

SEC Adopts Amendments to Financial Disclosure Requirements under Regulation S-X

On March 2, 2020, the Securities and Exchange Commission (the “SEC”) adopted amendments to Rules 3-10 and 3-16 under Regulation S-X relating to the financial and non-financial disclosure requirements of guarantors and issuers of guaranteed securities registered or being registered, and issuers’ affiliates whose securities collateralize securities registered or being registered.¹ The final amendments and rules are intended to reduce the disclosure burdens associated with registered securities that are guaranteed or have the benefit of collateral, thereby providing an incentive to use the registration process for offering such securities in lieu of issuing them in an unregistered offering.

The SEC adopted the amendments largely in the form proposed on July 24, 2018,² with some significant revisions based on comments from market participants.

The amendments will be effective on January 4, 2021. However, voluntary compliance with the final amendments will be accepted in advance of the effective date.

I. Background

The final rules amend Rule 3-10 and create a new Rule 13-01 under Regulation S-X, which contains the specific disclosure requirements that a registrant must provide about subsidiary issuers or guarantors in a registered offering. The existing Rule 3-10(a) requires every issuer of a registered security that is guaranteed and every guarantor of a registered security to file financial statements required by Regulation S-X unless an exception applies. The amended rule is intended to provide investors with more meaningful information about subsidiary guarantors and permit the omission of separate financial statements when they would not provide more meaningful information to investors.

The final rules also amend Rule 3-16 and create a new Rule 13-02 under Regulation S-X, which contains the specific disclosure requirements that a registrant must provide about any affiliates whose securities are pledged as collateral and their collateral arrangements in a registered offering. The final rules replace the existing requirement to provide separate financial statements of an affiliate whose securities constitute a substantial portion of the collateral (20% or more of the principal amount of the securities being registered) with financial and non-financial disclosure requirements about the affiliate(s) and the collateral arrangement(s).

II. Amendments to Rule 3-10 and Partial Relocation to Rule 13-01

An overview of the amendments to Rule 3-10 and the new disclosure requirements of Rule 13-01 as adopted follows:

1. **Conditions to Omitting the Financial Statements of a Subsidiary Issuer or Guarantor:** Rule 3-10 as amended

¹For the full text of the release, see SEC, Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant’s Securities, SEC Release No. 33-10762 (March 2, 2020), available at <https://www.sec.gov/rules/final/2020/33-10762.pdf> (the “Adopting Release”). Unless otherwise specified, quoted statements in this memorandum are taken from the Adopting Release.

²SEC Release No. 33-10526 (July 24, 2018) [83 FR 49630 (Oct. 2, 2018)] (the “Proposing Release”). We discussed the Proposing Release in our Firm Memorandum – [SEC Proposes Amendments to Financial Disclosure Requirements under Regulation S-X](#) (Aug. 15, 2018).

permits the omission of separate financial statements of a subsidiary issuer or guarantor in a registered offering of debt securities when the following conditions are met:

- Parent Company Financial Statements Condition: The parent company’s consolidated financial statements are filed with the SEC. Similarly to the SEC’s release on this topic in 2000 (the “2000 Release”)³, the definition of “parent company” will require the entity (1) to be an issuer or guarantor of the securities and (2) to be a Securities Exchange Act of 1934, as amended (the “Exchange Act”) reporting company (or will become one as a result of the registration statement subject to the Securities Act of 1933, as amended (the “Securities Act”). Unlike the 2000 Release, which also requires the parent company to directly or indirectly own 100% of each subsidiary issuer and guarantor, the new definition only requires that the parent company *consolidate* each subsidiary issuer and guarantor in its consolidated financial statements.
- Consolidated Subsidiary Condition: The subsidiary issuer or guarantor must be a consolidated subsidiary of the parent company pursuant to the relevant accounting standards. This eliminates the distinction between subsidiaries in corporate form and those in other than corporate form, and expands the type of subsidiaries that are eligible to omit their financial statements. However, a company is required to provide specific disclosure about any material factors that may affect payments to holders, including the rights of a non-controlling interest holder.
- Debt or Debt-Like Condition: The guaranteed security is a “debt or debt-like” security.
- Eligible Issuer and Guarantor Structures Condition: One of following eligible issuer and guarantor structures is applicable (this two-prong framework replaces (and broadens) the five exceptions in the existing Rules 3-10(b) through (f)):
 - the parent company issues the security or co-issues the security, jointly and severally, with one or more of its consolidated subsidiaries; or
 - a consolidated subsidiary issues the security, or co-issues it with one or more other consolidated subsidiaries of the parent company, and the security is guaranteed fully and unconditionally by the parent company.

