

February 22, 2016

Mr. Brent Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-20-15, Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant – Regulation S-X

Dear Mr. Fields,

CFA Institute,¹ in consultation with its Corporate Disclosure Policy Council (“CDPC”)², appreciates the opportunity to comment on the Securities and Exchange Commission’s (“SEC”) *Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant* (“Request for Comment”).

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures provided to investors and other end users is of high quality.

¹ With offices in Charlottesville, New York, Hong Kong, London, Mumbai and Beijing CFA Institute is a global, not-for-profit professional association of more than 136,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 151 countries, of whom more than 130,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 145 member societies in 70 countries and territories.

² The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

EXECUTIVE SUMMARY

We are sympathetic to the fact that the rules covered by this Request for Comment are complex and time-consuming to comply with, and may, at times, produce disclosures which are not meaningful or confusing to investors. Investors, after all, bear the cost of producing such information. Accordingly, we are supportive of the SEC's efforts to improve the efficiency of financial reporting requirements to the extent that such initiatives eliminate or improve disclosures that are not particularly meaningful or useful to investors. Eliminating or improving disclosures that are currently not decision-useful ultimately will benefit investors as well as preparers, by reducing the costs of preparing such unnecessary information, and by enabling investors to focus on what is truly important in the financial statements.

We believe that any decision to change current requirements must be demonstrated to meet the criteria of being an improvement in financial reporting from the perspective of the user, and we believe the SEC needs to do more research in general to identify improvements that will benefit constituents and have targeted investor outreach to demonstrate that this is a key priority for investors. We see other areas of focus which can improve disclosure effectiveness for a broader base of constituents. Thus, before spending significant time and resources on these regulations, we believe it is important that the SEC firmly establish that this is a key priority for investors. We believe the SEC could do so in part by:

1. *Obtaining More Empirical Information/Statistics on Use of Rules:* A useful starting point for the SEC would be to conduct empirical research on how many financial statements are filed under these regulations, and consider who is using them and how they are being used. Such empirical data would provide an objective basis to determine whether and how frequently companies utilize these complex rules in a given year, and will also facilitate more targeted analysis and outreach to investors on how they use this information.
2. *Conducting Targeted Investor Outreach:* The SEC should engage in more active, targeted outreach with investors in companies who currently file financial statements that include the disclosures covered by these rules to stimulate a dialogue on these rules and other disclosure issues. Interviewing investors to better understand how (or if) they are using the information required by these rules in making their investment decisions would be superior to a broad-based Request for Comment in identifying areas for improvement.
3. *Assessing the Original Intent of Rules and Their Relevance Today:* We recommend that the SEC conduct a thorough examination of the original purpose of these rules, and reconsider whether the original objectives of these rules are still relevant today. At a minimum, we suggest the SEC clarify the objectives of these disclosures, which will provide a basis for determining whether the objectives as articulated are aligned with those of the investor community, and whether and how the specific disclosure requirements need to be revised to meet these objectives.

Improve Pro Forma Requirements By Providing More Forward-Looking Information On A More Accelerated Basis: Within the Request for Comment, improvements in the timing and content of pro forma information have the greatest potential to improve disclosure effectiveness for investors. In particular, the timing of the pro forma information should be accelerated to

improve its decision-usefulness, as currently, the information is provided well after investors have assigned a value to the acquisition. In addition, as investors are more interested in projections while simultaneously using historical information to ground them, we believe the pro forma financial statements would be much more relevant if the SEC allowed for more forward-looking information and articulation of management's expectations to be incorporated into them.

In addition, more clarity could be achieved by aligning the SEC and GAAP pro forma rules as the current differences are confusing to investors. Furthermore, we do not perceive the potential benefits in requiring greater auditor involvement in pro forma information to be significant enough to warrant further consideration at this time.

Requirements Should Apply to All Entities Equally: In general, we do not support a differential disclosure regime for different sized entities. We believe investors will factor in the comparative lack of transparency and clarity leading to an increased cost of capital for entities exempted from the rules.

XBRL Should be Leveraged: The CFA Institute views the expanded use of XBRL as an opportunity to leverage data, enhance analysis, and facilitate company comparisons. Accordingly, we support the inclusion of all disclosures under these rules in an XBRL format.

