

August 27, 2018

SEC Adopts Amendments to Update and Simplify Disclosure Requirements

On August 17, 2018, the SEC adopted amendments to eliminate, integrate, update or modify certain of its disclosure requirements. The amendments are part of the SEC's efforts to improve disclosure effectiveness as well as implement the FAST Act's mandate to improve Regulation S-K. In addition, the amendments—which are focused on disclosure requirements that have become redundant, duplicative, overlapping, outdated, or superseded—are intended to facilitate the disclosure of information to investors and simplify compliance without significantly altering the total mix of information provided to investors. While many of the changes are highly technical in nature, issuers, preparers, and investors will likely view these amendments as positive, incremental changes to the SEC's disclosure requirements.

Overview of the Amendments

The amendments eliminate, integrate, update or modify:

- redundant or duplicative disclosure requirements that provide substantially the same disclosures as U.S. GAAP, IFRS, or other SEC requirements;
- overlapping disclosure requirements, which require reasonably similar disclosures as U.S. GAAP or other SEC requirements;
- outdated disclosure requirements, which have become obsolete as a result of the passage of time or changes in the regulatory, business, or technological environments; and
- superseded disclosure requirements that are inconsistent with newer accounting, auditing, and disclosure requirements.

Many of the amendments were adopted substantially in the form that they were proposed in July 2016, except for some disclosure requirements that the SEC referred to the FASB for potential incorporation into U.S. GAAP and several other requirements that the SEC determined to retain unchanged. The SEC noted that any disclosure requirements incorporated into U.S. GAAP could affect all public business entities in the same way because U.S. GAAP has no concept of scaled disclosure, such as the SEC regime for smaller reporting companies (SRCs) and issuers relying on Regulation A or Regulation Crowdfunding. The SEC is requesting that the FASB determine whether the referred disclosure items will be added to its agenda within 18 months after publication of the final rule in the Federal Register.

Disclosure Location Considerations

The SEC weighed certain disclosure location considerations that could result as a consequence of adopting the amendments, including the following:

- **Prominence Considerations** – the relocation of some disclosures in a filing may change the prominence and/or context of both the relocated disclosures and the remaining disclosures.

- **Financial Statement Considerations** – the relocation of some disclosures from outside to inside the financial statements would subject the information to annual audit and/or interim review, internal control over financial reporting, and XBRL tagging requirements, and would no longer qualify for safe harbor protection under the Private Securities Litigation Reform Act of 1995 (PSLRA). Conversely, relocation of disclosures from inside to outside the financial statements would have the opposite effect.
- **Bright Line Disclosure Threshold Considerations** – the removal of a bright line disclosure threshold could potentially reduce the amount of required disclosures and increase the judgment required to determine what disclosures are meaningful to investors.

Summary of the Amendments

The following summary highlights some of the noteworthy changes that will affect a company's typical disclosures made in its SEC filings.

Description of Business

Many of the below changes implicate prominence and financial statement considerations because these disclosures are located in the business description section of an annual report filing, while the corresponding disclosures are located in different sections of the filing (e.g., risk factors or MD&A) or in the notes to the financial statements.

- **Segments** – The amendments eliminate the requirement to provide financial information about segments¹ as part of the description of the business as U.S. GAAP and Item 303(b) of Regulation S-K require similar disclosures. Segment disclosures will continue to be available in the notes to the financial statements and, where applicable, in the MD&A.
- **Research and Development Activities** – The amendments eliminate the requirement to disclose, if material, the amount spent on research and development activities² as U.S. GAAP and IFRS require reasonably similar disclosures. However, the disclosure of trend information related to those items, where material, is required by Item 303 of Regulation S-K, and companies should continue to provide trend information disclosures in the business description section, as necessary. In addition, the amendments do not preclude companies from continuing to provide voluntary disclosures of their R&D activities as part of their business description or elsewhere outside of the financial statements.
- **Geographic Areas** – The amendments eliminate the requirement to disclose in the description of the business financial information by geographic area, the risks associated with an issuer's foreign operations and any segment's dependence on foreign operations³ as U.S. GAAP and other parts of Regulation S-K require similar disclosures. In addition, the SEC amended Item 303 of Regulation S-K to add an explicit reference to "geographic areas." The SEC also clarified that geographic areas are an example of a subdivision of a business that is required to be discussed when management believes such discussion would be appropriate to an understanding of the business and that discussion of geographic areas is not required in all circumstances.
- **Seasonality** – The amendments retained the seasonality disclosure requirements in annual reports,⁴ but eliminated Instruction 5 to Item 303(b) of Regulation S-K as U.S. GAAP, in combination with the remainder of Item 303, requires disclosures in interim reports that convey reasonably similar information. While investors could potentially receive less supplemental forward-looking information about seasonality because

