ALERT MEMORANDUM

SEC Proposes to Modernize and Simplify Disclosure Requirements for Public Companies

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If you have any questions concerning this memorandum, please reach out to your regular firm contact or any of our partners and counsel listed under Capital Markets in the "Our Practice" section of our website.

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On October 11, 2017, the SEC proposed a collection of amendments to its rules and forms intended to modernize and simplify some of the disclosure requirements applicable to U.S. public companies.[1] The proposals would implement a statutory directive under the 2015 FAST Act. They span a number of topics, including MD&A, property, risk factors, confidential treatment requests and exhibits, and are generally modest changes, although some may prove quite helpful for companies in practice.

We discuss the more significant of the proposed amendments below and summarize many of the proposal's other, more ministerial amendments in a list at the end. Underlying the most significant of the proposed changes is a principles-based approach that allows companies to tailor disclosure to their own circumstances and, perhaps most importantly, defers to companies to make judgments about materiality. The SEC says it is continuing to consider further changes to the disclosure regime, so this proposal could signal a trend in US public company disclosure requirements to emphasize quality over quantity and principles-based rather than prescriptive rules, which would benefit companies and investors alike by cutting back on irrelevant and immaterial disclosure. Comments on the proposal are due 60 days after it is published in the Federal Register.

[1] Release No. 33-10425 (Oct. 11, 2017), available at https://www.sec.gov/rules/proposed/2017/33-10425.pdf.

The following are the most significant of the proposed amendments:

- Limitation of the requirement to provide year-to-year comparisons in MD&A to the two most recent fiscal years
- Elimination of certain prescriptive line-item disclosure requirements for property disclosure and offering-related risk factors
- Ability to omit from all exhibits schedules and similar attachments that do not contain material information
- Elimination of the requirement to submit a confidential treatment request to the SEC for the redaction of confidential material in exhibits
- Elimination, for all but new registrants, of the requirement to file material agreements from the prior two years that are no longer in effect
- Inclusion of a description of all registered securities as an exhibit

Market participants have for many years been calling for a reexamination of the U.S. disclosure framework, which has built up by accretion as rules are added but rarely revised or removed. Disclosure overload is a widely recognized problem, and the build-up of prescriptive rules has certainly contributed to it, although other important factors include liability risks and the growing risks for "gatekeepers" like officers, directors and auditors. The complexity of the disclosure system is often cited as a deterrent to going public, and calls for changes that would reverse the declining IPO trend have increased significantly of late.

The proposed amendments are based in large part on the SEC staff's November 2016 Report on Modernization and Simplification of Regulation S-K,[2] as well as a July 2016 concept release on the business and financial disclosure requirements in Regulation S-K,[3] among other elements of the staff's disclosure effectiveness initiative.[4] The proposed amendments – which, like prior proposals, are a response to a Congressional mandate – do not address everything covered in the 2016 report and concept release, including some items that seem like "low-hanging fruit" ripe for change (in several cases along the same lines as the proposed amendments, such as the concept release proposals to eliminate the long list of topics currently required in a company's "Description of Business" and the requirement to file all amendments to previously filed material agreements, regardless of materiality). The amendments also do not tackle some areas where overly prescriptive disclosure has been most problematic, such as compensation disclosure or certain financial statement footnotes. We hope future proposals will include these items and perhaps even more comprehensive changes that not only roll back existing requirements but produce thoughtfully revised rules that contribute to more useful and less burdensome disclosure.

[2] Report on Modernization and Simplification of Regulation S-K (Nov. 23, 2016), available at https://www.sec.gov/reportspubs/sec-fast-act-report-2016.pdf. The report was mandated by the 2015 Fixing America's Surface Transportation Act (the "FAST Act").
[3] See Business and Financial Disclosure Required by Regulation S-K, Release No. 33-10064 (Apr. 13, 2016).
[4] These cover among other topics bank holding company disclosure, disclosure about entities other than the issuer required by Regulation S-X, Regulation S-K Subpart 400, duplicative requirements in Regulation S-K and property disclosures for mining registrants.

Year-to-Year Comparisons in Management's Discussion and Analysis

In an annual report on Form 10-K or Form 20-F, a company generally is required to discuss the three-year period covered by the financial statements in the filing and use "year-to-year comparisons or any other formats that in the registrant's judgment would enhance a reader's understanding." Virtually all companies provide year-to-year comparisons and do not use alternative formats.

The proposal would permit a company to provide the year-to-year comparison only for the most recent two years if: (1) the discussion of the earliest year is immaterial to understanding the company's financial condition, changes in financial condition and results of operations, and (2) the company has discussed the earliest year in the MD&A in its prior year Form 10-K or Form 20-F.

The proposal would also eliminate language, currently in an instruction, regarding the potential need to reference the five-year selected financial data in the discussion of trends.

