October 31, 2016

Mary Jo White
Chair
Securities and Exchange Commission

Re: "Disclosure Update and Simplification," Proposed Rule
File No. S7-15-16
RIN 3235-AL82

Dear Chair White,

We oppose the Securities and Exchange Commission's (SEC, or Agency) proposed rule, titled "Disclosure Update and Simplification" and ask that it be withdrawn.

Disclosure forms the bedrock of the SEC'S mission in protecting American investors.[1]

Now, the SEC proposes a major devaluation of this disclosure framework by proposing what the Agency calls "disclosure simplification." On its face, the rulemaking may appear to be a series of innocuous changes, but, in fact, the regulations would have far reaching and dangerous consequences for investors and the nation's corporate disclosure regime.

Unsound basis

The rulemaking rests on two unsound pillars:

The first is that investors are burdened with too much information from the companies in which they invest. We are unaware of this burden, or of any demand, serious or otherwise, expressed in the investment community for less disclosure. On the contrary, investors consistently ask for more information—one clear example being political spending information, as evidenced by a petition calling for this transparency with more than 1.2 million investor and public comments.

In the absence of true investor demand, the SEC is paradoxically hastening to make disclosure changes to lessen what information is provided. After soliciting comments to broad disclosure questions in their S-K concept release just months ago as a part of the agency's "disclosure effectiveness review" process, it seems unlikely that SEC could have digested the many

[1] Joel Seligman, THE TRANSFORMATION OF WALL STREET, Houghton Mifflin (2003)

thoughtful responses it received before it published this proposal to change disclosure rules. The "Disclosure Update and Simplification" NPRM came *before* the S-K comment deadline.[2]

The second pillar is the idea that materiality (the standard upon which corporations base their disclosure decisions) is overbroad and should be narrowed to only "financial materiality."

Materiality applies to the notes in financial statements, namely, the description by management of specific items that are part of the aggregate quantifications in the financial statements, either the income statement or balance sheet. (For example, certain revenue and expense results at a fast food chain may be different than expected, and management may explain that restaurants in a region of the country suffered food poisoning from bad chicken.[3])

Currently, as described by the Financial Accountings Standards Board (FASB), materiality means information that "could" influence investor decisions. [4] FASB now proposes to change the definition of materiality from what "could" influence an investor, to what "would" influence the investor.[5][6] FASB further proposes to declare that materiality is a legal concept.[7] This makes a firm's legal officer the pivotal arbiter of the issue. Currently, an independent auditor might take a contest over whether an item should be discussed in the notes to the firm's board audit committee. With this dynamic in force, the company's financial officer might tend to accept the auditor's recommendation instead of facing board arbitration. Under the new FASB rubric, a dispute between the auditor and in-house finance official will be settled by the in-house counsel. With this dynamic, the company's auditor is less likely to contest the omission of what she might consider material information. In short, the FASB proposal will result in less information.

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[2] *Business and Financial Disclosure Required by Regulation S-K* (Release No. 33-10064 (Apr. 13, 2016) available at https://www.sec.gov/rules/concept/2016/33-10064.pdf ;

[3] One imagines that the accounting industry might have developed a manual that establishes numerical metrics. The question of materiality is undoubtedly informed by the hundreds of independent auditor hours expended each year at many thousands of public companies, a ritual that has taken place for many decades. Further, the stock market provides a minute-by-minute evaluation of information that changes stock prices. Given this one might hope that a concept so basic as materiality would enjoy a more muscular description than what seems little beyond a tautology, namely, that which could change an investor's view.

[4] The SEC was created to buffer investors from the unscrupulous huckster in the private sector; so trusting the private sector to set standards (via FASB) could mean that hucksters have taken over or at least are influencing that standard setting process. P. 51611

[5] See FASB Project Update, (website visited October 2015), Available at: http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176156344894

[6] See press release, Univ of Tennessee, available at: http://tntoday.utk.edu/2015/10/29/carcello-speaks-proposed-rules-limiting-disclosure/

[7] These venues include the law, facts, and markets, which can be influence by emotion. Information contained in print may have a different impact than video. For example, it may be immaterial that a CEO is arrested for DUI. However, if this arrest is captured on video, this may lead to a different impression of the same information. See discussion, available at: http://www.theconglomerate.org/2010/10/is-your-ceo-being-arrested-for-dwidui-material.html. In another case, a CEO was caught on a surveillance camera abusing his dog. This became public, and the company was forced to issue a statement condemning its CEO. See San Diego Union, available at: http://www.sandiegouniontribune.com/news/2014/aug/25/centerplate-ceo-dog-kicking-san-diego-contracts/

This forthcoming definition of materiality should be stopped in its tracks. A number of investor organizations have called on FASB to stop this effort. The SEC's own Investor Advisory Committee similarly warned against debasing the definition of materiality. [8]

Regrettably, the SEC seems to also be trending in the same direction. Many of the changes proposed in the "disclosure simplification" that the agency is seeking comment on here would do away with SEC rules in favor of US GAAP, or generally accepted accounting principles disclosures, and would narrow the definition of materiality to that which is financially relevant. This could frustrate the investor demand for new information in many areas (such as political spending disclosure.) Corporate political expenditures may not be massive but they are still risky because they involve politics and could embroil the company in reputational issues and ultimately hurt the bottom line.

