Committee on Securities Law
of the Business Law Section of the
Maryland State Bar Association

July 21, 2016

VIA EMAIL TO RULE-COMMENTS@SEC.GOV

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Business and Financial Disclosure Required by Regulation S-K Concept Release, Request for Comments

Ladies and Gentlemen:

This letter expresses the views of the Committee on Securities Laws (the "Committee") of the Business Law Section of the Maryland State Bar Association ("MSBA"), with respect to the above-referenced concept release, SEC Release No. 33-10064, 34-77599, 81 FR 23915 (sometimes referred to herein as the "concept release"), relating to the Securities and Exchange Commission's (the "Commission") consideration of modernizing certain disclosure requirements in Regulation S-K and its request for public comment thereon. The membership of the Committee consists of securities practitioners who are members of the MSBA, and includes lawyers in private practice, business and government. The Business Law Section and the Board of Governors of the MSBA have not taken a position on the matters discussed herein, and individual members of the MSBA and their associated firms or companies may not necessarily concur with the views expressed in this letter.

We agree with the general concept of modernizing Regulation S-K. In response to the Commission's request for comment, we have comments on the following matters detailed below.

Sunset Provisions

1. We do not believe that new disclosure requirements should contain automatic sunset provisions. We believe it is appropriate for the Commission to study the impact of new rules and new and existing disclosure requirements, and to revise or eliminate them as appropriate. But sunset provisions would create uncertainty and chaos as rules expire

before the Commission has had time to fully study whether or not to retain the old rules or propose and finalize new rules to replace them. For example, we believe that some registrants would continue to include the disclosure required by rules that had expired on the assumption that the Commission may take action to re-adopt them. Others would eliminate the disclosure when the requirement expired, only to have to put it back if the requirement was re-instituted. We think this situation and resulting lack of comparability in disclosures among similar registrants would be confusing for investors.

Principles-Based vs. Descriptive Disclosure Requirements

2. We agree with the position of Standards & Financial Market Integrity Division, CFA Institute, discussed in the concept release, opposing a principles-based disclosure system, or at least, one that is more principles-based than the current system. We agree that such a system would result in inconsistent application of the disclosure threshold and limit comparability across various registrants. Further, relying solely or principally on a principles-based system would introduce confusion and uncertainty into the disclosure process. In our experience, registrants are uncomfortable without clear guidance as to what is expected of them with respect to their disclosures. Smaller registrants, especially, tend to question whether certain information must be disclosed if it is not set forth in the rules, and not having rules that at least outline what is required as a basic matter would make it much more difficult to advise these registrants. Finally, a principles-based disclosure system expands the opportunities for second-guessing of management's decisions regarding disclosures after the fact and will provide additional opportunities for expensive, though often frivolous, litigation. Principles-based disclosure rules would put registrants at a huge disadvantage in any enforcement action or lawsuit alleging failure to disclose required information. Namely, the Commission and plaintiffs' lawyers would have the benefit of hindsight when attempting to show that information a registrant did not disclose is material, while registrants have to make these determinations without the benefit of knowing how things turned out and how the markets actually reacted to the information once disclosed. As you know, materiality determinations are facts and circumstances based, and it is often not clear at the time disclosure or other decisions must be made whether information would be or will be considered material. When dealing with these uncertainties in the insider trading context, for example, registrants and their insiders are often very conservative in

making determinations of whether nonpublic information is material. In the context of an acquisition, for example, registrants will often "close the trading window" even before concluding that information has become material in order to avoid a claim of unlawful insider trading. We expect that, in an effort to avoid potential liability with respect to their Commission filings, many registrants dealing with a principles-based disclosure system would take a similar position with respect to disclosure in their reports filed with the Commission, leading to disclosure overload as registrants decide to disclose everything that could possibly be considered material at any point in the future or was ever considered material in the past. This is similar to what has happened with risk factor disclosure, which we address below. Thus, we believe that a principles-based approach to Commission disclosure requirements would thwart the Commission staff's (the "Staff') recent emphasis on encouraging registrants to focus on disclosing material information and eliminating from their reports information that is no longer material. Such an approach would also obfuscate the information that is important to investors, as investors would have no way to know what information is really important and would have to search the voluminous disclosure to identify the important information. Further, the increased uncertainty and amount of disclosure would increase the costs to registrants of producing such reports.

