

SEC ISSUES CONCEPT RELEASE SEEKING PUBLIC COMMENT ON MODERNIZING REGULATION S-K DISCLOSURE REQUIREMENTS

On April 13, 2016, the U.S. Securities and Exchange Commission (SEC) issued a 341-page concept release seeking public input on modernizing the business and financial disclosure requirements in Regulation S-K. The concept release is available online at <https://www.sec.gov/rules/concept/2016/33-10064.pdf>. Under the SEC's integrated disclosure system, most registration and reporting forms filed by U.S. public companies under the Securities Act of 1933 and the Securities Exchange Act of 1934 refer to Regulation S-K for many substantive disclosure requirements. The concept release is a follow-up to the SEC staff's December 2013 report issued to Congress addressing the SEC staff's review of disclosure requirements in Regulation S-K mandated by Section 108 of the Jumpstart Our Business Startups Act (JOBS Act).

The concept release is an important step in the SEC staff's Disclosure Effectiveness Initiative, a broad staff review of the SEC's public company disclosure, presentation and delivery requirements. While the concept release represents only a preliminary step towards potential rulemaking, the concept release does raise the real possibility of some substantial revisions to these requirements in the near future. At the SEC's open meeting to vote on publication of the concept release, SEC Chair Mary Jo White remarked that the concept release "takes a broad, 'step-back' look at how [the SEC] can make [its] disclosure regime better and more useful in 2016 and beyond" and that the SEC staff is sensitive to "both the concerns of various shareholders that they generally want more, not less, information, and to companies' concerns about requiring unnecessary, immaterial disclosures."

The concept release reviews and seeks comment on much of the business and financial disclosure requirements under Subparts 100, 200, 300 and 700 of Regulation S-K and Item 503 of Regulation S-K, as well as the exhibit requirements in Item 601 of Regulation S-K and the industry guides published by the SEC. With respect to the line-item disclosure requirements in these Subparts, some of the interesting specific possibilities explored by the concept release include (i) whether risk factor disclosure requirements should require discussion of the probability of occurrence and the effect on performance for each risk factor, (ii) whether risk factor disclosure requirements should specify generic risks that registrants are not required to disclose, (iii) whether risk factor disclosure requirements should require registrants to identify their ten most significant risk factors in order, (iv) whether to require auditor involvement regarding the reliability of management's discussion and analysis of financial condition and results of operations (MD&A) and (v) whether to require more frequent or granular disclosure of stock repurchases. Notably, the concept release neither reviews nor seeks comment on (i) other disclosure requirements in Regulation S-K, such as the disclosure requirements under Subpart 400, which includes disclosure requirements regarding management, executive compensation, beneficial ownership, related party transactions and corporate governance matters, (ii) the disclosure requirements applicable to foreign private issuers, business development companies or other categories of registrants or (iii) the financial statement requirements in Regulation S-X. The concept release also recognizes the role of information relating to public policy and sustainability matters (e.g., climate change and political spending) in voting and investment decisions and

raises the possibility that the SEC will consider adopting new disclosure requirements addressing public policy and sustainability matters.

Information for Investment and Voting Decisions

The concept release reviews much of the business and financial disclosure requirements in Items 101, 102, 201, 202, 301, 302, 303, 305, 503, 701 and 703 of Regulation S-K. The review of these disclosure requirements is organized around eight general topics: (i) core company business information, (ii) company performance, financial information and future prospects, (iii) risk and risk management, (iv) securities of the registrant, (v) industry guides, (vi) disclosure of information relating to public policy and sustainability matters, (vii) exhibits and (viii) scaled requirements.

Core Company Business Information

The concept release reviews Items 101(a)(1), 101(c) and 102 of Regulation S-K:

- Item 101(a)(1) (*General Development of Business*) requires a description of the general development of the business of the registrant during the past five years, or such shorter period as the registrant may have been engaged in business. The concept release seeks comment on, among other things, (i) whether a period shorter or longer than five years would be more appropriate, (ii) whether Item 101(a)(1) should be revised to require disclosure of a registrant's business strategy and (iii) whether to permit summary disclosure of the general development of a registrant's business in all filings except the initial filing.
- Item 101(c) (*Narrative Description of Business*) requires a narrative description of a registrant's business and identifies thirteen specific items that must be disclosed: (i) principal products produced and services rendered, (ii) new products or segments, (iii) sources and availability of raw materials, (iv) intellectual property, (v) seasonality of the business, (vi) working capital practices, (vii) dependence on certain customers, (viii) dollar amount of backlog orders believed to be firm, (ix) business subject to renegotiation or termination of government contracts, (x) competitive conditions, (xi) company-sponsored research and development activities, (xii) compliance with environmental laws and (xiii) number of employees. The concept release seeks comment on, among other things, (i) whether additional categories of information should be added to Item 101(c), (ii) whether a general description of industry should be a separate requirement, (iii) the existing requirement to disclose the importance to the segment and the duration and effect of all patents, trademarks, licenses, franchises and concessions held, (iv) the existing requirement to disclose any material portion of a business that may be subject to renegotiation of profits or termination of contracts or subcontracts at the election of the government, (v) the existing requirement to disclose the material effects of compliance with environmental laws on the capital expenditures, earnings and competitive position of the registrant and its subsidiaries, as well as any material estimated capital expenditures

and (vi) the existing requirement to disclose the number of persons employed by the registrant.

