a BDC's financial statements in evaluating a BDC's performance and its ability to make distributions. Therefore, we recommend the Commission consider replacing the "income" in the existing income test with investment income[6] earned by a BDC from the investee (as the numerator) and the total consolidated investment income earned by such BDC (the denominator).

While most BDCs are investment income oriented vehicles, BDCs (or other investment companies) that continually earn, or expect to continue earning, a significant amount of "income" from gains should be allowed to include such metric (gains and losses) as a basis for determining significance.

Modification of the financial statements and financial information provided under S-X 3-09 and 4-08(g)

Similar to our observations above, we recommend that the SEC consider whether the inclusion of financial statements of investee companies is necessary under most circumstances for BDCs. Neither the operating results nor the financial condition of an investee company is directly included in or traceable to an investment company's financial statements. For example, a portfolio company's balance sheet information does not correlate to the fair value recorded by the investment company for such portfolio company in its financial statements, nor is the portfolio company's net income (or a share thereof) included in the investment company's statement of operations.

Rule 12-14 of Regulation S-X ("S-X 12-14"), *Investments in and advances to affiliates*, requires investment companies, including BDCs, to provide a schedule that includes specific information for each controlled portfolio company. Such information includes fair value at the reporting date, and interest income and dividend income during the reporting period, whereby the totals of these items agree to the balance sheet and to the statement of operations of the investment company. Therefore, in lieu of attaching the financial statements or providing summarized financial information for significant investees, we support the SEC's recent investment company reporting modernization proposal[7] to expand the Schedule 12-14 on "controlled" investees to include net realized and unrealized gains on the investment for each significant portfolio company. These disclosures would be useful to users of the investment company's financial statements in assessing the contributions of each portfolio company to the investment company's operating performance and financial condition.

[6] As presented in accordance with ASC 946-945-S99-1.1 and Rule 6-07.1 of Regulation S-X.
[7] Securities Act Release 33-9776, page 136.

We believe that these measures would also reasonably achieve the objective of Section 31 of the Investment Company Act of 1940 to avoid unnecessary recordkeeping by, and to minimize the compliance burden on investment companies, while providing investors with information that is relevant to investment companies, including BDCs.

Alternatively, if the Commission believes S-X 3-09 and S-X 4-08(g) financial information is needed, we recommend that certain summarized information (which may include a schedule of investments for an investment company investee) for each significant investee (with no aggregation) be provided in lieu of separate financial statements consistent with our recommendations for operating companies discussed above.

IV. Financial statements of guarantors and issuers of guaranteed securities registered or being registered (S-X 3-10)

When an entity–generally a subsidiary or parent company of the issuer—guarantees a registered security, financial statements of that entity are required to be filed. Rule 3-10 of Regulation S-X ("S-X 3-10") provides exceptions to this requirement. Depending on the structure, sometimes a brief narrative discussion about the guarantee is sufficient, but in most instances, condensed consolidating financial information is required. The information that is required by S-X 3-10 is less costly to prepare than separate financial statements of each guarantor entity–which in certain situations can involve a large number of entities. Additionally, in instances involving a large number of guarantors with significant intercompany activity and balances, the condensed consolidating information may provide more insight about the entities that are guaranteeing the debt than separate financial statements.

While less costly to prepare and in some instances more useful than full financial statements, the preparation of this information is still very difficult, time consuming, and costly. Registrants do not typically design their accounting systems to capture the required information for each individual issuer, co-issuer or guarantor. In particular, investments by a parent entity in lower level subsidiaries, intercompany accounts, and cash flow information are not typically available, necessitating detailed and expensive analysis.

In addition to being costly and difficult to prepare, the information that is currently provided has limitations on its usefulness—primarily because intercompany activity—including dividends and equity earnings between the parent, issuer, guarantor entities, and non-guarantor entities are not necessarily separately identified.

We believe in evaluating the information that should be provided under S-X 3-10, the Commission should not start with the presumption that the subsidiary guarantor has a responsibility to report as an issuer; rather, we believe the Commission should determine what information an investor needs to evaluate the guarantee. Only that information should be required. In making this evaluation, the Commission should consider the historical situations in which a guarantor was required to make a debt payment, i.e., is extensive disclosure necessary for an event that would be viewed as remote?

Information that should be provided

Currently, in a typical note describing the guarantee, there is condensed consolidating information with the following columns:

1. Parent
2. Issuer
3. Guarantor subsidiaries
4. Non-guarantor subsidiaries
5. Eliminations
6. Consolidated

We believe the Commission should consider whether investors would be adequately informed by combining the amounts in columns 1 to 3. The current requirement to separately report the information in these columns does not necessarily provide investors with sufficient information about the issuer and guarantors. For example, a substantial portion of the profits could be derived from transactions or equity earnings from non-guarantor entities. Likewise, the majority of the operating cash flow could be dividends from the non-guarantor subsidiaries. Accordingly, while the entities guaranteeing the debt may look as if they could satisfy the debt obligation, the situation could dramatically change if the guarantee is invoked and activity with the non-guarantor entities changes.

