December 3, 2018

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

Attention: Mr. Brent J. Fields, Secretary

Re: Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities (File Number S7-19-18)

Dear Secretary Fields:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is writing in response to changes proposed by the Securities and Exchange Commission (the "Commission") to the rules regarding financial disclosures about guarantors and issuers of guaranteed securities and affiliates whose shares collateralize a registrant's securities (the "Proposal").[2] We appreciate the opportunity to provide comments to the Commission on the Proposal.

In our comment letter to the Commission's 2015 request for comment on the financial disclosure requirements for certain entities other than a registrant,[3] we offered suggestions for changes to Regulation S-X, including to existing Rule 3-10 and Rule 3-16. Our suggestions were focused on improving the quality of disclosure for investors while making the registration process less burdensome for the Commission and registrants. The Proposal seems to reflect consideration of our suggestions, and we laud the work that the Commission has done to propose changes that will make compliance with Rule 3-10 and Rule 3-16 easier for issuers while providing more useful information to investors. In this letter, we suggest some revisions to the proposed changes to Rule 3-10 and Rule 3-16 that we believe could result in more issuers registering offerings of guaranteed securities and securities collateralized by shares of affiliates.

---

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly one million employees, we advocate for legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. With offices in New York and Washington, D.C., SIFMA is the U.S. regional member of the Global Financial Markets Association. For more information, visit http://www.sifma.org.

[2] *Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities*, 83 Fed. Reg. 49,630 (proposed Oct. 2, 2018).

[3] *Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant,* 80 Fed. Reg. 59,083 (proposed Oct. 1, 2015).

We also believe our proposed revisions preserve the quality of the disclosure that investors will receive and, indeed, stand to make the disclosure less complex and more informative.

I. Rule 3-10

We generally support the proposed changes to Rule 3-10 but believe the following clarifications and revisions would increase the likelihood that issuers will offer guaranteed securities on a registered basis without compromising the information investors deem necessary to make an investment decision regarding those securities.

- The Commission should consider establishing a numerical threshold of guarantee significance at or below which Alternative Disclosures (as such term is used in the Proposal) would be deemed immaterial and thus not required and above which registrants would still be able to conclude that the Alternative Disclosures are not required because they would not provide material information.
    - We propose a threshold of 50%, measured on the same basis as the existing test that eliminates disclosure requirements for non-guaranteeing "minor" subsidiaries.[4] The rationale for this proposal is as follows:
        - For the changes to Rule 3-10 to have a meaningful impact on an issuer's decision whether to register a debt offering or rely on Rule 144A, the Commission must address the incremental securities law liability that deters issuers from registering debt offerings. This incremental liability results from the strict liability standard for issuers and negligence-based liability standard for underwriters and other offering participants under Section 11 of the Securities Act of 1933, versus the scienter requirement of Rule 10b-5 under the Securities Exchange Act of 1934 applicable to Rule 144A offerings. This heightened liability exposure is exacerbated because Section 11 also imposes liability for the omission of required information, which is not the case under Rule 10b-5. We believe this incremental liability exposure can only meaningfully be addressed by providing registrants with a non-exclusive safe harbor with respect to a materiality determination, particularly when materiality ultimately will be assessed with 20/20 hindsight.
        - If at least half the issuer consolidated group's assets, stockholders' equity, income and cash flows from operating activities (the relevant "financial metrics") derives from the issuer itself, we believe the issuer can reasonably be expected to repay the debt without the support of any of its subsidiaries. This conclusion is well supported by a ratings analysis published by S&P Global Ratings in which S&P has concluded that it will not lower the ratings of a corporate issuer based on structural

[4] Under the current rule, a non-guaranteeing subsidiary is "minor" if each of its total assets, stockholders' equity, revenues, income from continuing operations before income taxes, and cash flows from operating activities is less than 3% of the corresponding consolidated amount.

subordination if "[a]t least 30% of the issuer's and its subsidiaries' consolidated earnings, cash flow, or other similar financial metric is derived from operating assets owned by the issuer…."[5] This means that S&P has determined that as much as 70% of any of the relevant financial metrics can be derived from subsidiaries that are *not* obligors on the debt proposed to be issued without, in S&P's view, that having a material impact on repayment, which we believe is indicative of it not being material to prospective investors in that debt.

