



CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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July 14, 2014

Mr. Russ Golden
Chairman
Financial Accounting Standards Board
301 Merritt 7
P.O. Box 5116
Norwalk, CT 06856

Re: Proposed Statement of Financial Accounting Concepts on *Chapter 8: Notes to Financial Statements* (File Reference No. 2014-200)

Dear Chairman Golden:

The U.S. Chamber of Commerce (the “Chamber”) is the world’s largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. To achieve these goals, the CCMC has supported the development of robust financial reporting systems and encouraged efforts to improve standards and reduce complexity.

The CCMC appreciates the opportunity to comment on the Financial Accounting Standards Board (“FASB”) Exposure Draft on the *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements* (“the Proposal”), which amends an earlier version of the proposal published in July, 2012 (“July 2012 Proposal”). The CCMC commented on the July 2012 Proposal¹ and appreciates that a number of our concerns have been addressed. Indeed, we believe that the Proposal

¹ See November 19, 2012 CCMC letter to FASB on the *Disclosure Framework* (File Reference 2012-220).

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is an important project to improve disclosure effectiveness to promote efficient capital markets and protect investors in a 21st century economy.

However, a number of concerns remain and the Proposal itself raises some new issues as well. The CCMC believes that the Proposal may lead to duplicative disclosures that conflict with existing legal requirements, may force businesses to disclose information unrelated to financial reporting and not material to investors and the proposal seeks to use cost-benefit analysis in a manner to justify disclosure of non-financial information that may not be material or necessary to reflect economic activity. Additionally, the Proposal in its current form may undermine the ability of businesses to avail themselves of acceptable forms of accounting such as last-in-first-out (“LIFO”) accounting. This could cause economic harm to a company and its investors.

Overall, the CCMC is concerned about the boundary for determining information to be disclosed in notes to the financial statements as reflected in the Proposal. It appears that the explanation of concepts in the Proposal would not always appropriately confine note disclosures to information with a direct nexus to the financial statements. If the note disclosures no longer have a direct nexus to the financial statements, there is a risk that the disclosures will be used to advance political and social goals that are not a proper subject of financial reporting.

These concerns are discussed in more detail below.

Background

The Proposal is part of FASB’s initiative to improve the effectiveness of disclosures. Others, including the Securities and Exchange Commission (“SEC”), have undertaken similar efforts to modernize disclosures in order to facilitate the dissemination of decision useful information for investors and promote capital formation in a 21st century global economy. The CCMC applauds these efforts and believes that they are necessary for the SEC and FASB to achieve their missions.²

² For example, the U.S. Chamber of Commerce is holding an event on July 29, 2014 on “Corporate Disclosure Reform: Ensuring a Balanced System that Informs and Protects Investors and Capital Formation” to discuss the state of corporate disclosure and hear from stakeholders and experts on how the business community can be part of the solution to improve the structure of disclosure requirements.

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Corporate disclosures, both financial and non-financial, are the primary means for companies to communicate material information to investors to allow them to make informed decisions on how and where to deploy capital. While information delivery and markets have evolved dramatically, the basic disclosure framework has not kept pace. Therefore, the Proposal in conjunction with other disclosure effectiveness initiatives are critical to modernize information for investor decision-making, boost confidence, and help facilitate the economic activity that allows our capital markets to thrive.

The Proposal is one component of FASB's broad disclosure framework project and encompasses conceptual matters related to the notes to financial statements. FASB intends to use the concepts developed as a basis for establishing disclosure requirements in the future as well as evaluating existing disclosure requirements.³ Additionally, FASB's disclosure initiative includes a separate component related to decisions that reporting entities make when evaluating disclosure requirements. However, the Proposal states that the entity's decision process for complying with disclosure requirements is not part of the conceptual framework and will be exposed separately in a proposed Accounting Standards Update ("Update").⁴ We hope that this Update will be released soon so stakeholders can evaluate it in conjunction with the Proposal.

Furthermore, it is our understanding that FASB is also working on a simplification initiative to reduce narrow sources of unnecessary complexity in current standards, including disclosures in the notes to financial statements.

I. Holistic and Integrated Approach

The CCMC comment letter for the July 2012 Proposal ("CCMC 2012 Comment Letter") strongly recommended that the FASB take a holistic and integrated approach to disclosure and, therefore, work with the SEC and other regulators. The Proposal states that FASB is working in a coordinated manner with the SEC staff, and expects to continue to do so, to identify ways to improve the efficiency and effectiveness of disclosures, including ways to reduce overlapping

³ See paragraph 6 of the Proposal

⁴ See paragraph 7 of the Proposal.

