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December 3, 2018

Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

*Via email to rule-comments@sec.gov*

**Re: File No. S7-19-18**
**Request for Comment on Proposed Rules for Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities**

Ladies and Gentlemen:

This letter is submitted on behalf of the Securities Regulation Committee of the Association of the Bar of the City of New York. Our Committee includes a wide range of practitioners whose areas of interest and expertise include securities laws and the regulation of the U.S. capital markets.

We are responding to the request of the Securities and Exchange Commission for comment on proposed amendments to Rules 3-10 and 3-16 and proposed new Rules 13-01 and 13-02 of Regulation S-X regarding financial disclosures about guarantors and issuers of guaranteed securities and affiliates whose securities collateralize a registrant's securities. We applaud the Commission's effort to undertake a review of the requirements related to guaranteed and secured debt securities and to better tailor those requirements to the needs of investors based

on market experience. We have focused our comments on certain topics of particular importance to our Committee.

**Proposed Amendments to Rule 3-10**

The Commission requested comment on whether the proposed amendments to Rule 3-10 would result in an increase in the number of registered debt offerings involving guarantees. In our experience, the cost of complying with the current Rule 3-10 footnote requirements is often a significant factor in an issuer's decision whether to pursue a registered offering (or an offering with registration rights) versus a "Rule 144A for life" offering. We note that the disclosure requirements in indentures for Rule 144A for life offerings frequently carve out Rule 3-10 requirements altogether, which suggests that the current requirements are both burdensome to issuers and not material to investors.

We also note that in recent years there has been a more general trend toward Rule 144A for life transactions. While the proposed amendments to Rule 3-10 would reduce the burden of registering an offering of guaranteed securities, they may not result in a significant increase in the number of registered offerings that include guarantees. Nonetheless, even if the proposed amendments do not result in more registered offerings, they could result in more uniform and better financial disclosure for investors if the new standards are incorporated into market practice for Rule 144A offerings.

The Commission also requested comment on whether the current Rule 3-10 requirements impact an issuer's decision to issue guarantees in respect of debt securities. We believe it would be an overstatement to say that issuers structure debt offerings without guarantees in order to avoid the requirements of Rule 3-10. In our experience, the decision whether to include a guarantee is driven primarily by market factors, rating agency criteria and pricing considerations rather than regulatory burden.

*Eligibility Conditions*

We agree with the Commission's proposal to replace the current 100% owned condition with a consolidation condition, which will provide more flexibility to issuers. We believe that the proposed requirement to describe any factors that may affect payments to holders of the guaranteed security, such as the rights of a non-controlling interest holder, will provide investors with any necessary material disclosure in the event of a non-100% owned subsidiary.

With respect to the Eligible Issuer and Guarantor Structures condition, we agree with the Commission's proposal to establish a simplified two-part test.

*Disclosure Requirements*

We are supportive of the Commission's proposal to simplify the financial disclosure requirements of Rule 3-10. In our experience, issuers frequently face significant challenges and incur substantial costs in preparing and auditing the Rule 3-10 consolidating information. For these reasons, a typical offering memorandum in a Rule 144A offering does not include

Rule 3-10 consolidating information and instead includes relatively simple disclosure of the revenue, EBITDA (or similar measure), assets and liabilities of the non-guarantors.

We understand the Commission's rationale for proposing to replace consolidating information with summarized financial information as defined in Rule 1-02(bb)(1) of Regulation S-X. The proposed rule would simplify the disclosure, reduce costs and have the benefit of being defined by reference to an existing Regulation S-X rule. Nonetheless, we would urge the Commission to consider simplifying the disclosure even further and adopting a rule that reflects more closely current practice in the Rule 144A market. As other commenters have suggested, we would recommend that the new rule only require quantitative disclosure of revenue, operating income, assets and liabilities of the non-guarantors as a group.

We are supportive of the Commission's proposal to permit financial disclosure to be presented on a combined basis. We would suggest that the Commission consider permitting financial disclosure of the non-guarantors as a group (which is more consistent with market practice in Rule 144A transactions) rather than requiring such disclosure of the obligors as a group.

We are supportive of the Commission's proposal to limit financial disclosures to the most recent fiscal year and the most recent interim period.

With respect to non-financial disclosures, we are generally in agreement with the Commission's proposed rules.

*Location of Proposed Disclosures and Audit Requirement*

We would strongly urge the Commission to reconsider its approach to the location of the proposed new disclosures. We understand the rationale of allowing an issuer the flexibility to present the disclosures outside the financial statements in the MD&A or following "Risk Factors" in its initial registration statement and for a period thereafter. However, we are concerned that the complexity of this approach, and the issues it raises with respect to auditor responsibility for disclosures outside the financial statements, outweigh the benefits. Even if an issuer chose to exclude the disclosure from its financial statements in the initial period, the knowledge that those disclosures would be audited in a subsequent period would, we believe, likely cause the issuer to require its auditor to perform audit-like procedures in respect of the disclosure during the initial period. As a result, the cost savings of an issuer availing itself of the additional flexibility are likely to be minimal. Moreover, we are concerned that having disclosure migrate from the MD&A (or elsewhere outside the financial statements) to the financial statements could be confusing to investors with respect to both the location of the disclosure and the level of auditor assurance applied to the disclosure. We are not aware of any other Commission disclosure rule that operates in this fashion.