CONSIDERATION OF SPECIFIC RULES: Although we do not believe this is a key priority, we have the following suggestions for the other regulations discussed in the Request for Comment:

*RULE 3-05: Financial Statements Of Businesses Acquired Or To Be Acquired:
Nature and Timing of Significance Tests Can Be Improved*

We believe the current quantitative approach to assessing significance ensures objectivity and consistency across registrants and we would not support a change to a more principles-based approach. Improvements to the income test and investment test, such as incorporating a revenue and a fair value metric, respectively, could be considered. Allowing registrants to use practical expedients, such as permitting the timing of the tests to be performed as of a period closer to year-end, or using estimates that approximate the year-end results, should also be considered, to improve the efficiency of complying with these requirements.

RULE 3-09: Separate Financial Statements of Investees Provides Useful Information: Expanding and Reconciling Information Provides Greatest Potential for Improving Disclosure Effectiveness to Investors

As the SEC correctly notes, financial disclosures required about an investee are important to investors because the investee can have a significant financial impact on a registrant. In general, investors tend to want more rather than less information on the investee company, and we believe the information currently required should be readily available to the registrant, given its significant influence over the investee. We do believe there are some areas for improvement to the existing requirements:

- *Provide Reconciliations of Investee Financial Statements to US GAAP* – Where investee financial statements are prepared on a different basis from that of the registrant, we believe a reconciliation to the registrant’s financial statements should be provided.
- *Aggregated Information for Collectively Significant Investees is Not Useful* –When the 10% significance thresholds are met for collectively significant investees, we believe the current requirement to present aggregated financial information about the investee’s assets, liabilities and income (required by Regulation S-X, Rule 4-08(g)) do not provide decision-useful information to financial statement users given the potentially disparate nature of and differences in trends in results of these investees in terms of investment types and the potential for netting income and losses from different investees. We believe the current requirements should be replaced with information regarding each investee, such as a description of the nature and purpose and carrying amount of the investments held, the ownership interest in and earnings recorded from each investee, and other information as detailed further below.

RULE 3-10: Provides Useful Information on Guarantors of Securities: No Major Changes are Necessary

We believe that the disclosure requirements of Rule 3-10 for guarantors of securities provide useful information to investors which enables investors to evaluate separately the likelihood of payment by the issuer and guarantors. Accordingly, we do not support efforts to reduce or streamline the existing disclosure requirements, and we believe the SEC should proceed cautiously in the consideration of this issue. Certain amendments to this rule could be useful, as more fully articulated below, but we believe these to be around the margins.

RULE 3-16: Further Research is Warranted Before Considering Changes

We encourage the SEC to perform further research to thoroughly understand whether in fact registrants are structuring around the requirements of Rule 3-16, and to evaluate thoroughly the market impact of such actions. We believe further research on this issue is warranted before the SEC considers any amendments to the current requirements.

We discuss each of these points in more detail below.

GENERAL COMMENTS

Demonstrate Key Priority for Improving Effectiveness of Disclosures for Investors

We are sympathetic to the fact that these rules are complex and time-consuming to comply with, and may at times produce disclosures which are not meaningful or confusing to investors. Investors, after all, bear the cost of producing such information – ultimately the cost of engaging lawyers and accountants to produce such information reduces the return to investors.

Accordingly, we are supportive of the SEC's efforts to improve the efficiency of financial reporting requirements to the extent that such initiatives eliminate or improve disclosures that are not particularly meaningful or useful to investors. Eliminating or improving disclosures that are currently not decision-useful ultimately will benefit investors as well as preparers, by reducing the costs of preparing such unnecessary information, and by enabling investors to focus on what is truly important in the financial statements.

We note that most of the comment letters received by the SEC to date on this Request for Comment have been provided almost entirely by preparers and auditors of financial information. While we believe these constituents have an important perspective to provide, the purpose of financial reporting is to provide decision-useful information to investors, and therefore, ultimately, disclosure effectiveness is determined by investors. Initiatives such as changing thresholds for determining whether an investment is significant or streamlining reporting requirements may improve efficiency for preparers. Any decision to change current requirements, however, must be demonstrated to meet the criteria of being an improvement in disclosure effectiveness which is ultimately judged from the perspective of the user. Without substantial input from investors, we are concerned that disclosure efficiency will have primacy over disclosure effectiveness.