We suggest the hybrid approach suggested by the Federal Regulation of Securities Committee, Business Law Section, American Bar Association ("ABA Securities Committee") in their March 6, 2015 comment letter, as discussed in the concept release. That is, amending Item 10 of Regulation S-K to permit registrants to omit information otherwise required if no longer material. We note that Rule 12b-20 promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), already requires registrants to include "further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading." Together, these provisions would bring the concept of a principles-based approach into Regulation S-K but in a way that would aid comparability and provide a measure of certainty for registrants in determining what information is generally considered material and should be disclosed. We believe that a number of concerns with respect to prescriptive disclosure requirements, as outlined in the concept release, can be addressed by importing principles-based concepts, like the one just discussed, into Item 10, other provisions of Regulation S-K, or Rule 12b-20, as an overlay to the

prescriptive rules, as suggested by the Staff's Report on Review of Disclosure Requirements in Regulation S-K ("S-K Study") discussed in the concept release. For example, the concerns about registrants circumventing the prescriptive disclosure requirements "by structuring around the bright-line requirements of the standard," as noted in the concept release, can be addressed by providing instructions that with respect to agreements, transactions, etc., structured solely or principally with the intention of avoiding the disclosure requirements, disclosure of such agreements, transactions, etc., shall be required regardless of the fact that such disclosure is not technically required by Regulation S-K. This is similar to provisions in other rules, such as Rule 10b-18 under the Exchange Act, which provides that the rule's safe harbor is not available for repurchases made in technical compliance with the provisions of the rule that are part of a scheme to evade the federal securities laws. Another option is to provide an instruction that information substantially similar in nature, character or impact to the information required by the prescriptive requirements shall also be disclosed. Either option would address the concerns regarding circumvention of the prescriptive disclosure requirements by supplementing those requirements with those of prescriptive disclosure.

Information for Investment and Voting Decisions – Core Company Business Information – General Development of Business (Item 101(a)(1)) and Narrative Description of Business (Item 101(c))

3. With respect to the request for comment no. 26 in the concept release, while it is true that for registrants with a reporting history, much of the information required by Items 101(a)(1) and 101(c) of Regulation S-K is available in prior filings, we believe that it is nevertheless useful in annual reports on Form 10-K and that the Commission should not allow this information to be omitted in subsequent reports. We believe that it is useful to investors to have a description of the registrant's business, including the material developments described in Item 101(a)(1) and the description of the business required by Item 101(c), in a single document on an annual basis (i.e., in the annual report on Form 10-K). Permitting omission of this information from a registrant's Form 10-K would require investors to search through multiple filings in a time consuming attempt to piece together the current picture of the registrant and its operations. Conversely, inclusion of this information, as it is already prepared and only need be updated every year, imposes a minimal burden and cost on registrants. Further, we believe that as registrants prepare their Form 10-

Ks, using the prior year's report as a starting point, they are more likely to review previous disclosure and identify any needed updates. The personnel who prepare a registrant's periodic filings are busy, and as a practical matter, they are not going to review old disclosure that does not appear in the report they are currently preparing, as the current report will be what they focus on. We therefore believe the benefits of continuing to include this disclosure significantly outweigh any benefit of permitting the omission of this information.

4. We disagree with the suggestion that Item 101(a)(1) be amended to require registrants to disclose their business strategies. We note that a number of registrants already disclose their business or operating strategies in their registration statements or annual reports on Form 10-K. Not all registrants, however, will define "business strategy" in the same manner, and we doubt a definition could be designed that would cover all registrants' interpretation of this phrase. For some registrants, their operating strategy is proprietary, and disclosure could cause competitive harm. Other registrants may have a simple operating strategy that focuses on operating consistently with current operations, while still others may have an operating strategy that defies a short or simple explanation that would be proper for inclusion in Item 101(a)(1) disclosure. As a result, any required disclosure would lack comparability and, we believe, be of limited use to investors. We therefore believe that the benefits of any such required disclosure would not outweigh the costs, and that disclosure of business strategy should continue to be at the option of the individual registrant.

Information for Investment and Voting Decisions – Core Company Business Information – Number of Employees (Item 101(c)(1)(xiii))

5. Given the purpose of the requirement to disclose the number of persons employed by the registrant (as stated in the concept release, to "help investors assess the size and scale of a registrant's operations" and that "Changes in the number or type of persons employed can also be indicative of trends or shifts in a registrant's operations"), we believe it is appropriate to require registrants to distinguish among their total number of employees by distinguishing between full-time and part-time or seasonal employees and employees and independent contractors. The movement of a large number of a registrant's employees from full-time to part-time, for example, would likely indicate a downward shift in the registrant's operations, but under the current requirement such a change

would not be reflected in the registrant's disclosure of the number of its employees (other than on a voluntary basis). Similarly, the failure to distinguish between seasonal and permanent employees, and between full-time and part-time employees, can give a misleading impression of the size and scale of a registrant's operations by inflating the total number of employees figure disclosed in a registrant's filings with the Commission. In addition, a registrant's use of independent contractors as opposed to employees can provide insight into management's assessment of the stability of the registrant's current operations, for example, whether management expects that recent increases in business are expected to be sustained (if yes, the expectation would be to see hiring of more employees as opposed to independent contractors). Many registrants already distinguish between full-time and part-time employees, and the HR personnel that provide the information about number of employees for disclosure in a registrant's filings can easily break this information down into number of full-time, part-time and seasonal employees, as well as separating independent contractors from employees. Therefore, requiring this disclosure would impose limited, if any, additional burden on registrants, while providing meaningful disclosure to investors that furthers the intention of the disclosure requirement.

6. With respect to request for comment no. 57 of the concept release, we believe that permitting registrants to provide a range of the number of employees is unnecessary (registrants would still have to figure out the number of employees in each required category in order to include the proper range) and potentially confusing. We do, however, strongly suggest that the Commission permit registrants to provide an approximate number of employees, to allow for immaterial mistakes in classifications or start and end dates.

