

November 27, 2019

Vanessa A. Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: Proposed Rule: Modernization of Regulation S-K Items 101, 103 and 105,  
SEC Release Nos. 33-10668; 34-86614; File No. S7-11-19**

Dear Madam Secretary:

CFA Institute<sup>1</sup> 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) [\*Proposed Rule on Modernization of Regulation S-K Items 101, 103, and 105\*](#) ("Proposed Rule"). 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 and CFA Institute supports the SEC's efforts to ensure that the Acts are updated and remain relevant as markets and technology continue to evolve.

CFA Institute is providing comments consistent with our objective of promoting fair and transparent global capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures – and the related audits – provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally and in consultation with Corporate Disclosure Policy Council ("CDPC").<sup>2</sup>

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<sup>1</sup> CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154-member societies in 77 countries and territories.

<sup>2</sup> 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.

## OVERARCHING CONSIDERATIONS

Summarized below are our perspectives on several overarching considerations that we believe the Commission should bear in mind as it continues to review and update the Acts. We have provided various letters on this topic<sup>3</sup> to the SEC over the last five years.

### *Incremental vs. Fundamental Change:*

#### *The SEC Needs to Consider More Fundamental Changes*

As we note in our [2014 comment letter to the SEC](#), there is much that could be done to improve the effectiveness of disclosures for investors. To that end, the SEC needs to seek ways to make filings more meaningful to investors rather than making small refinements at the margin (e.g., improving the formatting of the risk section, increasing disclosure thresholds for environmental proceedings, etc.). The SEC needs to, in its own words, go “big game hunting” rather than play “small ball.” ***We encourage the SEC to take a step back and rethink more broadly its approach to these filings as these proposed revisions do not address the needs of investors – as are being widely discussed in the investor and other stakeholder community.***

### *Long Term Value Creation:*

#### *Investors Seek A More Meaningful Narrative Regarding Long-term Value Creation*

The current approach to Form 10-K is a “fill in the blank” and “check the box” approach whereby the SEC sets forth various questions or issues that registrants then respond or react to. For example, we find the distinction between the General Development of the Business (Item 101(a)) and Narrative Description of Business (Item 101(c)) sector to be somewhat artificial and not conducive to creating a holistic economic description of the business that will be meaningful to investors. Furthermore, many of the items to be addressed in these sections, such as backlog and availability of raw materials, were established at a time when the US economy was largely manufacturing-based, and they are no longer representative of the value drivers of today’s technology-based and intangible-based economy.

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<sup>3</sup> 2014 Disclosure Effectiveness Letter (November 2014)  
<https://www.cfainstitute.org/-/media/documents/comment-letter/2010-2014/20141112.ashx>

2016 Business and Financial Disclosure Required by Regulation S-K (October 2016)  
<https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20161006.ashx>

2016 Disclosure Update and Simplification Letter (December 2016)  
<https://www.cfainstitute.org/-/media/documents/comment-letter/2015-2019/20161207.ashx>

The Proposed Rule does not address the fundamental shift in the US economy and the manner in which investee companies create value, which have changed investors' needs for information. As emphasized in a recent letter to CEOs from BlackRock president Larry Fink:

*We are asking that every CEO lay out for shareholders each year a strategic framework for long-term value creation...Annual shareholder letters and other communications to shareholders are too often backwards-looking and don't do enough to articulate management's vision and plans for the future. This perspective on the future, however, is what investors and all stakeholders truly need, including, for example, how the company is navigating the competitive landscape, how it is innovating, how it is adapting to technological disruption or geopolitical events, where it is investing and how it is developing its talent.*<sup>4</sup>

To that end, ***an understanding of a company's strategy is fundamental to investor analysis and should not be voluntary***<sup>5</sup>. Companies, because they understand that this is what investors are most interested in, routinely discuss their strategy in investor pitch meetings and in analyst calls. While an entity's specific tactics to achieve its strategy need not be disclosed (if there are concerns about confidentiality), a robust discussion of the overall larger vision of the company can, and must, be disclosed to investors to make this section meaningful.

