SEC Adopts Rule Changes Aimed at Updating and Simplifying Disclosure Requirements

I. Background

On August 17, 2018, the Securities and Exchange Commission ("SEC") issued a release adopting amendments to Regulations S-K and S-X, as well as various SEC forms, aimed at cleaning up certain disclosure requirements.[1] The changes, which take effect thirty days after the final rule was published in the Federal Register, were initially proposed by the SEC on July 13, 2016[2] and address disclosure requirements that "have become redundant, duplicative, overlapping, outdated or superseded, in light of other [SEC] disclosure requirements, U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), or changes in the information environment."[3] The SEC noted that the amendments' simplification of disclosure requirements is intended to ease the disclosure process and facilitate the communication of information to investors, "without significantly altering the total mix of information provided to investors."[4] In addition to the amendments, the Release describes certain disclosure items that the SEC has referred to the Financial Accounting Standards Board (the "FASB") for further review and for the potential incorporation into U.S. GAAP or further amendments at a later date. While individually many of the changes affected by the amendments are modest and relate to simple cleanup, overall the amendments implicate a large number of regulations, the full list of which is set out in the Release. https://www.sec.gov/rules/final/2018/33-10532.pdf.

II. Amendments Overview

The SEC identified the following four types of disclosure requirements that are addressed by the amendments: (1) Redundant or Duplicative Disclosure Requirements; (2) Overlapping Disclosure Requirements; (3) Outdated Disclosure Requirements; and (4) Superseded Disclosure Requirements. The Release describes these categories, and the approach taken to each as follows:

- Redundant or Duplicative Disclosure Requirements – Requirements that include "substantially similar disclosures as U.S. GAAP, IFRS, or other [SEC] disclosure requirements." In order to simplify issuer compliance efforts, the SEC is removing these redundant or duplicative disclosure requirements.[5]

- Overlapping Disclosure Requirements - Requirements identified by the SEC as being "related to, but not the same as, U.S. GAAP, IFRS, or Other Commission Disclosure requirements."[6] These amendments effect:

    - the deletion of requirements that either (x) "require disclosures that convey reasonably similar information to or are encompassed by the disclosures that result from compliance

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[1] *See* Securities and Exchange Commission, *Disclosure Update and Simplification* Release No. 33-10532 (August 17, 2018) [hereinafter "Release"].

[2] *See* Securities and Exchange Commission, *Disclosure Update and Simplification* Release No. 33-10110 (July 13, 2016) [81 FR 51607 (Aug. 4, 2016)].

[3] Release, 1.

[4] *See Id.*

[5] *Id.* at 28.

[6] *Id.* at 36.

  - with the overlapping U.S. GAAP, IFRS, or [SEC] disclosure requirements”[7] or (y) “require disclosures incremental to the overlapping U.S. GAAP, IFRS, or [SEC] disclosure requirements and may no longer be useful to investors”[8]; and
  - the integration of “disclosure requirements that overlap with, but require information incremental to, other [SEC] disclosure requirements.”[9]

- Outdated Disclosure Requirements - Requirements that have become outdated “as a result of the passage of time or changes in the regulatory, business, or technological environments.”[10] The SEC expects these amendments to (1) simplify issuer compliance efforts, (2) minimize the loss of information or increased burden to investors and (3) require additional disclosure that is expected to be readily available to issuers.[11]

- Superseded Disclosure Requirements - Disclosure, auditing and accounting requirements that have become inconsistent with newer requirements. These amendments update existing disclosure requirements “to reflect more recently updated U.S. GAAP requirements or more recently updated [SEC] disclosure requirements.”[12]

III. Disclosure Location Considerations

In the Release, the SEC highlighted certain considerations regarding the effects of the amendments, chiefly those effects surrounding the location of certain disclosures. In particular, the SEC noted the following three categories of considerations:

A. Prominence Considerations

As the current location of certain disclosures may provide prominence and/or context to other disclosures located in proximity to them, the relocation of these certain disclosures “may [therefore] change the prominence and/or context of both the relocated disclosures and the remaining disclosures.”[13] Amendments in this category include the changes to the disclosure regarding seasonality, geographic areas and research and development activities, among others.