These amendments would benefit both companies and investors by eliminating discussions of periods or matters that have previously been disclosed. The proposal emphasizes that omission of the earliest year is permissible only if it is immaterial. As a result, revisions to the earliest year information as a result of a restatement or the retrospective adoption of a new accounting principle might be sufficiently material that a discussion of the earliest year would be warranted.

Companies may also need to adjust MD&A disclosure about material known trends, for which the earliest year (or even longer periods) may still be relevant. Ideally, companies would take the opportunity to craft improved MD&A disclosure that highlights material trends and year-to-year changes rather than simply walking through a laundry list of changes in financial statement line items. In determining whether to eliminate prior year disclosure, because information included in prior filings will not be part of the current filing, companies would need to be careful not to leave any gaps that could create a liability risk.

Materiality Thresholds for Risk Factors and Description of Property

Risk Factors

Under Item 503(c) of Regulation S-K, a company is required to discuss the most significant risks that make an offering speculative or risky. The discussion must be specific to the company and its business and not generally applicable to any company or offering. This item provides a list of examples of topics that may be addressed in the risk factors, many of which are only applicable in an offering context and particularly in an initial public offering. This list was not revised or eliminated when Forms 10-K and 10-Q were amended in 2005 to require risk factor disclosure. Today, most companies include risk factors addressing each of the examples if at all applicable, so in practice, the list has become more prescriptive than suggestive. And most companies include all of these risk factors not only in offering documents but also in their Form 10-K filings.

The proposal would eliminate these enumerated examples in an attempt to focus each company on a principles-based analysis of its own most significant risks. Ideally, this would result in companies providing more relevant and tailored disclosure to investors.

Description of Property

Under Item 102 of Regulation S-K and Item 4.D. of Form 20-F, a company is required to provide the location and general character of its principal plants, mines and other materially important physical properties including those of its subsidiaries.

Like the proposed change to risk factors described above, the proposal would eliminate the prescriptive elements of this requirement and instead emphasize materiality: it would require disclosure of the location and general character of principal physical properties, to the extent they are material. This disclosure could also be provided on a collective basis.

This proposed amendment would let companies remove unnecessary and immaterial disclosure that is often produced in response to this requirement. In particular, the explicit ability to provide collective disclosure could permit meaningful disclosure based on types of properties, geography or age of properties, among others.

Notably, the SEC did not propose to modify any of the instructions in the rule specific to the mining, real estate or oil and gas industries. Presumably there may be further changes to this item in connection with an overhaul of the specific disclosure requirements applicable to companies in those industries.

The requests for comment relating to this amendment include consideration of whether the requirement should require disclosure of uncertainties such as properties likely to be affected by natural disasters. Given the devastating impacts of recent natural disasters and the current focus on the effects of climate change, this may be a topic of discussion in the comments on the proposal.

Confidential Information in Exhibits

Securities Act Rule 406 and Exchange Act Rule 24b-2 permit a company to redact confidential information from an exhibit (or other document) if it submits a confidential treatment request to the SEC explaining both why the information is immaterial and why public disclosure of the information will cause competitive harm to the company.

The proposal would eliminate the need for a confidential treatment request related to redactions of confidential information from a material contract exhibit filed pursuant to Item 601(b)(10) of Regulation S-K and the Instructions to Exhibits in Form 20-F, but would not change the underlying substantive rule that permits redactions only for information that is not material and that would subject the company to competitive harm if publicly disclosed. In contrast to the procedure under current rules, the proposed amendment would not require a company to submit an unredacted version of the exhibit to the SEC at the time of filing. Instead, a company would be required to provide an unredacted version and a competitive harm analysis to the SEC staff only upon request.

The proposal would also formalize the SEC staff's current practice of permitting a company to redact personal confidential information, including bank account numbers, home addresses and similar information, from all filed exhibits without submitting a confidential treatment request.

The proposed amendments would be a welcome change for companies. Confidential treatment requests have become quite lengthy and are time-consuming to prepare. They also frequently need to be produced in a tight time frame (for example, within four business days after signing if a company chooses to file a material agreement as an exhibit to an Item 1.01 Form 8-K, as is

common in the merger context). Companies would still have to analyze prior to filing the requirements for redacting confidential information from an exhibit, so they are in a position to provide that analysis to the SEC subsequently upon request.

Omission of Schedules from Exhibits

Under Item 601 of Regulation S-K and the instructions to exhibits in Form 20-F, a company generally is required to file in their entirety all material agreements not made in the ordinary course of business. In only one instance (a plan of acquisition, reorganization, arrangement, liquidation or succession), a company may omit schedules and other attachments to a material agreement unless they contain information that is material to an investment decision and is not otherwise disclosed in the agreement or the disclosure document.