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disclosures.⁵ The CCMC is encouraged that the FASB recognizes the importance of taking a holistic and integrated approach to disclosure.

However, the CCMC remains concerned that certain language in the Proposal would “open the door” for the FASB to promulgate duplicative disclosure requirements that would exacerbate rather than reduce financial reporting complexity and disclosure overload. For example, the Proposal states:

*The Board attempts to avoid requiring information in notes that entities are otherwise required to provide, for example, in SEC filings or other regulatory reports. However, there are valid reasons why the Board at times considers requiring disclosure of information in notes when the entity provides similar or identical information in other forms of communication.*⁶

The Proposal goes on to explain that “valid reasons” include that some entities may not be subject to the disclosure requirement, the information may not be required every period or be as timely as the financial statements and notes, or the required information may not be as complete or subject to the same degree of scrutiny and verification.⁷

Thus, it appears that the Proposal would allow FASB to determine that certain SEC disclosures, for example, in Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”), should be subject to audit – contravening an SEC decision. As a result, the FASB could require public companies to make duplicative disclosures in the notes to financial statements of information already required by the SEC to be disclosed in MD&A.

This is a classic example of overload that runs counter to the concept of disclosure effectiveness. Should this come to pass it will create burdens for businesses, harm investors, and expand liability risk. This is an example of why cost-benefit analysis should be used in determining the appropriateness of proposals. It is also unclear what investor interest FASB is trying to address with duplicative disclosures that can cause economic harm and disadvantage investors.

⁵ See paragraph 8 of the Proposal.

⁶ See paragraph D21 of the Proposal.

⁷ Ibid.

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In addition, it appears that the Proposal would allow FASB to extend to private companies various SEC disclosure requirements such as those in MD&A. For example, the Proposal provides that if financial statement amounts changed from previous reporting periods or dates, and that information is not otherwise available or apparent, it would be appropriate for FASB to require companies to provide that information in the notes.⁸ Public companies already provide a good deal of this type of information in MD&A, including a three year comparison of results of operations with explanations for changes in these results by income statement line-item. It is unclear how such a notes disclosure would provide investors in public companies with more relevant information than they already have.

Therefore, while existing MD&A disclosures may preclude public companies from having to provide such notes disclosures, the Proposal would open the door to FASB requiring private companies that use Generally Accepted Accounting Principles in the U.S. (“U.S. GAAP”) to provide such information in the notes.

An extension of MD&A notes disclosures to private companies creates its own sets of problems. For example, any such extension fails to take into consideration that the needs of financial statement users of private companies is radically different than public company financial statement users. These differences in user needs, in our view, preclude any need for such disclosures for private companies that use U.S. GAAP. It should also be noted that public policy entities with jurisdiction over private companies have not mandated such disclosures for private companies and Congress has explicitly narrowed the scope of disclosures for Emerging Growth Companies through the Jumpstart our Business Startups Act (“JOBS Act”).

Accordingly, the CCMC believes that such an expansion of disclosure to private companies is not appropriate.

Further, the Proposal appears to allow FASB to formulate its own, unique MD&A-type disclosures in the notes to financial statements for all types of entities, including public companies. For example, in the name of providing additional information about financial statement line-items, the Proposal suggests that the notes could include:

⁸ See paragraph D37.

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Potential effects of changes in general legal and economic conditions, accounting methods, market forces, and factors specific to the entity or sector such as social perceptions or initiatives, imminent obsolescence, supply chain concerns, new regulations, availability of trained workers, management turnover, or environmental hazards⁹ [emphasis added].

The CCMC appreciates that the Proposal attempts to articulate reasonable objectives for the notes and high level information on the boundaries for the notes.¹⁰ This is consistent with the recommendation of the CCMC 2012 Comment Letter that the framework needs a practical and workable set of core principles for disclosures.

However, various statements in the Proposal, including those that articulate *exceptions* to items that generally should *not* be required by FASB in the notes, makes for a disclosure boundary with a very “slippery slope.” Also, if the exceptions create ambiguity as to what must be disclosed, issuers may end up disclosing more than is required to reduce the risk of liability. This could lead to the disclosure of immaterial information that worsens the problem of disclosure overload.

Instead, the CCMC recommends that the Proposal emphasize the core concept that note disclosures need to have a direct nexus with the financial statements. In addition, under a holistic and integrated approach, the CCMC also recommends that FASB not lose sight of the fact that the articulation of concepts in Chapter 8 needs to ensure that the concepts will “withstand the test of time” in avoiding duplicative disclosures and disclosure overload.

