

February 5, 2020

## SEC Proposes Amendments to Regulation S-K and Releases Public Statement on Disclosure Initiatives

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### **In Addition to Proposing Amendments to Simplify and Update MD&A Disclosure, the SEC Chairman Released a Public Statement Regarding Environmental and Climate-Related Disclosures and Other Disclosure Initiatives**

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#### **SUMMARY**

On January 30, 2020, the Securities and Exchange Commission proposed amendments to modernize, simplify and enhance disclosure requirements in Regulation S-K. The amendments are intended to eliminate duplicative disclosures and to focus on material information for the benefit of investors, while simplifying compliance efforts for registrants. Separately, the SEC issued guidance to provide registrants with disclosure considerations for key performance indicators and metrics disclosed in MD&A.

In addition, on January 30, 2020, SEC Chairman Jay Clayton released a public statement on a variety of topics, including the proposed amendments, environmental and climate-related disclosure, the impact of the coronavirus and other ongoing disclosure modernization initiatives.

The proposed amendments are available on the SEC's website at <https://www.sec.gov/rules/proposed/2020/33-10750.pdf>. Public comments on the proposed amendments will be due within 60 days after publication of the proposed amendments in the Federal Register. The guidance on key performance indicators and metrics in MD&A is available on the SEC's website at <https://www.sec.gov/rules/interp/2020/33-10751.pdf>.

## PROPOSED AMENDMENTS TO REGULATION S-K

### Background

In December 2013, the SEC Staff released its “Report on Review of Disclosure Requirements in Regulation S-K” (the “Report”), which was mandated by Section 108 of the Jumpstart Our Business Startups Act. Based on a recommendation in the Report, the SEC initiated a comprehensive evaluation of its disclosure requirements which included an assessment of the information that the SEC’s rules require registrants to disclose, how and where this information is presented, and how the SEC can better use technology as part of these efforts. Additionally, the Fixing America’s Surface Transportation Act (the “FAST Act”) requires the SEC to study ways that Regulation S-K can be modernized and simplified. The proposed amendments are part of the comprehensive evaluation performed pursuant to the Report and are informed by the objectives of the FAST Act.

### Proposed Amendments

The proposal addresses multiple items of Regulation S-K and related rules. Of particular note are the following aspects:

- ***Elimination of Certain Requirements.*** The proposal would eliminate several current requirements in order to reduce duplicative disclosure and focus on material information. Specifically, the proposal would eliminate:
  - Item 301 (Selected Financial Data). Registrants would no longer be required to provide five years of selected financial data.
  - Item 302 (Supplementary Financial Information). Registrants would no longer be required to provide two years of selected quarterly financial data as required by Item 302(a) or information about oil and gas producing activities as required by Item 302(b) (subject, in the case of Item 302(b), to finalization of related amendments to U.S. GAAP by the Financial Accounting Standards Board).
  - Item 303(a)(5) (Tabular disclosure of contractual obligations). Registrants would no longer be required to provide a contractual obligations table given the overlap with information required in the financial statements and to promote the principles-based nature of MD&A.
- ***Item 303 (Management’s Discussion and Analysis (“MD&A”)).*** The proposal also includes changes intended to modernize, simplify and enhance the disclosure requirements of Item 303. Specifically, the SEC has proposed the following changes:
  - Add a new Item 303(a) (Objective) describing the principal objectives of MD&A. The new Item 303(a) would incorporate much of the substance of current Instructions 1, 2 and 3 to current Item 303(a) and would codify SEC guidance that states that a registrant should provide a narrative explanation of its financial statements that enables investors to see a registrant “through the eyes of management.” The proposal is intended to serve as a reminder to registrants as they prepare their MD&A that the general purpose of the disclosure is to provide both a historical and prospective analysis of the registrant’s financial condition and results of operations, with particular emphasis on the registrant’s prospects for the future. Current Items 303(a) and 303(b) would be retained and recaptioned as Items 303(b) and 303(c), respectively.
  - Replace current Item 303(a)(4) (Off-balance sheet arrangements) with a principles-based instruction intended to prompt registrants to discuss off-balance sheet arrangements in the broader context of MD&A. Current Item 303(a)(4) requires off-balance sheet disclosure to be in a separately captioned section and contains prescriptive requirements that overlap with the

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requirements of U.S. GAAP. The SEC's proposal would replace the current requirements with an instruction emphasizing the importance of discussing off-balance sheet obligations in the broader context of MD&A disclosure when those obligations have or are reasonably likely to have a material current or future effect on a registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources.