¹ Item 101(b) of Regulation S-K and Item 7(b) of Form 1-A. The SEC also eliminated Rule 3-03(e) of Regulation S-X as it was redundant with U.S. GAAP.

² Item 101(c)(1)(xi) of Regulation S-X, Item 101(h)(4)(x) of Regulation S-X, Item 5.C of Form 20-F and Item 7(a)(1)(iii) of Form 1-A.

³ Item 101(d)(1)-(3) of Regulation S-K.

⁴ Item 101(c)(1)(v) of Regulation S-K.

the PSLRA safe harbor is not available for such information when it is disclosed in the notes to the financial statements, the SEC stated its belief that, even without Instruction 5, the requirements in Item 303 elicit disclosure of forward-looking information in interim reports to the extent that the effects of seasonality may become material.

Market for Registrant's Common Equity

Regulation S-K requires a company to disclose basic information about the public trading market (or absence thereof) and historical trading prices for its common equity.⁵ The SEC observed how this disclosure requirement has become outdated, given that investors can easily access a company's stock price information for free on numerous websites. As a result, the SEC eliminated the requirement for a company to disclose the high and low sales prices of its common equity for each full quarterly period within the two most recent fiscal years and interim periods and replaced it with disclosure of the trading symbol(s) for each class of the company's common equity. Other specific disclosure requirements will apply to issuers with common equity that is traded over-the-counter and issuers with no class of publicly-traded common equity. Foreign private issuers will be subject to similar disclosure requirements as U.S. issuers as Form 20-F will be updated with consistent changes.

Dividends

Companies will also no longer need to state the frequency and amount of any cash dividends in the body of a Form 10-K, Part I of a Form S-1, or other relevant filings, as Regulation S-X will be amended to require similar disclosure.

In addition, the amendments consolidate disclosure requirements pertaining to restrictions that currently, or are likely to, materially limit the issuer's ability to pay dividends on its common equity⁶ into a single requirement in Regulation S-X. Similar changes are being made with regard to Form 20-F that will apply to foreign private issuers.

Warrants, Rights and Convertible Instruments

The amendments eliminate the requirement to disclose on Form S-1 or Form 10 the amount of common equity subject to outstanding options, warrants, or convertible securities, when the class of common equity has no established U.S. public trading market.⁷ U.S. GAAP more broadly requires disclosure of the terms of significant contracts to issue additional shares, the number of shares authorized for certain equity awards, and, in the calculation of diluted earnings per share, the weighted-average incremental shares that would be issued from the assumed exercise or conversion of options, warrants, and convertible securities.

Ratio of Earnings to Fixed Charges

Regulation S-K requires issuers that register debt securities to disclose the historical and pro forma ratios of earnings to fixed charges and issuers that register preference equity securities to disclose the historical and pro forma ratio of combined fixed charges and preference dividends to earnings.⁸ Regulation S-K also requires the filing of an exhibit setting forth the computation of any ratio of earnings to fixed charges.⁹ The amendments eliminate these requirements because U.S. GAAP and IFRS require disclosure of many of the components commonly used in the ratio (e.g., income, interest expense, lease expense) as well as information from which other ratios may be computed that convey reasonably similar information about an issuer's ability to meet its financial obligations.

⁵ Item 201(a) of Regulation S-K.

⁶ Item 201(c)(1) of Regulation S-K.