***We encourage the SEC to think more broadly about how to create a more meaningful narrative for investors regarding long-term value creation, and in that regard we suggest that the SEC consider the guiding principles and content elements set forth by the International Integrated Reporting Council (IIRC).*** Those principles include a

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<sup>4</sup> Letter from Laurence Fink, chief executive at BlackRock, to chief executives at S&P 500 companies and large European corporations, as published online by Business Insider in February 2016 at <https://www.businessinsider.com/blackrock-ceo-larry-fink-letter-to-sp-500-ceos-2016-2/>

<sup>5</sup> We note the following in Footnote 58 to the Proposed Rule:

*Several commenters supported requiring disclosure of a registrant's business strategy. See, e.g., letters from IIRC, NEI Investments (July 21, 2016), NYSSCPA, PRI, S. Percoco, AFL-CIO and International Corporate Accountability Roundtable (July 19, 2016). Other commenters opposed requiring disclosure of a registrant's business strategy. See letters from Allstate, Fenwick, Maryland Bar Securities Committee and CFA Institute, **although CFA Institute supported voluntary disclosure of a registrant's business strategy.***

This is not our view. We do not support voluntary disclosure of a registrant's business strategy. We revisited our [comment letter dated October 6, 2016](#) to determine how our view may have been misconstrued. Review of the letter in totality notes that we prefer a balance of rules and principles when it comes to disclosures. We also make it clear that principles are not sufficient and that rules must accompany principles to ensure that key disclosures are not omitted or obscured. We clearly note that disclosure of business strategy is essential and that management should want to tell its story. We believe the following language may have been misinterpreted.

*General Development of Business (Item 101(a)(1)): Qs 24-30 Q 27. We would support inclusion of a registrant's business strategy, but we do not support another SEC mandate to achieve this goal. This is a disclosure that companies should want to provide. They should want investors to know and understand their strategies and how the financial statements, investments and even compensation strategies all reflect those corporate strategies.*

We believe our notation that management should want to provide the disclosure and that an SEC should not have to mandate it was taken as that we believe discussion of strategy should be voluntary. Again, this is not our view which should be apparent from our views expressed elsewhere in the comment letter regarding strategy specifically and other disclosures more broadly.

To ensure there is no confusion on this point, we want to make it perfectly clear that disclosure of business strategy should not be voluntary – and that if the SEC has to mandate strategy disclosures then this should be done.

focus on the strategy and future orientation of the business, a discussion of risks, challenges, uncertainties, and opportunities that affect the organization's ability to create value over the short, medium and long-term, and a discussion of the entity's governance structure and business model and how they support its ability to create value going forward. ***Integrated reporting also focuses on connectivity of information, meaning the filing should depict the interrelatedness and interdependencies of the factors that affect the organization's ability to create value over time.*** An integrated approach thus relates the organization's strategic objectives to its performance and achievement of those objectives for the period and their outcomes in terms of effects on the financial results and capital of the organization.

Accordingly, ***we believe the SEC should be moving towards creating a document that links the description of the business, including its development over time and its strategy and orientation going forward, to the risks it faces and how they impact its ability to create value, to the entity's financial performance and its achievement of its strategic objectives for the current period.*** In SEC parlance, the discussion in the General Development of the Business and Narrative Description of the Business sections should be combined and connected to the sections on Risk Factors, and both in turn should be connected to the discussion of the entity's financial performance and results in Management's Discussion and Analysis (MD&A).

***The Proposed Rule considers sections of the registration or periodic filing document individually. This is inconsistent with the request investors are making of companies globally – such as highlighted by Mr. Fink in his letter to CEOs. The Commission's approach in the Proposed Rule is also inconsistent with respect to the global narrative on value creation and sustainable business models<sup>6</sup> being promulgated by investors and other stakeholders. Said differently, the SEC's disclosure regime needs to adapt to market demands to remain a leading disclosure regime.***

#### ***Environmental, Social and Governance (ESG) Disclosures: The SEC Needs A More Systematic Approach***

To date, the SEC has incorporated select ESG factors into the 10-K and other filings but consideration has been on an *ad hoc* basis. For example, the Dodd-Frank Act mandated conflict mineral disclosures but did not mandate a discussion of any other environmental factors. This Proposed Rule expands human capital disclosures and compliance with material government regulations, including environmental regulations, but it does not consider environmental factors in a broader way, such as the registrant's risks and opportunities arising from climate change factors, which is increasingly of interest to investors. The Proposed Rules also does not consider other types of social and governance factors.

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<sup>6</sup> Our definition of sustainability is broader than environmental, social and governance factors. Sustainability includes all the elements/inputs/processes – including, for example, financial – of a business that are necessary to create and sustain a business over the long-term.

To improve disclosure effectiveness in this area, *we think it is essential that the SEC add some clarity regarding their definition and views on the terms sustainability and on ESG disclosures and to what degree this information does, or does not, belong in SEC filings. The current narrative on ESG disclosures by investors makes it is readily apparent investors are seeking such information because it is not simply values but value relevant to the investment decision-making process. Investors are obtaining and relying on information that they perceive is material to the investment decision-making process and such information is often not included within registrants offering and registration documents and is not subject to any type of assurance.*

*The time has come for the SEC to act on the issue of ESG disclosures before investors rely on inaccurate, incomplete or inconsistent information.* We believe a first step should be for the SEC to engage in investor outreach in order to systematically consider what sustainability factors are important to investors and then consider to what extent these factors should be included in its filings and how best to do so. This would be more effective than the current ad hoc approach.

