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November 12, 2014

Keith Higgins
Director, Division of Corporate Finance
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: The SEC's Disclosure Effectiveness Initiative

Dear Mr. Higgins:

CFA Institute[1] is pleased to provide you with our perspectives on areas for consideration in conjunction with the Securities and Exchange Commission's (SEC's or Commission's) initiative to improve disclosure effectiveness (hereafter referred to as the "Disclosure Effectiveness Initiative"). Our comments are principally focused on the financial and certain other disclosures within Regulation S-K and Regulation S-X. We have also provided some preliminary thoughts on compensation disclosures.

The Importance of the Acts & Investor Perspectives

The Securities Act of 1933 and the Securities and Exchange Act of 1934 (collectively, the "Securities Acts" or the "Acts") were transformative to the profession of securities analysis and investment decision-making. CFA Institute supports the Disclosure Effectiveness Initiative and believes it is essential to maintain and improve the transparency of information provided under the Acts and to see that they are updated as markets and technology evolve. In fact, many needed updates are long overdue.

[1] With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 121,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 146 countries, of whom more than 115,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 139 member societies in 60 countries and territories.

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As the Commission embarks on this initiative we encourage a more proactive outreach to investor groups through roundtables or other convening events so as to obtain a wider range of investor and user views as a balance to the likely volume of perspectives from industry and commercial interests. In that regard, we caution against any misperceptions that:

a) investors are generally overwhelmed by the volume and complexity of information and that financial statements and SEC filings are filled with immaterial information; or
b) that the solution to disclosure effectiveness should focus entirely on eliminating rather than refining and even adding disclosures in certain areas observed to be deficient during the financial crisis.

CFA Institute's Ongoing Disclosure Effectiveness Efforts
CFA Institute has a long history of promoting more fair and transparent disclosure from issuers and has been a tireless advocate for investor protection. Most recently, in 2013 CFA Institute included in our report, *Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust, and Volume*[2,3], the results of an investor survey that asked our members to weigh-in on issues of volume (Chapters 3, 4 and 5), complexity (Chapter 6) and materiality (Chapter 7) as it relates to financial reporting disclosures. As noted in that publication, CFA Institute undertook this survey and published this report to bolster limited investor input to date. This study showed investors did not see volume, complexity or materiality as the key disclosure effectiveness issues.

We also undertook writing this report because standard-setters efforts did not appear focused on recent economic disruptions and their impact on investors' perception of transparency and integrity of disclosures. Further, they didn't seem to take account of the irreversible trend toward greater use of technology and connectivity in delivering financial reporting information; the usefulness of the current accounting model; nor the development of a measurement model that more accurately communicates the full story on issuer value creation. We provide our perspectives on such trends in Chapter 2, along with our overall recommendations for improving disclosure effectiveness in Chapter 8, of that publication. Many such recommendations have applicability in the context of the SEC's Disclosure Effectiveness Initiative. In the following paragraphs, we further emphasize such recommendations as they relate to the SEC's ongoing Disclosure Effectiveness Initiative.

Effectiveness of Disclosure Reform
Investors Must Be Engaged Directly & Results Must Be Judged by Investors – We noted above the need for more direct investor input regarding excessive volume, complexity and materiality. The same is true of this initiative. The success of the Disclosure Effectiveness Initiative should be judged primarily from the perspective of those who actually use and rely heavily upon financial statements. This includes many investment professionals who must fulfill their fiduciary duties on behalf of millions of US investors.

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[2] A condensed version of the report which summarizes the survey findings is also available at http://www.cfainstitute.org/ethics/Documents/investor-perspectives-on-disclosures.pdf.
[3] Hereafter referred to as the 2013 Financial Reporting Disclosures Report.

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<u>*Overarching Considerations*</u> – Summarized below are our perspectives on several overarching considerations that we believe the Commission should bear in mind as it undertakes this initiative.