II. Cost-Benefit Considerations

The CCMC 2012 Comment Letter emphasized the importance of including cost-benefit considerations in a disclosure framework. The CCMC and others believe that the use of cost-benefit analysis is necessary for effective standard setting and providing a better means of understanding the consequences of standards as they are developed and in the immediate post-implementation phase.¹¹ Thus, the CCMC is

⁹ See item (d) in paragraph D38. For additional examples that raise a similar concern, see paragraphs D52(c) and various items in D57 of the Proposal.

¹⁰ Paragraphs S2-S4 of the Proposal provide a general description of the purposes of the notes and the boundaries of disclosures. Paragraph S5 describes information that generally should not be required by the Board in the notes.

¹¹ As noted in CCMC’s letter of November 19, 2012, the use of cost-benefit analysis has been expanded by Congress to the Public Company Accounting Oversight Board (“PCAOB”) in the development of audit standards and emerging growth companies through the JOBS Act, as well as through SEC-Self Regulatory Organization (“SRO”) rulemakings,

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pleased to see that the Proposal recognizes the importance of cost-benefit considerations and the need to avoid negative consequences in promulgating disclosure standards for notes to financial statements.¹² However, the CCMC has several concerns regarding the discussion of these matters in the Proposal.

The CCMC is concerned with the manner in which FASB seeks to use Cost-Benefit Analysis. The Proposal allows for FASB to promulgate disclosure requirements about general economic, political, and social conditions, events, and circumstances that are common knowledge if the FASB determines that such information is “not generally available” or “because the entity is in a better position to evaluate” the effects of significant economic, social, or political change.¹³

The CCMC believes that this goes far afield of providing financial disclosures to reflect economic activity. Attached with this letter is a June 26, 2014 comment letter (“WFE Letter”), which we request be considered in the record in conjunction with this comment letter, from the Chamber to the World Federation of Exchanges and the Investor Initiative for Sustainable Exchanges on a proposal for Environmental, Social and Governance (“ESG”) disclosures. We believe that such determinations must be made by appropriate legal authorities, which in this case would be the SEC and not FASB, and that such disclosures must meet materiality standards as required under law.

Consistent with CCMC’s overarching concern, the Proposal appears to leave the door open for FASB to promulgate requirements for disclosure of information in the notes even though such information is not entity-specific and does not have a direct connection to the financial statements. Since any such required information would also be subject to an audit, we also wish to reinforce the concern expressed in our 2012 Comment Letter about the need to recognize and address issues related to the auditability of note disclosures.

Cost-benefit analysis is a tool that can and should be used for factual empirical based standard setting. We hope that FASB will commit itself to that goal.

such as announcements by the Financial Industry Regulatory Authority (“FINRA”) and the Municipal Securities Rulemaking Board (“MSRB”) that they would incorporate cost-benefit analysis into their rulemaking process. The PCAOB has recently issued guidance on its use of cost benefit analysis in standard setting.

¹² See, for example, paragraphs D17, D19, and D23 of the Proposal.

¹³ See footnote 7 in the Proposal.

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Requiring that note disclosures have a direct nexus to the financial statements helps to ensure the integrity of financial reporting, which would be compromised if note disclosures ended up being used to advance political and social policy goals.

III. Future-Oriented Information

The CCMC appreciates that the discussion in the Proposal now recognizes that the SEC requires disclosure of future-oriented (i.e., “forward-looking”) information in MD&A and accordingly is subject to a safe harbor against litigation. The CCMC also appreciates that the Proposal attempts to articulate some concepts for the types of future-oriented information that might be usefully disclosed in the notes subject to cost constraints and the avoidance of significant negative consequences to companies and their investors and creditors. However, even though the specific examples provided to illustrate the concepts may not seem unreasonable on their face, the CCMC is again concerned that the Proposal would open the door for FASB promulgating disclosures of forward-looking information that do not have a direct nexus to the financial statements, would put management in the shoes of users in analyzing their financial statements, and would raise problems with respect to auditability.

This could create information clutter degrading the decision making capability of investors and increasing liability risk.

