

SEC Enacts Significant Changes to Financial Disclosure Rules

November 25, 2020

Continuing in its effort to streamline disclosure requirements for companies while improving disclosure for investors, last week the SEC **enacted** sweeping changes to a number of financial disclosure requirements in Regulation S-K. The rule changes, among other things, eliminate the requirement that registrants provide selected financial data for the previous five years. The new rules also aim to streamline and reduce duplicative disclosure by eliminating certain prescribed information, such as tabular disclosure of contractual obligations and off-balance sheet arrangements, in favor of a more principles-based approach.

We welcome the rule changes as a right step in streamlining and modernizing MD&A disclosure. As a general matter, the final rules reflect an effort by the SEC to take a more principles-based approach to disclosure, as recommended by Davis Polk and others in comment letters to the SEC. A couple of the changes are impactful, but in general the final rules merely codify a number of requirements that are currently found in SEC guidance and interpretations.

The final rules apply to registration statements and periodic reports. In addition, the SEC adopted parallel amendments to financial disclosure rules applicable to foreign private issuers (“FPIs”).

The final rules are effective 30 days after publication in the Federal Register.

Existing Requirements vs. New Rules

The following table sets forth the new rules.

Current Rules	New Rules	Comments
Item 301, <i>Selected financial data</i>	Requirement to provide five years of selected financial data is eliminated.	<p>This will reduce disclosure requirements.</p> <p>Disclosure of material trends is otherwise required in MD&A. As such, registrants should consider whether to include:</p> <ul style="list-style-type: none"> trend information for periods earlier than those presented in the financial statements may be necessary to provide material information relevant to an assessment of the registrant’s financial condition or results of operations; and

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		<ul style="list-style-type: none"> as part of an introductory section, a tabular presentation of relevant financial information, may help a reader's understanding of the MD&A.
<p>Item 302(a), <i>Selected quarterly financial data</i></p>	<p>Item 302(a), <i>Disclosure of Material Quarterly Changes</i></p> <ul style="list-style-type: none"> Requirement to provide two years of tabular selected quarterly information is eliminated. Disclosure required only when there are one or more <i>material retrospective changes</i> for any quarters in last two fiscal years or any subsequent interim period. Disclosure should provide: <ul style="list-style-type: none"> – explanation for material changes; and – for each affected quarterly period and the fourth quarter in the affected year, summarized financial information related to statements of income and earnings per share reflecting such changes. 	<p>For new registrants, new rules will apply beginning with the first filing on Form 10-K after the IPO. This is a useful change – under current rules, an IPO company that wants to do a follow-on offering in its first year must prepare incremental reviewed quarterly information, and this rule change will avoid that requirement.</p>
<p>MD&A</p>		
	<p>Item 303(a), <i>Objective</i></p> <p>New section adds disclosure objectives applicable to all of MD&A, including providing:</p> <ul style="list-style-type: none"> material information relevant to an assessment of the financial condition and results of operations of the registrant, including cash flows from operations and outside sources; material events and uncertainties “known to management that are reasonably likely” to cause reported financial information not 	<p>Codifies existing SEC guidance to include disclosure of matters based on “management’s assessment” that are reasonably likely to have a material impact on future operations.</p>

Current Rules	New Rules	Comments
	<p>to be indicative of future operating results or financial condition; and</p> <ul style="list-style-type: none"> material financial and statistical data that the registrant believes will enhance the reader's understanding. 	
<p>Item 303(a), Full fiscal years</p>	<p>Item 303(b), Full fiscal years</p> <p>Full fiscal years discussion focused on the following three requirements:</p> <ul style="list-style-type: none"> liquidity and capital resources results of operations critical accounting estimates <p>If there are material changes from period-to-period, including when material changes within a line item offset one another, disclosure of the underlying reasons (not only the causes) for these material changes in quantitative and qualitative terms is required.</p> <p>“Product lines” has been added as an example of a subdivision of a registrant’s business (in addition to geographic areas) that should be disclosed when, in the registrant’s judgment, the discussion is necessary to an understanding of the business.</p>	<p>The amendments are aimed at greater analysis in the MD&A rather than a discussion that merely repeats numerical data contained in the financial statements.</p>
<p>Item 303(a)(1), Liquidity</p> <p>Item 303(a)(2), Capital resources</p>	<p>Item 303(b)(1), Liquidity and Capital Resources</p> <p>Analyze ability to generate and obtain adequate amounts of cash to meet both short-term and long-term requirements and cash requirements from known contractual and other obligations. Specify the type of obligation and the relevant time period for the cash requirements.</p>	<p>Codifies current SEC guidance that:</p> <ul style="list-style-type: none"> short-term liquidity and capital resources include cash needs for up to next 12 months; and