We understand the complexity of the application of these rules, but doubt significant reworking of these disclosures provides, at this time, the greatest opportunity for enhancing decision-usefulness of information to investors. We believe there are other areas of focus that can improve disclosure effectiveness for a broader base of constituents. We refer you to [our letter dated November 12, 2014](#) for a discussion of matters which we believe should be of higher priority for the SEC. Accordingly, before spending significant time and resources on whether and how to amend the separate company financial statement and pro forma rules, we believe it is important that the SEC firmly establish that this is a key priority for investors.

Empirical Information/Statistics on Use of Rules

If the SEC decides to proceed with this initiative, we suggest that, as a starting point, the SEC should conduct empirical research on how many financial statements are filed under these regulations, and consider who is using such information and how it is being used. Such empirical data would provide an objective basis to determine whether and how frequently companies – and ultimately their investors – utilize these complex rules in a given year. Such information will also facilitate more target analysis and outreach to investors on how they use this information. Comment letters alone, while useful, can ultimately provide only anecdotal information in this regard. Further, with most comment letters provided by preparers, auditors and lawyers there is a likely bias toward efficiency and lower costs rather than effectiveness and benefits of the rules.

Targeted Investor Outreach Needed

We are also concerned that investors are not sufficiently focused on this Request for Comment. 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 time frame for consideration of the topics need 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. Further, we encourage the SEC to use more plain-English terminology in publishing its initiatives as the rules referenced in the title of the Request for Comment are likely not as familiar to investors as they are to preparers and auditors. Finally, we suggest the SEC provide additional time to investors to respond to the Request for Comment, as a sixty-day comment period can prove insufficient if a request for comment is not widely advertised prior to its release.

In short, the investor perspective must be a critical element of the SEC's review and decision-making process as it considers the feedback on this rule. Little input has been received from investors as of the date of our submission of this letter. We encourage the SEC to engage in more active outreach initiatives with investors, to stimulate a dialogue on these rules and other disclosure issues. One suggested approach would be to conduct targeted outreach with investors in companies who currently file financial statements that include the disclosures covered by these rules.

Using the aforementioned empirical analysis of the use and application of these rules we would suggest the SEC perform outreach to investors of companies invoking the use of these rules and providing information required by the rules. Interviewing investors in such entities to better understand how (or if) they are using the information required by these rules in making their investment decisions would be highly instructive to the SEC in how to improve the rules to improve the effectiveness of the rules. We believe more research in general and targeted active engagement of investors would be superior to the passive approach of awaiting comment letter responses to a broad-based Request for Comment using nomenclature which is not familiar to even sophisticated investors.

Assessing the Original Purpose and Intent of Rules and Their Relevance Today

Another key ingredient in consideration of any potential change in this area should be a thorough examination of the original purpose of these rules. For example, is the primary purpose of these disclosure requirements to facilitate value decisions being made by investors, or are they intended more as “anti-abuse” provisions that have developed over time in reaction to various issues noted with registrant filings? Once this review is performed, the SEC can then look at whether the information provided is fulfilling the original intent of the regulations.

Even more importantly, the SEC should assess whether the original objectives of these rules are still relevant today or if the objectives themselves should be revised. For example, if the primary purpose of the disclosures is to facilitate investment decisions, the timing of these disclosures may not be as useful to investors operating in the faster-paced environment that exists today, as compared to when the original requirements were developed, and in light of additional information available in the marketplace today under Regulation FD. As it relates to disclosures under Rule 3-05, for example, we see the information coming well after the market has priced the acquisition.

In short, we believe the SEC should thoroughly consider the foundation on which these rules were built, and whether the foundation has shifted, or needs to shift, in light of changes in the marketplace that have occurred since the rules were originally promulgated.

At a minimum, we suggest the SEC consider clarifying the objectives of these disclosures. For many of these rules, the objectives can only be inferred from the disclosure requirements themselves. We believe a clear and precise articulation of the objectives will provide a useful roadmap for the SEC’s evaluation of the efficacy of the existing requirements, and will also facilitate a dialogue as to whether the objectives as articulated are aligned with those of the investor community, and whether and how the specific disclosure requirements need to be revised to meet these objectives.