Our comments on human capital disclosures are described below.

#### ***Risk Disclosures:***

##### ***Investors Seek an Integrated Approach to Risk Disclosures***

Investors care deeply about risk disclosures, and therefore, improving risk disclosures continues to be a high priority for them. We believe a key challenge for the SEC is to mandate better integration and linkage among the risk disclosures to the business description, financial statements, and the discussion of results in MD&A. Simply put, the registrant should address how the risk factors enumerated in Section 105 of the filing have impacted the results in the financial statements and how they might impact results going forward. *While the recommendations in the Proposed Rule seek to better order risk disclosures we do not believe the approach goes far enough as the risk disclosures need to be better integrated into the discussions throughout the document.* For example, as risks manifest themselves better articulation of how they have done so in management’s discussion and analysis or in the liquidity section. The Commission should also require that risk disclosures be specific to the registrant rather than generic statements that apply to all or most companies.

#### ***Technology:***

##### ***The SEC’s Proposal Does Not Address Technology***

As we have noted in the past (see, for example, our [2013 Financial Reporting Disclosures Report](#) and the aforementioned 2014 and 2016 comment letters), technology must be a pervasive consideration in any initiatives regarding disclosure effectiveness. The use of technology allows investors to search and display similar information in different sections of SEC filings simultaneously, such that analysts 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.

***While the SEC has made great strides in automating the financial statement portion of registrant filings, other parts of the filings, such as the sections addressed in this proposal, still lag behind.*** As a result, investors rely primarily on data providers to extract information and provide it in a substantially more useful format than existing SEC documents. Improving access and searchability of information within the SEC's filings would serve investors by enabling them to rely on the SEC's primary source information rather than having to rely on such secondary source documents.

***We believe the SEC can be a world leader in making filings fully electronically searchable and we encourage the SEC to consider how the information in these sections can be electronically tagged and made machine-readable.***

## SPECIFIC CONSIDERATIONS

While we have not responded to the detailed questions within the Proposed Rule, we provide perspectives on the key aspects of the specific proposals below.

### *General Development of Business (Item 101(a)) & Narrative Description of Business (Item 101(c))*

As discussed above, ***we support a more integrated approach to Item 101(a) and Item 101(c) and recommend that the SEC consider combining these two sections to create a new section that focuses on the entity’s approach to long-term value creation.***

In addition to discussing the factors specified in the proposal, which are largely based on major “transactional events” such as bankruptcy, mergers, acquisitions and dispositions, we believe that a core focus of this new, combined section should be a discussion of the overall strategy of the business and how the entity is implementing and performing on that strategy. The items that the SEC has identified – including a description of revenue-generating activities, products and/or services, and any dependence on key products, services, product families, or customers; the status of development efforts for new or enhanced products, trends in market demand and competitive conditions; resources material to a registrant’s business, such as raw materials, and intangible assets; the extent to which the business is or may be seasonal; and a robust description of human capital factors – all provide a useful starting point for this discussion. ***However, the focus of this combined section should be on how all these factors support or otherwise relate to the entity’s overall strategic plan.***

### *Incremental or Complete Disclosures*

In terms of the other changes set forth in the proposal, ***we do not support the proposals to permit hyperlinks or to permit registrants to provide the disclosure by other means such as by a filer information page on the company’s website. We believe that this section should stand on its own, and the use of hyperlinks or reference to other web filings will result in a piecemeal, fragmented narrative and will make it too cumbersome for a reader to piece together the full story, especially if is the first time the reader is reviewing the company’s filings. Given the Commission’s stated concern for the nonprofessional investor, we believe that having all information in one place is essential.***

Further, we worry that such information can be changed at a later date and may be altered should issues with disclosures arise subsequently. We believe the SEC’s goal should be to create a standalone document that provides “one-stop shopping” for the investor. ***For the same reasons, we do not support the proposal for registrants to provide only an update of the general development of the business that focuses on only material developments in the reporting period.*** While such updates should certainly be the primary emphasis of this section, a complete discussion should include whatever historical information is necessary to understand the registrant’s present state of affairs. ***If the section is not a complete discussion, investors are left trying to piece together a***

*story that has changed over time.* Finally, we believe the process of preparing a complete report is essential to the company executing an integrated thought process regarding how they communicate with investors.

