CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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[redacted]

October 27, 2016

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

Re: **Disclosure Update and Simplification; 17 CFR Parts 210, 229, 230, 239, 240, 249, and 274; Release Nos. 33-10110; 34-78310; IC-32175; File No. S7-15-16; RIN 3235-AL82**

**Request for Comment on Subpart 400 of Regulation S-K; 17 CFR Part 229; Release Nos. 33-10198; 34-78687; File No. S7-18-16**

**Exhibit Hyperlinks and HTML Format; 17 CFR Parts 229, 232, 239 and 249; Release Nos. 33-10201; 34-78737; File No. S7-19-16; RIN 3235-AL95**

Dear Mr. Fields:

The U.S. Chamber of Commerce (the "Chamber") created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century global economy. [1] The CCMC welcomes the opportunity to comment on three recent releases proposing rules or requesting comment issued by the Securities and Exchange Commission (the "SEC" or "Commission"), entitled (1) ***Disclosure Update and Simplification*** (the "Disclosure Update Release"), (2) ***Request for Comment on Subpart 400 of Regulation S-K Disclosure Requirements Relating to Management, Certain Security Holders and Corporate Governance Matters*** (the "Subpart 400 Release"), and (3) ***Exhibit Hyperlinks and HTML Format*** (the "Exhibit Release"; together with the Disclosure Update Release and the Subpart 400 Release, the "Releases").

[1] The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.

The Chamber continues to be troubled that the United States has less than half of the number of public companies than it did in 1996; the number of public companies has gone down 19 of the last 20 years.[2] While there are many factors that contribute to this phenomenon, we believe a less complex, more predictable regulatory environment will help encourage more businesses to pursue a public listing. A 2015 study by the Stanford University Rock Center on Corporate Governance found that 55% of investors surveyed, who controlled $17 trillion in assets, found the proxy statements too long and only 1/3 of the information to be relevant.[3]

The Chamber has issued a study on disclosure effectiveness and proposed means of streamlining information to make the capital formation and investor processes more efficient and competitive.[4] The Chamber commends the Commission for continuing its disclosure effectiveness initiative. We support a system of securities regulation in which investors are provided with decision-useful information to deploy capital efficiently and for businesses to raise the financial resources needed to grow and expand. The releases are an important step forward in this process. While we have some concerns with several aspects of the releases, we are supportive of these measures and look forward to working with the SEC on these measures.

## **Role of Materiality**

The guiding concept of "materiality," as laid out by the Supreme Court in seminal cases such as *TSC Industries v. Northway*[5] and *Basic Inc. v. Levinson*,[6] has played the central role in our American capital markets for decades and has contributed to the formation of the deepest, most diverse, most liquid markets the world has ever known. The ability of businesses of all sizes—from young Main Street entrepreneurs to more mature companies that have employed millions of Americans for generations—to seek appropriate forms of investment from investors of all walks of life within our disclosure-based regulatory system is the hallmark of American free enterprise.

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[2] Barry Ritholtz, *Where Have All the Public Companies Gone?*, BLOOMBERG, June 24, 2015, *available at* https://www.bloomberg.com/view/articles/2015-06-24/where-have-all-the-publicly-traded-companies-gone-.

[3] https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf

[4] http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/07/CCMC_Disclosure_Reform_Final_7-28-20141.pdf?x48633

[5] 426 U.S. 438 (1976).

[6] 485 U.S. 224 (1988).

Materiality has also long been the dividing line for determining what should be disclosed and what should not have to be disclosed under the federal securities laws. To that end, considering materiality through the eyes of a "reasonable investor" is a critical feature of the Supreme Court's test. Materiality does not turn on the needs of an investor that is not representative of investors more broadly or that is looking to advance some special interest. This approach to materiality mitigates the risk that SEC disclosure documents will become too dense and impenetrable for investors by seeking to be all things to all people. It also helps ensure that the SEC, in fashioning and enforcing the disclosure regime under the federal securities laws, focuses on what is best for investors overall and adheres to the agency's mission as the country's capital markets regulator.