Incremental vs. Fundamental Changes – There is much that could be done to improve the effectiveness of disclosures for investors. To that end, we believe more than incremental changes (e.g. removal of historical share prices, dividend changes, stock performance graphs, dividend changes, etc.) are necessary to increase disclosure effectiveness for investors. The SEC needs to, in its own words, go "big game hunting" rather than play "small ball."

Scope & Prioritization – Typically, investors have a rather limited capacity to comment on accounting and disclosure initiatives. To that end, the SEC's breadth of scoping, order of priorities and timeframe for consideration of the topics needs to be very clear for investors to be able to comment meaningfully on specific areas of improvement. Precision in the SEC's focus will enhance investors' ability to provide input.

Measuring Increased Effectiveness – Clarity on the scope of this initiative is also essential to measuring increased effectiveness. For the SEC to demonstrate to investors that effectiveness has been increased they need to define the areas of focus, why they represent opportunities for increasing effectiveness, and how the SEC's actions will enhance effectiveness for investors.

Regulatory Coordination – Investors also see coordination of the SEC's efforts with the disclosure initiatives of other standard setters and regulators as essential. Most specifically, coordination with the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) is essential as financial statements are foundational elements of SEC reporting.

Who Are the Users? & How Do They Source Financial Information? – A clearer understanding of by whom and how disclosures are being used is critical. In our view, the SEC would be best served by beginning the process of improving disclosure effectiveness with an empirical study of who is using financial statements and how they are using them. In recent remarks[4], you noted the growth in institutional holdings of invested assets over recent decades. While this is true, we believe the analysis is not about the location of the assets. Rather, it must look at the manner in which assets are being managed (e.g. passive vs. active, macroeconomic, quantitative). Specifically, consider by whom and how the investments decisions are actually being made. Such insight will likely inform a clearer understanding of the use of financial information from public SEC filings. We agree with recent SEC statements that sophisticated investors are likely the most appropriate audience for SEC filings as they are generally those investors doing the detailed analysis and acting as price-makers. Further, we encourage the SEC to examine the degree to which financial information is sourced directly from SEC filings or secondarily from data providers, as well as user preferences regarding the construction and delivery of the financial information.

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[4] *Shaping Company Disclosure: Remarks before the George A. Leet Business Law Conference;* Keith Higgins, Director of Division of Corporation Finance; October 3, 2014.

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Investors & Information Overload – As we note in our 2013 Financial Reporting Disclosures Report, most investors do not express a concern about being overloaded with information. The claims of disclosure overload and excessive volume are usually preparer-expressed, not investor -expressed, concerns. Preparers also sometimes express that the need for additional disclosures is driven by the variety of users seeking information. Our long-standing perspective is that if the disclosure requirements of equity investors – those who hold the residual equity of the firm – are met then all other investors and creditors will have their informational needs met. Accordingly, we think this perspective should frame your decision-making when posed with this question.

Redundancy – Many observe that disclosure effectiveness could be improved by the elimination of redundant information. During our survey of members for our 2013 Financial Disclosures Report we noted that investors found that redundancy was an issue, but that the volume of disclosures wasn't driven substantially by this issue. Our members supported cross-referencing to eliminate redundancies so long as the level of auditor assurance was not diminished. That said, there are many sections within SEC filings that are meant to touch upon the same topic but from a different perspective. The real question the SEC must consider is not whether sections need to be eliminated, but whether they need to be better tailored to meet the original objective of the disclosure outside the financial statements – an objective focused on discussion, context, subjectivity or sensitivity of the items under discussion (e.g. critical estimates).

Principles-Based Reporting Regime & Scaled Disclosure Regime – We do not support a principles-based reporting regime. We have long argued that principles-based standards create the possibility that the standards may be inconsistently applied leading to non-comparable information that would be less beneficial to investors. A principles-based approach also doesn't bode well with the development of technology and the structuring of consistent data within and between companies. Further, the financial crisis clearly revealed that principles-based reporting was not sufficient, for example, in the articulation of liquidity and capital resources within MD&A. Some have suggested that a principles-based approach may provide a company with more flexibility to provide disclosures that it believes are material to investors. We note that there is nothing in the SEC's requirements that prevents companies from doing so today. We do not see disclosure effectiveness being improved through greater implementation of principles-based disclosures in SEC filings.