On top of these two unsound pillars teeters a bewilderment of indecipherable statutory, accounting, and legal terms masking some decidedly dangerous changes. This inscrutability is emphasized by SEC Commissioner Kara Stein. Commissioner Stein wrote:[9]

> Despite its 500 plus page length, this proposal may be framed in such a hyper-technical way that it fails to provide a bonafide opportunity for a wide variety of commenters to truly access and understand what is being proposed and what we are seeking comment on. Any rulemaking release on a technical subject matter can and should, be made accessible to all of the stakeholders who will be impacted if the proposal is adopted. Unfortunately, the release before the Commission today may exclude commenters from the dialogue and limit access to our rulemaking process to specialized experts. For example, how can non-experts compare distinctions between Rule 4-08(m)(1)(ii) of Regulation S-X and Accounting Standards Codification 860-30-50-7 without more information? How are investors to weigh in if they can't make heads or tails of the subject matter?

Only an attorney schooled in economics, business history, and accounting, and blessed with an encyclopedic understanding of SEC statutes, experience with the history of GAAP, IFRS and other standard setting wars, and afforded at least years' time of reading, study, review and consultation, could possibly do justice to a definitive comment. Further, the perils of not commenting on this rule could lead to a disastrous narrowing of the key standard upon which many investors seek increased disclosures.

[8] Letter to the FASB from the SEC Investor Advisory Committee available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-letter-fasb-materiality-012116.pdf

[9] Stein's continues: "How are investors to weigh in if they can't make heads or tails of the subject matter? I requested the release provide greater clarity and context for these topics and others. This was not adequately done. It is bitterly ironic that a release on disclosure effectiveness fails to present information in a clear, concise, and understandable way to the public. How can we require issuers to provide information in plain English, yet fail to meet this standard ourselves? Moreover, how are we to fulfill our mission of investor protection if we effectively exclude commenters from engaging on rulemakings that will impact the disclosure they receive? How are we to be the investor's advocate, if we do not provide investors with bonafide opportunities to engage?
See: https://www.sec.gov/news/statement/stein-statement-open-meeting-071316-disclosure-update.html

Selected Specific Problems

We highlight only a few of the specific dangers beyond our general concerns surround narrowing disclosure and the definition of materiality:

1. *Repurchase agreements.*

The Agency proposes to delete Rule 4-08(m)(1)(ii). (The Agency does not explain what this rule does in the preamble, simply the reasons it proposes to delete it.)[10] This rule requires that firms that borrow money through the repurchase agreement (repo) market should declare the details of these liabilities if they exceed 10 percent of the assets of the firm. This10% dependence level is enormously important both to investors in the borrowing firm, and to counterparties as they make credit decisions. The financial crisis demonstrated that firms such as Lehman had grown addicted to repo, and had manipulated tax and other rules to enable its dependency. In fact, repo disclosure should be enhanced, not deleted.[11] The Agency makes no reference to these issues; instead, the basic reason that the SEC proposes to eliminate this requirement is that U.S. GAAP provides for similar or overlapping reporting. Similar, overlapping standards are not the same standards, just as two photographs of a building from different angles or distances may be similar or overlapping, but are not the same. A photograph from 50 feet is similar but not the same as one from 500 feet.

GAAP, or Generally accepted accounting principles, it must be noted, are not generally accepted. Nor is the publication freely available. One edition spans 7,692 pages across four volumes.[12] U.S. GAAP differs from accounting standards in other countries (an acute problem given that

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[10] Here is the rule:

> **(A)** If, as of the most recent balance sheet date, the carrying amount (or market value, if higher than the carrying amount) of securities or other assets sold under repurchase agreements, other than securities or assets specified in paragraph (m)(1)(ii)(B) of this section, exceeds 10% of total assets, disclose in an appropriately captioned footnote containing a tabular presentation, segregated as to type of such securities or assets sold under agreements to repurchase (e.g., U.S. Treasury obligations, U.S. Government agency obligations and loans), the following information as of the balance sheet date for each such agreement or group of agreements (other than agreements involving securities or assets specified in paragraph (m)(1)(ii)(B) of this section) maturing (*1*) overnight; (*2*) term up to 30 days; (*3*) term of 30 to 90 days; (*4*) term over 90 days and (*5*) demand:
> ***(i)*** The carrying amount and market value of the assets sold under agreement to repurchase, including accrued interest plus any cash or other assets on deposit under the repurchase agreements; and
> ***(ii)*** The repurchase liability associated with such transaction or group of transactions and the interest rate(s) thereon.
> **(B)** For purposes of paragraph (m)(1)(ii)(A) of this section only, do not include securities or other assets for which unrealized changes in market value are reported in current income or which have been obtained under reverse repurchase agreements.