In recent years, there have been many efforts to erode the longstanding approach to materiality. This development has complicated and confused what materiality means and will further overload investors with information that few find to be useful when evaluating a company's financial and operational performance. Some special interests are advancing conceptions of materiality that would abandon altogether the traditional notion of materiality rooted in the Supreme Court's jurisprudence. These interest groups want to expand what businesses are mandated to disclose to advance the groups' own parochial agendas and to further goals that are extraneous and contrary to the SEC's mission. As the Commission considers further reform of Regulations S-K and S-X, the guiding principle for public company disclosure is, and should remain, materiality as viewed by a reasonable investor.

## DISCUSSION

## Disclosure Update Release

### Overview

As part of the Commission's broader initiative to improve disclosures for investors and companies, the Disclosure Update Release proposes to streamline SEC disclosure rules, removing duplicative, outdated, and overlapping requirements found in those rules. In specific instances, it proposes to amend rules that call for information that is already covered by U.S. GAAP or IFRS. The release identifies various requirements under Regulation S-X or Regulation S-K that mandate disclosures substantially similar to those required under U.S. GAAP, IFRS or other SEC rules, and proposes to eliminate those that are duplicative.

The SEC proposes to delete a variety of requirements that provide for disclosures that convey similar information due to overlapping U.S. GAAP, IFRS or SEC mandates, or provide for disclosure incremental to overlapping U.S. GAAP, IFRS or SEC disclosure rules that may no longer be useful to investors. We generally support such proposals; an example of redundant or duplicative requirements includes disclosure of related parties: Rule 4-08(k) (1) of Regulation S-X—as well as Item 404 of Regulation S-K—mandates identification of related party transactions, while Accounting Standards Codification 850-10-50-1 requires much of the same disclosure under U.S. GAAP. An example of overlapping requirements is the disclosure of the ratio of earnings to fixed charges. Companies that register debt securities are required to disclose historical and pro forma ratio of earnings to fixed charges under Item 503(d) of Regulation S-K; the SEC notes that U.S. GAAP and IFRS require disclosure of many of the same components of this ratio, as well as information from other ratios that convey reasonably the same information about an issuer's obligation to meet its financial obligations.

An example of an outdated requirement is the requirement, under Item 201(a)(1) of Regulation S-K, to disclose the stock market price on which a public company's stock trades along with the historical stock price information. The SEC notes in its proposed rule that there are many free websites that offer this information (in greater detail) than is required by SEC disclosure rules. An example of a superseded requirement relates to disclosure of discontinued operations. Instruction 1 to Rule 11-02(b) of Regulation S-X makes reference to discontinued segments and Item 302(a)(3) of Regulation S-K requires a description of the effect of any disposals of segments of a business. The SEC points out that the U.S. GAAP definition of discontinued operations has changed multiple times since the SEC disclosure rules were adopted and now such U.S. GAAP definitions no longer includes any reference to the term "segment."

By eliminating these duplicative, overlapping, or superseded requirements, we support the SEC's objective to simplify compliance efforts, while still providing material information to investors. However, throughout the proposal, the SEC concedes that, in many cases, the streamlined disclosure rules could move information from the management's discussion and analysis (MD&A) section of a regulatory filing to the financial statements and their accompanying footnotes. While we support the objective of streamlining disclosure requirements and eliminating redundancies, we are concerned that the relocation of the information could establish audit requirements where none existed before, subject the information to additional internal control requirements or the rules for tagging information in XBRL. Movement of information into the financial statement footnotes also creates the risk that the disclosure will lose the benefit of the forward-looking statement safe harbor afforded under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), which could in turn make issuers more reluctant to disclose such information.

**Overlapping Requirements**

The Disclosure Update Release examines what it considers to be "overlapping" requirements that are related to, but not the same as, U.S. GAAP, IFRS or other SEC rules. These disclosure requirements convey reasonably similar information or require disclosures incremental to the overlapping SEC rules or accounting principles. The overlapping requirements proposed for deletion or integration include provisions relating to: material events subsequent to the end of the fiscal year and changes in accounting principles reportable in interim filings; segment financial information; financial information by geographic area; seasonality; material research and development expenditures; the frequency and amount of cash dividends; tabular disclosure of changes to employee equity plans; ratios of earnings to fixed charges; invitations for competitive bids; foreign currency restrictions; and restrictions on dividends. We generally support these amendments though, as the SEC notes, the "proposal relating to some topics would result in the relocation of disclosures from outside to inside financial statements, subjecting this information to annual audit and/or interim review, internal control over financial reporting, and XBRL tagging requirements."