- Item 102 (*Description of Property*) requires disclosure of the location and general character of the principal plants, mines and other materially important physical properties of the registrant and its subsidiaries. Item 102 also requires identification of the segments, as reported in the financial statements, that use the properties described. The concept release seeks comment on, among other things, (i) whether to retain or eliminate Item 102, and (ii) whether disclosure about corporate headquarters, office space and other facilities is important to investors.

The concept release also generally seeks comment on (i) whether any of these disclosure requirements should be eliminated or modified and (ii) whether any new disclosure requirements should be added.

Company Performance, Financial Information and Future Prospects

The concept release reviews Items 301, 302(a) and 303 of Regulation S-K:

- Item 301 (*Selected Financial Data*) requires disclosure of selected financial data for each of the registrant's last five fiscal years and any additional fiscal years necessary to keep the information from being misleading. The concept release seeks comment on, among other things, (i) the benefits of having five-year information in one table and (ii) whether to retain, modify or eliminate Item 301.
- Item 302(a) (*Supplementary Financial Information*) requires certain registrants to disclose quarterly financial data of selected operating results, including variances in these results from amounts previously reported and the effect of any disposals of segments of a business and extraordinary, unusual or infrequently occurring items recognized in each quarter, as well as the aggregate effect and the nature of year-end or other adjustments that are material to the results of that quarter. Item 302(a) also requires these registrants to separately present fourth quarter information, which is not otherwise required in their annual financial statements. The concept release seeks comment on, among other things, (i) whether a separate presentation of fourth quarter information is important to investors and therefore merits retaining Item 302(a) and (ii) whether to otherwise modify or eliminate Item 302(a).
- Item 303 (*Management's Discussion and Analysis of Financial Condition and Results of Operations*) requires disclosure of MD&A. Item 303(a) requires registrants to discuss in their MD&A disclosures liquidity, capital resources and results of operations. Item 303(a) also requires disclosure of off-balance sheet arrangements and contractual obligations. The concept release seeks comment on, among other things, (i) how to improve the requirements in Item 303, (ii) whether the various SEC staff guidance on MD&A should be consolidated into a single source, (iii) whether registrants should be required to provide an executive-level overview, (iv) whether to require a different format or presentation of the

MD&A and (v) whether to require auditor involvement regarding the reliability of MD&A disclosure.

- While Item 303 does not specifically address critical accounting estimates, Item 303 requires the MD&A to disclose trends, events or uncertainties known to management that could materially affect reported financial information. The SEC's 2003 MD&A guidance states that registrants should provide disclosure about critical accounting estimates or assumptions in the MD&A where their nature is material and their impact on financial condition or operating performance is material. The concept release seeks comment on, among other things, how disclosure requirements could be revised to improve the discussion of critical accounting estimates in the MD&A.

The concept also generally seeks comment on (i) whether any of these disclosure requirements should be retained, modified or eliminated and (ii) whether any new disclosure requirements should be added to these items.

Risk and Risk Management

The concept release reviews Items 503(c) and 305 of Regulation S-K:

- Item 503(c) (*Risk Factors*) requires concise and logically organized discussion of the most significant factors that make an investment in a registrant's securities speculative or risky and includes specific examples of such factors. Item 503(c) requires an explanation of how each risk affects the registrant and discourages disclosure of risks that could apply to any registrant. The concept release seeks comment on, among other things, (i) whether to require discussion of the probability of occurrence and the effect on performance for each risk factor, (ii) whether Item 503(c) should specify generic risks that registrants are not required to disclose, (iii) whether to require registrants to identify in order their ten most significant risk factors and (iv) how to otherwise improve risk factor disclosure, including whether to require or encourage registrants to describe risks with greater specificity and context.
- Item 305 (*Quantitative and Qualitative Disclosures about Market Risk*) requires registrants to provide (i) quantitative disclosure about market risk sensitive instruments using a tabular presentation, a sensitivity analysis or value at risk disclosures and (ii) qualitative information about market risk, including disclosure, to the extent material, of the registrants' primary market risk exposures, how those exposures are managed, and any changes to either the primary market risk exposures or the way they are managed. The concept release seeks comment on, among other things, (i) how to improve Item 305, (ii) whether Item 305 should be more prescriptive and (iii) whether registrants should be required to provide additional disclosure about other risks, including credit risk, liquidity and funding risk and operational risk.