Note that a subsidiary guarantee is no longer required to be “full and unconditional” in order to avoid the separate financial statement requirement. The rationale for the change is that, with a full and unconditional guarantee from the parent company, the parent consolidated financial statements would provide sufficient meaningful information to investors, even if a subsidiary’s guarantee is not full and unconditional or a subsidiary guarantor is not wholly owned. This change may facilitate registered offerings of securities that are guaranteed by subsidiaries in foreign jurisdictions that place restrictions on upstream guarantees which would render such guarantees not full and unconditional.

- Revised Alternative Disclosure Requirement: In lieu of the separate financial statements of a subsidiary issuer or guarantor, the registrant would provide the disclosures as described below

³ See SEC, Financial Statements and Periodic Reports for Related Issuers and Guarantors, SEC Release No. 33-7878 [65 FR 51691 (Aug. 24, 2000)].

(the “Revised Alternative Disclosures”):

o Financial Disclosures: The registrant would be required to provide Summarized Financial Information, as defined in Rule 1-02(bb)(1) of Regulation S-X, for each issuer and guarantor rather than “condensed consolidating financial information” as described in Rule 3-10(i) of Regulation S-X (“Consolidating Information”). Summarized Financial Information requires the following balance sheet and income statement line items:

- Current assets, noncurrent assets, current liabilities, noncurrent liabilities, and, when applicable, shares of redeemable preferred stock and non-controlling interests.
- Net sales or gross revenues, gross profit (or, alternatively, costs and expenses applicable to net sales or gross revenues), income or loss from continuing operations, net income or loss, and net income or loss attributable to the entity.
- An issuer’s or guarantor’s amounts due from, amounts due to, and transactions with, subsidiaries that are not issuers or guarantors or with related parties, which must be presented in separate line items.
- If the information provided in response to the above requirements (e.g., factors that may affect payments to holders of the guaranteed security) is applicable to one or more, but not all, issuers and/or guarantors, separate disclosure of the Summarized Financial Information applicable to those issuers and/or guarantors is required except that, in limited circumstances (i.e., where the separate financial information applicable to those issuers and/or guarantors can be easily explained and understood), narrative disclosure may be provided in lieu of the separate Summarized Financial Information otherwise required.

Unlike Consolidating Information, Summarized Financial Information does not include cash flow statement information. Note also the following:

1. The information is to be presented for the issuer and all guarantors on a combined basis, with intercompany transactions between issuers and guarantors to be eliminated.
2. Under the existing rule, non-guarantor subsidiaries of an obligor are included using the equity method in the Consolidating Information of such obligor. Under the amended rule, financial information of entities that are not obligors must be removed entirely from the financial information of the obligor group, even if an issuer or guarantor would otherwise consolidate the non-issuer or non-guarantor subsidiary under the applicable accounting standards.
3. Summarized Financial Information must be provided as of and for the most recently ended fiscal year and the most recent year-to-date interim period included in the parent company’s consolidated financial statements. Thus, a Form 10-Q must include Summarized Financial Information for the most-recently ended fiscal year, not just for the most recent year-to-date interim period. Information for prior fiscal years or the comparative period in the prior fiscal year is not required.