B. Financial Statement Considerations

Certain amendments involve the relocation of disclosure information from outside to within the financial statements, thereby subjecting the information to annual audit and/or interim review, internal control over financial reporting, and XBRL tagging requirements, as applicable. Further, the safe harbor afforded under the Private Securities Litigation Reform Act of 1995 would no longer apply to such disclosures. Accordingly, the reverse is true for those items that are moved from inside to outside the financial statements.[14] Many of the changes that

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[7] *Id.*

[8] *Id.*

[9] *See Id.*

[10] *Id.* at 100.

[11] *See Id.*

[12] *See Id.* at 109.

[13] *Id.* at 25.

[14] *Id.*

implicate prominence considerations also fall into this category, including the changes to the disclosure regarding seasonality and geographic areas.

C. Bright Line Disclosure Threshold Considerations

Where a bright line disclosure threshold has been removed pursuant to the amendments, the amount of disclosure provided to investors may potentially change as it is no longer subject to a minimum threshold, but reliant upon the judgment of the issuer as to whether the information is meaningful to investors.[15] The SEC noted that the amendment relating to restrictions on dividends was the only change that implicated bright line disclosure thresholds. However, additional disclosure requirements with bright line disclosure threshold considerations have been referred to the FASB for potential incorporation into U.S. GAAP.

IV. Notable Changes

While the majority of the amendments are highly technical and do not alter the overall mix of information issuers must provide, the below items represent a few of the more notable changes stemming from the Release.

A. Business Disclosures

1. Segments

The SEC has removed Item 101(b) of Regulation S-K and Item 7(b) of Form 1-A and the related requirement in Rule 3-03(e) of Regulation S-X, thereby eliminating the requirement to provide financial information about segments in the business description sections[16] of an issuer's periodic filings or prospectuses. The SEC explained that similar disclosures will remain available in the notes to the financial statements and the MD&A pursuant to Item 303(b) of Regulation S-K.[17]

2. Research and Development

The amendments remove the requirements under Items 101(c)(1)(xi) and 101(h)(4)(x) of Regulation S-K to include in the business sections of periodic reports and prospectuses the amount spent on research and development activities. The SEC explained that U.S. GAAP already requires the disclosure of similar information in the notes to the financial statements and any material information would be required in MD&A.[18]

3. Geographic Areas

The amendments remove Items 101(d)(1) and 101(d)(2) of Regulation S-K, which required the disclosure of financial information by geographic region in the business section. The SEC explained that U.S. GAAP already requires similar geographic information. Moreover, the SEC has amended Item 303(a) of Regulation S-K to include an explicit reference to "geographic areas" to highlight the need to consider geographic impact in the MD&A. In doing so, the SEC noted that it believes this change, coupled with the risk factor disclosure required under Item

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[15] *Id.* at 25-26.

[16] *See Id.* at 71.

[17] *See Id.*

[18] *See Id.* at 50.

503(c) of Regulation S-K, will provide any necessary disclosure information as it pertains to geographic factors and associated risks.[19]

4. Seasonality

The SEC eliminated Instruction 5 to Item 303(b) of Regulation S-K, which required a discussion of any seasonal aspects of an issuer's business where the effect is material. The SEC explained that U.S. GAAP, in conjunction with the remainder of Item 303, already requires disclosures in interim reports that provide similar information to the disclosures required by Instruction 5 to Item 303(b). Additionally, the SEC noted that it believes that, even without Instruction 5, Item 303's requirements would still "elicit disclosure of forward-looking information in interim reports to the extent that the effects of seasonality may become material." Nevertheless, with respect to annual reports, the seasonality disclosure requirements stemming from Item 101(c)(1)(v) are being maintained given concerns that U.S. GAAP may not elicit disclosure regarding the extent to which the business of an issuer or its segment is or may be seasonal during the fourth quarter.[20]

B. Market Price

The SEC has removed from Item 201(a)(1) of Regulation S-K the requirement for inclusion of historical price information for issuers whose common equity is traded in an established public trading market. Recognizing that such market data is now readily available to investors, the SEC instead has replaced this requirement with the requirement to disclose the issuer's trading symbol, which can be used to obtain current and historical financial information on stock price, among other information.[21]