To improve the value of the information about issuers/guarantors, we recommend disclosure of all significant assets and income statement amounts–along with dividends received–relating to the non-guarantor entities. This will allow a reader to evaluate the financial information of the guarantor entities if the guarantee is invoked and the relationship between the guarantor entities and the non-guarantor entities ceases to exist.

We are aware that in many exempt transactions, e.g., 144A transactions with no registration rights, condensed consolidating information is not provided. Frequently, the disclosures are limited to either the amount of assets of the entities guaranteeing the debt or the amount of assets of entities that are not guaranteeing the debt. Income statement and cash flow information is frequently not provided. Recognizing that there are differences between a pledge of assets and a direct guarantee, we recommend that the Commission evaluate if balance sheet information alone would be sufficient for an investor. Balance sheet information would provide a debt holder with insight into the nature and liquidity of the assets held by guarantors, as well as the composition of liabilities and obligations. In the event of default, these assets would potentially be utilized to satisfy obligations, as well as service the debt in connection with the guarantee. While we acknowledge there is a difference in the disclosure requirements between exempt and registered offerings, with respect to debt securities, the investor pool is typically the same. Accordingly, the Commission should evaluate if the information about the guarantor entities in exempt offerings would be sufficient for registered offerings.

Frequency of providing information

Suspending reporting requirements

While it is not in the regulations, Securities Act Release No. 7878 states that as a condition to use of Rule 12h-5 of the 1934 Act ("Rule 12h-5") condensed consolidating information is required in the parent's financial statements for as long as the registered security is outstanding. This is true even if the subsidiary issuer or guarantor suspends its reporting obligation under Section 15(d) of the 1934 Act. In contrast, a subsidiary guarantor or issuer that fully reports under S-X 3-10(a) may discontinue filing financial statements for as long as their reporting obligation is suspended. We recommend the Commission consider eliminating this distinction by allowing a company to suspend its requirement to file the information required by S-X 3-10 if it suspends its reporting obligation under Section 15(d) of the 1934 Act (even if the company continues to file reports on a voluntary basis).

Eliminate quarterly reporting

The Commission should evaluate whether the costs of providing quarterly information exceed the information value to investors, particularly in situations when there is a remote likelihood of the guarantee being invoked. As indicated above, we do not believe there should be a presumption that quarterly information should be provided solely because the guarantee is a security; rather, information should only be provided if it is necessary to inform investors. Quarterly information can be provided to the extent necessary to comply with the updating concept in S-X 10-01(a)(5).

If the Commission does not believe that eliminating quarterly reporting is possible, it would appear, given the objective of the financial information, that year-to-date information should be sufficient as compared to also including the quarter on a stand-alone basis.

Additionally, if the Commission believes that some quarterly information is necessary, we recommend that they consider if summarized financial information, as specified in S-X 1-02(bb), would be sufficient.

Eliminate prior year information

We believe the Commission should consider whether investors would be adequately informed if only information for the current year was provided. Currently, companies incur significant costs in recasting this information for changes such as discontinued operations, etc.

Recently acquired subsidiary issuers and subsidiary guarantors

While only applicable under the 1933 Act, S-X 3-10(g) requires separate financial statements of a recently acquired entity that is a guarantor or an issuer. As a result, more detailed information is being provided about such an entity than is being provided about any of the other guarantor entities. A company can incur significant costs and effort to prepare such financial statements that will never be required again. Given these financial statements will only be included at the time the company is first registering the debt security, at which time the probability of the guarantee being invoked would usually be remote, the

Commission should evaluate if are other more cost effective ways of providing information about the acquired entity.

We recommend the Commission consider if the level of disclosure should be allowed to be consistent with the level of disclosure that will be provided in a subsequent reporting period. Based on the existing regulations, this information would consist of a balance sheet, income statement, and cash flow statement prepared in a manner consistent with Rule 10-01 of Regulation S-X ("S-X 10-01"), for the applicable periods prior to the acquisition.

We also believe the Commission should consider if the existing test to evaluate significance in which the net book value or purchase price is compared to the principal amount of securities being registered is the most appropriate metric to determine when financial statements are required under S-X 3-10(g). For example, there could be situations in which the recently acquired issuer/guarantor(s) could be significant in relation to the amount of the securities being registered, but immaterial in relation to the existing issuer/guarantor(s). In this situation, it would not appear that a user would find the incremental financial statements/information necessary to evaluate the combined results. We believe that a comparison of the acquired issuer/guarantor to the existing issuer/guarantor(s) may be a better measure of relative significance.

Significance of the guarantee

We recommend that the Commission consider if condensed consolidating information is necessary in the following situations:

- Currently, a company can provide a narrative disclosure when all subsidiaries are guaranteeing the debt and the parent company–as issuer or guarantor—has no independent assets or operations. However, condensed consolidating information is needed if the parent company has independent assets and operations. We believe the Commission should consider whether this distinction is sufficiently important to warrant the more expanded disclosure or whether narrative disclosure would be sufficient.