Requirements Should Apply to All Entities Equally

As a general matter, we would be concerned with an approach that would establish, or expand, a differential disclosure regime for different sized entities. We have previously articulated our views regarding different reporting requirements with respect to private companies, stating that investors will factor the differences into their price determinations – that is, they will price the lack of transparency, clarity and comparability in what may be perceived to be lower-quality requirements. Our views are similar for a more scaled SEC disclosure regime for smaller reporting companies, emerging growth companies, and other entities. It is our view that the SEC overweights the cost of complying with the rules and underweights the increased cost of capital for entities exempted from the rules.

Use of XBRL

The CFA Institute views the expanded use of XBRL as an opportunity to leverage data, enhance analysis, and facilitate company comparisons. Accordingly, we support the inclusion of all disclosures under these rules in an XBRL format.

SPECIFIC COMMENTS

RULE 3-05:

FINANCIAL STATEMENTS OF BUSINESSES ACQUIRED OR TO BE ACQUIRED

Financial Statements & Pro Forma Information:

Are They Provided to Investors When Decision-Relevant?

Rule 3-05 guides when financial statements of businesses acquired or to be acquired are to be provided to investors and also impacts when pro forma information is provided to investors. We provide our views on the financial statement and pro forma requirements in the detailed subsections which follow.

We think it is essential, however, for the Commission to consider the bigger picture and the market context into which the financial statements and pro forma information required by Rule 3-05 are provided. Such information is provided substantially after the announcement of – and market reaction to – an acquisition by a registrant. From this we can safely conclude that pricing decisions are made by investors long before acquired subsidiary or pro forma information is available to investors and after it would be most decision relevant.

Accordingly, we recommend that the SEC evaluates the effectiveness of such disclosures that it also contemplate the timing of the provision of such information. While historical information is important to the investment decision-making process and it can be an essential anti-abuse mechanism, we think it would be extremely useful for the SEC to compare the pro forma disclosures to the information that registrants provide to investors in connection with “marketing the deal” to the public, which is furnished to the SEC under Regulation FD. Such an analysis may provide important insights into what information is actually being used by investors in making investment decisions, and whether that information should be incorporated into the SEC’s financial statement and pro forma requirements (e.g. via a reconciliation of the two) to make them more relevant to, and effective for, investors.

Financial Statements: Regulation, S-X Rule 1-02(w) – Significance Tests³

Nature of Significance Tests

Principles vs. Rules – While a principles-based approach for determining what information is material to investors is theoretically attractive, we believe that use of quantitative factors makes application of the rules more consistent across registrants. Accordingly, we support the continued application of the quantitative approach.

Income Test – We are aware of concerns expressed that application of the income test can at times yield anomalous results, especially in circumstances when the registrant has near break-even results or when either entity has large, nonrecurring expenses or income in the period tested. To address this, we would not be opposed to an approach whereby the income test can be accompanied by a revenue test. While we do not have specific suggestions regarding the appropriate quantitative thresholds for such a test at this time, we would be happy to provide comments on the SEC’s proposal once it considers the suggestions of other constituents.

Investment Test – We are also aware of concerns expressed regarding the application of the investment test: specifically, that it compares a fair value metric (the purchase price) to a historical book value metric (the total assets of the registrant), which may not provide a meaningful comparison for purposes of determining the overall significance of an acquisition to the registrant’s business. We believe that a fair value test that compares the purchase price of the acquired business to the fair value of the registrant is more relevant to investors, who are generally focused on the significance of an investment from an economic value perspective. In addition, in the current business environment in which intangible assets play a greater role in determining the value of an investment or acquisition, but which are not always reflected at fair value in the financial statements, a test that focuses on the fair value of the investment will prove more meaningful to investors.