C. Interim Events

The SEC has deleted the requirements under Rules 8-03(b)(2) and 10-01(a)(5) of Regulation S-X to disclose material events subsequent to the end of the most recent fiscal year. In the Release, the SEC explained that these requirements have been eliminated because they call for information that is already encompassed by additional disclosures required for compliance with U.S. GAAP and Regulation S-K, in combination.[22]

D. Dividends

The SEC has eliminated from Item 201(c)(1) of Regulation S-K the requirement to disclose the frequency and amount of cash dividends declared and has further amended Rule 3-04 of Regulation S-X to require the disclosure of dividend amounts in the interim periods.[23] Additionally, the SEC has amended Rule 4-08(e)(3) of Regulation S-X to incorporate the requirements of Item 201(c)(1) of Regulation S-K and Rule 4-08(d)(2). Previously, where restricted assets exceeded 25% of consolidated net assets, Rule 4-08(e)(3) required a description of (1) the restrictions on the ability of subsidiaries to transfer funds to the issuer and (2) the amount of the restricted net assets. With the incorporation of Item 201(c)(1) and Rule 4-08(d)(2), Rule 4-03(e)(3) is therefore revised to require disclosures pertaining to dividend restrictions when material, rather than when restricted net assets exceed the 25% threshold.[24]

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[19] *See Id.* at 72-73.

[20] *See Id.* at 73-76.

[21] *See Id.* at 101-06.

[22] *See Id.* at 77.

[23] *See Id.* at 62-63.

[24] *See Id.* at 80-81.

E. Ratio of Earnings to Fixed Charges

The SEC removed from Item 503 of Regulation S-K the requirement to disclose the ratio of earnings to fixed charges when registering debt or preferred stock and removed the corresponding Item 601 exhibit requirement. The SEC also made corresponding changes to remove references to the ratio from the titles of items in SEC forms. The SEC noted that "information about [an] offering's effect on fixed charges, such as interest rate, maturities, and amount of proceeds used to discharge indebtedness, is currently required by Item 504 of Regulation S-K."[25] Additionally, the SEC acknowledged that other ratios, such as the interest coverage ratio, the debt-service coverage ratio and other variations of the ratio of earnings to fixed charges, can be calculated from information readily available in the financial statements and accomplish similar objectives as the ratio of earnings to fixed charges. [26]

F. "Where You Can Find More Information"

Recognizing that investors do not avail themselves of this resource anymore, the amendments remove the requirement to refer to the Public Reference Room and its physical address and phone number. Instead, the SEC has expanded the requirements to call for disclosure of the SEC's internet address and a statement that electronic copies of SEC filings are available online, and all issuers will now be required to include their internet addresses, if one is maintained.[27]

V. Items Referred to FASB

In addition to the amendments made by the SEC, the Release noted that a number of items were being referred to the FASB. The FASB has 18 months from the date that the SEC's amendments are published in the Federal Register to determine whether these items will be added to the FASB's agenda for potential incorporation into U.S. GAAP. The items referred to the FASB include, but are not limited to, disclosure requirements pertaining to major customers, foreign currency, repurchase and reserve repurchase agreements, products and services, discount on shares, equity compensation plans, income tax disclosures, debt obligations, consolidation matters, related party transactions and interim financial statements. If incorporated into U.S. GAAP, these changes could potentially affect all entities that prepare financial statements under U.S. GAAP.[28]

VI. Conclusion

The effect of the amendments is to clean up many of the requirements that have become redundant, duplicative, overlapping, outdated or superseded, in light of other SEC disclosure requirements, U.S. GAAP, or changes in the information environment. Additionally, while many changes were adopted by the SEC in the release, more changes may come as a result of the large number of referrals made by the SEC to FASB. The amendments articulated in the release take effect thirty days after their publication in the Federal Register (September 17, 2018).

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[25] *See Id.* at 59.

[26] *See Id.* at 57.

[27] *See Id.* at 107-08.

[28] *Id.* at 83-101.

If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email Helene Banks at 212.701.3439 or hbanks@cahill.com; Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; or Kostantinos Skordalos at 212.701.3281 or kskordalos@cahill.com.