We are also concerned by an approach that would establish, or expand, a differential disclosure regime for different sized entities. We have previously articulated our views regarding differential reporting requirements with respect to private companies stating that investors will factor the differences (i.e. they will price the lack of transparency, clarity and comparability in what may be perceived to be lower-quality requirements) into their price determinations. Our views would be similar for a more scaled SEC disclosure regime.

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Technology – There is a detailed discussion in our 2013 Financial Reporting Disclosures Report regarding technology and how it must be a pervasive consideration in any future initiatives regarding disclosure effectiveness. We laud the SEC for advancing this notion beginning in 2009 – given increasing investor expectations regarding the availability of information – and for recognizing that the current technology is focused on the end of the financial reporting process (i.e. the filing of forms). We support approaches that migrate away from simply automating the historical paper-based delivery system or manually tagging and extracting information from such forms.

We are supportive of the "company file" notion being discussed, so long as information is updated in a timely fashion, the level of audit assurance is clear and not reduced from current levels, and there is an ability to integrate the information. As we note elsewhere herein, integration of information and key messages is a significant issue in existing SEC filings. To the extent that a company file would exacerbate this issue, we would not favor such an approach. We would encourage the SEC to consider technology that allows investors to search and display similar information in different sections of SEC filings simultaneously such that investors can "connect the dots" of related disclosures. Investors also welcome changes in technology which would better highlight and emphasize changes (i.e. the delta) from period to period (and between original and amended filings) as the change, or lack of change, from expectations can provide meaningful insights for analysis.

In developing technological solutions, we also seek structured quantitative data – combined with management explanation of results in a quantitative and qualitative fashion – which isn't bounded by the document in which the information is contained. Data providers extract information and provide it in a substantially more useful format than existing SEC documents; hence, the greater use of such secondary sources. The ability to improve access and searchability of information within the SEC's primary source documents would only serve to increase the use and the integrity of primary source information. We also seek technology which – like with the integration example above – facilitates effective communication principles such as better layering of information or linkage between documents. The development of technological solutions must, however, be done simultaneously with the consideration of changes in content, which we consider in the following sections.

Finally, as we consider the SEC's recent remarks on this topic, we think it is important that the SEC clarify the objectives they are attempting to achieve through the greater use of, or improvement in, technology. We think it is important for the SEC to step back and consider a series of questions including:

- Is the objective of the technology change to improve communication to investors?
- Is technology being used to enhance the amount, quality and timeliness of the delivery of basic financial data to investors, regulators or others?
- Are technological changes being made to improve the access and searchability of data (both quantitative and qualitative)?
- Is the SEC seeking to provide a database of company-specific information which can be searched and compared between periods and between companies?

- Is the objective of the technology to improve the regulatory oversight mission, to improve quality and access of information to investors, or both?
- How will the SEC's role be different from or similar to that of data aggregators?

Clearer insight as to the purpose and underlying objective of the changes in technology (i.e. such as the creation of a company file) and the SEC's role in the provision of information to investors through technological solutions would be helpful in communicating to and obtaining the support of investors.

Communication Principles – In our 2013 Financial Disclosures Report survey, investors believed that enhancing communication principles were second only to improving the effectiveness of financial statement presentation. Communication principles related to emphasizing matters of importance; better integration of information within and between financial statements and foreparts; more entity-specific tailoring of disclosures; improved organization and layering of information; better use of tables and charts; reconciliation of disclosures to financial statements; and improved cross-referencing were seen as top priorities. We made this same point in our letter to the FASB on its proposed conceptual framework on the notes to the financial statements[5]. Invoking communication principles will ensure that SEC filings serve as a communication tool to investors, not just a compliance exercise to meet SEC requirements.