#### ***Time Period Covered by Disclosures***

***We believe that the required time frame for the discussion of the business should continue to be the previous five years, and it should not be shortened. We believe the current five-year required timeframe makes sense because it is consistent with and therefore supports the five-year summary financial tables.*** In addition, by providing three years of income statement information, the financial statements effectively provide detailed financial information for the entity going back four years, so a description of the business should support at least that time period.

***We also think it is important for the company to provide a more forward-looking view of the business such that considerations such as the future viability and going concern of the business can be assessed.*** This is a major consideration in the UK at this time of audit reform and is something the US should consider.

As it relates to smaller reporting entities, we believe the SEC should retain the current requirement that if a smaller reporting company has not been in business for three years, it must provide the same information for predecessor(s) of the smaller reporting company if there are any.

#### ***Disclosure by Segment***

We believe that the SEC should continue to require the discussion and description of the business by segment, where applicable. For companies with a diverse array of segments – for example, a conglomerate that spans the manufacturing, technology, health care, financial, and other sectors – an overall discussion for the business as a whole can be virtually meaningless.

We support a balance between a principles and a rules-based approach to this section. While we want sufficient principles to allow companies to tell their story, we support a degree of rules and we strongly recommend that the SEC enumerate the various factors that an entity should consider including in the discussion, to promote consistency and comparability of this disclosure across businesses.

#### ***Intangible Assets***

With regard to disclosure of intangible assets, we continue to believe (as we stated in our prior correspondence) that a discussion of the business' reliance on copyrights and trade secrets is warranted, to the extent material to the company's ability to generate value for investors. While there may be a cost to initially compiling this list, it would seem to be critical to the registrant's own understanding of its business and strategic plan going forward and for that reason we think a cost/benefit analysis should be performed. We suggest that the SEC require the disclosure of the specific intangible assets that are critical to its success.



As we recently communicated to the [FASB in our comment letter on goodwill](#), we think the FASB and SEC should be working to provide improved disclosures on value creation and a disclosure (or accounting model) that reflects the importance in the current economy of all types intangibles whether purchased or internally generated. Disclosures such as when cash flows are nearing an impairment or how useful lives are determined are examples of disclosures that would be useful additions.

### ***Human Capital Disclosures***

We also support the proposed expansion of the discussion of human capital factors, as human capital is an important (yet not explicitly valued) asset that impacts the valuation of most companies. It is particularly critical in certain growth sectors. With the rise of technological innovation as well as fundamental shifts in the economy and workforce, investors are more than ever focusing on how companies leverage their work force to create long-term value. ***The efforts of the [Human Capital Management Coalition](#) have rightly focused investors on this issue. The [significant number of investor responses to this Proposed Rule consultation](#) highlights the importance of this issue to investors'. This should not go unnoticed by the Commission.***

We find that the historical approach of disclosing only the costs of compensation and benefits and the number of employees is inadequate for understanding the impact that such a vital intangible asset has on the performance and prospects of a business, and thus we support the expansion of human capital disclosures to include a discussion of how each company looks at its human capital and, in particular, where management focuses its attention in this space. However, ***we are concerned that the proposal, as worded, to discuss “any human capital measures or objectives that management focuses on in managing the business” (emphasis added) could result in fairly generic, boilerplate disclosure such as “We strive to hire top quality talent.”*** Accordingly, we strongly urge that the Commission make clear that specific metrics<sup>7</sup>, to the extent they are available, applicable, and/or reviewed by management, should be disclosed.

***We are supportive of the comments made by the [Sustainability Accounting Standards Board](#) regarding the reference by the SEC to SASB standards in the making of these disclosures.***

### ***ESG Disclosures More Broadly***

***As noted above, we encourage the SEC to think more broadly about reporting on ESG factors and believe that the SEC should undertake a more systematic study of these issues, rather than approaching these factors in the fragmented and piecemeal fashion.*** ESG is a rapidly evolving area and can mean different things to different people, and, therefore, a logical starting point would be to define what ESG means, and whether

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<sup>7</sup> At a minimum, we believe that companies should provide a breakdown of their total employees such as by employees and independent contractors; full-time and part-time or seasonal employees; or domestic or foreign employees, where relevant. We are supportive of universal disclosures [proposed by the Human Capital Management Coalition](#).

reporting should be coordinated through regulatory filings or whether the SEC should support an independent standard setter to develop standards in this area. To the extent these disclosures are to be made in regulatory filings, we would encourage to SEC to develop an overall framework that would incorporate the use of specific metrics to promote the consistency, reliability, and comparability of such disclosures. Investor outreach would be a critical first step in identifying what sustainability factors are important to investors and what sort of metrics are important to them.

