

Public **Chatter**

# Understanding the SEC Comment Letter Process

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## Understanding the SEC Comment Letter Process

- *by Jason Day*

This guidebook about "Understanding the SEC Comment Letter Process" is meant to be practical. I'm hoping its quasi-conversational nature helps you more easily consume the lessons imparted. Enjoy – and please share your own practice tips or your own anecdotes, for the next edition of this Guidebook!

### 1. For the Uninitiated, The Basics of the Corp Fin Comment Process

The Caller ID shows the SEC calling from a “202” area code. A small pit forms in your stomach. What did we do wrong?

The SEC Staffer asks for an email address to send a comment letter, weighing in on your recent 10-K filing and you are left waiting nervously for a couple hours to find out how bad (or good) the comments are...

No need to sweat it though once you understand the comment process and have a few savvy tips in your back pocket - so let's get to it:

1. **At First, It's Scary** - For the uninitiated, an SEC comment can be intimidating. The last time you saw one may have been in connection with an IPO when an army of counsel, bankers and auditors were there to guide you through the process.
2. **Your '34 Act Filings Will Be Reviewed Periodically** - The SEC Staff for the Division of Corporation Finance - commonly known as “Corp Fin” - is required to review the SEC filings of public companies at least every 3 years and sometimes does so more frequently. Larger companies will be reviewed annually or even continuously (or at least it may feel like it).
3. **Your Filings Will Be Reviewed Without You Necessarily Knowing It** - Lawyers and accountants on the Staff will pull your recent 10-K or 10-Q filings for a review without letting you know. If they have any questions or concerns on the filings, they will write them up into a “comment letter” for you to respond to in writing. They will typically email the comments to an officer of the company (and will often call first to confirm email addresses).
4. **Number of Comments Can Vary** - The results of a SEC Staff review can range from 20 or more comments in a comment letter, asking questions about a variety of topics, to a single comment. Or no comments, meaning that you may never find out they conducted a review. If a tree falls in the woods but no one is around to hear it....
5. **Mix of Accounting and Legal Types of Comments** - Often, there are two types of comments in a single comment letter because there were two types of professionals at the SEC reviewing your filing (although sometimes just the SEC's accountants will conduct the review). Most routine '34 Act reviews contain just a small handful of targeted comments and routinely skew more towards accounting questions.

6. **Accounting Comments Sometimes Pose Challenges** - Legal comments tend to be more infrequent and easier to deal with, while accounting comments can often require significant analysis of technical accounting rules, second guessing of judgments - or even in rare cases revision of the financials.

## 2. The Art of Responding to Corp Fin Comments: What to Do

Effectively responding to SEC comments is part art and part science. It takes a bit of both to be sure that you fully and accurately respond, which should definitely help you in your efforts to preempt additional comments. Here's a bunch of pro tips to consider:

1. **Read and Understand** - Be sure to read the comment letter fully and carefully to understand exactly what the SEC Staff is asking, paying particular attention to whether the comment is requesting updates in the form of future disclosure, supplemental information, or revision to a current filing. There is a big difference between the three. Also be sure to share the comment letter with the appropriate members of your disclosure team to collect all perspectives.
2. **Respond to Each Question** - SEC Staff comment letters often contain multiple comments each with several sub-questions. It is important to review each comment thoroughly and be sure to respond to each portion of the question or request. This seems obvious but we often see companies fail to address a few sub-questions in their initial drafts.
3. **Decide to Fight or Surrender** - You should be strategic in acquiescing to - or fighting - a comment. You need not assent to every request in an SEC comment letter as there is often room for debate or discussion with the Staff.

It can be fine to disagree with the Staff and put forth additional facts and arguments on why your approach is correct. That said, in order to avoid additional rounds of comments and to save your credibility for more significant disputes, it is often prudent to agree to comply with minor comments or requests that can painlessly be implemented then to stand on principle - even if you may not fully agree with the SEC's position.

4. **Deciding Whether to Contact the Staff** - Companies are sometimes reluctant to call the Staff. However, if a comment is unclear, it is more than appropriate to call the Staff member listed on the comment letter for clarification. It is often better to ask the SEC for clarification rather than responding to the comment without fully understanding it - flying in somewhat blind like that will increase the likelihood of a second round of comments.