4. The registrant must briefly describe the basis of presentation applicable to each of the required financial disclosures.
 - Non-Financial Disclosures: The final rules require the following non-financial disclosures:
 - A description of the issuers and guarantors of the guaranteed security.
 - A description of the terms and conditions of the guarantees, and how payments to holders of the guaranteed security may be affected by the composition of and relationships among the issuers, guarantors, and subsidiaries of the parent company that are not issuers or guarantors of the guaranteed security.
 - A description of other factors that may affect payments to holders of the guaranteed security, such as contractual or statutory restrictions on dividends, guarantee enforceability, or the rights of a non-controlling interest holder.
 - Quantitative and Qualitative Information: In addition to the above, the final rules require:
 - Any financial and narrative information about each guarantor if the information would be material to investors in evaluating the sufficiency of the guarantee.
 - Sufficient information so as to make the financial and non-financial information presented not misleading.
2. When Financial Disclosure is Required: The final rules replace the existing “no independent assets or operations” and “minor” numerical thresholds used to determine the form and content of disclosure with a requirement to provide all financial disclosures “to the extent material.” The Adopting Release includes four non-exclusive examples of when disclosure may be deemed to be not material and therefore not required. These examples are:
 - 1) The assets, liabilities and results of operations of the combined issuers and guarantors of the guaranteed security are not materially different than corresponding amounts presented in the consolidated financial statements of the parent company;
 - 2) The combined issuers and guarantors, excluding investments in subsidiaries that are not issuers or guarantors, have no material assets, liabilities or results of operations;
 - 3) The issuer is a finance subsidiary of the parent company, the parent company has fully and unconditionally guaranteed the security, and no other subsidiary of the parent company guarantees the security; and
 - 4) The issuer is a finance subsidiary that co-issued the security, jointly and severally, with the parent company, and no other subsidiary of the parent company guarantees the security.

The final rules do not require any explanation or reasoning to be provided if any Summarized Financial Information is omitted because it is not material unless one of the above four identified exceptions is being relied upon, in which case, it must be disclosed.

3. Location of Revised Alternative Disclosures:

- The parent company is permitted to provide the Revised Alternative Disclosures in a footnote to its consolidated financial statements or alternatively in its Management’s Discussion and Analysis of Financial Position and Results of Operations (“MD&A”).
- If the disclosures are not otherwise included in the consolidated financial statements or MD&A, the parent company must include the disclosures in its prospectus immediately following “Risk Factors,” if any, or otherwise, immediately following pricing information described in Item 105 of Regulation S-K.
- Unlike the proposed rule, which would have required the disclosures to be included in the footnotes to the parent company’s consolidated financial statements for annual and quarterly reports beginning with the annual report subsequent to the first bona fide sale (thus requiring that such disclosure be audited), the parent company will have the flexibility to include the disclosures in either of the two locations listed above in all of its filings.

4. Recently Acquired Subsidiary Issuers and Guarantors:

- The final Rule 13-01(a)(5), consistent with the proposed rule, eliminates the existing Rule 3-10(g) requirement to provide pre-acquisition audited financial statements of a recently acquired subsidiary issuer or guarantor in certain circumstances. This change does not affect the requirements of Rule 3-05 of Regulation S-X, which requires pre-acquisition financial statements of any acquired business that meets the significance thresholds set forth therein.
- The final rules did not adopt the proposed rule requiring specific disclosures about recently-acquired subsidiary issuers and guarantors if material to an investment decision in the guaranteed security. Instead, Summarized Financial Information for recently-acquired subsidiary issuers and guarantors must be included in registration statements if the subsidiary issuer or guarantor is a significant “business” acquired after the date of the parent company’s most recent balance sheet and the acquired business and/or one or more of its subsidiaries are obligated as issuers and/or guarantors. An acquired business is deemed “significant” if it meets any of the conditions specified in the definition of “significant subsidiary” in Rule 1-02(w), substituting 20% for 10% in each place it appears therein, based on a comparison of the most recent annual financial statements of the acquired business and the parent company.
- As a side note, in some offerings made in connection with an acquisition (including where the funds will be used to fund the acquisition), some or all of the entities to be acquired may be required by the indenture to become guarantors of the notes upon or following consummation of the acquisition. In such cases, we are aware of the SEC staff’s position that the guarantees of the entities being acquired are securities being offered in the offering and, in accordance with Section 5 of the Securities Act, required to be registered. If the notes are issued prior to the consummation of the acquisition (whether the proceeds are held in escrow until closing or not), there may be difficulties in obtaining the consent of the board of directors of the target company to permit such target company to become a registrant under a registration statement of the acquiror prior to the closing of the acquisition. The amended rule does not change the requirement for target companies that will provide guarantees upon or following the closing of an acquisition to be registrants under a registration statement for notes issued prior to the closing of the acquisition.

5. **Continuous Reporting Obligations:** The Revised Alternative Disclosures are required to be disclosed for as long as the issuers and guarantors have a reporting obligation under Section 15(d) of the Exchange Act with respect to the guaranteed securities (typically the later of one year after the issuance or when the security is no longer held by more than 300 persons), rather than for so long as the guaranteed securities are outstanding. This change harmonizes Rule 3-10 with the conditions for suspending reporting obligations of issuers and removes the anomalous situation where a parent guarantor was required to continue providing disclosure under Rule 3-10 even when the subsidiary issuer was eligible to suspend its own reporting obligations.