[11] *See, e.g.*, Steven Smalt and J. Marshall Mc Comb II, *An Examination of Repurchase Agreements*, Journal of Finance and Accountancy, Volume 19, March 2015 available at http://www.aabri.com/manuscripts/152156.pdf (outlining the accounting loophole that Lehman Brothers took advantage of in effecting its infamous "Repo 105" transactions. These accounting manoeuvers allowed Lehman Brothers to temporarily remove billions of dollars of assets from its balance sheet, thereby hiding the true extent of its leverage.)

[12] Accounting Standards Codification, explained here: https://attestationupdate.com/2011/04/28/just-how-many-pages-are-there-in-gaap-sas-and-ssars/

many public companies operate in multiple nations). And it can change, regardless of what the SEC does. As with many other proposals, the Agency is ceding its responsibility to safeguard disclosure to private sector organizations, in this case GAAP and FASB. The SEC should instead oblige its mandate.

2. *Pro forma business combination*

The agency proposes[13] to delete pro forma (forward looking, with results combined for as yet separately operating units) financial information in interim filings for business combinations, as provided in Rule 8-03(b)(4). Annually, Berkshire Hathaway CEO Warren Buffett lectures on the accounting manipulations of those who merge companies, where promises are highlighted and problems not disclosed.[14] More than half of all mergers fail.[15] If financial reporting were accurate and frequent, accountants would be better positioned to recognize problems as they occur, and ideally, advise merger-inclined executives that the marriage may not be such a good idea; delayed reporting can allow hope to replace harsh reality. Requiring pro forma projections on an interim basis results in some discipline; eliminating this will permit even more whitewashing.

3. *Executive compensation*

The Agency proposes[16] to delete its requirement that executive compensation be disaggregated. Disaggregation allows investors to see what in the pay package is cash, stock, options, etc. The reason for the deletion is that the Agency notes that the major stock exchanges require such disaggregation as a listing requirement. As with GAAP, the agencies can change their listing standards. Wells Fargo faces scrutiny now because it failed to identify that bonus figures were tied to cross selling quotas that, in turn, proved illusory. Had it been clear to investors that the millions in bonuses for Named Executive Officers stemmed from line salespeople (paid $25,000 a year) to open eight accounts for each customer,[17] or be fired, or cheat and try not to get caught, then this runaway fraud might have lasted a year, instead of two decades.[18] As with the other changes we mentioned, this is presented as a modest change—but the consequences for information provided could be disastrous. Already, CEO pay is high and the metrics by which it is judged are opaque. Obscuring the information makes matters worse.

Conclusion

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[13] P. 51621

[14] Berkshire Hathaway, 10-k, http://www.berkshirehathaway.com/reports.html

[15] See, for example, *Why Half of All M&A Deals Fail, and What You Can Do About It,* Forbes editors FORBES (MARCH 19, 2012) http://www.forbes.com/sites/forbesleadershipforum/2012/03/19/why-half-of-all-ma-deals-fail-and-what-you-can-do-about-it/#75b3fd5020ae

[16] p 51626

[17] What average person holds eight accounts at a bank? Checking, credit card, mortgage, home equity line of credit, insurance, wealth management number six.

[18] See *An Examination of Wells Fargo's Unauthorized Accounts and the Regulatory Response*, SENATE BANKING COMMITTEE (September 20, 2016) http://www.banking.senate.gov/public/index.cfm/hearings?ID=B80F9B81-4331-4F95-91BC-718288EC9DA0

If the Agency is truly interested in addressing disclosure, it should begin with a series of national listening sessions with *investors*. It should collect suggestions from these investors. It should read the comments to the S-K release, which almost universally demand more disclosure. It may then relay the suggestions and comments to issuers (selected as those recognized by investors for good governance) to examine what they can and cannot do to accommodate investor interests.

Meanwhile, this proposal should be withdrawn.

For questions, please contact Lisa Gilbert at [redacted], or Bartlett Naylor at [redacted].

Sincerely,

As You Sow
Bellamy Woods LLC
Brighton Shores LLC
CSC, LLC
Essential Information
Greenpeace
Howard's End LLC
Institute for Policy Studies, Global Economy Project
Interfaith Center on Corporate Responsibility (ICCR)
NF Trust
OpenTheGovernment
Public Citizen
Rolyan Fund
Sunlight Foundation
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