Information for Investment and Voting Decisions – Company Performance, Financial Information and Future Prospects – Content and Focus of MD&A (Item 303 – Generally)

7. We agree with the suggestions of the ABA Securities Committee, discussed in the concept release, that various Staff guidance on MD&A be codified or at least consolidated into a single source. In our experience, it is difficult for registrants, particularly smaller companies, to reconcile and comply with guidance set forth in multiple places. We suggest codification, however, of at least the most material aspects of such guidance, as opposed to solely consolidation. As a practical matter,

registrants tend to give more weight to, and are more careful about ensuring compliance with, requirements set forth in the Commission's actual rules as opposed to Staff guidance, particularly in connection with a principles-based requirement like MD&A.

Information for Investment and Voting Decisions – Company Performance, Financial Information and Future Prospects – Content and Focus of MD&A (Item 303 – Generally) – Quality and Focus of Analysis

8. We note the discussion in the concept release of prior Staff guidance providing that "[a]n effective analysis of known material trends, events, demands, commitments and uncertainties should include an explanation of the underlying reasons or implications, interrelationships between constituent elements, or the relative significance of those matters." We also note that Item 303 of Regulation S-K requires that registrants "provide a narrative discussion of the extent to which such increases are attributable to increases in prices or to increases in the volume or amount of goods or services being sold or to the introduction of new products or services" to the extent that the financial statements disclose material increases in net sales or revenues; and it further requires that, with respect to interim periods, that registrants "[d]iscuss any material changes in the registrant's results of operations with respect to the most recent fiscal year-to-date period for which an income statement is provided and the corresponding year-to-date period of the preceding fiscal year." We suggest that these items be revised to clearly instruct that such discussions should be quantitative as well as qualitative. This would avoid the temptation for registrants, particularly smaller entities, to simply provide a laundry list of reasons that sales, revenues or expenses changed from the prior period without providing any indication which of such factors had the most impact. As advisers to companies, we often find it difficult to convince companies to provide the type of information that would help investors understand the impact that each of the various factors they list had on the line items being discussed, as "nothing in Item 303 says I have to provide this information."

9. We urge the Commission not to require tagging of the data provided in MD&A. XBRL tagging of the financial statements is an expensive and time-consuming burden on our small registrant clients, which our clients and the Committee believe often outweighs any benefits with respect to these small registrants. We are aware of at least one registrant that, upon becoming eligible to deregister and cease filing Exchange Act reports, did

so, with the additional expense of the XBRL exhibits (which such former registrant estimated would have been approximately $27,000 for the 2014 fiscal year, the year following the filing of its Form 15) one of the significant factors in its decision, particularly given the lack of any tangible benefit of such reporting. We believe the Commission should consider how the added costs and other burdens of additional reporting obligations result in registrants deciding to deregister, resulting in less information in the marketplace and less liquidity for stockholders. Further, because MD&A discussions, unlike financial statements, are not directly comparable from company to company, the tagging process will be even more complicated than it is for financial statements while providing less benefit, as the main purpose of XBRL in the financial statement context was to allow for users of financial statements to use software that would more easily permit comparisons between registrants.

Information for Investment and Voting Decisions – Company Performance, Financial Information and Future Prospects – Content and Focus of MD&A (Item 303 – Generally) – Forward-Looking Information

10. In response to request for comment no. 99 of the concept release, we encourage the Staff to adopt the test outlined by the Supreme Court in *Basic v. Levinson*, modified to be limited to a material effect on the registrant's financial condition or results of operations. This is in keeping with the purpose of the MD&A, for determining when a known trend, demand, commitment, event or certainty must be disclosed in the MD&A section of a registrant's filing or report, in contrast to the current two-step test where management must first determine if a known trend, event or uncertainty "is likely to come to fruition" and must only provide disclosure if the registrant can't determine that it is not reasonably likely to occur and a material effect on its financial condition or results of operations is reasonably likely. First, having a different standard for analyzing when information must be disclosed is confusing to registrants, and we believe that many registrants are unlikely to understand the differences between the two tests and correctly apply them in differing circumstances. Second, the distinction between a current circumstance that may be material and should be analyzed for purposes of disclosure and insider trading prohibitions under *Basic*, and a known trend, demand, etc., that should be analyzed for purposes of MD&A disclosure under the "reasonably likely to come to fruition" test, is not always clear. Finally, we believe that the "reasonably likely to come to fruition" test can result in the non-disclosure of information that a reasonable investor could

consider material. For example, an event that has only a 10% chance of coming to fruition would not likely be considered by a registrant as "reasonably likely" and therefore requiring disclosure in the MD&A under the current test. Such an event, however, that would result in the Company's becoming worthless or, on the other hand, becoming extremely valuable, would still likely be considered by a reasonable investor to be important, and we believe such information should be disclosed. On the other hand, we believe it unlikely that information that would have been disclosed under the "reasonably likely to come to fruition" test would not be disclosed under the *Basic* test.