The proposal would extend this ability to omit schedules and other attachments to all types of exhibits. Similar to the existing exception, omission would not be permitted if the information is material to an investment or voting decision and not otherwise disclosed in the exhibit or the disclosure document. A company would be required to include in the exhibit a list briefly identifying the contents of all omitted schedules. A company would be required to submit a copy of any omitted schedule to the SEC staff upon request.

This proposed amendment would represent a return to what used to be relatively common market practice even in the absence of explicit guidance in the rules, and would be a welcome reduction for companies in cost and effort relating to required exhibits. Companies will need to review any schedules and other attachments to be omitted for any information that could be material. If this amendment is adopted, contracting practices are likely to be affected by the contrast between a per se filing requirement for the body of the agreement and a materiality judgment, sometimes involving liability risks, on whether to file exhibits or schedules.

Look-Back Period for Material Contracts

Under Item 601 of Regulation S-K and the instructions to exhibits in Form 20-F, companies are required to file all material contracts not made in the ordinary course of business if (1) the contract will be performed at or after the filing of the report or (2) the contract was entered into not more than two years prior to the filing. The second condition applies even if the contract has been fully performed or is otherwise no longer in effect. The proposal would limit the (frequently long) list of material agreements to those that remain to be performed at the time of the filing.

The proposal would leave in place for newly reporting registrants the requirement to provide material contracts that were entered into within the two years prior to the filing.

Description of Securities

Item 202 of Regulation S-K and Item 12 of Form 20-F require a registration statement to describe in detail the terms of the securities being offered.

The proposal would require a company to provide this description, as an exhibit to its annual report, for all securities registered under Section 12 of the Exchange Act.

Companies that registered securities after Item 202 came into effect should be able to use the disclosure from each corresponding registration statement and would be permitted to incorporate the disclosure by reference into their annual reports. For companies that have not previously provided this disclosure, new drafting will be required.

Other Proposed Amendments

- Directors, Executive Officers, Promoters, and Control Persons (Item 401)
  - To clarify that an instruction about the location of information about a company's executive officers applies to all disclosure about executive officers required by Item 401 and not only Item 401(b)
- Compliance with Section 16(a) of the Exchange Act (Item 405)
  - To permit companies to rely on electronically filed Section 16(a) reports to disclose whether any Section 16 filers missed or were not timely in their filings (the proposal would also eliminate the requirement in Exchange Act Rule 16a-3(e) that reporting persons furnish Section 16 reports to the registrant)
  - To eliminate checkbox on cover page of Form 10-K that disclosure of delinquent Section 16 filings is not included
  - To add an instruction that disclosure is not required if there are no delinquencies to report, and to change the heading to "Delinquent Section 16(a) Reports"
- Corporate Governance (Item 407)
  - To update a reference to an outdated audit standard and to clarify that emerging growth companies are not required to disclose Compensation Discussion and Analysis
- Outside Front Cover Page of the Prospectus (Item 501(b))
  - To eliminate instructions that suggest a company should change its name if the name is too similar to that of a well-known company
  - To permit companies to include a statement that the offering price will be determined by another method as further explained in the relevant prospectus
  - To expand the required list of securities exchanges for the securities being offered to include all principal U.S. markets, not only national securities exchanges
  - To eliminate portions of legend requirements regarding compliance with state law offering requirements if state law is preempted
- Plan of Distribution (Item 508)
  - To clarify by defining the term "sub-underwriter" in Securities Act Rule 405
- Undertakings (Item 512)
  - To eliminate the requirement to include certain undertakings because they are obsolete or duplicative of other required filings
- Subsidiaries of the Registrant and Legal Entity Identifiers (Item 601(b)(21)(i))
  - To require companies to include legal entity identifiers, if available, of their significant subsidiaries
- Incorporation by Reference – Item 10(d)
  - To eliminate the prohibition on incorporating documents by reference generally if they have been on file with the Commission for more than five years

- Incorporation by Reference – Securities Act Rule 411, Exchange Act Rule 12b-23 and Rule 12b-32
    - To eliminate certain requirements to file copies of any information incorporated by reference as an exhibit (while retaining the requirement to file annual reports when incorporated by reference)
    - To require hyperlinks to information that is incorporated by reference if available on EDGAR
    - To prohibit incorporation by reference or cross-referencing in financial statements of information outside the financial statements
    - To restrict the incorporation of financial information required to be given in comparative form for two or more fiscal years or periods unless the information incorporated by reference includes the entire comparative period
    - To eliminate requirements that financial information incorporated by reference must comply with the requirements of the form or report into which it is incorporated
- Incorporation by Reference – Forms
    - To allow issuers filing Forms 10, 10-K and 20-F to exclude item numbers and captions or to create their own captions tailored to their disclosure
- XBRL Requirements
    - To require cover page data on many reports to be tagged in Inline XBRL
    - To include the trading symbol for each class of registered securities on the cover page of Forms 10-K, 10-Q, 8-K, 20-F and 40-F

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