Foundational Content Considerations – In addition to considering overarching issues related to content, it is important to evaluate whether the financial statements upon which SEC disclosures are built meet investor needs. Without addressing disclosure effectiveness within the financial statements, modifying disclosures in SEC filings – which are meant to supplement and explain the basic financial statements – only amounts to superficial changes and are unlikely to substantially increase the usefulness of the documents. In our view, to achieve transformational improvements in disclosure effectiveness the SEC should work with the standard-setters to address foundational issues such as:

a) *Financial Statement Presentation* – Investors told us in the survey supporting our 2013 Financial Reporting Disclosures Report that improving financial statement presentation is a more significant priority than improving disclosures. Presently, the level of aggregation, the inability of investors to link events across statements (balance sheet, income statement and cash flow statement), and the indirect method cash flow statement limit the ability of disclosures to provide insight into the financial statements;
b) *The Most Challenging or Troublesome Disclosures* – Improving some of the most challenging disclosures (e.g. estimates, judgments, and choices; risks and uncertainties; off-balance sheet items; commitments and contingencies; intangible assets; and going concern issues); and

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[5] Our comment letter on the FASB's *Proposed Statement of Financial Accounting Concepts, Chapter 8: Notes to Financial Statements* can be found at http://www.cfainstitute.org/Comment%20Letters/20140918.pdf.

c) *Forward-Looking Information* – Providing consistency in perspectives on the degree to which forward-looking information should or shouldn't be incorporated into financial statements. Recently, CFA Institute issued a report, *Forward-Looking Information: A Necessary Consideration in the SEC's Review on Disclosure Effectiveness,* in which we provide investors perspectives on the usefulness of forward-looking information. Specifically, we note that the argument that forward-looking information shouldn't be included in financial statements is inconsistent with the current reality that financial statements include an extensive amount of forward-looking information.

Regulation S-X – The SEC needs to recognize that it is challenging for investors to discern the completeness or sufficiency of the requirements of Regulation S-X without considering how they integrate with the disclosure requirements within U.S. GAAP. Investors not steeped in accounting rules generally won't know whether the rule governing the disclosures they are provided is driven by an SEC or U.S. GAAP requirement.

One positive step toward reviewing the efficiency and effectiveness of these Regulation S-X disclosures is a review of the overlap with requirements in U.S. GAAP. Another would be to review whether changes in underlying financial statements, such as the nature of measurements (e.g. increased use of fair value), changes the character of the disclosures outside the financial statements. A third, and potentially more difficult, step would be to evaluate whether the existing industry-specific disclosures required under Regulation S-X remain appropriate, and whether changes in the economy necessitate additional industry-specific disclosures for certain sectors in either or both Regulation S-X and S-K. For example, the lack of recognition of intangibles means that financial statements of technology and social media companies have little connection to the valuation of the business and are, therefore, not significantly decision-useful. Additional industry-specific disclosures have the capacity to make financial statements and SEC documents for such entities more useful over time.

Separate Company Financials & Pro Forma Information – We understand that SEC staff may be looking at changes relating to the sections of Regulation S-X that address the provision of separate company financial statements related to business combinations, and the associated pro-forma financial information. In our view, this is a low priority for users in terms of improving disclosure effectiveness. We understand the complexity of the application of the separate company financial statement and pro-forma rules, but doubt significant reworking of those disclosures at this time provide, at this time, the greatest opportunity for enhancing decision-usefulness of information to investors. We think there are other priorities which can improve disclosure effectiveness for a broader base of constituents.

<u>*Regulation S-K*</u> – As the SEC considers the rules in Regulation S-K on risk, market risk and MD&A disclosures, one of the most important outcomes would be to require better integration of these related topics. Each section stands alone in many cases.

Risk Factors – Linkage of risks to the business description along with making the risks more entity-specific, categorizing them by nature, assessing them for significance and connecting them to financial results such that they can be priced is important to increasing disclosure effectiveness.