III. Amendments to Rule 3-16 and Partial Relocation to Rule 13-02

The amendments to the disclosure for collateralized securities largely parallel the changes to the disclosure for guaranteed securities. An overview of the amendments to Rule 3-16 and the new disclosure requirements of Rule 13-02 follows.

1. **Financial Disclosures:**

- **Summarized Financial Information:** The registrant would be required to provide Summarized Financial Information about the consolidated affiliate(s) and the collateral arrangement as a supplement to the registrant's consolidated financial statements. Like the financial disclosure requirements for subsidiary issuers and guarantors under Rule 13-01, Rule 13-02 will not require disclosure of additional line items "to the extent they are not material to an investment decision" (as was proposed by Rule 13-02(a)(5)), but will require additional disclosures if necessary to comply with Rules 13-02(a)(6) and (7).⁴ Unlike the final amendment to Rule 13-01, the financial information of all subsidiaries that are consolidated with an affiliate whose securities are pledged will be included in the Summarized Financial Information, even if the securities of those subsidiaries are not pledged.
- **Disclosures of Summarized Financial Information on a Combined Basis:**
 - Summarized Financial Information of each affiliate whose securities are pledged as collateral that is consolidated in the registrant's consolidated financial statements may be presented on a combined basis.
 - Further, the financial information of *all* subsidiaries that would be consolidated by the affiliate will be included in the Summarized Financial Information (even if the securities of those subsidiaries are not pledged as collateral).
- **Periods Presented:** The registrant is required to provide the financial disclosures as of and for the most recently ended fiscal year and the most recent year-to-date interim period included in the parent company's consolidated financial statements.
- **Basis of Presentation:** The registrant must briefly describe the basis of presentation applicable

⁴ Rules 13-02(a)(6) and (7) require the registrant to provide any financial and narrative information about each such affiliate if the information would be material for investors to evaluate the pledge of the affiliate's securities as collateral and sufficient information so as to make the financial and non-financial information presented as not misleading. Therefore, as an unconsolidated affiliate's financial information is not included in the registrant's consolidated financial statements, in certain circumstances, disclosure may be required to satisfy the requirements of Rules 13-02(a)(6) and (7).

to each of the required financial disclosures.

2. Non-Financial Disclosures: The final rules require certain non-financial disclosures about the securities pledged as collateral, each affiliate whose securities are pledged (both to be included in an exhibit to the subject filing), the terms and conditions of the collateral arrangement, and whether a trading market exists for the pledged securities.
3. When Disclosure is Required: The final rules replace the existing “substantial portion” threshold with a requirement to provide all disclosures required in Rule 13-02 “to the extent material.” This is a change from the proposed rule which would have only required the financial and non-financial disclosures “to the extent material *to holders of the guaranteed security*.” Unlike the proposed rules, the final rules do not require any explanation or reasoning to be disclosed if any Summarized Financial Information is omitted because it is not material.
4. Location of Disclosures: The final rules impose the same requirements and provides the same flexibility with regard to placement of the required disclosures in the registration statement and filings as the final Rule 3-10.
5. Recently Acquired Affiliates Whose Securities are Pledged as Collateral: The final rules generally impose the same requirements as the final Rule 13-01(a)(5) does with respect to recently acquired subsidiary issuers or guarantors.

IV. Foreign Private Issuers, Smaller Reporting Companies and Offerings Pursuant to Regulation A.

The SEC also adopted corresponding amendments to the disclosure requirements for foreign private issuers, smaller reporting companies and issuers offering securities pursuant to Regulation A. Please refer to the Adopting Release and the related rules for the specific requirements and details.

V. Conclusion

With the adoption of the amendments to the financial disclosure requirements under Regulation S-X applicable to registered offerings, the SEC intends to focus investors on the information that is material given the specific facts and circumstances and to reduce the burdens of compliance with a registered offering, thereby facilitating reporting companies to offer guaranteed or collateralized securities on a registered basis.

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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, please do not hesitate to email publications@cahill.com or call or email Douglas Horowitz at 212.701.3036 or dhorowitz@cahill.com; Susanna Suh at 212.701.3686 or ssuh@cahill.com; or Paul Rafla at 212.701.3388 or prafla@cahill.com.