IV. Materiality

The Proposal states:

The Board’s judgments about whether to establish disclosure requirements necessarily are based on broad general considerations of relevance rather than on materiality, which is entity specific. ... Therefore, materiality decisions must be made by each individual entity, and the Board should establish requirements that are not so prescriptive that they preclude reporting entities from making materiality judgments.¹⁴

In addition to our earlier comments and the WFE letter discussion on materiality, we would like to reiterate a point in the CCMC 2012 letter that the definition of materiality in the FASB Statements of Financial Accounting Concepts

¹⁴ See paragraph D18 of the Proposal.

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(“Concepts Statements”) differs from that based on court decisions interpreting the federal securities laws and contained in the auditing standards of the Public Company Accounting Oversight Board (“PCAOB”).¹⁵ For example, PCAOB Auditing Standard No. 11 states:

In interpreting the federal securities laws, the Supreme Court of the United States has held that a fact is material if there is ‘a substantial likelihood that the ... fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.’ As the Supreme Court has noted, determinations of materiality require ‘delicate assessments’ of the inferences a ‘reasonable shareholder’ would draw from a given set of facts and the significance of those inferences to him. ...

While we recognize that Concepts Statements are not authoritative under the FASB Codification, this inconsistency in definitions creates confusion and could increase litigation risks for companies and auditors alike. The CCMC is encouraged that recently FASB reached the tentative decision “to amend Topic 270, Interim Reporting, to reflect that disclosures about matters required to be set forth in annual financial statements should be provided on an updated basis in the interim report *if there is a substantial likelihood that the updated information would be viewed by a reasonable investor as significantly altering the ‘total mix’ of information available to the investor*” (emphasis added).¹⁶

We also would refer FASB to the WFE letter attached and the extensive discussion of materiality and its legal significance.

As a result, the CCMC recommends that the FASB use the definition of materiality in the Concepts Statements which is consistent with securities laws, court decisions, and PCAOB auditing standards.¹⁷ Otherwise, the disclosure framework envisioned by the FASB does not appear to be a workable one for reporting entities to apply.

¹⁵ By way of reference, Statement of Financial Accounting Concepts No. 8 defines materiality as follows: “Information is material if omitting it or misstating it *could* influence decisions that users make on the basis of the financial information of a specific reporting entity” (paragraph QC11, Chapter 3).

¹⁶ See Tentative Board Decisions (as of May 30, 2014) under Disclosure Framework – Entity’s Decision Process on the FASB website.

¹⁷ We appreciate that this could also involve the FASB working with the IASB to maintain converged definitions.

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V. Appendix A

Appendix A of the Proposal contains a series of questions about the nature of items being considered that, if answered positively, indicate FASB should consider requiring disclosure when setting new accounting standards or updating existing standards. We recognize that the questions in Appendix A would be considered subject to the concepts discussed in the Proposal, including the one on costs. However, as a threshold matter, the CCMC is concerned the Appendix consists of nearly 20 questions, most all of which have multiple sub-parts, that FASB would routinely ask in crafting disclosure requirements on each and every standard-setting initiative. There is no prioritization or hierarchy to the questions and we believe this approach is not commonly deployed in the standard setting process used by FASB. This irregularity will in our view harm the ability of FASB to meet its goal to enhance disclosure effectiveness.

The CCMC recommends that any such Appendix should likewise include questions for FASB to consider on eliminating disclosures that are obsolete, unnecessary or redundant when setting or updating accounting standards. The CCMC notes that questions of this nature would be consistent with the expressed intent, as previously discussed, to use the concepts developed as a basis for evaluating existing disclosure requirements, not just establishing new disclosure requirements in the future.

The CCMC is also concerned that some questions in Appendix A have wide ranging consequences that should be subjected to more rigorous debate, analysis and scrutiny. For example, Question L15 asks if there is an alternative measure or way of applying a measurement that clearly would be useful in assessing prospects for cash flows. If so, FASB could require information to be disclosed to identify the alternative and indicate the magnitude of the difference between the reported and alternative measurement.¹⁸ Routinely imposing a requirement for disclosing the latter would be burdensome. One means of mitigating this concern, though it does not eliminate it, is to state that the term “clearly would be useful” would mean in all cases – “clearly would be useful on a cost-benefit basis.”

¹⁸ See page 34 of the Proposal.

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Additionally, in Question L15 discussed above, the LIFO (as opposed to FIFO) method of inventory costing is used as an example. LIFO is also used in Question L10 of Appendix A as an example of an accounting method where the results produced are counter to what a reader might otherwise expect.¹⁹ These examples make LIFO appear to be an “outlier” accounting choice and could mistakenly be interpreted as suggesting that the FASB is distancing itself from LIFO accounting. This fails to recognize that LIFO is an appropriate choice under the Internal Revenue code and U.S. GAAP. Accordingly, a large number of companies use LIFO accounting, and a switch from this method of accounting could cost businesses over \$150 billion dollars, a cost that will ultimately fall onto investors. Again, such a change in financial reporting will drive economic activity harmful to investors.