Information for Investment and Voting Decisions – Risk and Risk Management – Risk Factors (Item 503(c))

11. In response to request for comment no. 144 of the concept release, we urge the Commission not to *require* that registrants discuss how they are addressing each of the risks they discuss in their risk factor discussion. First, this assumes that registrants will always be able to address each of the risks they face, but this is not always true. Further, in some instances a registrant's disclosure of how it is addressing a particular risk could be competitively harmful to the registrant; if a registrant devises an effective or unique way to address a risk particular to its industry, it would not want to provide that information to competitors.

    We think it would be helpful, however, to *allow* registrants to provide this type of disclosure. We note that registrants that attempt to provide information about how they are addressing certain risks may receive a comment from the Staff upon review of their filing that mitigating disclosure is not permitted in the risk factor discussion. We think that in instances where the registrant is comfortable telling investors how they are addressing the risks they face that they should be permitted to do so, as this information can be helpful to investors and give investors a better sense of the registrant's opinion of how material a particular risk is.

12. In response to request for comment no. 146 of the concept release, we urge the Commission not "to require registrants to discuss the probability of occurrence and the effect on performance of each risk factor." Predicting the future is a difficult undertaking at best. While understanding and addressing relevant risks is essential for every operating company, expecting registrants to quantify the magnitude of each risk they face and the specific impact on their performance if the risk comes to fruition is simply unreasonable. The future cannot be predicted with such specificity.

Among other concerns, the impact on the registrant from the identified risk will vary depending on the magnitude of the actual risky event when it comes to pass. For example, many registrants include disclosure about the risk of a recession or another economic downturn; the effect on a registrant's performance, however, will vary depending on the length and severity of the recession or downturn as well as the industries most impacted by such recession or downturn (tech in 2001, banks and real estate in 2007). Similarly, the impact of a cybersecurity breach will vary depending on the magnitude of the breach and the person or group behind it as well as the motives of such person or group. As another example, in the current regulatory environment many financial institutions warn that, as financial institution regulation is a constant focus of federal and state legislators, there is a risk that future legislation could have a material impact on the registrant's business, operations and financial condition; again, expecting registrants to guess what Congress will do next and the impact of theoretical future actions is asking too much of anyone. A person who could predict the future well enough to provide this level of disclosure would be running the country, if not the world, instead of a company. Further, the additional potential liability when registrants inevitably guess wrong would outweigh any benefit of disclosure of such guesses. Requiring registrants to include disclosure that will necessarily be wrong in many instances when the actual event comes to pass will impose unnecessary costs on registrants when they need to defend lawsuits that may be filed when their guesses turn out to be wrong. We expect that in most of these cases no fraud will be involved, but the wrong disclosure will be enough for plaintiffs' lawyers to file suit and expose companies to unnecessary expenses.

We further think that such disclosure would be potentially misleading by implying that the occurrence and outcome of risks can be predicted with such specificity when this generally will not be the case.

13. We agree with the comments of others, discussed in the concept release, objecting to any suggestion to limit the number of risk factors that registrants may disclose or the length of the risk factor disclosures, and we urge the Commission not to adopt any such limits. While the members of the Committee understand, and in some cases share, the frustration of some over the length of risk factor discussions in general, as a practical matter imposing such limits without protecting registrants from liability tied to not including risk factor disclosure that appears in other registrants' reports is unfair and untenable. It is simply too easy for

plaintiffs' lawyers, after the fact, to point to a risk factor that other registrants disclosed and argue that the disclosure of the registrant they are suing was deficient because it did not include that risk factor. Without liability reform to prevent these types of suits from being filed, limiting registrants' risk factor disclosure will increase their risks of liability and expensive litigation even when they are found to have not violated the securities laws. This is simply grossly unfair to registrants and should not be considered in the current legal environment.

Further, limiting risk factor disclosure in this way will reduce comparability among registrants and industries. Registrants in industries with fewer inherent risks will be able to include risks that are further down on the "materiality" scale that those in an industry with more inherent risk, even though such risks may be applicable to registrants in both industries. In addition, it is inevitable that risks some registrants consider material would have to be cut from their risk factor disclosures due to number or page limits, denying investors important information. We believe the risk incurred by excluding material risk factor disclosure from registrants' reports far outweighs any benefits of limiting this disclosure.

In order to address some of the concerns regarding the length of risk factor discussions, we believe it is appropriate, and would be helpful, for the Commission to require, as suggested in request for comment no. 152 of the concept release, that registrants disclose in order their ten most significant risk factors, whether under separate heading or otherwise. We believe an even better suggestion is for the Commission to incorporate into Item 503(c) current Staff guidance directing that registrants generally discuss their risks in order of significance, such that the most significant risks are presented first. Including such a provision in Item 503(c), as opposed to leaving this concept as part of Staff guidance, makes it more likely that registrants will comply with the requirement, and having the risks set forth in order of importance would allow investors to concentrate on the most significant risks if that is their desire while not preventing registrants from discussing less significant but still material risks or subjecting them to increased liability.