For example, the requirements in Regulation S-K, Item 103, to disclose certain legal proceedings can in certain cases be more expansive than those in U.S. GAAP, under which certain loss contingencies must be disclosed. However, there is a significant overlap between the disclosure requirements. We believe that the incorporation of Item 103, among other requirements, into U.S. GAAP might be more burdensome on issuers and auditors related to the development and auditing of additional estimates and disclosures. Incorporation of Item 103 requirements into U.S. GAAP could result in more instances of immaterial disclosure of the possible range of loss, more disclosure that is subject to audit or review (such as the internal control requirements), and a more general materiality threshold in connection with environmental legal proceedings. It would also give rise to issues under the PSLRA because such disclosures, which may be inherently forward-looking, would not be afforded the safe-harbor in U.S. GAAP that they presently are afforded under Regulation S-K. Given the complex issues any change may engender, we suggest the SEC conduct more analysis and outreach in this area, particularly with the accounting and legal professions, and focus its attention elsewhere for the time being as it furthers its disclosure effectiveness initiative.

**"Bright-Line" Threshold Issues**

The proposed rules may result in the removal or addition of bright-line disclosure thresholds, i.e., a threshold below which no disclosure is required, which may change the disclosure burden on issuers and the amount of information disclosed to investors. For example, unlike U.S. GAAP, Regulation S-K requires disclosure of the amount of revenue from any class of similar products and services that account for 10% or more of revenue. We believe such a quantitative threshold runs counter to the concept of materiality as it imposes an arbitrary threshold. The CCMC generally opposes the continued use of special materiality tests (such as 10% of revenue or total assets) in the context of individual items under Regulation S-K. These kinds of heuristics create inconsistency across Regulation S-K disclosure items and have the potential to confuse or mislead investors. Instead, we urge the Commission to abandon such special tests in favor of the *TSC/Basic* approach of considering, with other quantitative and qualitative factors, whether the required disclosure would significantly alter the total mix of information available to a reasonable investor.

Similarly, some of the proposed amendments would relocate certain disclosure from outside to inside the financial statements, which would thereby subject this information to audit or review, internal control over financial reporting and XBRL tagging requirements, as well as eliminate the protections provided by the safe harbor for forward-looking statements under the PSLRA. The unavailability of this safe harbor may, in turn, deter companies from disclosing certain forward-looking information. The SEC also cautions that eliminating seemingly redundant requirements may in practice elicit less or different disclosure. For instance, many of the SEC rules proposed for elimination or integration due to apparent redundancies provide bright-line disclosure thresholds, while their counterparts under U.S. GAAP, IFRS or other SEC rules do not. We are sensitive to these concerns and offer an approach further below that may help remedy the migration of certain disclosure requirements to the financial statements.

**Outdated and Superseded Requirements**

The Disclosure Update Release also identifies disclosure requirements that, as a result of the passage of time or changes in the regulatory, business environment, have become obsolete or ineffectual. We are generally supportive of these efforts. The SEC proposes replacing disclosure of the high and low sale prices for an issuer's common stock with a requirement that the issuer need only provide its ticker symbol, given that this information is readily available online. Similarly, the SEC suggests deleting the provision requiring foreign private issuers to provide exchange rate data where the financial statements are prepared in a currency other than the U.S. dollar, as this information is easily found on numerous websites. The SEC also proposes updating certain disclosure requirements to address inconsistencies that have developed over time among the various accounting, auditing and SEC disclosure frameworks. The proposed amendments aim to revise SEC disclosure requirements in light of changes to U.S. GAAP, such as by making conforming changes to the statement of cash flows and statement of comprehensive income and information relating to consolidation, discontinued operations and pooling-of-interests.