It would be inappropriate to undermine the use of LIFO accounting via a Statement of Financial Accounting Concepts.

VI. Other Matters

The Proposal states:

*In preparing responses to this Exposure Draft, respondents should consider the differences in status of the FASB Concepts Statements and the Accounting Standards Codification, as well as the possibility that FASB Concepts Statements could be elevated to authoritative status in the future.*²⁰

Formulating responses to the Proposal based on the possibility that FASB Concepts Statements could be elevated to authoritative status in the future is a daunting assignment.²¹ The Concepts Statements are currently intended to be used by FASB in developing accounting standards and are crafted based on this intent. It is not at all clear if or how the Concepts Statements generally or the Proposal specifically could be practically or workably applied by preparers (and auditors). Asking them to do so would raise a number of issues, not the least of which relate to

¹⁹ See page 32 of the Proposal.

²⁰ See paragraph P11 of the Proposal.

²¹ We also note that it appears inconsistent with the statement in the Proposal, as previously discussed, that the entity’s decision process for complying with disclosure requirements is not part of the conceptual framework and will be exposed separately in a proposed Accounting Standards Update (paragraph P7).

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the litigious nature of the U.S. legal system. If the FASB is seriously considering this move, we respectfully suggest that it should be separately discussed and subject to its own due process.²²

Conclusion

The CCMC appreciates the opportunity to comment on the Proposal. While the CCMC believes that the Proposal is an improvement over the 2012 Proposal, we still have significant concerns, some of which are new. In its current form, the Proposal may inhibit disclosure effectiveness by contributing to financial statement complexity.

The CCMC stands ready to assist in the effort to develop a framework for effective disclosures, including in the notes to financial statements, which convey relevant information for market participants and mitigate disclosure overload and financial reporting complexity.

Sincerely,

A handwritten signature in black ink, appearing to read 'TK' followed by a long, sweeping flourish.

Tom Quaadman

²² Relatedly, Question 10 for Respondents asks: “If no disclosure guidance for a transaction, event, or line item is specified in U.S. GAAP, how will an entity consider the nonauthoritative guidance in this chapter?” (See page 7 of the Proposal.) As a threshold matter, the Proposal does not lend itself to application by preparers (or auditors) under circumstances where US-GAAP does not contain any disclosure requirements. The CCMC recommends that the FASB acknowledge that such conceptual guidance is intended to be used solely by the Board in promulgating standards for disclosures in notes to financial statements.



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United Nations Global Compact
Via Electronic Submission: listingstandards@unglobalcompact.org

Re: Investors Listing Standards Proposal: Recommendations for Stock Exchange Requirements on Corporate Sustainability Reporting

Dear Mr. Naacke, Ms. Rembert, and To Whom It May Concern:

The U.S. Chamber of Commerce (“Chamber”) is the world’s largest business federation, representing the interests of more than 3 million businesses and organizations of every size, sector, and region. The Chamber has recently established its Global Risk and Governance Initiative (“GRGI”) to promote modern and appropriate international structures for capital formation, risk management and corporate governance needed by businesses to fully function in a 21st century global economy. To achieve this objective it is an important priority for the GRGI to foster transparency in public companies’ periodic disclosures, in order to provide investors

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with useful information for making decisions about their investments or potential investments.

The GRGI welcomes the opportunity to comment on the *Investors Listing Standards Proposal: Recommendations for Stock Exchange Requirements on Corporate Sustainability Reporting* (“Proposal”). However, the GRGI has significant concerns that the Proposal conflicts with existing legal requirements for the materiality of disclosures and creates a “one-size-fits-all” approach that is too prescriptive for the nuanced and balanced needs of businesses and their investors. The Proposal also has the potential to conflict with efforts by regulators to improve disclosure effectiveness and enhance communications between businesses and their investors. Accordingly, the GRGI believes that the discussion of material disclosures of non-financial information should be had by domestic securities regulators rather than through exchange listing standards.