³ The significance tests described in S-X Rule 1-02(w) are used by registrants in complying with various SEC requirements, including (1) S-X Rules 3-05, 3-09, and 4-08(g) and (2) Item 2.01 of Form 8-K. For example, registrants must apply these significance tests when evaluating whether they are required to provide separate financial statements of (1) an acquired business under Rule 3-05 or (2) subsidiaries not consolidated and 50 percent or less owned persons under Rule 3-09. Significance is evaluated based on three tests:

1. *investment test*—the amount of the registrant’s investment in the acquired business compared to the registrant’s total assets;
2. *total asset test*—the total assets of the acquired business compared to the registrant’s total assets; and
3. *income test*—the acquired business income from continuing operations (before income taxes, extraordinary items and cumulative effect of a change in accounting principle) compared to that of the registrant (and if the acquired business had a net loss, then the test looks to the absolute value amount).

Significance Test: Date of Determination of Significance

We are also sympathetic to the difficulties that registrants have encountered in performing the significance tests given that the measurement date for the application of Rule 1-02(w) occurs at the end of a registrant's fiscal year, which therefore necessitates that the consolidated financial results of the fiscal year for both the registrant and the equity method investee are known. Therefore, we would not be opposed to permitting the tests be performed as of a date closer to year-end, or using estimates that approximate the year-end results assuming no significant changes.

Periods Presented

As we noted below in our discussion of pro forma financial information, investors are more interested in the future prospects of the registrant – including the acquired business – than they are in the historical information of the acquired business, especially when it is presented in financial statements on a historical cost basis.

Pro Forma Information

Within the Request for Comment, improvements in the timing and content of pro forma information have the greatest potential to improve disclosure effectiveness for investors. As we articulate above, the timing of the pro forma information should be accelerated to improve its decision usefulness. As we note below, reconsideration of the objective or pro forma information, the nature of the ability to reflect adjustments and provide greater forward-looking insight and articulation of management's expectations are where investors see the greatest need for improvement.

Objectives of Pro-Forma Information: SEC Should Evaluate

At a minimum, we suggest the SEC consider clarifying the objectives of pro forma disclosures. For example, the pro forma information described in Article 11 of Regulation S-X is based on the historical financial statements of the registrant and the acquired business and generally includes adjustments to show how the acquisition might have affected those financial statements had it occurred at an earlier time. Adjustments to the pro forma balance sheet and income statements must be “factually supportable” and “directly attributable to the transaction” and adjustments to the income statement must demonstrate “continuing impact.”

Notwithstanding this, the overall objective of providing pro forma information is not entirely clear to the investor community. For example, it is not clear if the intent of the pro forma information is to provide investors with information on how the acquisition will impact the acquirer in the future, or if the disclosures are intended as a kind of benchmark against which investors can judge future performance by management. A clear articulation of the objectives of this and other information that is required in these regulations would go a long way in helping the SEC determine whether the information provided is relevant and useful to investors. Historical information provides good grounding and an assessment of the historical earnings capability but it will be more useful if it was better contextualized in the ongoing operations including fair value adjustments and management actions in running the business. We believe a clearer articulation of the principles and framework on which these disclosures are based would also benefit both investors and preparers, as the rules today are quite complex and not well understood in the marketplace beyond a group of highly sophisticated legal and accounting professional advisors.

Content of Pro Forma Disclosures Should be More Forward Looking

From our perspective, the pro forma rules are so reflective of the past that frequently they are of limited use to investors. In fact, we observe that many companies explicitly state that the pro forma financial statements are of limited use as they exclude the effects of management actions or other events that do not meet the “factually supportable” criterion. Investors are primarily interested in understanding how a company will look going forward and in assessing its future prospects. Therefore, historical earnings and historical earnings per share in an equity offering are less relevant to investors than projections of future performance⁴. Thus, the current limitations on significant planned changes by the acquirer, such as workforce reductions, facility closings, actually hinder, rather than help, the investor. While investors recognize that

⁴ Pro forma information on financial institutions, for example, is virtually meaningless to investors because of its backward look on interest rates and the inability to reflect significant planned changes by the acquirer.

management's plans and projections may be more aspirational rather than possible, they would like to have the capacity to discern management's success in achieving them.

Moreover, we believe that many investors today do not sufficiently appreciate the accounting distinctions between "pro forma" and "projected" financial information. Accordingly, we recommend that the SEC consider expanding the current pro forma requirements to incorporate more forward-looking information in order to reflect more meaningful insight into management's plans for the combined entity, including synergies and other operational changes.