- Add a new disclosure requirement to Item 303 (Critical accounting estimates) to clarify and codify existing SEC guidance in this area by explicitly requiring disclosure of critical accounting estimates, defined as estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the registrant's financial condition or results of operations. For each critical accounting estimate, the proposed amendments would require registrants to disclose, to the extent material, why the estimate is subject to uncertainty, how much each estimate has changed during the reporting period, and the sensitivity of the reported amounts to the material methods, assumptions and estimates underlying the estimate's calculation. The new requirement would call for quantitative as well as qualitative information when quantitative information is reasonably available and would provide material information to investors. The SEC notes that registrants often repeat the information in the financial statement footnotes about significant accounting policies and that the proposal is intended to eliminate disclosure that duplicates the financial statement discussion of significant accounting policies and, instead, promote enhanced analysis of measurement uncertainties that supplements the financial statement disclosures.
- Revise the interim MD&A requirement in current Item 303(b) (Interim periods) to provide flexibility by allowing companies to compare the results of operations for their most recently completed quarter to either the corresponding quarter of the prior year (as is currently required) or to the immediately preceding quarter. If a registrant switches the basis of comparison, the registrant would be required to discuss the reasons for the change and provide both comparisons when the change is first made. The SEC's proposal would retain the current requirement to discuss any material changes in a registrant's results of operations between the most recent fiscal year-to-date interim period(s) and the corresponding period(s) of the preceding fiscal year.
- Other proposed amendments, summarized in the Appendix, are incremental changes to Item 303 that are intended to clarify MD&A disclosure requirements, codify existing SEC guidance and reduce repetitive and immaterial disclosure.

The proposal also contains corresponding amendments that would apply to foreign private issuers ("FPIs") providing disclosure required by Form 20-F or Form 40-F as well as FPIs that choose to file on domestic forms.

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### **GUIDANCE REGARDING THE USE OF KEY PERFORMANCE INDICATORS AND METRICS**

The guidance issued by the SEC addresses the use of key performance indicators and metrics in MD&A. The guidance provides that registrants including such metrics should consider the existing MD&A requirements, and whether additional disclosures are necessary in order to provide investors with adequate context for understanding the metrics presented.

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The guidance states that the SEC Staff would generally expect, based on the facts and circumstances, disclosures similar to the disclosures it requires around non-GAAP financial measures to accompany the metric:

- a clear definition of the metric and how it is calculated;
- a statement indicating the reasons why the metric provides useful information to investors; and
- a statement indicating how management uses the metric in managing or monitoring the performance of the business.

The guidance also indicates that registrants should consider whether there are estimates or assumptions underlying the metric or its calculation, and whether disclosure of such items is necessary for the metric not to be materially misleading.

Finally, the guidance also reminds registrants of the requirements to maintain disclosure controls and procedures in Exchange Act Rules 13a-15 and 15d-15, and of the importance of effective controls and procedures when disclosing key performance indicators or metrics derived from a registrant's own information.

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## **PUBLIC STATEMENT BY CHAIRMAN CLAYTON**

### **Environmental and Climate-Related Disclosure**

In a public statement on January 30, 2020, Chairman Clayton outlined a number of key characteristics of environmental- and climate-related matters and related investment-oriented disclosures that should be recognized as threshold issues in crafting, reviewing and regulating such disclosures, consistent with the SEC's disclosure-based regulatory system, including (i) the landscape around environmental and climate-related issues is, and will continue to be, complex, uncertain, multi-national/jurisdictional and dynamic; (ii) capital allocation decisions based on climate-related factors are substantially forward-looking and likely involve assumptions regarding complex and uncertain matters; (iii) the SEC's disclosure-based regulatory regime is largely built around historic and currently verifiable information, with limited forward-looking disclosure requirements; (iv) regulators should not substitute their operational and capital allocation judgments for those of issuers and investors when crafting and implementing disclosure mandates and guidance; and (v) the U.S. regulatory regime stands apart from an investor protection perspective and a liability and enforcement perspective, so even analogous disclosure mandates should not be expected to create uniform effects across jurisdictions.