We submit that the Proposal is not in the best interest of investors. As a threshold matter, the Proposal conceives of a materiality standard that fundamentally conflicts with the long-standing materiality definition found in the U.S. federal securities laws. If enacted in the U.S., the Proposal would sow confusion by overwhelming investors with voluminous information that is immaterial under the Supreme Court’s formulation. Inundating investors with what the U.S. Supreme Court has called an “avalanche of information” is not in investors’ best interests. Accordingly, the central risk of the Proposal is that it in fact would undercut the goal of facilitating investor decision making. We also oppose any effort to impose a new set of disclosure requirements intended to advance a narrow special interest to the detriment of reasonable investors overall.

Discussion

We believe that efforts to improve investors’ access to critical information about their investments will ensure that capital will be put to its highest and best use, and that investors will retain confidence in the efficiency and integrity of the public

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company capital markets. Insofar as the U.S. is concerned, this confidence is undermined when the federal securities laws are used to advance a special interest group's idiosyncratic agenda at the expense of providing useful information to investors overall. We fear an erosion of confidence in the integrity of the regulatory regime when that regime is used for special interest purposes other than advancing investor decision-making.

Because reporting should reflect the legitimate needs of the broad base of investors, we agree that companies should engage in robust communications with investors and should regularly assess their reporting practices in relation to investors' needs. Of course, the reporting of non-financial information and metrics can be an important part of this dialogue critical to the capital formation process. To ensure that the needs of the broad base of investors and businesses are met, these communications and disclosures must follow the manner and means mandated by securities laws and regulations for the jurisdictions relevant to the capital formation activities.

It is also important to note that the Chamber has previously commented on non-financial reporting standards.¹ These letters to both the International Integrated Reporting Council ("IIRC") and the Sustainability Accounting Standards Board ("SASB") commented upon the draft conceptual frameworks ("Framework"). We believe the concerns the Chamber raised to both the IIRC and SASB last year are also applicable to the Proposal.

Our specific concerns regarding the Proposal are as follows here:

¹ See letter of July 15, 2013 from the Chamber to the International Integrated Reporting Council's Consultation Draft of the International <IR> Framework; see also letter of July 26, 2013 from the Chamber to the Sustainability Accounting Standards Board on the SASB Conceptual Framework Exposure Draft.

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1. Consistent with the current requirements under the law in the United States, reporting should be drafted with the reasonable investor in mind and should not be dictated by a minority of investors or a small group of special interest activists, who may seek to further interests other than those of the company and its shareholders generally.

Again, the guiding principle for disclosure should be materiality, which is premised on the needs of the “reasonable investor.” A minority of special interests in the U.S. has in recent years sought drastically increased corporate disclosure on narrow issues and interests, particularly in the Environmental, Social, and Governance (“ESG”) space, through the shareholder proposal process under U.S. Securities and Exchange Commission (“SEC”) Rule 14a-8. By and large, investors have soundly rejected these proposals.

For instance, between 2006 and 2013 (through June 2013), 261 votes on public companies’ political spending and/or companies lobbying practices disclosure and related actions have been held among Fortune 250 companies. These proposals have averaged only 19.95% support.² Moreover, with the exception of an outlier 2006 vote at one company that was supported by the company’s management, not a single one of these 261 proposals has been supported by a majority of votes cast.³ Likewise, 60 proposals during the same period on animal use practices reporting and related actions have achieved average shareholder vote support of 4.53%, with no single such proposal gaining the support of even 10% of shareholders.⁴ In sum, these voting results provide empirical evidence of what the “reasonable investor” does—and does not—want. Accordingly, we believe that these examples effectively illustrate that shareholders, broadly, do not find information of the sort described above to be decision-useful information.

Yet, this is the type of information the Proposal would mandate be disclosed.

² Source: Manhattan Institute Proxy Monitor Data, available at <http://www.proxymonitor.org/>

³ *Id.*

⁴ *Id.*

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Some interest groups view public companies' communications to be a forum for advancing social goals or other narrow interests ahead of building long-term economic value for shareholders. But this perspective has not been widely accepted by the courts or the SEC. Given that the Proposal is intended primarily for shareholders, it is important that the Proposal explicitly reflect that disclosures—whether or not they are requested by or useful to some special interest group—must benefit shareholders broadly. The disclosures the Proposal contemplates do not do so.

2. The Proposal must be sensitive to and incorporate companies' need to comply with existing laws and applicable regulations, including existing legal definitions and usage of “materiality” and “systemic risk” in evaluating their disclosure obligations.