As an alternative approach, we would recommend simply requiring the disclosure in the liquidity and capital resources section of the MD&A or in a separate section following "Risk Factors" and eliminating the audit requirement altogether. This is the approach currently taken in the Rule 144A market and has been accepted by the investor community. If disclosure outside

the financial statements is sufficient at the time of the initial investment decision, it should be sufficient for future periods.

**Proposed Amendments to Rule 3-16**

We are supportive of the Commission's proposal to replace the current Rule 3-16 financial statement requirement with simplified financial and non-financial disclosures about the affiliates and collateral arrangements. As the Commission is aware, many secured debt offerings contain so-called "cut-back" provisions that automatically reduce the number of securities pledged to a level that would not require separate financial statements under Rule 3-16. We believe a more simplified disclosure requirement could encourage issuers to comply with the rule rather than carving it out and lead to better disclosure for investors.

*Disclosure Requirements*

With respect to the financial disclosure requirements, we would urge the Commission to consider an even more simplified and flexible approach along the lines described above with respect to Rule 3-10. We would recommend that the new rule only require quantitative disclosure of revenue, operating income, assets and liabilities of the relevant affiliates as a group.

We are supportive of the Commission's proposals to permit disclosure of financial information of affiliates on a combined basis and to limit financial disclosures to the most recent fiscal year and the most recent interim period.

We are concerned that there could be overlap in disclosure requirements and potential confusion in a situation where a subsidiary is a guarantor (in which case the amended Rule 3-10 requirements would apply in respect of obligors/non-obligors) and has had its shares pledged as collateral (in which case the amended Rule 3-16 requirements would apply in respect of pledged affiliates/non-pledged affiliates). We agree with the views of other commenters that, from an investor's point of view, the guarantee is generally considered more valuable than the pledged securities. In order to avoid duplicative and potentially confusing disclosure, we would urge the Commission to consider tailoring the new Rule 3-16 disclosure requirements such that they would only apply to the extent the Rule 3-10 requirements are not otherwise applicable.

With respect to non-financial disclosures, we are generally in agreement with the Commission's proposed rules.

*When Disclosure is Required*

We understand the Commission's rationale for replacing the existing "substantial portion" of collateral test (which includes a 20% numerical threshold) with a materiality test, and we agree that issuers should have the ability to make a determination about whether disclosure is material to holders of a collateralized security. In addition to a general materiality test, we believe it may be helpful to include in the final rule a safe harbor with a numerical threshold below which the disclosure would be deemed immaterial. For example, the Commission could retain the existing 20% threshold in the form of a safe harbor, such that any collateral

arrangement that does not trigger the existing rule would be deemed immaterial for purposes of the new rule.

*Location of Proposed Disclosures and Audit Requirement*

For the same reasons discussed above with respect to the proposed amendments to Rule 3-10, we would strongly urge the Commission to reconsider its approach to the location of the proposed new disclosures under Rule 3-16 and to require the disclosures only in the liquidity and capital resources section of the MD&A or in a separate section following "Risk Factors."

*Impact on Outstanding Debt Securities*

We note that the Commission's proposed amendments to Rule 3-16 may affect a number of issued and outstanding registered debt securities that have Rule 3-16 "cut-back" provisions. The typical Rule 3-16 "cut-back" provision states that capital stock or other securities of an affiliate will be included in the collateral:

> "…to the extent that such capital stock or other securities can secure the notes without Rule 3-16 of Regulation S-X (or any other law, rule or regulation) requiring separate financial statements of such affiliate to be filed with the SEC …."

As a result, if Rule 3-16 is modified as proposed, the standard "cut-back" provision would no longer operate to exclude capital stock and other securities of affiliates, since Rule 3-16 will no longer require the provision of "separate financial statements." As a result, holders may discover that their debt securities are now secured by additional capital stock and other securities of affiliates following the adoption of the Rule 3-16 amendments. Issuers that are currently relying on Rule 3-16 "cut-back" provisions would be required to evaluate whether the additional financial and non-financial disclosures about the affiliate and the collateral arrangements would be necessary because they are "material" to holders of the collateralized security.

Because of this impact on outstanding debt securities, we would recommend that the Commission provide for a meaningful phase-in period following approval of any final rule.

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We thank you for the opportunity to comment on this important Commission initiative. Members of our Committee would be happy to discuss any aspect of this letter with the Commission staff.

Respectfully submitted,

/s/ David S. Huntington

David S. Huntington
*Chair, Securities Regulation Committee*