Again, the Disclosure Update Release notes that, in many cases, the streamlining of disclosure requirements would result in the relocation of disclosures within a filing, potentially changing the prominence or context of both the relocated disclosures and the remaining disclosures. To the extent disclosure migrates into the financial statements from other narrative text outside the financial statements, we are again concerned that such disclosure would no longer benefit from the protections of the PSLRA for forward-looking statements, which may cause public companies to be less forthcoming with such forward-looking information.

**Additional Comments**

*Interim Financial Statements*. We strongly concur with the proposal to eliminate Instruction 5 to Item 303(b) as both Instruction 5 and U.S. GAAP require disclosures about seasonality in interim periods. Moreover, we believe information should be provided in interim financial statements only if there are significant changes in financial position since the most recent annual financial statements or significant differences in results of operations that are unclear from the line items. However, we note that there has been a recent trend in FASB disclosure standards to require the same level of disclosures for interim and full-year financial statements. This has the unfortunate consequence of forcing preparers to forego their normal materiality judgments, which in turn may weigh down financial statements with immaterial information, thereby perhaps making useful information less visible and consequently less understandable. Thus, we believe that it is critical for both the SEC and the FASB to clearly set forth the principle that interim disclosures should be made only if they significantly update the year-end information, and that existing disclosure requirements that do not incorporate this concept should be amended to do so.

*Use of pro forma information.* In 1980, the SEC issued a concept release that requested comment on whether the requirements for the presentation of historical and pro forma ratios should be retained or deleted.[7] Responses from commenters were mixed with a substantial number of commenters supporting retention of the requirement. However, we agree with the SEC that, today, there are a variety of analytical tools available to investors that may accomplish a similar objective as the ratio of earnings to fixed charges. This ratio measures the issuer's ability to service fixed financing expenses—specifically, interest expense, including management's approximation of the portion of rent expense that represents interest expense, and preference dividend requirements—from earnings. Other ratios that accomplish similar objectives include other variations of the ratio of earnings to fixed charges, the interest coverage ratio, and the debt-service coverage ratio, which can be calculated based on information readily available in the financial statements. We suggest that a more useful and practical dividing line for forward-looking information would be to require that information regarding estimates and assumptions embedded within a current measurement used within the financial statements be included in the footnotes; and information regarding sensitivity analyses, the effects of alternate assumptions regarding future cash flows, and other expectations regarding the future be included in MD&A, in part to assuage PSLRA concerns, but also to make the information easier for investors to locate and process.

[7] Release No. 33-6196, Ratio of Earnings to Fixed Charges, 45 Fed. Reg. 16,498 (Mar. 7, 1980).

*Disclosure of accounting principles, methodology, and critical estimates.* It cannot be stressed enough that the primary purpose of the notes to the financial statements is to supplement information on the face of the financial statements. In this regard, we believe that notes to the financial statements should only contain information likely to be material to investors, and that would be material to a significant number of reporting entities. We commend the SEC for its efforts to coordinate with the FASB on standard setting and rooting out redundancy between U.S. GAAP and Regulation S-X.

By way of example, for derivative financial instruments, as defined under U.S. GAAP, U.S. GAAP requires disclosure of how and why the issuer uses derivative instruments, how the derivative instruments and related hedged items are accounted for, and how they affect the financial statements. Although Regulation S-X is more detailed than U.S. GAAP, the specificity in Regulation S-X is derived, in part, from the absence of a comprehensive accounting model for derivatives when the Commission adopted these disclosure requirements. Since that time, the FASB has adopted an accounting model for derivative financial instruments, as defined under U.S. GAAP.

**Disclosure Location and Prominence Considerations**

As noted several times above, the SEC has highlighted the benefits and pitfalls associated with moving certain disclosures to the financial statement disclosures and vice versa. In light of these concerns, which we wholeheartedly share, we believe the SEC should lead a project to clarify the definition and placement of forward-looking information and coordinate with the FASB to avoid situations in which disclosures implicitly or explicitly require forward-looking information without the benefit of safe-harbor protections for preparers. Specifically, we believe there needs to be greater clarity regarding the dividing line between the type of forward-looking information that should be reported in MD&A versus the "future-oriented information" that the FASB believes is appropriately reported in U.S. GAAP financial statements.