⁷ Item 201(a)(2)(i) of Regulation S-K.

⁸ Item 503(d) of Regulation S-K.

⁹ Item 601(b)(12) of Regulation S-K.

Extraordinary Items

The SEC updated various disclosure requirements and forms to replace the outdated reference to “extraordinary items,” which the FASB had eliminated from U.S. GAAP in January 2015.

Where You Can Find More Information

The amendments eliminate the requirement to identify the Public Reference Room and disclose its physical address and phone number,¹⁰ but retain the requirement to disclose the SEC’s internet address and a statement that electronic SEC filings are available there. This requirement will also be expanded to foreign private issuers. In addition, all issuers will be required to disclose their Internet addresses, if they have one (previously, only accelerated filers and large accelerated filers were required to provide their Internet address and all other issuers were merely “encouraged” to do so).

Exhibits

The following exhibit requirements were eliminated (the SEC’s exhibit-numbering system has been preserved, however, as the below items have been removed and “[Reserved]”):

- Item 601(b)(11) – Statement re: computation of per share earnings;¹¹
- Item 601(b)(12) – Statement re: computation of ratios;
- Item 601(b)(19) – Report furnished to security holders;¹²
- Item 601(b)(22) – Published report regarding matters submitted to vote of security holders;¹³ and
- Item 601(b)(26) – Invitation for competitive bids.¹⁴

Referrals to the FASB

As noted above, the SEC is referring a number of items to the FASB for potential incorporation into U.S. GAAP, including disclosure requirements relating to major customers, products and services, foreign currency, repurchase and reverse repurchase agreements, equity compensation plans, discount on shares, income tax disclosures, consolidation matters, debt obligations, related party transactions, and interim financial statements. Companies should take note as any disclosure requirements that are incorporated into U.S. GAAP could potentially affect all entities that prepare financial statements under U.S. GAAP, including SRCs.

In contrast to the foregoing items, the SEC decided not to refer the disclosure requirements relating to legal proceedings, which are one type of loss contingency, to the FASB for potential incorporation into U.S. GAAP. The SEC had previously solicited comments as to whether to amend or refer these disclosure requirements to the FASB. The SEC had observed that issuers commonly repeated some or all of the disclosures provided in the notes to the

¹⁰ Item 101(e)(2) and Item 101(h)(5)(iii) of Regulation S-K; Forms S-1, S-3, S-4, S-11, F-1, F-3, and F-4; Item 1118(b) of Regulation AB; and Forms SF-1, SF-3, N-1A, N-2, N-3, N-5, N-6, and N-8B-2.

¹¹ This provision was eliminated as substantially redundant or duplicative of U.S. GAAP or IFRS disclosures. Instruction 6 to “Instructions as to Exhibits” of Form 20-F was similarly eliminated.

¹² General Instruction D(3) to Form 10-Q, which refers to Item 601(b)(13) of Regulation S-K, provides specific instructions to address incorporation by reference into Form 10-Q of information that is separately made available to security holders.

¹³ This provision became obsolete since shareholder voting results may be disclosed in Forms 10-K and 10-Q and Item 5.07 of Form 8-K.

¹⁴ This provision was deleted as it provided little additional value to investors. Those participating in a competitive bid would directly receive the invitation, and all other investors would have access to the registration statement covering the securities offered at competitive bidding, as well as the results of the competitive bidding and the terms of reoffering.

financial statements under U.S. GAAP or included a cross-reference to those disclosures when complying with the SEC disclosure requirement. Many commenters opposed the integration of the Regulation S-K and U.S. GAAP requirements, expressing concerns about financial statement disclosure considerations (including the PSLRA safe harbor) and bright line disclosure threshold considerations. The SEC concluded that further consideration is warranted with respect to the implications of potential changes to these requirements.

Effective Date of the Amendments

The amendments will become effective 30 days after the final rule is published in the Federal Register. While the timing of the rule's official publication is uncertain, calendar year-end reporting companies should take note as these amendments could affect their preparation of third quarter 2018 reports on Form 10-Q.

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