Greater discussion and analysis of the information would be most helpful to investors and would allow them to reconcile the pro forma information with other information which is being provided in press releases and other information provided in connection with Regulation FD.

If the SEC determines that providing this type of forward-looking information is inconsistent with an overall objective to keep pro forma information "factually supportable," one possible approach would be to require that forward-looking pro forma information be segregated from the traditional pro forma information and be accompanied by appropriate disclosures.

At the same time, we would encourage the SEC to keep intact the current limitations on presentation of financial results that is addressed to a limited feature of a company's overall financial results (for example, earnings before interest, taxes, depreciation, and amortization), or that sets forth calculations of financial results on a basis other than GAAP.

SEC and GAAP Pro Forma Rules Should be Aligned

We further note that differences in the SEC and the U.S. GAAP pro forma rules detract substantially from the overall usefulness of these disclosures. For instance, under the SEC pro forma rules, nonrecurring charges or credits associated with the transaction for which pro forma financial information is presented are not allowed to be included in the pro forma operating results; however, under the U.S. GAAP rules, nonrecurring charges or credits are required to be included in the pro forma operating results. Such a difference in methodology will result in different pro forma operating results for the same transaction when pro formas are prepared under the SEC rules versus the U.S. GAAP rules. We believe these differences create unnecessary confusion for investors and should be aligned

We similarly feel the differences in: (i) the periods to present pro forma operating results should be conformed, where the SEC rules require pro forma operating results for the latest fiscal year and subsequent interim period included in the filing but the U.S. GAAP rules require pro forma operating results presented for both the current and prior comparable periods; and (ii) the assumed transaction "as if" date should be conformed, where under the SEC rules, the pro forma operating results are presented as if the transaction had occurred at the beginning of the fiscal year presented whereas under the U.S. GAAP rules when presenting comparative financial statements, the pro forma operating results are presented as if the transaction occurred at the beginning of the comparable prior annual reporting period. We encourage the SEC and the FASB to jointly address these inconsistencies.

In short, we believe pro forma operating results for a transaction in any given period should be the same under both SEC and U.S. GAAP pro forma rules. To the extent that is not the case, we view it to be an unnecessary distraction and a source of confusion to preparers and users alike.

Auditor Involvement in Pro Forma Information

Some have suggested greater auditor involvement in pro forma information. While we respect that some review or attestation over the information may be useful to underwriters in comfort letters related to registration statements, we are concerned by such a recommendation as we don't believe that auditors are sufficiently knowledgeable regarding the existing or acquired business or the strategic plans of management to provide anything more than mathematical assurance over the information provided.

***RULE 3-09:
SEPARATE FINANCIAL STATEMENTS OF SUBSIDIARIES NOT CONSOLIDATED
AND 50% OR LESS OWNED PERSONS AND RELATED REQUIREMENTS***

Overall Perspectives

As the SEC correctly notes, financial disclosures required about an investee are important to investors because the investee can have a significant financial impact on a registrant. While we are aware of many requests to reduce the amount of information currently required – such as full financial statements of significant equity method investees – on the grounds that obtaining the required information is too difficult or cumbersome, we note that investors find full financial statements of the investee necessary in order to make informed investment decisions about the registrant. As you will note in our [letter to the FASB this past summer on its proposal to alter the equity method](#), we highlight that investors want more rather than less information on the investee company.

We believe that the financial information regarding an equity method investee needed to comply with Rule 3-09 should be readily available or obtainable. When making an acquisition – particularly where there is significant influence – companies generally perform due diligence and in doing so review the financial records of the investee. Thus, the company is likely to have access, or can negotiate access, to information to perform the necessary accounting. Further, equity method investors, by definition, have significant influence over the operating and financial policies of affiliates. This implies that equity method investors have access to the information necessary to affect operating and financial decisions of affiliates and to comply with the Rule 3-09 requirements. Accordingly, we would be opposed to any initiative to reduce the thresholds at which full financial statements are required for equity method investees.

In addition, where Rule 3-09 financial statements are prepared on a different basis from that of the registrant, we believe a reconciliation to the registrant's financial statements should be provided. Again, that information is necessary for the registrant to account for its investment, and, therefore, should be readily available.