Since SEC registrants are required to provide forward-looking information with respect to certain disclosures in portions of registrants' regulatory filings that are in MD&A, and thus outside of audited financial statements, and because the SEC also encourages registrants to provide forward-looking information where doing so would be useful to investors, we believe this is a project in which the SEC should take the lead. The objective of financial reporting does not require a reporting entity's management to assess the entity's prospects for future cash flows, but to provide information to assist investors in making their own assessments. The federal securities laws and SEC rules provide a safe harbor for some forward-looking information; however, as is well understood, the safe harbor does not extend to audited financial statements.

Despite this, some of the disclosures that are currently required by the FASB, as well as some of the disclosures that are required under Regulation S-K, seem to sweep "MD&A-type information" into the footnotes. Disclosures such as how changes in assumptions would impact results require entities to maintain records for choices that management did not make, or for events that have not occurred. In this regard, we note that in the past, the FASB has required sensitivity analyses and other similar information to be provided in the footnotes to the financial statements because such disclosures would therefore also apply to private companies that were, by definition, not subject to the SEC's MD&A requirements. We have not observed that the SEC has conducted similar analyses.

We support the development of a disclosure framework to establish fundamental concepts of disclosure, and to provide an overarching framework and guide that can be used by the FASB in developing individual disclosure standards, as well as by preparers in determining what disclosures to provide in the absence of specific guidance. We believe that the SEC and FASB should work in close collaboration with other regulatory and standard-setting authorities. We also believe that for this type of framework to be most effective, it should be based on a few, clearly articulated principles. In this regard, we find the principles—relevance, materiality, and cost-benefit considerations—to be the most important components of this framework. However, we are concerned that these principles are not sufficiently emphasized in the proposal to convey their foundational nature.

In particular, as noted earlier in this letter, the concept that FASB should only require information that is material to investors should be the starting point for the disclosure framework. We commend FASB for its recent effort to focus accounting disclosure on material topics.[8] In addition to emphasizing materiality as a key disclosure principle, the FASB should also emphasize the concept of materiality. We believe that materiality decisions must be made by each individual entity, and FASB should establish requirements that are not so prescriptive that they preclude reporting entities from making materiality judgments. We believe it is critical that preparers have the flexibility to exercise discretion and judgment in applying disclosure requirements, and a significant component of this is determining whether a particular disclosure is material to the entity. In this regard, we strongly encourage the FASB to review its existing standards and ensure that they incorporate the ability for preparers to apply materiality determinations. We believe this will further the goal of "removing the clutter" from financial statements by enabling preparers to apply materiality judgments to existing disclosures.

Another important element in developing disclosures that the proposal sets forth is the need to carefully consider the cost of providing information in relation to the benefits produced. We agree with the view that the cost of a requirement to provide information in notes normally is not justified by the benefits if (a) that information is not specific to the individual entity and is readily and cost effectively available from sources other than the entity and (b) knowledgeable users should be aware of the need for the information and its availability.

## Subpart 400 Release

### Item 401: Directors, Executive Officers, Promoters and Control Persons

The Commission amended Item 401 in 2009[9] to expand the disclosure requirements regarding the qualifications of directors and nominees, past directorships held by directors and nominees, and the time period for disclosure of legal proceedings involving directors, nominees and executive officers. In particular, as amended Item 401 includes a requirement to disclose the particular experience, qualifications, attributes or skills that led the board to conclude that a nominee should serve as a director. As part of the 2009 amendments, the Commission also

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[8] See FASB Press Release, *FASB Proposes Improvements To Materiality To Make Financial Statement Disclosures More Effective* (Sept 24, 2015), *available at* http://www.fasb.org/cs/ContentServer?pagename=FASB%2FFASBContent_C%2FNewsPage&cid=1176166401832.

[9] Release Nos. 33–9089; 34–61175; IC–29092, Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334 (Dec. 16, 2009).

significantly expanded the list of disclosable legal proceedings involving directors, executive officers, and nominees covered under Item 401(f) of Regulation S–K.