14. For reasons similar to those discussed in comment number 12 above, we urge the Commission not to prohibit disclosure of any category of risks, including generic risks common to an industry or all registrants in general, or specific risks. We disagree with the notion that such disclosure

cannot, by definition, ever impart material information to investors. While institutional and sophisticated individual investors may understand these types of generic risks, not all investors will, especially those risks that are industry-specific, and we believe that a description of these risks can be important to such an investor's investment decisions. Further, designating specific risks that registrants can never include will likely eliminate important disclosure from the reports of a subset of registrants. For example, a commonly disclosed risk factor is the risk of loss of key personnel. It is true that almost every company will depend on their key personnel and have some risk related to the loss of such personnel. There are, however, some registrants, particularly smaller registrants, for whom the loss of their principal executive officer or founder, for example, would truly be devastating. Similarly, larger companies may have the resources to train replacements for key personnel that smaller companies may not. Preventing such a registrant from providing this type of disclosure would be a disservice to investors, who may then not have a true understanding of the risks of an investment in such registrant.

Further, limiting the length, number or content of a registrant's risk factor disclosure conflicts with the long-held Staff position that additional disclosure that is not required by the Commission's rules is permitted as long as it is not misleading.

Securities of the Registrant – Purchases of Equity Securities by the Issuer and Affiliated Purchasers

15. While the Commission did not ask for comment on this issue in the concept release, we request that the Commission consider adding an instruction to Item 703 of Regulation S-K clarifying whether registrants who have a repurchase program authorized are required to include the table and footnotes to the table required by Item 703 of Regulation S-K in Exchange Act reports covering periods in which no repurchases were actually made. Even though Part II, Item 2(c) of the Commission's form of Quarterly Report on Form 10-Q and Part II, Item 5(c) of the Commission's form of Annual Report on Form 10-K direct registrants to provide the information required by Item 703 of Regulation S-K "for any purchase made in the quarter covered by the report" or "for any repurchase made in a month within the fourth quarter of the fiscal year covered by the report," respectively, there is still confusion on this point. Some practitioners believe that the disclosure is required even if no repurchases were made during a quarter covered by a report, and others point to the

instructions of Form 10-Q and 10-K that clearly require the disclosure only if there were any repurchases during the applicable quarter. If the Commission determines to require this disclosure in reports covering quarters in which no repurchases are made, Forms 10-K and 10-Q, as well as the language in Item 703(a) requiring the disclosure for "any purchase made by or on behalf of the issuer or any 'affiliated purchaser,'" should be revised accordingly.

Industry Guides

16. We caution the Commission against eliminating the industry guides with the intention of eliciting the same or similar information through comment letters. While the analysis of comment letters cited by the Commission in the concept release may be a means of refining disclosures that are otherwise required under the Commission's rules, we do not believe that this is an appropriate method by which to elicit particular disclosures, such as those set forth in the Industry Guides. Among other things, the breadth and specificity of the requirements in the industry guides is unlikely to be addressed in comment letters. We also believe that this would reduce comparability as registrants develop their own interpretations of the requirements based on the superseded industry guides and Staff comments. Further, such third-party analysis is not available with respect to industry-specific issues in all instances. Many registrants, particularly smaller registrants, do not have the means to analyze all of the Staff comment letters issued to registrants in their industry to determine the expected industry-specific disclosure. Finally, based on our experience, we believe that the industry guides do help registrants in preparing disclosure for their periodic reports and ensures that relevant and useful information is disseminated to investors. And as we have stated previously, based on our experience with smaller registrants, we believe that a number of smaller reporting company registrants would not voluntarily provide this information if it was not required (or at least strongly encouraged in formal guidance) either in Regulation S-K or as set forth in the industry guides.

Industry Guides – Guide 3 Statistical Disclosure by Bank Holding Companies

17. Assuming the industry guides are retained, we believe that General Instruction 3(c) to Guide 3, which provides that the "reported period" for which disclosure is required, for registrants with assets of less than $200 million or net worth of $10 million or less as of the end of the last fiscal year may provide only two years' worth of the information required by

Guide 3, instead of providing the information for the last three years or five years, should be revised to apply to all smaller reporting companies and to emerging growth companies that choose to provide the scaled financial statement disclosure consistent with that required of smaller reporting companies. Most of the Guide 3 disclosure requirements track the financial statement requirements – three years. Similarly, for companies that are only required to provide two years of financial statements, it makes sense that the Guide 3 requirements track the financial statement requirements. Further, it is inconsistent and confusing for Regulation S-K to have scaled disclosure requirements for smaller reporting companies and emerging growth companies while Guide 3 has scaled disclosure requirements based on an entirely different measure. We do not believe the additional year or years of disclosure provide any material information to investors. If there is concern that two years of information may not be adequate to show trends, the Commission could consider adding an instruction providing that disclosure of prior year(s) information in accordance with General Instruction 3(a) and 3(b) shall be required to the extent necessary to keep the information provided from being misleading.