Be prepared to succinctly ask the clarifying question and avoid debate or substantive discussion. You probably will want to save that for your written response.

## 3. The Art of Responding to Corp Fin Comments: What *Not* to Do

It's important to know what to do when dealing with SEC Staff comments on your filings. But it's just as important to know what not to do! Here are some pro tips to consider:

1. **Don't Rush the Process** - The comment letter will typically state that you have you 10 business days to respond to the comments. However, don't hesitate to ask the SEC Staff for additional time to respond if you need it.

2. **Don't Write Something in Response That You Don't Want the World to Know** - All responses to comment letters will eventually be made public. Poorly drafted responses, insufficient answers, and protracted exchanges with the SEC Staff on issues can lead to additional comments and reflect poorly on the company.

It is almost always better to take the time to craft well thought-out responses rather than rush the process and respond with incomplete answers you would rather investors, employees and other stakeholders not see.

3. **Don't Forget That Promise to Make "Futures" Disclosure When You Make Subsequent Filings** - The Staff may ask for - or you may voluntarily provide - sample future disclosure as part of your responses to comments. Responses will also often include commitments to disclose particular information in the future.

This can be a hard thing to manage, particularly if the key interface with the Staff in the process leaves the company. That's why it's important - prior to submitting your responses - you make sure your full SEC disclosure team is comfortable with any sample future disclosure and commitments.

It can be embarrassing - and frustrating for the SEC Staff - to receive a future comment asking that you comply with your previous promise made in a prior comment response letter. It may be prudent to add your future disclosure commitments to a checklist or other disclosure control used in your 10-K and 10-Q filing process so they don't get lost over time or as part of turnover in your own key staffers.

4. **Don't Go Over a Staffer's Head if Your Instinct is Telling You Not to (And Vice Versa)** - Carefully consider when to appeal above the initial Staff reviewer's head. If no resolution can be achieved with respect to a particular comment - or if the company wants to press a policy argument - it may be necessary to move up the ladder of the SEC Staff reviewer hierarchy. Both the lawyers and the accountants that issued the comment letter have a tree of superiors to whom you can make an appeal.

If a resolution can't be achieved in that first call or two, explain professionally to the initial reviewer that you would like to speak with the next level up the SEC food chain and ask if they would help to facilitate such conversation. If there is a policy argument or complicated issue, the initial Staff reviewer may well bring in their superiors on their own volition.

#### 4. Should In-House Lawyers Keep Track of SEC Comment Letter Trends?

In a word, probably not. Okay, that's two words. I find that some in-house lawyers will look at the SEC Staff comment letters sent to their peer companies to get an inkling of what the Staff might ask their company about their 10-Ks and 10-Qs.

But otherwise, keeping track of comment letter trends is something that law firms and the Big 4 tend to handle for them. Partly because the law firms and accountants have access to specialized databases that slice and dice the comment letter database more easily than the SEC's Edgar allows you to do.

These specialized databases can be pricey but they're pretty cool in that you can search, redline, prepare peer reports and set alerts for filings made by certain companies or certain types of filings. It can be weirdly kind of fun to redline and see all the nit changes that companies make in response to the Staff's comments.

That said, here are some pro tips when it comes to analyzing comment trends:

1. **Know the Current Hot Topics** -The SEC typically focuses many of its comments on several current hot button issues (e.g., financial measures not in accordance with generally accepted accounting practices, fair value measurements and estimates, loss contingencies, or segment reporting, among others).
2. **Monitor Peer Comments** -You can prepare for and preempt potential SEC comments before you file by knowing the current hot button issues. You can track and monitor the comments and responses of your industry peers or proactively consult with your audit firm or outside counsel for updates on emerging comment trends.
3. **Monitor Broader Disclosure Trends** - While its prudent to stay ahead of SEC comment trends to preempt easily addressed comments, don't lose sight that many current disclosure trends are not driven by SEC rules or comments. Today's SEC disclosure trends, like the current focus on ESG topics, arise from investor, proxy advisor or stakeholder initiatives with SEC rulemaking catching up later, if at all.