Item 401 has benefitted investors by increasing the quality of material information that they receive concerning the background and skills of directors and nominees for director, thereby enabling investors to make better-informed voting and investment decisions. We believe that Item 401 does not need further amendment or revision at this time. Instead, we would request that the SEC focus its attention elsewhere as it pursues the disclosure effectiveness initiative.

**Item 402: Executive Compensation**

The SEC thoroughly rewrote its disclosure rules on executive compensation in 2006[10] with the adoption of the Compensation Discussion & Analysis (CD&A) requirement in Item 402 of Regulation S-K. These rules, as amended in 2006, greatly expanded tabular disclosure concerning executive compensation of named executive officers and directors. They also required a new narrative discussion and analysis of executive compensation. According to the SEC's adopting release, the 2006 amendments were "intended to provide investors with a clearer and more complete picture of the compensation earned by a company's principal executive officer, principal financial officer and highest paid executive officers and members of its board of directors."[11]

Over the past decade, CD&A has become the subject of substantial commentary and a growing amount of criticism. The complexity of the SEC's rules and interpretations, coupled with the technical nature of the broader subject of executive compensation, means that special expertise is often required to understand what CD&A requires a company to disclose. When in doubt about whether a particular fact needs to be disclosed, many companies now err on the side of disclosing it, even if the information is not necessarily useful or even material to investors.

Despite the Commission's laudable goal of using CD&A to shed light on a company's executive compensation practices and philosophy, the discussion at most

[10] Release No. 33-8732A, Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53,158 (Aug. 29, 2006).
[11] *Id.* at 53,159.

companies has instead resulted in a narrative that is overly dense and laden with technical jargon and immaterial information. CD&A can be impenetrable, even for sophisticated investors. The length of CD&A alone—a 20-page narrative is not uncommon and it has been known to run on for over 40 pages at some companies—can obscure what is material. We regularly hear stories about readers of proxy statements who struggle to comprehend CD&A, which can lead to misunderstandings in the marketplace and impair the ability of investors to make informed decisions.

Registrants undoubtedly share some responsibility for this state of affairs, yet it exists as a natural outgrowth of the SEC's rules and subsequent interpretations. CD&A has become the archetypal example of the "avalanche of information" that Justice Marshall predicted and warned against in *TSC*. Notably, in 2015 Stanford University released a study of institutional investors, who control over $17 trillion dollars in assets, finding that the majority found the proxy statement to be too long and that only a third of the information was relevant.[12] Of several key findings in the Stanford study, we find this one particularly germane to the issue of Item 402 of Regulation S-K:

**Investors are Deeply Dissatisfied with Compensation Disclosure**

> Less than half (38 percent) of institutional investors believe that information about executive compensation is clear and effectively disclosed in the corporate proxy. Responses are consistently negative across all elements of compensation disclosure. Sixty-five percent say that the relation between compensation and risk is "not at all" clear. Forty-eight percent say that it is "not at all" clear that the size of compensation is appropriate. Forty-three percent believe that it is "not at all" clear whether performance-based compensation plans are based on rigorous goals. Significant minorities cannot determine whether the structure of executive compensation is appropriate (39 percent), cannot understand the relation between compensation and performance (25 percent), and cannot determine whether compensation is well-aligned with shareholder interests (22 percent). "Corporations must do a better

[12] DAVID F. LARCKER ET AL., STANFORD UNIV., 2015 INVESTOR SURVEY: DECONSTRUCTING PROXY STATEMENTS—WHAT MATTERS TO INVESTORS 1 (FEB. 2015), available at https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf.