18. We suggest that the dollar threshold for disclosure of time certificates of deposit and other time deposits in Item 5.D of Guide 3 be increased from $100,000 to $250,000 in order to be consistent with the current $250,000 FDIC insurance limit and current disclosure requirements for the notes to the financial statements in accordance with generally accepted accounting principles in the United States (GAAP).

<u>Disclosure of Information Relating to Public Policy and Sustainability Matters</u>

19. We urge the Commission to resist the temptation to join the current, misguided trend of using the disclosure requirements of the federal securities laws, principally the Exchange Act, for purposes wholly unrelated to investor protection. As the concept release notes, "[s]ome investors *and interest groups* ... have expressed a desire for greater disclosure of a variety of public policy and sustainability matters, stating that these matters are of increasing significance to voting and investment decisions" (emphasis supplied). While such matters may be increasingly significant to voting and investment decisions of certain groups of investors – i.e. special interest groups, they are, for the most part, not material to an investment decision made by a "reasonable investor" – i.e., based on an investor's economic interest. There are investors, investor

groups and institutional investors and investment funds that focus on one or another type of environmental, social or governance ("ESG") concerns, and make investment decisions accordingly. That is their right, just as it is their right to request the disclosure of information in this regard from registrants in whom they are considering investing. To the extent registrants want to court these types of investors, they are free to voluntarily provide this information even now. But investing based on social concerns is not what is meant by the "reasonable investor," and catering to such investors is not the Commission's mission or the purpose of the disclosure requirements of the federal securities laws. To the extent ESG disclosure does not provide *material* disclosure to the *reasonable investor*, requiring this type of disclosure from all registrants under the Exchange Act or otherwise is inappropriate. We agree with the commenters, as discussed in the concept release, that it is inappropriate to use the disclosure requirements of the securities laws to address "societal issues unrelated to investor protection" and to "use the federal securities laws to address various societal concerns without giving effect to the bedrock materiality principle." The federal securities laws are not designed to give investors the right to obtain all information they might want to know or that might be of interest to them, but rather, only that information that a reasonable investor would consider material to an investment decision.

Recently, Congress has been the worst offender in this regard, requiring the Commission to adopt rules, such as the conflict mineral and the pay ratio rules, that it couldn't even pretend have any relation to investor protection or the disclosure of material information as defined by the Supreme Court in *Basic vs. Levinson*. As securities lawyers, this perversion of the federal securities laws truly offends us. We urge the Commission not to make this situation worse. In fact, we urge the Commission to explore ways to educate members of Congress on the intent and purpose of the federal securities laws and attempt to prevent further inappropriate uses of these statutes.

Moreover, the goals of many of these ESG initiatives are laudable, such as the end to the civil war in the Congo and addressing increasing economic inequality, but they are unlikely to be accomplished through the use of Commission disclosure requirements. This is especially true because the disclosure or proposed disclosure is or would be required solely of companies that file periodic reports with the Commission while no such requirements are or would be imposed on non-reporting companies. In

addition, the costs of many of these requirements, including the conflict minerals and pay ratio rules, which the Commission itself estimates are often quite substantial, far outweigh any benefit to investors, especially because for the most part there are none. To the extent there is a societal benefit from such disclosures, there is no logical reason why these costs should be imposed solely on companies that file Exchange Act reports or through the facilities of the federal securities laws. We urge the Commission not to go down this road.

Further, there are practical concerns to starting down the slippery slope of requiring ESG disclosure for societal reasons. The Commission cannot possibly adopt rules that address the disclosure desires of every special interest group. Without the materiality threshold, how would the Commission decide which ESG disclosures registrants should be required to include? We reiterate that the reasonable investor would not consider these disclosures material in making an investment decision.

Please note that we do not object, wholesale, to all ESG-related disclosure requirements. To the extent there is objective proof that the matters behind these disclosures have a material economic impact on registrants or are otherwise material under the standard set forth in *Basic v. Levinson*, consideration of requiring such disclosure would be appropriate. But this is not the situation with respect to the majority of ESG disclosure requirements being proposed by special interest groups or, for that matter, implemented by Congress.

Exhibits

20. We suggest that Items 601(a)(10) and 601(b)(10) be revised to read "*Other* instruments defining the rights of security holders, including indentures." While the filing requirement of these items is read that way anyway – registrants do not file their articles of incorporation and bylaws as both Exhibit 3(i)/(ii) and as Exhibit 4, even though these documents are the main, and often the sole, instruments defining the rights of security holders, we believe that making this clarification would be helpful.

21. We do not believe the benefits of providing exhibits in a tagged or searchable manner would provide a material benefit to stockholders, and that any benefit would be outweighed by the costs to registrants. Exhibits filed through EDGAR are already text searchable when viewed on the Internet. Further, the information set forth in an exhibit to a report (other than the XBRL exhibits that are already tagged) is not like the financial

statement data that users of this information would generally compare across companies.