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	<p>As part of analysis, include discussion of:</p> <ul style="list-style-type: none"> • <i>Liquidity</i>: disclosure requirements unchanged • <i>Capital resources</i>: Expanded to include material cash “requirements,” including capital expenditures. 	<ul style="list-style-type: none"> • disclosure format should not duplicate disclosure in other parts of filing.
<p>Item 303(a)(3)(ii), Result of Operations – Known trends or uncertainties</p>	<p>Item 303(b)(2)(ii), Result of Operations – Known trends or uncertainties</p> <p>Requires discussion of any known trends or uncertainties that have had or that are “reasonably likely” to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.</p>	<p>“Reasonably likely” standard is based on management’s assessment</p>
<p>Item 303(a)(3)(iii), Result of Operations – Net sales and revenues</p>	<p>Item 303(b)(2)(iii), Result of Operations – Net sales and revenues</p> <p>Requires discussion of “material changes” from period to period in net sales or revenue.</p>	<p>Codifies existing SEC guidance</p>
<p>Item 303(a)(3)(iv), Results of operations – Inflation and Price Changes</p> <p>Instructions 8 and 9</p>	<p>Item 303(a)(3)(iv), Results of operations – Inflation and Price Changes</p> <p>Prescriptive requirement to discuss the impact of inflation and changing prices on net sales and revenues and on income from continuing operations is eliminated.</p>	<p>Disclosure of the impact of inflation or changing prices will still be required as part of MD&A if it is part of a known trend or uncertainty.</p>
<p>Item 303(a)(4), Off-balance sheet arrangements</p>	<p>Instruction 8 to Item 303(b)</p> <p><i>Separately captioned section eliminated.</i></p> <p>Replaced with principles-based instruction to incorporate discussion of commitments that have had, or are “reasonably likely” to have, a material</p>	<p>.</p>

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	<p>current or future effect into broader discussion of liquidity and capital resources</p>	
<p>Item 303(a)(5), Contractual obligations table</p>	<p>Requirement to disclose known contractual obligations in tabular format is eliminated.</p>	<p>Disclosure of material cash requirements from known contractual and other obligations will be required under new Item 303(b)(1) as part of the liquidity and capital resources discussion. This will result in a slight change in presentation but no real change in disclosure.</p>
<p>Instruction 4 to Item 303(a) – (Material changes in line items)</p>	<p>Item 303(b)(1), <i>Liquidity and Capital Resources</i></p>	<p>Codifies existing SEC guidance and clarifies that disclosure of the underlying reasons for material changes in quantitative and qualitative terms is required where there are material changes in a line item (including where material changes within a line item offset one another).</p>
<p>Item 303(b), <i>Interim periods</i></p>	<p>Item 303(c), <i>Interim periods</i></p>	<p>This is a welcome change to explicitly permit sequential comparisons.</p> <p>If the registrant changes the basis of comparison, it must discuss the reasons for changing the basis of comparison and provide both comparisons in the first filing in which the change is made.</p>
	<p>Registrants given flexibility to compare their most recently completed quarter to <i>either</i> the corresponding quarter of the prior year <i>or</i> to the immediately preceding quarter.</p> <p>If the registrant chooses to discuss the immediately preceding quarter, then it must provide summary financial information for that quarter or identify prior filings that contain such information.</p> <p>Retains requirement to discuss material changes in results of operations of the most recent fiscal year-to-date period with the</p>	

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	<p>corresponding period of the preceding year.</p>	
Critical Accounting Estimates	<p>Item 303(b)(3)</p> <p>To the extent the information is material and reasonably available, disclose qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimate is reasonably likely to have. Should include:</p> <ul style="list-style-type: none"> • why each critical accounting estimate is subject to uncertainty; • to the extent the information is material and “reasonably available,” how much each estimate and/or assumption has changed over “a relevant period”; and • the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation. 	<p>Largely codifies existing SEC guidance.</p> <p>May use any presentation, but format should not duplicate disclosure already in the filing.</p> <p>Registrants will have flexibility to determine the “relevant period” necessary to discuss material changes</p>
Item 303(c), Safe harbor	<p>Statement that statutory safe harbors specifically apply to all forward-looking information provided in off-balance sheet arrangements and tabular disclosure of contractual obligations disclosure is eliminated.</p>	<p>Disclosure related to contractual obligations and off-balance sheet arrangements will continue to be subject to statutory and regulatory safe harbors which apply to forward-looking information.</p>
Item 303(d), Smaller reporting companies	<p>Rule stating that smaller reporting companies may disclose impact of inflation and price changes, and are not required to provide contractual obligations table is eliminated.</p>	<p>These are conforming changes.</p>

Application to Foreign Private Issuers

The new rules eliminate the requirement that FPIs provide five years of selected financial data pursuant to Item 3.A of Form 20-F. The new rules also amend Form 20-F and Form 40-F to substantially conform to the disclosure MD&A requirements pursuant to new Item 303. For FPIs that do not file annual reports on Form 20-F, the instructions to new Item 303(b) have been amended to require FPIs to consider the impact of hyperinflation if hyperinflation has occurred in any of the periods for which financial statements are filed.

Effective date

The new rules will become effective 30 days after they are published in the Federal Register. Registrants are required to comply with the rules beginning with the first fiscal year ending on or after the date that is 210 days after publication in the Federal Register (the “mandatory compliance date”). Although registrants will not be required to apply the new rules until their mandatory compliance date, they may comply with the final amendments any time after the effective date, so long as they provide disclosure responsive to an amended item in its entirety.

Registrants will be required to apply the new rules in a registration statement and prospectus that on its initial filing date is required to contain financial statements for a period on or after the mandatory compliance date.

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

Pedro J. Bermeo	212 450 4091	pedro.bermeo@davispolk.com
Maurice Blanco	212 450 4086	maurice.blanco@davispolk.com
Joseph A. Hall	212 450 4565	joseph.hall@davispolk.com
Michael Kaplan	212 450 4111	michael.kaplan@davispolk.com
James Lin	+852 2533 3368	james.lin@davispolk.com
John B. Meade	212 450 4077	john.meade@davispolk.com
Emily Roberts	650 752 2085	emily.roberts@davispolk.com
Byron B. Rooney	212 450 4658	byron.rooney@davispolk.com
Richard D. Truesdell, Jr.	212 450 4674	richard.truesdell@davispolk.com
Elizabeth Weinstein	212 450 3889	elizabeth.weinstein@davispolk.com