Chairman Clayton also affirmed that the Staff frequently engages on environmental- and climate-related disclosure topics through Staff trainings, meetings with investors and market participants and outside speaking engagements. The efforts have been particularly focused on (i) better understanding what environmental- and climate-related information investors currently use and how they use that information to make investment decisions; (ii) better understanding the extent to which and how issuers identify, assess

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and manage environmental- and climate-related risks in their particular business and industry; and (iii) reminding issuers and other market participants of how the SEC's principles-based disclosure requirements apply to environmental- or climate-related matters.

Finally, Chairman Clayton encouraged market participants to continue to engage with the SEC on the issue of environmental- and climate-related disclosures, particularly by addressing the threshold issues he outlined above and assisting the SEC in better understanding how market participants use environmental- and climate-related information to make capital allocation decisions.

### **Impact of the Coronavirus**

Chairman Clayton also announced that he had asked the SEC Staff to monitor and provide guidance and other assistance to issuers and other market participants regarding disclosure relating to the current and potential effects of the coronavirus. He acknowledged that this is an uncertain issue and that the effects may be difficult to assess or predict with any meaningful precision, but stated that how an issuer plans for that uncertainty and responds to events as they unfold may nevertheless be material to an investment decision.

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## APPENDIX

Additional proposed amendments to Item 303 (Management's Discussion and Analysis ("MD&A")) of Regulation S-K include the following:

- Amend Instruction 4 to current Item 303(a) to clarify that MD&A requires a narrative discussion of the "underlying reasons" for material changes from period-to-period in one or more line items in quantitative and qualitative terms, rather than only the "cause" for material changes, and to clarify that registrants should discuss material changes within a line item even when such material changes offset each other.
- Amend current Item 303(a)(2) (Capital resources) to specify that a registrant should broadly disclose material cash commitments including, but not limited to, capital expenditures. Item 303(a)(2) currently requires a registrant to discuss its material commitments for capital expenditures as of the end of the latest fiscal period, and to indicate the general purpose of such commitments and the anticipated sources of funds needed to fulfill such commitments. The proposed amendment would require a registrant to describe its material cash requirements, including commitments for capital expenditures, as of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirements.
- Amend the second sentence of current Item 303(a)(3)(ii) (Known trends or uncertainties) to provide that when a registrant knows of events that are *reasonably likely* to cause (as opposed to *will* cause) a material change in the relationship between costs and revenues, such reasonably likely change must be disclosed.
- Amend current Item 303(a)(3)(iii) (Net sales and revenues), which currently requires disclosure related to material *increases* in net sales or revenues, to clarify that a results of operations discussion should describe not only increases but also decreases in net sales or revenues.
- Eliminate current Item 303(a)(3)(iv), which requires registrants to discuss the impact of inflation and changing prices where material, along with the related Instructions 8 and 9 to Item 303(a), in order to encourage registrants to focus their MD&A on material information that is tailored to their respective facts and circumstances.
- Eliminate current Items 303(c) (Safe harbor for forward-looking information) and (d) (Smaller reporting companies) as conforming changes. The elimination of current Item 303(c) would not alter the availability of the regulatory safe harbors in Securities Act Rule 175 and Exchange Act Rule 3b-6, which expressly apply to forward-looking information in MD&A disclosure. Current Item 303(d) is proposed to be eliminated because it specifically and exclusively referenced items that the proposal would eliminate.
- Eliminate current Instructions 13 and 14 to Item 303(a), which cross-reference to industry guides, as simplifying amendments.