Market Risk – Improving market risk disclosures, especially those related to financial institutions, should be a high priority. We encourage strong consideration be given to the lessons learned from the 2008 financial crisis and the recommendations of the Financial Stability Board's Enhanced Disclosure Task Force. Some have suggested that market risk disclosures and other Regulation S-K sections are duplicative with financial statement disclosures. We, instead, see the issue as one of needing better integration and linkage among the financial statements, business description, risk disclosures, articulation of market risks and the discussion of results in MD&A.

Management Discussion & Analysis (MD&A) – As we consider MD&A, we believe the requirements may be too principles-based, as we emphasize above. Further, we disagree with the idea that the prior year/comparative period MD&A should be removed as investors require the information and removal would force them to hunt for it. We believe that enhancements could be made in the disclosure of liquidity funding gaps, for example, and we believe that improvements in the ability to contextualize the contractual obligations table are necessary.

Industry Guides – As it relates to industry guides, we think they remain a relevant disclosure tool and they provide an opportunity to present a more complete and cohesive picture of the business for a variety of industries. That said, we think that industry guides must be updated to reflect changes in other disclosure requirements within Regulation S-X and Regulation S-K and the contents of underlying financial statements (e.g. updated measurements). Presently, there also appears room for improvement with respect to: a) the nature of the industries covered by industry guides, b) the industry guide requirements relative to U.S. GAAP and industry disclosure requirements with Regulation S-X, and c) the integration of the disclosures required by industry guides and the disclosures related to risks, market risks and MD&A. In reviewing and improve industry guides, it is essential to engage analysts and investors directly from the respective industries.

Executive Compensation – CFA Institute has developed a framework for Compensation, Discussion & Analysis (CD&A) disclosures and would encourage the SEC to make important changes in the Regulation S-K rules to reflect a much more concise, plain language and transparent disclosure regime. Issuers tell us time and again that the complexity and length of Regulation S-K rules in this area have led to very lengthy, inconsistent and largely opaque disclosures. Our template allows companies leeway in determining how best to tell their customized, company-specific story, while meeting all of the disclosures obligations. As an example of how disclosure effectiveness in this area could be improved markedly, the SEC can

require companies to disclose the following information in an executive summary at the beginning of their CD&A:

- Compensation developments in the last year – what has changed and why.
- How is compensation linked to performance? Discuss metrics used.
- How is compensation linked to execution of strategy? Discuss metrics used.
- Performance targets used to judge compensation. To what extent were these targets met over the previous year, or longer period of measurement? Have these changed from previous year? If so, why?
- If changes to peer group, why?
- Engagement activities with investors. If none, that is fine, but if there has been, the company should talk about it.
- Process for setting compensation.

Sustainability Disclosures – For some investors, sustainability disclosures are those related to environmental, social or governance (ESG) issues. Other investors have a much broader definition of sustainability (e.g. having a sustainable business model and a market for one's goods or services). A small, albeit growing, constituency of investors has advocated for the inclusion of sustainability information/disclosures – mostly those within the former, rather than latter definition. Investors in the U.S. have experienced the inclusion of such information in SEC filings in a very ad hoc fashion without a clear understanding of the prioritization of such disclosures relative to other sustainability disclosures or broader improvements needed in financial reporting disclosures. For example, the Dodd-Frank Act mandated conflict mineral disclosures but failed to provide for additional disclosures related to items which were directly related to the financial crisis. To improve disclosure effectiveness in this area we think it would be useful for the SEC to add some clarity about its perception on what falls within the definition of sustainability reporting and to what degree the information does, or does not, belong in SEC filings.

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Thank you again for the opportunity to provide some advance input on this initiative. If you or your staff have questions or seek further elaboration of our views, please contact me at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org or Jim Allen at +1.434.951.5558 or by email at james.allen@cfainstitute.org.

Sincerely,

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