

SEC Proposes Additional Disclosure Reforms

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Last Wednesday, the SEC issued a [proposal](#) aimed at eliminating or updating duplicative, overlapping and obsolete disclosure requirements. The proposal is welcome, but largely technical in nature and generally focused on duplicative requirements. As a result, if adopted, it will likely have only a small impact on the total amount of information companies are required to disclose. Needed reforms that would eliminate truly obsolete disclosure requirements will likely wait for the outcome of action on the SEC's pending Regulation S-K concept release (our client memorandum and summary are available [here](#) and [here](#)).

The proposal is part of the SEC's ongoing "disclosure effectiveness initiative," launched in 2013, in which it articulated the overarching goal of improving the public company disclosure requirements for the benefit of both investors and companies. The proposal is also part of the SEC's efforts to comply with the mandates set forth in the JOBS Act of 2012 and the FAST Act of 2015, both of which instructed the SEC to analyze Regulation S-K to determine how its disclosure requirements could be modernized and simplified, and to propose revisions to these requirements. The proposal is the fourth major work product of the disclosure effectiveness initiative, following the publication last month of proposed rules to modernize mining disclosures (our client memorandum is available [here](#)), the publication in April 2016 of the Regulation S-K concept release and the publication in September 2015 of a request for comment on financial disclosure requirements for entities other than the registrant (our comment letter is available [here](#)).

The comment period will close 60 days after the proposal's publication in the Federal Register (the deadline is expected to be in the second half of September 2016).

Duplicative Requirements

The SEC identified a number of requirements in Regulation S-K and Regulation S-X that require substantially the same disclosure as U.S. generally accepted accounting principles, International Financial Reporting Standards or other disclosure requirements. The SEC proposes to eliminate those requirements to simplify compliance efforts while providing substantially the same information to investors. In particular, the amendments, if adopted, would eliminate duplicative disclosure requirements relating to:

- Accounting policies followed by entities consolidated into a company's financial statements.
- Significant changes in amounts of debt issued subsequent to the latest balance sheet date.
- Income tax rate reconciliation.
- Information about securities subject to warrants or rights.
- Certain related party transactions.
- Material contingencies in interim financial statements notwithstanding disclosure in annual financial statements.
- Presentation of earnings per share.
- Reasons for making material accounting changes in an interim period.
- Effects of discontinued operations in interim financial statements.

Overlapping Requirements

The SEC also identified disclosure requirements in its rules that are related to, but not the same as, U.S. GAAP, IFRS or other disclosure requirements. The SEC is seeking comment on whether to delete these disclosure requirements or integrate them into the overlapping requirements. The SEC is also soliciting comments as to whether disclosure requirements that overlap with, but require information incremental to, U.S. GAAP should be retained, modified or referred to the Financial Accounting Standards Board for potential incorporation into U.S. GAAP. The proposal includes amendments to the SEC's disclosure requirements that would:

- Address overlapping disclosure requirements under U.S. GAAP and Regulation S-K for legal proceedings and major customers.
 - *Legal proceedings* – Given the substantial overlap between what is required under U.S. GAAP and what is required under Item 103 of Regulation S-K, the proposal observed that when complying with Item 103 issuers typically repeat some or all of the disclosure provided in the relevant note to the financial statements under U.S. GAAP or include a cross-reference. In this regard, the proposal seeks comment on the potential consequences of incorporating the incremental requirements set forth in Item 103 into U.S. GAAP. Assuming that the most expansive requirements from either Item 103 or U.S. GAAP are retained, the proposal notes that integration of the incremental Item 103 requirements into U.S. GAAP could lead to the disclosure of possible loss or range of loss in more circumstances than under existing requirements. The proposal also seeks comment on whether incorporating these disclosures into U.S. GAAP would require revisions to PCAOB standards or the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information.
 - *Major customers* – Item 101 of Regulation S-K is more expansive than U.S. GAAP disclosure requirements in that Regulation S-K requires disclosure of a loss of a customer, or a few customers, if the loss would have a material adverse effect on a segment (or, in the case of a smaller reporting company, a material adverse effect on the company). This is a qualitative standard, but Item 101 also includes a bright-line requirement for a company (other than a smaller reporting company) to disclose by name any customer that represents 10% or more of the company's revenues and whose loss would have a material adverse effect on the company. By contrast, for each customer that comprises 10% or more of total revenue, U.S. GAAP requires disclosure of that fact, without identification of the customer by name. The proposal seeks comment on whether the requirement to identify major customers by name should be eliminated, as such disclosure could be competitively harmful to either the issuer or the customer.
- Eliminate specific disclosure requirements with respect to derivative accounting policies.
- Eliminate specific disclosure requirements in interim financial statements with respect to such matters as (i) material events subsequent to the end of the most recent fiscal year, (ii) changes in accounting principles and (iii) pro forma business combination information.
- Integrate disclosure of material restrictions on dividends and related items into a single requirement.
- Eliminate Item 201(d) of Regulation S-K, which sets forth disclosure requirements for securities authorized for issuance under equity compensation plans, in light of existing U.S. GAAP requirements to disclose reasonably similar information.
- Eliminate the requirements in Regulation S-K and Form 20-F to provide disclosure, if material, regarding the amount spent on research and development activities, as this disclosure is already required under U.S. GAAP.

Some of the proposed streamlining efforts would result in the relocation of disclosures within a filing. The SEC is seeking comments on the following potential concerns:

- **Prominence Considerations:** The relocation of these disclosures may affect investors by changing the prominence and/or context of both the relocated disclosures and the remaining disclosures.
- **Financial Statement Considerations:** Some of the proposed requirements would relocate the disclosure from outside to inside the financial statements, subjecting this information to annual audit and/or interim review, internal control over financial reporting and XBRL tagging requirements. These disclosures would also no longer be able to rely on the Private Securities Litigation Reform Act of 1995 safe harbor for forward-looking statements to the extent they fell within the scope of the PSLRA exclusion for forward-looking statements set forth in U.S. GAAP-prepared financial statements and, therefore, issuers may no longer volunteer forward-looking information in their disclosure. Conversely, some of the proposed requirements would relocate the disclosure from inside to outside the financial statements and, thus, would have the opposite effect.
- **Bright-Line Threshold Considerations:** Some of the SEC disclosure requirements include bright-line disclosure thresholds not found in the overlapping requirements, so that matters involving amounts below that threshold would not be required to be disclosed. As a result, the SEC seeks comment on whether it should retain these bright-line thresholds, including whether there are certain disclosure requirements that warrant bright-line thresholds, whether bright-line thresholds result in too much or too little detail for investors and whether there are alternative disclosure thresholds that could be applied in lieu of bright-line tests.

Obsolete Requirements

The SEC also identified disclosure requirements that have become obsolete or superseded as a result of the passage of time or changes in the regulatory, business or technological environment. The proposal, if adopted, would simplify compliance efforts by reducing or eliminating these obsolete requirements, including the following:

- Eliminating the requirement to provide a ratio of earnings to fixed charges. This is a welcome change because, in our experience, this ratio is generally ignored by investors in favor of more relevant tools to analyze a potential investment, such as the ratio of adjusted EBITDA to interest expense and ratios of total and net debt to adjusted EBITDA.
- Reducing the information required to be disclosed regarding the trading market and trading prices for a company's common equity, in light of that information being readily available on commercial websites and being more current than the information required in response to Regulation S-K.
- Addressing the requirements applicable to foreign private issuers under Form 20-F that deviate from the corresponding requirements applicable to domestic companies under Regulation S-K, including in respect of the market and historical prices for a company's common equity and foreign currency exchange rate data.
- Eliminating required disclosures about the availability of information in person at the SEC's so-called "reading room" in Washington, D.C.

The SEC also proposes to codify its approach to permitting a foreign private issuer to file a registration statement on Form F-1 if the audited financial statements are not older than 15 months at the time of the filing (as opposed to the 12-month requirement that would otherwise apply) without the need to submit a waiver request. Under current rules, a waiver request is required, but in our experience it is always granted.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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