We believe any effort to define the content of mandatory disclosure requirements must begin with the concept of “materiality.” Public companies in the United States are subject to existing legal standards for public disclosure, including definitions of “materiality” developed over time by the courts and by regulators. For example, under the current public company reporting regime in the United States, the Supreme Court has determined that information is material if there is “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of the information made available” for purposes of making an investment decision.⁵ Writing for the Court in *TSC Industries*, Justice Thurgood Marshall cautioned that there are limits on the scope of disclosure.⁶ For example, “some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good.”⁷ Justice Marshall continued, “if the standard of materiality is unnecessarily low . . . management’s fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of information—a result that is hardly conducive to informed decision making.”⁸ Put differently, Justice Marshall recognized that

⁵ See *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (emphasis added).

⁶ *Id.* at 448.

⁷ *Id.*

⁸ *Id.* at 448-49.

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investors are worse off when they are overwhelmed by voluminous disclosures – what we might term “information overload.”

Thus, the Supreme Court rejected a lower court’s definition of materiality that turned on whether a reasonable shareholder “might” consider a particular fact to be important in favor of a higher threshold of importance before deeming something to be “material” under the U.S. securities laws.⁹

Accordingly, the concept of materiality does have outer limits. For example, courts have held that public companies are not required to disclose a fact simply because an investor may have some interest in it. Indeed, as the influential Second Circuit Court of Appeals has observed repeatedly, disclosure “is not a right of confession.”¹⁰ Further, the staff of the SEC has provided substantial guidance on “materiality” as it applies to both financial and non-financial disclosures.¹¹

The Proposal, however, conceptualizes materiality in terms of having “a direct or indirect impact on an organization’s ability to create, preserve, or erode economic, environmental, and social value for itself, its stakeholders, and society at large.” This definition is entirely inconsistent with the concept of materiality espoused by the Supreme Court and the SEC. Neither the U.S. federal courts nor the SEC has ever advanced a definition of materiality like the one put forward in the Proposal. The Proposal’s treatment of economic, environmental, and social factors puts the Proposal squarely at odds with the Supreme Court’s focus on the “total mix of information” when evaluating materiality and would open the floodgates of disclosure in sharp contrast to the balance the Court sought to strike in *TSC Industries*. Further, the Proposal’s definition departs from the well-understood “reasonable investor” standard in favor of ill-defined and highly subjective audiences to include “stakeholders” and “society at large” creating confusion as to both the legal standard of disclosure as well as the purpose of the securities law regime.

⁹ *Id.*

¹⁰ *City of Pontiac v. UBS AG*, No. 12-4355-cv (2nd Cir. May 6, 2014), slip op. at 21.

¹¹ *See, e.g.*, Staff Accounting Bulletin No. 99 – Materiality. 17 CFR Part 211 (Amended) Staff Accounting Bulletin Series § M, Topic 1.

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This benefits neither businesses nor investors.

Many of the substantive standards put forward in the Proposal are also either duplicative of, or in direct conflict with, existing public company disclosure requirements. When material, public companies are already required to disclose much of the information contemplated by the Proposal. Some of the existing affirmative disclosure obligations for public companies under Regulation S-K¹² relevant to ESG topics include Item 101 (Business Description), Item 103 (Legal Proceedings), Item 303 (Management's Discussion and Analysis), Item 407 (Corporate Governance) and Item 503(c) (Risk Factors).

Any new approach to corporate disclosure should take into account existing legal requirements that apply to public companies. Further, while we believe it is appropriate for disclosure requirements to evolve, it is important that they do so in an effective manner to retain the focus on information that is important to the investment decisions of reasonable shareholders. It is equally important to avoid applying multiple and potentially conflicting definitions of "materiality."

The same is true for systemic risk. While systemic risk is not clearly defined in U.S. federal law, the various definitions being discussed by regulators and others in the U.S. and abroad generally turn on material financial distress or failure of the financial markets and the broader economy.

Thus, as with materiality, the Proposal contemplates a definition of systemic risk that is inconsistent with the general understanding of the term. Specifically, the Proposal becomes untethered from the basic financial stability of the U.S. by incorporating social and environmental concerns. To be sure, these concerns are not unimportant. But they are also not relevant to the soundness of the U.S. or global economy from a financial point of view. Further, they could justify almost endless disclosure, once again contrary to the limits of what has long been required to be

¹² 17 C.F.R. Part 229.

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disclosed under the U.S. federal securities laws based on the *TSC Industries* longstanding conception of “materiality.”

3. The Proposal appears to adopt a “one-size-fits-all”-approach creating conflict with existing legal obligations and undercutting the effective and tailored communications that already occurs between businesses and their investors.