Aggregated Information about Investees (Regulation S-X, Rule 4-08(g) ⁵)

When the 10% significance thresholds are met for collectively significant investees, aggregated financial information about the investee's assets, liabilities and income are required to be disclosed. We believe that the aggregate assets, liabilities and net income disclosures that are required by Regulation S-X, Rule 4-08(g) do not provide decision-useful or relevant information to financial statement readers given the disparate nature of and differences in trends in results of these investees in terms of investment types and the combining of income and losses from different investees.

In lieu of the aggregated financial information, we suggest allowing registrants to make disclosures about their investees in the notes to the financial statements that provides financial statement users with:

- (a) a description of the nature and purpose of the investments held;
- (b) the number of investees, and a list of the registrant's ownership interest in each investee;
- (c) the carrying amount of each of the investments;
- (d) the amount of equity earnings recorded or other returns received for each; and
- (e) additional information on an individual investee if earnings from the investee comprise half or more of the total investment income generated by the aggregate investments.

⁵ Rule 4-08(g) requires quantitative disclosures of the equity method investees' assets, liabilities and net income on an aggregated basis, when the quantitative thresholds for determining significance under the asset, investment or net income significance tests of Rule 1-02(w) exceed 10% in the aggregate.

***RULE 3-10:
FINANCIAL STATEMENTS OF GUARANTORS AND ISSUERS OF GUARANTEED
SECURITIES REGISTERED OR BEING REGISTERED***

Our overall reaction to the disclosure requirements under Rule 3-10 is that they provide useful information to investors. The disclosures allow investors to evaluate separately the likelihood of payment by the issuer and guarantors, and we do not support efforts to reduce or streamline the existing disclosure requirements (by providing selected financial information, or ratios in lieu of the current requirements).

Financial markets are markets in information, and efforts to reduce or streamline existing disclosure requirements related to guarantors undermine the very purpose of the rule. Reducing guarantor disclosures has the effect of not providing information on the entity that investors may ultimately look to for repayment. If this were to occur, it might reduce the cost of compliance with SEC regulations, but it will certainly increase the risk premium charged by investors, as a failure to provide information on the guarantor is tantamount to no guarantee. Generally, we believe investors want more rather than less information on guarantors.

We also do not support suggestions to permit registrants to combine the separate disclosure of the condensed financial information of the issuer and the guarantor (on the theory that an investor presumably places more emphasis on whether the payment occurs, rather than which entity makes the payment), because investors are, in fact, keenly focused on the separate financial condition of the legal entity that is or could be liable for the payment.

We would, however, support initiatives to reduce the interim reporting requirements under this rule – unless there has been a material change in the issuing or guaranteeing entity’s financial condition. We would similarly support an initiative to eliminate the reporting requirements if there is a novation and an issuer or guarantor is no longer liable for the underlying debt.

RULE 3-16: FINANCIAL STATEMENTS OF AFFILIATES WHOSE SECURITIES COLLATERALIZE AN ISSUE REGISTERED OR BEING REGISTERED

We note with some concern the comments of various constituents that market participants routinely “structure around” the requirements of Rule 3-16 to avoid compliance with its filing requirements. We encourage the SEC to perform further research on this issue to thoroughly understand the market impact of such actions. In particular, in situations in which registrants have explicitly disclosed in the risk factors in their registrations statements that stock and other securities of their subsidiaries will automatically be relieved from a lien if the pledge of such securities would require filing separate financial statements pursuant to Rule 3-16, we would suggest the SEC speak to investors in such companies to ascertain whether these “fall-away” provisions were factored into their investment and/or pricing decisions. We believe further research on this issue is warranted before the SEC considers any amendments to the current requirements. If the rules are being structured around to eliminate providing such information, the SEC should understand whether investor price for the loss of information. If investors don’t reduce the risk premium charged – because they haven’t been provided information on the collateral – then the rule has been structured around but there also has been no benefit given to the existence of the collateral by investors. Structuring around a rule only harms investors when in fact they are unaware of what ultimately has occurred and they don’t price for it.

Thank you again for the opportunity to comment on the SEC Request for Comment. If you or your staff have questions or seek further elaboration of our views, please contact Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/Sandra J. Peters
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Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council