One change we believe would be useful to investors and other users of Commission filings would be for EDGAR to include in filed reports hyperlinks to exhibits that are incorporated by reference. Currently, persons using EDGAR to review a filing and who want to review an exhibit incorporated by reference has to look for the exhibit in the exhibit list, identify the filing from which the exhibit is incorporated, and then do a new search for that filing. This can get tedious and confusing when trying to review multiple exhibits. Some pay services provide these types of hyperlinks to incorporated exhibits, but not all users of Exchange Act reports have access to these services. We believe updating EDGAR to provide these hyperlinks would vastly improve the experience of users of these reports.

Exhibits – Schedules and Attachments to Exhibits

22. We agree with the ABA Securities Committee that the Commission should add an instruction permitting the omission of all schedules, as well as attachments, to *all* exhibits required to be filed, unless the schedules contain material information that is not otherwise disclosed in the exhibit or filing. As the Commission noted in the concept release, much of the information contained in schedules to exhibits to filings will either be immaterial or adequately described elsewhere in the filing. The filing of this information adds an unnecessary expense for registrants, particularly when the schedules are not in a format that can easily be converted in the format needed for filing. In this instance we don't see any benefit to investors or registrants of requiring registrants to provide (what can be voluminous amounts of) immaterial information. In response to the Commission's specific question on this issue, we don't see why this position should be limited solely to exhibits filed under Item 601(b)(2), Item 601(b)(10), or any specified subset of required exhibits.

23. While registrants and their advisers always welcome guidance from the Commission on defining materiality, we don't see a rationale for providing guidance on evaluating materiality specifically for purposes of including schedules and attachments to exhibits. The concept of materiality is well understood among registrants and their advisers, even if it is not always easy to apply in practice. We don't see, however, why this analysis would be different for attachments and schedules to exhibits than in analyzing whether information is material in other contexts. We

further expect that despite any Commission instruction that such guidance assessing materiality is limited to consideration of attachments and schedules to exhibits, such guidance would be applied to materiality determinations generally. We also believe that having varying concepts of materiality for different portions of reports would be confusing for both registrants and investors as well as other users of Commission filings.

24. While we agree that including a list of omitted attachments and schedules, to the extent not clear from the exhibit itself, would be reasonable and helpful, we urge the Commission to not require registrants to disclose how they assessed materiality for purposes of omitting schedules and attachments to exhibits. First, we see no reason to single out exhibits for such an analysis; registrants make materiality decisions all the time when deciding what information to include in their filings, and as a general matter they are not asked to memorialize and disclose their analysis in this regard. Further, such decisions do not always lend themselves to a written analysis, and the disclosure of the registrant's rationale why the information in such schedules and attachments is not material may itself reveal confidential or competitively harmful information or information that is not yet ripe for public disclosure. Such disclosure would also be an additional source of liability for registrants. Rather than undertaking the time, expense and risk of providing such an analysis, we expect that most registrants would opt to file the attachments and schedules that could otherwise be omitted, thereby eviscerating any benefit of the change, should it be implemented.

25. Finally, we urge the Commission to codify Staff practice and allow registrants to omit, without a formal request for confidential treatment, personally identifiable information ("PII") from all exhibits filed with the Commission as well as any schedules and attachments to such exhibits. PII does not provide any material information to investors or other users of SEC filings, yet its public disclosure can have devastating consequences for the individuals whose PII has been disclosed. As the Commission is well aware, things have changed greatly since Item 601 of Regulation S-K was adopted in 1980. At that time, unlike today, an unauthorized person who gained knowledge of a person's or entity's bank account number, or even an individual's social security number, could do little harm with this information. Further, as Commission filings were not widely available in 1980 as they are today – maintained in paper in the Commission's public reading room as opposed to being available to the world instantaneously and forever on the Internet, few people would have, as a practical matter,

had access to such PII in 1980. But today, requiring registrants to spend time and money to omit information that no one would think is material or, for that matter, should even be included in a document being posted to the Internet, is a waste of both their and the Staff's time and resources. Codification of the Staff's practice in this regard is long overdue.

Exhibits - Amendments

26. In response to request for comment no. 234 of the concept release, we believe, given the ready availability of exhibits on EDGAR, that an amendment-only exhibit provides investors with the information they need to evaluate the impact of an amendment on a registrant. Further, we urge the Commission not to adopt a requirement that registrants "file a complete, amended and restated agreement each time an exhibit is modified," whether highlighting changes or otherwise, because such a document would not, in reality, exist; we think it highly inappropriate to ask registrants to create and file a document that does not actually exist and believe that many registrants would be highly uncomfortable doing so. We believe that such a requirement conflicts with the general rule that electronically filed documents should be a true representation of the actual document. Furthermore, the fact that the exhibit list will list the original document and all current amendments should avoid any confusion on the part of users of Commission filings. For these reasons, we urge the Commission to similarly eliminate the instruction requiring registrants to file a complete copy of their articles of incorporation and bylaws as amended following an amendment to these documents in cases where these documents are not amended and restated. We believe that requiring a marked copy of the amendment showing the changes to the amended portions of these documents would, however, be appropriate.