First, businesses that currently disclose ESG indicators do so in a manner that is intended to best meet the needs of their investors. These disclosure decisions are not made in a vacuum. Instead, corporations—now more than ever before—are engaging in direct dialogues with their respective investors in an effort to customize sustainability and related disclosures. The prescriptive nature of the Proposal defeats the goal of enhanced communication that serves investors overall by depriving businesses and investors of their ability to shape a dialogue that best fits each of their needs. Furthermore, as stressed above, the Proposal risks setting too low a standard of materiality, which will lead to the avalanche of information Justice Marshall warned against in *TSC Industries*.

Additionally, as exemplified by the appellate court’s decision concerning the SEC’s conflict minerals rulemaking, certain mandated disclosures may in fact violate the First Amendment under the U.S. Constitution when they are premised on advancing the government’s ideological message with the intent of stigmatizing companies.¹³ The D.C. Circuit’s opinion should, therefore, be a cautionary tale as the Proposal is heavy on advancing ideological messages that are still the subject of considerable debate and disagreement in the marketplace.

4. Any new approach to overhauling public company disclosures should be implemented with the goal of keeping information timely and relevant and promoting effective disclosure.

¹³ See *National Ass’n of Mfrs., U.S. Chamber of Commerce et.al. v. SEC*, No. 13-252 (D.C. Cir. Apr. 14, 2014).

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Even under current requirements in the U.S., some disclosure documents— notably the proxy statement—already suffer from “information overload” resulting in disclosure ineffectiveness. For instance, in the five years between 2006 (when the SEC drastically expanded proxy statement disclosure requirements) and 2011, the average length of proxy statements filed by Dow 30 companies in the U.S. increased 54%, from 46 pages to 71 pages.¹⁴ In some cases, there is simply too much information for investors to digest, or information may be obsolete and not useful. Accordingly, it is important that this Proposal and proposals on corporate sustainability reporting generally be developed and implemented in a way to ensure that corporate disclosures focus on the most important information and avoid piling on additional reporting requirements, which are not considered material to the “reasonable investor.”

To the extent that reporting in accordance with the Proposal would result in companies disclosing large amounts of information that is not considered material under the existing disclosure regime,¹⁵ investors would not benefit and in fact would be harmed. Additionally, as the SEC is currently contemplating means to improve disclosure effectiveness, we believe that the current period of time is not opportune to move forward with the consideration of the Proposal.

Conclusion

The GRGI believes that it is important for the outdated public company reporting regime to be updated in an effort to improve investors’ access to information that is useful to their investment decisions. These decisions must of course also facilitate capital formation and contribute to the fair and orderly operation of the capital markets.

¹⁴ See Gregory, Holly, “Innovations in Proxy Statements,” Weil Gotshal and Manges LLP Opinion (July/August 2012). Available at http://www.weil.com/files/upload/July-August2012_Opinion.pdf.

¹⁵ The Proposal’s allowance in Section 3.29 and elsewhere that disclosures should be “concise” does not reduce this concern, as the Proposal is calling for disclosure of a large volume of information that is not “material” as that term is applied under the current US reporting regime.

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However, this objective should only occur through the federal securities laws and not via exchange listing standards. This construct will allow for regulators to deal with disclosures on a holistic basis to address the needs of all investors in the marketplace. We believe it is critical that the concerns and considerations discussed above be addressed to adequately recognize companies' and shareholders' investment information needs without adding unnecessary complication to the public company reporting regime or making public company disclosures a forum for narrow special interests. And any further efforts in this initiative must be grounded in the traditional definition of materiality, always keeping the reasonable investor in mind.

We thank you for this opportunity to provide comments on the Proposal and would be happy to discuss our comments further with you.

Sincerely,



Gary Litman
Vice President
International Strategic Initiatives



Tom Quaadman
Vice President
Center for Capital Markets
Competitiveness

cc:

The Honorable Luis A. Aguilar, U.S. Securities and Exchange Commission
The Honorable Daniel M. Gallagher, U.S. Securities and Exchange Commission
The Honorable Michael S. Piwowar, U.S. Securities and Exchange Commission
The Honorable Kara M. Stein, U.S. Securities and Exchange Commission
Mr. Keith F. Higgins, U.S. Securities and Exchange Commission
The Honorable Hans Hoogervorst, International Accounting Standards Board
Mr. Paul Beswick, U.S. Securities and Exchange Commission
Dr. Jean Rogers, Sustainability Accounting Standards Board

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Ms. Teresa S. Polley, Financial Accounting Foundation
Mr. Russell G. Golden, Financial Accounting Standards Board