> job of articulating the rationale behind plan design," says [Aaron] Boyd, [Director of Governance Research at Equilar]. "It is not enough that disclosure in the Compensation Discussion & Analysis (CD&A) section of the proxy meets regulatory requirements. Companies should take renewed effort to be clear and concise in explaining their choices."[13]

The last ten years' experience with Item 402 demonstrates that reforms are needed to ensure that CD&A continues to provide investors with the material information they need to make informed investment and voting decisions when evaluating a given company's executive compensation system. One possible approach to reconceptualizing Item 402 is to eliminate the required compensation tables (which seems to be the source of much confusion to readers of proxy statements) except the summary compensation table, while placing a greater emphasis on qualitative analysis surrounding executive compensation decisions, management of risk and construction of compensation plans. We also recommend that the Commission revisit the issue that has plagued summary compensation tables for years, i.e., the fact that equity awards granted after year end are considered compensation for the next proxy statement while cash compensation is considered cash compensation in the current year, thus distorting the reporting of compensation awards in a way that does not reflect how compensation is actually assessed and granted by registrants and their compensation committees.

To inform its future actions, we recommend that the Commission collect data from a broad cross-section of issuers and investors as to their preferences through surveys, hearings, roundtables and other appropriate means. Of course, materiality should continue to be the filter through which any future disclosure requirements must pass.

**Item 404: Transactions with Related Persons, Promoters and Certain Control Persons**

Item 404 provides that companies must disclose any transactions with "related persons" (such as a director or executive of the company or their immediate family)

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[13] *Id.* at 1.

and creates a presumptive materiality threshold of $120,000. This amount is scaled for smaller reporting companies but not for other companies.

The Item 404(a) disclosure threshold was last updated in 2006[14] when the SEC increased it from $60,000, where it had been set since the early 1980s, to $120,000. While we certainly agree that disclosure around material related party transactions is useful information for investors making investment and voting decisions, we also believe that the SEC should revisit the threshold to consider whether $120,000 is appropriate for all companies and thus whether Item 404 is serving its intended purpose. As with other one-size-fits-all standards, the $120,000 level may be over-inclusive for some companies and under-inclusive for others.

Specifically, the SEC could consider deleting any quantitative threshold from Item 404(a) and instead require only the disclosure of material related party transactions. Another option would be to implement a scaled approach to disclosure of related party transactions for all companies, expanding the smaller reporting company model. Scaling for larger companies could be based on a percentage of total assets, as is currently the requirement for smaller reporting companies,[15] or some other financial metric, such as a percentage of total revenue.

**Item 407: Corporate Governance**

One of the newer items under Regulation S-K, the Commission first adopted Item 407 in 2006[16] largely to reorganize and recodify prior reporting requirements. The Commission amended Item 407 in 2007[17] and again in 2008.[18] The Commission then made substantial revisions to Item 407 in 2009 with its "Proxy Disclosure Enhancements" release, greatly expanding the scope and breadth of required

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[14] Release Nos. 33–8732A; 34–54302A; IC–27444A, Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53,158 (Aug. 29, 2006).

[15] Item 404(d)(1) currently provides that smaller reporting companies must provide related-party disclosure when the amount involved exceeds the lesser of $120,000 or one percent of the average total assets at yearend for the last two completed fiscal years.

[16] Release Nos. 33–8732A; 34–54302A; IC–27444A, Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53,158 (Aug. 29, 2006).

[17] Release Nos. 33–8876; 34–56994; 39–2451, Smaller Reporting Company Regulatory Relief and Simplification, 73 Fed. Reg. 964 (Dec. 19, 2007).

[18] Release Nos. 33–8961; 34–58656, Technical Amendment to Item 407 of Regulation S–K, 73 Fed. Reg. 57,238 (Sept. 26, 2008).

corporate governance disclosure.[19] Among many other topics, the 2009 amendments expanded the required discussion around diversity in the process by which candidates for director are considered for nomination by a company's nominating committee as well as the disclosure about a company's board leadership structure and the board's role in the oversight of risk, each topics that continue to be top of mind for investors today. The Commission most recently amended Item 407 in 2012 to implement changes required by the Dodd-Frank Act in respect of listing standards for compensation committees.[20] Relative to the many other disclosure requirements that have not seen this level of scrutiny and modification over the past decade, we urge the Commission to instead focus its attention on other areas of Regulation S-K as it continues its disclosure effectiveness initiative.