### *Legal Proceedings (Item 103)*

We share the views of the [Council of Institutional Investors](#) as expressed in their comment letter as follows:

We have long believed a fundamental overhaul of the financial reporting related to legal proceedings is necessary and long overdue.

Investors have long demanded, and have not received, better and timelier qualitative and quantitative disclosures related to legal proceedings. Disclosures relating to legal proceedings, including environmental proceedings, may be critical to investors in making buy-sell or hold decisions because frequently they are associated with material cash outflows or events that have the potential to greatly affect a company's liquidity, capitalization or business prospects. We believe the existing disclosure requirements, including those required by U.S. Generally Accepted Accounting Principles, simply do not provide sufficient information necessary for investors to understand the nature, and potential magnitude and timing of any loss contingencies relating to legal proceedings.

In [2008 we provided a comment letter to the FASB](#) on improving loss contingency disclosures. In [2010 the FASB issued a consultation](#) on improving loss contingency disclosures. Pressure from the SEC at the time lead to this consultation. We did not issue a comment letter at that time, though we provided our perspectives verbally to the FASB in February 2011. The FASB has made no improvements based upon that consultation.

Given is unlikely that any substantive change can be made to this section without changing the financial statement disclosures, as many times the contents of this section are a simply a duplication of the legal footnote from the financial statements, we believe the SEC's most significant action should be an improved tabular presentation of the information. This table would include items such as:

- name of legal proceeding,
- facts of legal proceeding,
- management's position with respect to case,
- amounts if any accrued (and financial statement caption) or why not,
- change in status of legal proceeding since last date,
- settlements,
- settlements above or below amounts accrued.

This orderly presentation in tabular format, would facilitate investors focusing on key items of interest and key changes. It would also allow investors to assess the settlements and the sufficiency of the accrual over time. This presentation would also facilitate data tagging of key attributes of the case. These tables would not require any information not already required under SFAS 5, but would facilitate increased understanding and analysis of the information by investors.

### ***Risk Factors (Item 105)***

#### ***Summary Risk Factor Disclosure***

We agree with the SEC’s proposal to require a summary risk factor disclosure. In our view, such a summary should not merely be a shorter version of the risk factor section but should highlight the material risk factors that the entity faces. This summary would then do for the risk section what the requirement to disclose critical accounting policies did for the financial statements and critical audit matters will do for the auditor’s opinion – namely, highlight those factors which are most material to the entity and, therefore, are most important for investors to understand. In addition, we believe the risk summary should be required for all registrants – rather than imposed after an arbitrary page limit is reached – similar to the manner in which critical accounting policies and critical audit matters (CAMs) are mandated for all registrants.

#### ***Contextualize by Magnitude***

In identifying material risk factors, we believe the registrant should consider those risk factors that the company’s Board of Directors is discussing. In addition, the summary should be organized by the magnitude of the risk factor, and distinguish between those risk factors which might occur infrequently but would have a severe impact on the business, versus those factors which might occur more frequently but may not have as severe an impact on the business. In other words, additional contextualization of each risk factor will assist investors in analyzing the risks that a company faces.

#### ***Organize by Relevant Headings***

We also support the SEC’s proposal to require risk factors to be organized under relevant headings, with any risk factors that may generally apply to an investment in securities disclosed at the end of the risk factor section under a separate caption of General Risk Factors.

#### ***Integrated Approach***

Finally, and most fundamentally, as discussed above, the SEC should adopt an integrated approach to risk reporting whereby the MD&A includes a discussion of how the risk factors identified by the entity ultimately impacted or could impact the financial results, and how they might impact the business’ strategy and results going forward.

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Thank you again for the opportunity to provide our input on this Proposed Rule. If the SEC 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](mailto:sandra.peters@cfainstitute.org).

Sincerely,

*/s/ Sandra J. Peters*

Sandra J. Peters CPA, CFA  
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cc:

The Honorable Jay Clayton, Chairman, U.S. Securities and Exchange Commission  
The Honorable Commissioner Robert J. Jackson, Jr., U.S. Securities and Exchange Commission  
The Honorable Commissioner Hester M. Peirce, U.S. Securities and Exchange Commission  
The Honorable Commissioner Elad L. Roisman, U.S. Securities and Exchange Commission  
The Honorable Commissioner Allison Herren Lee, U.S. Securities and Exchange Commission

Mr. William H. Hinman, Director,  
Division of Corporation Finance, U.S. Securities and Exchange Commission  
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Mr. Sagar Teotia, Chief Accountant, U.S. Securities and Exchange Commission

Mr. Rick Fleming, Investor Advocate, U.S. Securities and Exchange Commission