- There are a number of situations in which the guarantors/issuers are holding companies, with minimal independent assets and operations. The Commission should consider if a narrative description of that fact would be sufficient to illustrate that the assets and operations of the entities guaranteeing the debt are not significant. For example, condensed consolidating information could only be required if the adjusted assets (total assets less intercompany assets less liabilities that have a more senior claim than guarantee debt) of the issuer and guarantor(s) exceed a defined percentage of consolidated assets.

- Similarly, there are situations in which the adjusted assets of the issuer and the entity or entities guaranteeing the debt are substantially more than the amount of the borrowing, such that it would appear that details of the condensed consolidating information is unnecessary. For example, if the borrowing is $100 million and there are $2 billion of assets in the guarantor subsidiary, it would seem that disclosure of that fact alone might be sufficient for an investor; detailed financial information would not be necessary. We recommend the Commission consider if there is a ratio of the amount of debt to assets of the issuer and guarantor subsidiaries in which a narrative discussion would be sufficient.

Other

- Require each entity (i.e., column) to account for its investment in other entities under the cost method. Income would only be recognized when dividends are received. Under the current methodology, a substantial amount of income of the entities in the guarantor column could come from the application of the equity method of non-guarantor entities. If the guarantee is invoked, the issuer or guarantor entity may not have access to the undistributed earnings of the non-guarantors.

- With respect to annual reports on Form 10-K, we recommend that the Commission consider whether the required information can be filed as an Article 12 schedule no more than 90 days after year end. As described above, the preparation of this information can take significant incremental time. If the company registered the debt, it would be a nonaccelerated filer and would have 90 days to file this information. The fact that the company also has equity securities registered should not impact the timing of when this information should be provided.

- We recommend that the Commission reconsider if a non 100% owned subsidiary that is a guarantor must file separate financial statements. Specifically, the Commission should evaluate if separate disclosure in the footnote/schedule about subsidiaries that are not 100% owned is sufficient.

V. ***Financial statements of affiliates whose securities collateralize an issue registered or being registered***

Rule 3-16 of Regulation S-X ("S-X 3-16") requires separate financial statements of affiliates whose securities collateralize an issue of registered debt if their securities constitute a substantial portion of collateral. To assess whether audited annual financial statements of such affiliates are necessary, registrants are required to perform the "substantial portion of collateral" test on the offering date and as of the end of each fiscal year for which a Form 10-K or Form 20-F is required.

If the test is met, the requirement is for that entity to provide the same financial statements that would be required as if it were a registrant. Accordingly, not only would the affiliate's financial statements be required, but financial statements under S-X 3-05 and S-X 3-09 with respect to acquisitions and investments of the affiliate could also be required.

Tests of significance

Under the existing rule, assuming all other factors remain the same, as the debt is paid down (and therefore becomes more collateralized) there is an increasing probability that financial statements would be required, even though there is generally a declining probability that an investor would look to foreclose on the collateral. Frequently, indenture agreements are drafted such that if this event were to occur and financial statements would be required, the provision in the agreement requiring collateral becomes null and void (if not entirely, at least to the extent that the S-X 3-16 requirements were triggered). Accordingly, a provision that is designed to benefit investors is actually taken away once financial statements become required. We recommend that the denominator in the test should be the amount of collateralized securities originally issued, not the amount outstanding as of the reassessment date.

Information to be provided

It has been our experience that the instances of a security that has been pledged being foreclosed upon in satisfaction of the obligation is very limited. Given the unlikely scenario that an investor will ever own securities in the subsidiary that has been pledged, the Commission should evaluate if less than full financial statements would provide sufficient information for investors. For example, would information about each entity in a level of detail required by S-X 10-01 or S-X 1-02(bb) that is included in the Registrant's financial statements give holders of the collateralized securities a sufficient understanding of the financial condition of the affiliate(s)? In evaluating the level of disclosure, we recommend the Commission evaluate the number of instances in which the collateral pledge of securities is invoked in connection with registered securities subject to S-X 3-16. For instance, the Commission could consider requiring disclosures based on the probability that the collateral will be foreclosed.

We also recommend that the Commission consider whether the costs of providing financial statements or information of other entities that are not pledging their securities, e.g., S-X 3-05 and S-X 3-09, are justified by the information needs of investors.

VI. Special instructions for real estate operations to be acquired

When the SEC amended S-X 3-05 in 1996, it deferred changes to S-X 3-14 so that they could be done as part of a "more comprehensive disclosure scheme." There are certain differences between S-X 3-05 and S-X 3-14 that the Commission should consider eliminating and, to the extent they have similar objectives, other provisions should be aligned. Specifically, the Commission should consider aligning:

- the applicability of Rule 3-06 of Regulation S-X (i.e., periods of 9 to 12 months satisfy the requirement to provide one year of financial statements in certain circumstances);
- the use of audited pre-acquisition and post-acquisition periods to satisfy the disclosure requirement;
- the significance thresholds (e.g., 20% vs. 10%); and
- the requirements pertaining to individually insignificant acquisitions.

In addition, given the age of this rule and its very brief guidance, the Commission staff has provided extensive interpretative guidance–including requiring financial statements in certain instances that are not specified by the rule. We recommend a comprehensive review of S-X 3-14 to determine what financial information should be provided and when, and, to the extent appropriate, the Commission could codify the staff's interpretive guidance.