## **Exhibit Release**

Subject to the qualifications described below, we support the proposed requirements concerning exhibit hyperlinks on a going-forward (but not retroactive) basis. We concur that doing so will in many cases make navigating SEC documents more user-friendly for investors. Proposed Rule 105(c) of Regulation S-T provides as follows:

> If a filer includes an external hyperlink within a filed document, the information contained in the linked material will not be considered part of the document for determining compliance with reporting obligations, *but the inclusion of the link will cause the filer to be subject to the civil liability and antifraud provisions of the federal securities laws with reference to the information contained in the linked material*. (emphasis added)

This language appears largely unchanged from the current rule text, but we believe it takes on new significance in light of the proposed hyperlink requirement.

Currently, it is common to include email addresses and URLs of all kinds in contracts and other documents that might be required to be filed under Item 601 of Regulation S-K. Typical examples include links to a contractual counterparty's

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[19] Release Nos. 33–9089; 34–61175; IC–29092, Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334 (Dec. 16, 2009).
[20] Release Nos. 33–9330; 34–67220, Listing Standards for Compensation Committees, 77 Fed. Reg. 38,422 (June 20, 2012).

website, a customer service or supplier website, a service provider's website (such as a website listed on the letterhead of an Exhibit 5 opinion), a government agency's website (such as sec.gov, eeoc.gov or corp.delaware.gov), a disclosure schedule of owned domain names attached to a credit agreement or purchase agreement, and a proprietary online portal established for purposes of advancing a contractual relationship (such as an online data room established for due diligence purposes or to facilitate communications among lenders). Many software programs, including commonly available word-processing programs, automatically create functional hyperlinks to third party websites whenever letters such as "http" or "www" precede a domain name. Read literally, proposed Rule 105(c) would extend civil liability and antifraud liability to each of these third-party websites simply by virtue of the existence of a hyperlink.

The content of websites of the type described in the preceding paragraph is usually not prepared with a view towards compliance with the federal securities laws, and subjecting registrants to liability for them (particularly when the site is controlled by an unrelated third party) strikes us as a particularly harsh and unintended result. It is one thing to subject a registrant to liability concerning a hyperlink when the registrant intentionally directs the reader there for purposes of satisfying the federal securities laws, such as a hyperlink to a reconciliation of non-GAAP financial information under Regulation G or the hyperlink referenced in Item 1.01(b) of Form SD. It is quite another when the overly broad language of Proposed Rule 105(c) creates a liability dragnet with regard to a large body of other hyperlinks included for non-SEC purposes, such as those described in the preceding paragraph. We do not object to liability in the case of the former, but object to liability in the latter case, and urge the Commission to clarify the scope of Rule 105(c) in any final rule.

We are also concerned about the disproportionate burden the Exhibit Release would have on smaller reporting companies and non-accelerated filers. As the release indicates, these types of issuers are more likely to make their filings in ASCII format, which would require refiling of exhibits or other technical measures to satisfy the requirement to hyperlink in HTML format. Even when such companies make Edgar filings in HTML format, they may not have the same resources as large companies to complete the exercise of hyperlinking to historical filings. Although the Exhibit Release does not appear to address compliance transition periods, we request that the Commission grant smaller reporting companies and non-accelerated filers one additional year beyond the compliance date for accelerated filers to allow sufficient time for these smaller companies to comply with any final rules and take advantage of any technological enhancements that their larger peers may develop over this time.

## CONCLUSION

As the SEC continues its disclosure effectiveness initiative, materiality should be the central focus of its efforts. Issues and goals outside the SEC's core mission should be left to other governmental bodies, civil society organizations, and the private sector to address by means other than the federal securities laws. As an example, we do not believe that SEC-mandated disclosures should be used to further social, cultural, pecuniary or political motivations that the federal securities laws were not designed to advance. The SEC disclosure regime should not be an avenue for special interests to impose their agenda on shareholders at large, particularly when doing so does not maximize long-term value creation at a company. We commend the Commission for its efforts to streamline and improve disclosure, as reflected in the Releases.

We thank you for your consideration of these comments and would be happy to discuss these issues further with the Commissioners or Staff.

Sincerely,

Tom Quaadman

cc: The Honorable Mary Jo White
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar