



July 14, 2014

*Via Electronic Mail*

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**Re: SEC Report on Review of Disclosure Requirements in Regulation S-K; and FASB File Reference No. 2014-200: Proposed Statement of Financial Accounting Concepts, Chapter 8: Notes to Financial Statements**

Dear Sirs:

The Clearing House Association L.L.C. (“The Clearing House”),<sup>1</sup> an association of major commercial banks, is pleased to comment on the report recently released by the Securities and Exchange Commission (“SEC”), *Report on Review of Disclosure Requirements in Regulation S-K* (the “SEC Report”) and the related Exposure Draft (the “ED”) released by the Financial Accounting Standards Board (the “FASB” or the “Board”), *Proposed Statement of Financial Accounting Concepts, Chapter 8: Notes to Financial Statements* (the “FASB ED”) (together, the “Proposals”). The Clearing House strongly supports efforts to identify ways to improve the efficiency and effectiveness of disclosures, and supports the recent remarks of Mr. James Kroeker in which he noted, in relation to the FASB ED, that the

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<sup>1</sup> Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world’s largest commercial banks, which hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily, which represents nearly half of the automated clearing-house, funds transfer, and check-image payments made in the U.S. See The Clearing House’s web page at [www.theclearinghouse.org](http://www.theclearinghouse.org).

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objective of these efforts should be to “remove the clutter, and focus on making disclosures more useful to investors.”<sup>2</sup>

### **Executive Summary**

As described in detail in this letter, our principal suggestions and recommendations are as follows:

- **Cooperation and harmonization.** The Clearing House strongly recommends the SEC and FASB work in close cooperation with each other and with other standard-setting authorities to develop a comprehensive disclosure framework and set of requirements that is complementary and not duplicative.
- **Elimination of redundancies.** The Clearing House recommends the SEC take the lead on a targeted review to eliminate redundancy between disclosures in Management's Discussion and Analysis ("MD&A") and the footnotes to financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"), and recommends the SEC update its Guide 3, *Statistical Disclosure by Bank Holding Companies* ("Guide 3").
- **Forward-looking information.** The Clearing House recommends the SEC lead a project to clarify the definition and placement of forward-looking information and then coordinate with FASB to avoid situations in which disclosures implicitly or explicitly require forward-looking information without the benefit of safe-harbor protections for preparers.
- **Principles-based disclosure framework.** The Clearing House recommends the FASB develop a more principles-based disclosure framework. Appendix A in the ED is overly detailed and should be eliminated in favor of a few, clearly articulated principles including relevance, materiality, and cost-benefit considerations.
- **Interim disclosures.** The Clearing House recommends the SEC and FASB emphasize that interim disclosures should be made only if they significantly update the year-end information.

A detailed discussion of each recommendation is provided below.

**A. The SEC and FASB should work in close cooperation with each other and with other standard-setting authorities to develop a comprehensive disclosure framework and set of requirements that is complementary and not duplicative.**

We have elected to respond jointly to the Proposals because we believe it is critical for the SEC and FASB to work together on improving disclosures. Duplication in public filings exists in part because of conflicting or redundant disclosure requirements among regulators and standard-setters. These redundancies will not be reduced or eliminated unless the SEC and FASB work hand-in-hand with each other to review and evaluate the current disclosure regime, with each organization taking the lead in certain areas, as more fully described below.

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<sup>2</sup> Remarks of James L. Kroeker, 33<sup>rd</sup> Annual SEC and Financial Reporting Institute Conference, University of Southern California, Leventhal School of Accounting, Pasadena, California, June 5, 2014.

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For the same reasons, we strongly recommend that both the SEC and FASB work in close cooperation with banking regulators and other groups that promulgate disclosure requirements, such as the Basel Committee on Banking Supervision (“the Basel Committee”) and the Financial Stability Board, as these bodies have overlapping objectives. For example, as an increasing number of major commercial banks become subject to disclosure under the Regulatory Capital Rules<sup>3</sup> over the next year, capital disclosures may be spread across the Supervision & Regulation section of the Forms 10-K and 10-Q, capital and liquidity disclosures in MD&A, and separate Pillar 3 disclosure documents published to company websites. Required disclosures may become more redundant as additional disclosure requirements are established. Thus, we encourage the SEC and FASB to collaborate with these other groups as well so that disclosure standards are complementary, while still addressing the specific regulatory and investor needs for which these disclosures are developed.

In addition, we note that the International Accounting Standards Board (the “IASB”) has on its agenda a Disclosure Initiative project that encompasses many of the same topics that the FASB and SEC have undertaken: Materiality, Disclosure Principles, and a Standards Level Review. We strongly encourage the FASB and SEC to coordinate with the IASB on these projects to the fullest extent possible, so that U.S. and international disclosure principles are broadly consistent and compatible, and global banks are not subject to two conflicting disclosure regimes.

**B. The SEC should take the lead on a targeted review to eliminate redundancy between disclosures in MD&A and the footnotes to U.S. GAAP financial statements and should update Guide 3.**

As an overall matter, while we support a comprehensive review of disclosure requirements by the SEC, we believe a more effective use of the SEC’s resources would be to initiate a targeted project on eliminating disclosure redundancies and updating industry specific requirements. Preparers often find these redundancies burdensome, and investors can find them confusing, as often the specific requirements are similar but not exactly the same, causing many to question the significance of the differences. A case in point are the requirements to disclose commitments and contingencies in both the MD&A and footnotes; these disclosure requirements are broadly similar, yet different in subtle respects. As a result, investors may struggle to reconcile the two disclosures and understand why some information is included in one but not the other. We believe that a targeted review of these types of overlap would provide an immediate and positive benefit to investors and preparers as disclosures would, by definition, be clarified and streamlined.

With respect to industry-specific guidance, we suggest that the SEC update Guide 3. This guidance is duplicative of other U.S. GAAP disclosure requirements in certain areas, such that we believe there is an opportunity to streamline disclosures here as well. For example, the notes to the financial statements now include more robust credit quality disclosures for loans presented by portfolio class which are broadly similar to some of the Guide 3 loan disclosure requirements, but with some

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<sup>3</sup> Final Basel III regulatory capital rules as approved by the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System.

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differences, including the number of periods presented. In addition, Guide 3 has not been updated since the mid-1980s and, therefore, we believe a fresh look is warranted, given the level of change in the accounting standards for financial instruments over the last three decades. The Clearing House would be happy to assist the SEC in this effort and provide specific recommendations if a project is undertaken.

**C. The SEC should lead a project to clarify the definition and placement of forward-looking information and coordinate with the FASB to avoid situations in which disclosures implicitly or explicitly require forward-looking information without the benefit of safe-harbor protections for preparers.**

Another area that we believe the SEC and the FASB should work closely on is the topic of forward-looking information. Specifically, we believe there needs to be greater clarity regarding the dividing line between the type of forward-looking information that should be reported in MD&A versus the “future-oriented information” that the FASB believes is appropriately reported in U.S. GAAP financial statements. Since SEC registrants are required to provide forward-looking information with respect to certain disclosures in portions of registrants’ regulatory filings that are in MD&A, and thus outside of audited financial statements, and because the SEC also encourages registrants to provide forward-looking information where doing so would be useful to investors, we believe this is a project in which the SEC should take the lead.

We agree with the principle that the FASB has articulated in the ED in paragraph D25: “The objective of financial reporting does not require a reporting entity’s management to assess the entity’s prospects for future cash flows, but to provide information to assist investors and creditors in making their own assessments.” As the FASB notes in the ED, federal securities laws and SEC rules provide a safe harbor for some forward-looking information;<sup>4</sup> however, the safe harbor does not extend to audited financial statements.

Despite this, some of the disclosures that are currently required by the FASB, as well as some of the disclosures that are proposed in the Appendix to the FASB ED, seem to sweep “MD&A-type information” into the footnotes, such as explanations of how cash flows would resolve if uncertainties about a line item are resolved in a manner differently from what the entity expects (paragraph L3 and L14); and how changes in macroeconomic or market factors would affect the prospects for an entity’s future cash flows (paragraphs L5, L6, and L7 of the FASB ED). Disclosures such as these, regarding how changes in assumptions would impact results, require entities to maintain records for choices that management did not make, or for events that have not occurred.

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<sup>4</sup> The FASB ED references Section 27A(C) of the Securities Act of 1933, *Application of Safe Harbor for Forward-Looking Statements*; Section 21E of the Securities Exchange Act of 1934, *Application of Safe Harbor for Forward-Looking Statements*, on Safe Harbor; Securities Act Rule No. 175, *Liability for Certain Statements by Issuers*; and Exchange Act Rule 3b-6, *Liability for Certain Statements by Issuers*.

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We suggest that a more useful and practical dividing line for forward-looking information would be to require that information regarding estimates and assumptions embedded within a current measurement used within the financial statements be included in the footnotes; and information regarding sensitivity analyses, the effects of alternate assumptions regarding future cash flows, and other expectations regarding the future be included in MD&A.

In this regard, we note that in the past, the FASB has required sensitivity analyses and other similar information to be provided in the footnotes to the financial statements because such disclosures would therefore also apply to private companies that were, by definition, not subject to the SEC's MD&A requirements. In light of the fact that the Financial Accounting Foundation has recently established the Private Company Council (the "PCC"), with an eye towards (1) reducing the complexity of, (2) increasing the relevance of, and (3) closely weighing the cost-benefit considerations of, the disclosures for private companies, it would seem that the PCC would now be the best organization to decide whether, and how, to mandate forward-looking information for private companies.

Finally, we concur with the FASB's observations in the ED in paragraph D25 that "there sometimes are potentially significant negative consequences to issuers of financial statements (and ultimately to their investors and creditors) of providing some future-oriented information. Predictions, projections, forecasts, or similar assertions about uncertain or unknown future events that are beyond management's control cause the most concern because some of that information may turn out to be materially different from the actual future events or conditions when they occur. Some potential consequences are litigation or threat of litigation and loss of credibility"; and in paragraph D17 that "including some types of future-oriented information in notes may have negative effects on the cash flow prospects of the reporting entity and its investors and creditors. Those negative consequences should be avoided if possible." We recommend that these considerations be taken into account by the SEC as it develops its guidance on forward-looking information.

**D. FASB should develop a more principles-based disclosure framework. Appendix A is overly detailed and should be eliminated in favor of a few, clearly articulated principles including relevance, materiality and cost-benefit considerations.**

We support the development of a disclosure framework to establish fundamental concepts of disclosure, and to provide an overarching framework and guide that can be used by the FASB in developing individual disclosure standards, as well as by preparers in determining what disclosures to provide in the absence of specific guidance. We believe that the FASB is best-suited to lead this project, working in close collaboration with the SEC and other regulatory and standard-setting authorities, as suggested above.

We believe that for this type of framework to be most effective, it should be based on a few, clearly articulated principles. In this regard, we find the principles that are set forth in paragraphs D17 through D19 of the FASB ED -- relevance, materiality, and cost-benefit considerations -- to be important components of this framework. However, we are concerned that these principles are not sufficiently emphasized to convey their foundational nature. Rather, they are given equal or lesser weight with many other items that are discussed.

At the same time, we believe the questions listed in Appendix A of the FASB ED are overly detailed and do not appear to be principles-based. Some of the questions even appear to rise to the level of a particular disclosure standard (for example, question O1 regarding potential and existing

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litigation). As such, it is difficult to envision the output of this approach. We are concerned that if these questions are finalized as part of the final standard, the guidance will become a "checklist" rather than a robust framework from which to build a consistent and cohesive set of disclosure requirements.