    - As a logical concomitant to our proposal, we also suggest the Commission permit issuers to exclude from the Alternative Disclosures information about any one or more guarantor subsidiaries the exclusion of which in the aggregate from the calculation would not cause any financial metric that otherwise exceeds 50% to be reduced to 50% or less. In other words, so long as Alternative Disclosures relate to subsidiary guarantors contributing more than 50% of any financial metric, including information regarding any additional guarantor subsidiaries would be surplusage, and thus not justifying the incremental disclosure burden. For example, if the only financial metric – e.g., cash flow – greater than 50% for all guarantor subsidiaries was at 91%, information for a subset of subsidiary guarantors could be excluded from the required Alternative Disclosures if in the aggregate those guarantors accounted for no more than 40% of cash flow.

    - Providing a non-exclusive safe harbor of immateriality in applying registered offering disclosure requirements is not a novel concept. Rule 430A under the Securities Act employs precisely this approach, mandating the filing of a post-effective amendment when changes to issue price or offering size are deemed "material," but providing a 20% floor at or below which the change is deemed immaterial and above which the registrant must evaluate materiality.

- Under the Commission's Rule 3-10 proposal, a registrant that does not make Alternative Disclosures would be required to discuss why they were not provided. The Commission should consider eliminating this requirement.

    - Requiring an open-ended narrative discussion by a registrant of its materiality assessment is likely to serve as a deterrent to registering an offering because it is burdensome and issuers would be unwilling to take the liability risk associated with exposing their reasoning.

[5] *Reflecting Subordination Risk in Corporate Issue Ratings*, S&P Global Ratings, Mar. 28, 2018, at para. 21, available at https://www.standardandpoors.com/en_US/web/guest/article/-/view/type/HTML/id/2085570. Used with permission from standardandpoors.com, a Site of S&P Global Ratings. Pursuant to this analysis, S&P will not downgrade for structural subordination at all if 50% or less of the group's debt is at the subsidiary level. If more than 50% is at the subsidiary level, the rating on parent debt will be downgraded for structural subordination unless at least 30% of relevant financial metrics of the group is derived from the issuer's standalone financial statements.

    - In other contexts where registrants are required to include specified financial information if material, they are not required to explain their reasoning if they determine the information is not material and thus omitted. For example, Rule 11-01(a)(8) in Article 11 of Regulation S-X requires registrants to include pro forma financial information if material to an investor. Article 11 does not, however, require a registrant to state that no information is called for by that Rule because it has determined that no such information is material.

    - If the Commission does decide to retain this requirement, it should clarify that it is sufficient for issuers to make a simple statement that the disclosure is not provided because management does not believe it to be material.

- To further the objective of encouraging registered offerings, the Commission should consider permitting the Alternative Disclosures to be provided outside the financial statements not only at the time of the offering but thereafter as well so long as they are required. We believe this would reduce the audit cost to issuers associated with including the Alternative Disclosures in the financial statements.

<u>II. Rule 3-16</u>

We also generally support the proposed changes to Rule 3-16. Replacing the requirement for full financial statements of the affiliated issuer of collateral securities with the Alternative Disclosures is a salutary step toward promoting registered offerings. However, as discussed above with respect to Rule 3-10, the Commission must address, and ameliorate, the incremental liability risk associated with a registered offering if it wants to make a meaningful change to offering practices. This applies with particular force in the context of Rule 3-16, where the benefit of share collateral may be marginalized by structural subordination, on the one hand, and market overhang risk, on the other. Keeping in mind the burden on issuers relative to the benefit to investors, we ask the Commission to consider the following suggested revisions to certain elements of the proposed rule.

- Instead of replacing the 20% numerical threshold in current Rule 3-16 with a subjective materiality determination, we propose, for the reasons given above with respect to Rule 3-10, retaining a numerical threshold but making it a non-exclusive safe harbor at or below which the share collateral would be deemed immaterial and above which the registrant must evaluate materiality. As proposed in our 2015 comment letter, we suggest this threshold be raised to 50%. This is predicated on both the issuer’s unsecured credit supporting a substantial portion -- at least half -- of the investment proposition and the relative weakness of share collateral as security.

- As we also suggest with respect to Rule 3-10, the Commission should consider removing the requirement that, in circumstances where registrants do not make supplemental disclosures because these disclosures are not material, the registrant provide a statement explaining the absence of these disclosures.

- As we also suggest with respect to Rule 3-10, the Commission should consider permitting supplemental disclosures to always be provided outside the financial statements.

- The Commission should consider eliminating the requirement that registrants provide supplemental information on a quarterly basis about affiliates whose securities collateralize a registrant's securities. Annual information about these affiliates should be sufficient for investors, and requiring quarterly presentation of granular data about affiliates, and in particular affiliates over which a registrant does not necessarily have control as a practical matter, would be both burdensome and costly.

***

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

Very truly yours,

Aseel M. Rabie, Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association