Exhibits – Material Contacts

27. For the reasons discussed above in our comment no. 23 as set forth under "Exhibits – Schedules and Attachments to Exhibits" above, we urge the Commission not to adopt a materiality standard for contracts not made in the ordinary course of business in determining when such contracts need to be filed. As the Commission noted in the concept release, quoting from its 2004 adopting release with respect to Form 8-K amendments, the materiality standard is "already familiar to reporting companies." We believe this concept is familiar to many of the users of Commission filings as well. We strongly believe that the definition of "material" should be consistent with respect to all materiality determinations that registrants

make, and are required to make, with respect to their Commission filings as well as for other purposes (i.e. "closing the window" in connection with their insider trading policy). As we have said, we believe that differing standards of materiality for different areas of Commission filings will sow confusion among registrants as well as investors and other users of Commission filings. We see little need, or material overall benefit, of altering the materiality standard that both registrants and many others have become familiar with.

Scaled Requirements – Scaled Disclosure Requirements for Eligible Registrants

28. In response to request for comment no. 274 of the concept release, and consistent with our comment no. 9 under "Information for Investment and Voting Decisions – Company Performance, Financial Information and Future Prospects – Content and Focus of MD&A (Item 303 – Generally) – Quality and Focus of Analysis" above, we again urge the Commission to eliminate the XBRL tagging for smaller registrants, including not only smaller reporting companies but, consistent with the recommendation of the Commission's Advisory Committee on Small and Emerging Companies' September 2015 recommendation to revise the definition of "accelerated filer" to include companies with a public float of $250 million or more (but less than $700 million) and that the Commission exempt smaller reporting companies from XBRL tagging, to smaller accelerated filers as well. We believe that the time and expense spent on preparing their XBRL exhibits far exceeds any perceived benefit of requiring smaller registrants to provide this information. Given the small size and the limited following of most of these smaller companies (smaller reporting companies in particular), we believe that the information in most of these exhibits is not being "downloaded directly into spreadsheets, analyzed in a variety of ways using commercial off-the-shelf software, [or] used within investment models in other software formats." By contrast, the costs to smaller registrants can be significant. For example, one Committee member's client, a smaller reporting company with approximately $155 million in assets, estimates that it spends approximately $15,000 per year complying with the Commission's XBRL requirements. Another Committee member's client, with a public float of $134.9 million at June 30, 2015 and approximately $1.6 billion in assets, estimates it spends approximately $35,000-$40,000 per year on outside service providers to comply with the XBRL requirements (including an annual update for the taxonomy).

Scaled Requirements – Frequency of Interim Reporting

29. We do not believe that the rules regarding quarterly reporting should be revised or eliminated. We agree with the comments noted in the concept release that eliminating the quarterly reporting requirements would result in the potential for inconsistent reporting intervals across registrants and industries and that this would not fix the short-termism focus of the capital markets.

    The quarterly reporting paradigm has become so ingrained that we doubt many registrants would take advantage of the option to report semi-annually or on an even less frequent basis. For one thing, we expect that a majority of investors would demand quarterly reports. The concept release notes, for example, that 58% of institutional investors preferred to receive quarterly information. Even non-exchange listed clients have institutional investors that hold their stock and, we believe, would expect or demand to receive quarterly financial disclosures. Further, the quarterly reporting model is the norm in other industries. Financial institutions, for example, file quarterly call reports with their regulators, and we expect that banking client registrants would continue to maintain quarterly reporting so that their Commission and bank regulatory filings were consistent. Registrants (and, for that matter, non-registrants) enter into financing, merger and other agreements that require them to provide quarterly financial information, and we suspect that most parties to these agreements would not be satisfied with annual or semi-annual reporting. Further, the move to annual or semi-annual reporting would lengthen the period of time that insiders would be unable to trade in a registrant's securities in order to comply with the insider trading prohibitions of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. We do not believe that registrants, in most cases, would want to impose additional restrictions on the ability of their insiders to trade just to avoid a couple of extra quarterly reports. Therefore, we expect that only a small minority of registrants would take advantage of a less frequent reporting option, but the result of those that did would be to increase investor confusion as they tried to compare information across companies and industries, since registrants would be reporting on different schedules and unequal levels of information would be available to investors depending on whether registrants took advantage of the ability to report less often.

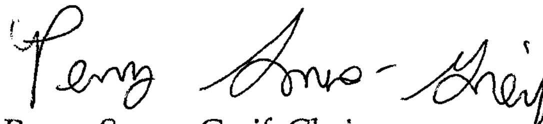
    Further, we don't see how investors or the markets (including the over-the-counter markets if semi-annual reporting were permitted for non-

listed registrants) would benefit from the trading of securities of companies for which investors and those that advise them have less information than they currently have, i.e., on the basis of information provided under a semi-annual reporting scheme. Decreasing the frequency of reporting would put Commission requirements seriously out of step with modern demands for current information. While those of us in Generation X or older might decry the 24-hour news cycle and data overload of modern life, that is the world in which we live; we believe a move to less frequent reporting would be out of step with this reality and the current expectations and needs of the investing community. We urge the Commission not to move forward with this concept.

We appreciate the Commission's consideration of the foregoing comments.

Very truly yours,

Committee on Securities Law of the Business Law Section of the Maryland State Bar Association



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