The concept release also generally seeks comment on how these disclosure requirements can be updated and improved.

Securities of the Registrant

The concept release reviews Items 201(b)(1), 202, 701 and 703 of Regulation S-K:

- Item 201(b)(1) (*Related Stockholder Matters – Number of Equity Holders*) requires disclosure of the approximate number of holders of each class of a registrant's common equity as of the latest practicable date. The concept release seeks comment on, among other things, (i) whether to retain, modify or eliminate Item 201(b)(1) and (ii) whether disclosure regarding the number of record holders is important to investors, given that most investors hold shares in street name.
- Item 202 (*Description of Registrant's Securities*) requires a description of the terms and conditions of securities that are being registered. Item 202 disclosure is required only in registration statements and certain proxy statements, but is not required in periodic reports. The concept release seeks comment on, among other things, whether to require Item 202 disclosure each year in the Form 10-K.
- Item 701 (*Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities*) requires disclosure of recent sales of unregistered securities and use of proceeds from registered offerings of securities. Forms 10-K and 10-Q only require Item 701 disclosure not previously disclosed on a Form 8-K. The concept release seeks comment on, among other things, (i) whether to retain or eliminate Item 701, (ii) whether to revise Forms 10-K and 10-Q to require disclosure of all unregistered sales of securities during the reporting period and (iii) whether to remove Item 701 disclosure requirement from Forms 10-K and 10-Q.
- Item 703 (*Purchases of Equity Securities by the Issuer and Affiliated Purchasers*) requires tabular disclosure of shares of equity securities repurchased by the registrant and affiliated purchasers. The concept release seeks comment on, among other things, (i) whether to require more frequent or granular disclosure of repurchases (e.g., disclosure about the incurrence of indebtedness to fund repurchases or the impact repurchases had on performance measures, such as earnings per share), (ii) whether to require repurchases exceeding a specified threshold to be reported on Form 8-K and (iii) how to otherwise revise Item 701.

The concept release also generally seeks comment on whether any of these disclosure requirements should be modified and whether any new disclosure requirements should be added.

Industry Guides

The SEC currently has five industry guides intended to provide uniformity and enhance comparability of disclosure of registrants in the same industries. The five guides address

disclosures by: (i) bank holding companies, (ii) oil and gas programs, (iii) real estate limited partnerships, (iv) property-casualty insurance underwriters and (v) mining companies. The concept release generally seeks comment on whether the guides elicit disclosure that is important to investment and voting decisions. In particular, the concept release seeks comment on, among other things, (i) whether registrants find the guides useful in preparing disclosure, (ii) whether to codify industry-specific disclosure requirements in Regulation S-K and (iii) whether any of the guides should be updated.

Disclosure of Information Relating to Public Policy and Sustainability Matters

The concept release notes that certain new disclosure requirements mandated by Congress address specific public policy concerns (e.g., conflict minerals disclosure requirements) and that some groups have expressed a desire for greater disclosure of a variety of public policy and sustainability matters (e.g., climate change and political spending). The SEC recognizes the role of sustainability and public policy information in voting and investment decisions may be evolving, even though some registrants historically have not considered this information material. The concept release generally seeks comment on, among other things, (i) how specific sustainability and public policy matters are important to informed investment and voting decisions, (ii) if the SEC proposes disclosure requirements on sustainability or public policy issues, which existing reporting frameworks published by other organizations the SEC should consider using and (iii) whether addressing sustainability or public policy issues would be consistent with the SEC's rulemaking authority and mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation.

Exhibits

The concept release seeks comment on whether the exhibit requirements of Item 601 of Regulation S-K continue to provide investors with information important to making informed investment and voting decisions. In particular, the concept release seeks comment on, among other things, (i) whether to modify or eliminate any of the exhibit requirements in Item 601, (ii) whether to continue to allow registrants to omit schedules and attachments for a plan of acquisition, reorganization, arrangement, liquidation or succession required to be filed as an exhibit under Item 601(b)(2), (iii) whether to allow registrants to omit immaterial schedules and attachments from other filed exhibits, (iv) whether to continue to require registrants to file all amendments or modifications to previously filed exhibits as required under Item 601(a)(4), (v) whether to revise the standards for determining whether a contract is a material contract required to be filed as an exhibit under Item 601(b)(10) and (vi) whether to revise Item 601(b)(21) to require registrants to disclose not only significant subsidiaries, but all subsidiaries.