Accordingly, we suggest eliminating Appendix A in its entirety, and, at the same time, refining and emphasizing the disclosure principles discussed above so that it is clear what the basic concepts are, namely:

- 1) disclosures should be relevant to users of financial information;
- 2) preparers should have the ability to determine whether a particular disclosure is material to the entity; and
- 3) information that is readily and cost effectively available from sources other than the entity should not be required to be provided in the entity's audited financial statements.

In particular, the concept that the Board should only require information that is relevant to investors should be the starting point for the disclosure framework.

In addition to emphasizing relevance as a key disclosure principle, the FASB should also emphasize the concept of materiality. We agree with the Board's assertion in paragraph D18 that "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." We believe the concepts of relevance and materiality are inextricably linked, in that providing immaterial information could obscure more relevant information in financial statements, thereby undermining their overall usefulness.

Thus, we believe it is critical that preparers have the flexibility to exercise discretion and judgment in applying disclosure requirements, and a significant component of this is determining whether a particular disclosure is material to the entity. In this regard, although the ED states that "an important goal of this project is to enable individual organizations to exercise more discretion and flexibility in applying existing and future relevant disclosure requirements," this does not seem to be emphasized in the ED. Accordingly, we strongly recommend that this concept be expanded upon and clearly articulated as a foundational concept in the disclosure framework. We further recommend that the FASB consider combining its project on the Entity's Decision Process with this ED given that there appears to be considerable overlap between the two, especially with regard to materiality decisions.

In addition, we strongly encourage the FASB to review its existing standards and ensure that they incorporate the ability for preparers to apply materiality determinations. We believe this will further the goal of "removing the clutter" from financial statements by enabling preparers to apply materiality judgments to existing disclosures.

Another important element in developing disclosures that the ED sets forth is the need to carefully consider the cost of providing information in relation to the benefits produced. We agree with the concept set forth in paragraph D19, that:

[T]he cost of a requirement to provide information in notes normally is not justified by the benefits if (a) that information is not specific to the individual entity and is

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readily and cost effectively available from sources other than the entity and (b) knowledgeable users should be aware of the need for the information and its availability. Generally, entities should not be required to provide in notes information about general economic, political, and social conditions, events, and circumstances that are common knowledge and not specific to the entity.

We believe investors would be better served if this type of publicly-available information were eliminated, as again, we believe this would further the goal of “removing the clutter” from financial statements.

E. **The SEC and the FASB should emphasize that interim disclosures should be made only if they significantly update the year-end information.**

Finally, we strongly concur with the principle set forth in paragraph D64 of the FASB ED that "information should be provided in interim financial statements only if there are significant changes in financial position since the most recent annual financial statements or significant differences in results of operations that are unclear from the line items." However, we note that there has been a recent trend in FASB disclosure standards to require the same level of disclosures for interim and full-year financial statements. This has the unfortunate consequence of forcing preparers to forego their normal materiality judgments, which in turn may weigh down financial statements with immaterial information, thereby perhaps making useful information less visible and consequently less understandable. Thus, we believe that it is critical for both the SEC and the FASB to clearly set forth the principle that interim disclosures should be made only if they significantly update the year-end information, and that existing disclosure requirements that do not incorporate this concept should be amended to do so.

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In conclusion, we support the SEC's and the FASB's efforts to improve and enhance disclosures. We hope that you find our suggestions regarding areas of focus and improvement useful. We would be happy to meet with you in person to discuss these suggestions in more detail, or provide additional thoughts on any of our individual recommendations. If you have any questions, please contact me at (212) 613-9883 (email: [david.wagner@theclearinghouse.org](mailto:david.wagner@theclearinghouse.org)) or Ryan Pozin at (212) 613-0135 (email: [ryan.pozin@theclearinghouse.org](mailto:ryan.pozin@theclearinghouse.org)).

Sincerely yours,

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