Scaled Requirements

The concept release reviews the regulatory relief available to certain smaller registrants in the form of scaled disclosure requirements. Currently, registrants that qualify as "smaller reporting companies" (SRCs) or "emerging growth companies" (EGCs) are eligible for scaled disclosure. The concept release summarizes the scaled disclosure accommodations available to SRCs and EGCs.

The concept release seeks comment on, among other things, (i) whether there are any disclosure requirements for which scaling is not appropriate, (ii) whether there are additional item requirements that the SEC should consider scaling for SRCs, (iii) whether EGCs should be allowed to take advantage of the scaled disclosure requirements currently available only to SRCs, (iv) whether SRCs or other categories of registrants should be permitted to file periodic reports less frequently than quarterly and (v) whether certain registrants should be required to file periodic reports more frequently than quarterly.

Presentation and Delivery of Information

The concept release notes that the SEC's disclosure system results in some fragmentation of information. The concept release seeks comment on how the SEC's disclosure requirements can facilitate the readability and navigability of registrants' disclosure documents, including on the use of tools such as cross-referencing, incorporation by reference, hyperlinks and registrant websites. The concept release also discusses how the SEC has recommended a "layered" approach to MD&A disclosures (e.g., providing an executive-level overview to highlight what management believes is the most important information, while still providing detailed data and analysis) and seeks comment on whether a "layered" approach should be required for other types of disclosures. The concept release also discusses structured disclosures (i.e., disclosures that include both numeric and narrative-based disclosures that are made machine-readable by having reported disclosure items tagged using a markup language, such as XML or XBRL) and seeks comment on ways to minimize the costs of providing structured disclosures, particularly over time, while still realizing the intended benefits to investors and other users of such disclosures.

Disclosure Framework

Principles-Based, Prescriptive or Objectives-Oriented Approach

The concept release compares the "principles-based" approach and the "prescriptive" or "rules-based" approach that underlies much of the disclosure requirements in Regulation S-K and reviews the concept of materiality as used in U.S. federal securities laws. Disclosure requirements that "articulate a disclosure objective and look to management to exercise judgment in satisfying that objective" are often referred to as "principles-based" and disclosure requirements that "rely on bright-line tests rather than management's judgment to determine when disclosure is required" are sometimes referred to as "prescriptive" or "rules-based." Information is "material" if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision. The concept release seeks comment on, among other things, (i) whether the SEC should revise principles-based rules to use a consistent disclosure threshold, (ii) whether a materiality standard or a different standard (e.g., "objectives-oriented" approach) should be used, (iii) whether the current definition of materiality should be retained or modified, (iv) whether the SEC should limit prescriptive disclosure requirements and emphasize a principles-based approach and (v) whether the SEC should develop qualitative thresholds for disclosure.

Audience for Disclosure

The concept release notes the diverse composition and levels of sophistication of investors who use disclosure required by Regulation S-K, including both individual investors and institutional investors, and how different investors use the disclosure in different ways and seek varying degrees of information. The concept release seeks comment on, among other things, (i) whether disclosures should assume some level of investor sophistication, (ii) whether disclosure rules should require a particular format for various types of investors to facilitate investment and voting decisions, (iii) whether the SEC should use investor testing to gather input on investors' use of and access to disclosure and (iv) whether the SEC should consider the extent of investor reliance on market prices or third-party analyses as opposed to disclosure by registrants.

Compliance and Competitive Costs

The concept release acknowledges the costs of disclosures to registrants, including the administrative and compliance costs of preparing and disseminating disclosure as well as the potential costs of disclosing sensitive information to competitors. The concept release seeks comment on, among other things, (i) whether current disclosure requirements appropriately consider the costs and benefits of disclosure to registrants and investors and (ii) whether there are accommodations that could be made to reduce costs for registrants while still providing investors with information that is important or useful to making informed investment and voting decisions.

Automatic Sunset Provisions

The concept release also notes that the SEC has occasionally adopted rules temporarily or with automatic sunset provisions so that the SEC can assess the effect of or necessity for a rule before adopting the rule permanently. The concept release seeks comment on, among other things, (i) whether the SEC should use automatic sunset provisions more, (ii) the appropriate length of time for any sunset provisions, (iii) whether the SEC should require its staff to study and report on the impact of new disclosure requirements when adopting them and (iv) ways disclosure requirements could be revised to adapt more easily to future market changes and technological advancements.

Comment Period

The comment period for the concept release will end 90 days after its publication in the *Federal Register*. As this concept release presents an opportunity for public companies to provide input to the SEC on business and financial disclosure requirements in the hope that the SEC will ultimately adopt revisions that may reduce disclosure costs by eliminating redundant, overlapping, outdated and/or unnecessary disclosure, public companies are encouraged to review the concept release and submit comments.

About Curtis

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