The SEC proposes to modernize and simplify its disclosure requirements

Last October, the United States Securities and Exchange Commission (**SEC**) published for comment proposed amendments seeking to modernize and simplify certain disclosure requirements applicable to issuers that register securities for public offering in the United States or that are otherwise subject to the ongoing reporting requirements of the U.S. federal securities laws. Congress directed the review of such disclosure requirements in Section 72003 of the Fixing America's Surface Transportation Act (**the FAST Act**), a 2015 statute that required the SEC to prepare recommendations and propose rules aimed at improving "the readability and navigability of disclosure documents" and "modernizing and simplifying" the disclosure requirements "in a manner that reduces the costs and burdens on companies while still providing all material information." As required by the FAST Act, a report with the recommendations of the SEC staff was delivered to Congress on 23 November , 2016[1]; the new proposed rule, published in the Federal Register on 2 November , 2017, seeks to implement those staff recommendations that were found acceptable by the commissioners[2].

The proposed amendments affect several items of Regulation S-K (the regulation codifying the disclosure requirements applicable to U.S. domestic issuers) and several of the forms used to satisfy registration or reporting obligations under the U.S. federal securities laws. In particular, the proposed amendments would modify the following items of Regulation S-K:

- Item 102 (Description of property);
- Item 303 (Management's disclosure and analysis of financial condition and results of operations (**MD&A**));
- Items 401, 405 and 407 (Management, security holders and corporate governance).

In addition, the proposals amend rules governing (i) the presentation of certain information to be included in a registration statement or prospectus (items 501 (outside front cover page of the prospectus) and 503 (risk factors) of Regulation S-K), (ii) the filing of exhibits with the SEC (item 601 of Regulation S-K) and (iii) incorporation of information by reference into SEC filings.

The following is a summary of the proposed amendments:

Description of Property

As currently formulated, item 102 of Regulation S-K requires companies to "state briefly the location and general character of the principal plants, mines and other materially important physical properties of the registrant and its subsidiaries." In response to the staff's conclusion that this formulation "often results in disclosure of immaterial information," the proposed amendments seek to clarify that the disclosure required by this item is only needed with respect to physical properties that are material to the company. This is sought to be accomplished by changing the language quoted above to read as follows: "To the extent material, disclose the location and general character of the registrant's principal physical properties." The point is further emphasized by adding the following language to instruction 1 to this item: "A registrant should engage in a comprehensive consideration of the materiality of its properties." Beyond this clarification, no substantive change to the requirement appears to be intended.

1 See "Report on Modernization and Simplification of Regulation S-K" (Nov. 23, 2016), available at: https://www.sec.gov/files/sec-fast-act-report-2016.pdf.

2 See FAST Act Modernization and Simplification of Regulation S-K, Securities Act Release No. 10,425, Exchange Act Release No. 81,851, Investment Advisers Act Release No. 4791, Investment Company Act Release No. 32,858, 82 Fed. Reg. 50,988 (proposed Nov. 2, 2017), available at https://www.gpo.gov/fdsys/pkg/FR-2017-11-02/pdf/2017-22374.pdf.

MD&A

The proposed amendments reject the staff's recommendation that when three-year financial statements are included in a filing the MD&A comparison of the earliest two periods should be substituted with a hyperlink to the prior electronic filing (**EDGAR**) where such discussion was included for the first time. They retain, in principle, the need for year-to-year comparison of the earlier periods, but allow discussion of the earliest year of three years to be omitted if (i) it is not material to an understanding of the company's financial condition, changes in financial condition and results of operations; and(ii) the company has filed on EDGAR a prior-year annual report on Form 10-K in which such discussion was included. The proposal would extend this change to foreign private issuers whose MD&A disclosure is governed by item 5 of Form 20-F (and not by item 303 of Regulation S-K).

Management, security holders and corporate governance

The proposal includes several technical amendments to the disclosure requirements regarding these matters as follows:

- amendments to item 401 of Regulation S-K to codify the staff's interpretive advice that seeks to eliminate ambiguities regarding the potential need for duplicative information in proxy statements and annual reports;
- amendments to rule 16a-3 under the Securities Exchange Act of 1934, as amended, to eliminate the need for delivery to the company of paper copies of certain reports filed with the SEC via EDGAR by its directors, executive officers and controlling persons regarding their holdings of company securities, and to item 405 of Regulation S-K to clarify to what extent the company may rely on a review of such EDGAR filings in preparing its own reports;

- amendments to update a reference to outdated auditing standards in item 407 of Regulation S-K;
- amendment to item 407 of Regulation S-K to clarify that emerging growth companies (generally, companies with less than US$1.07bn in gross revenues during the most recent fiscal year) do not need to include in their annual reports certain disclosure regarding involvement of the compensation committee in the compensation discussion and analysis section of the report.

Amendments regarding certain information to be presented in a registration statement or prospectus

The proposal includes the following minor amendments to rules governing certain information included in a registration statement or prospectus:

- elimination of the language in an instruction to item 501 of Regulation S-K which provides that when a company's name may create the possibility of confusion with another company, and if additional disclosure does not suffice to eliminate such possibility, the SEC may require a name change unless certain exceptions apply;
- amendment to allow information regarding how the price of the securities will be determined to be included at a location in the prospectus other than the cover page, provided a cross-reference to such location (including page number) is included on the cover page;
- amendment to item 501 of Regulation S-K to require the disclosure, in the case of securities not listed on a U.S. exchange, of the principal U.S. market(s) where the company, through the engagement of a registered broker-dealer, has sought and achieved quotation, together with the corresponding trading symbols;
- amendment to allow, in circumstances where state law does not prohibit the offering of the securities (for example, because state law is preempted by federal law), the removal from the red herring legend of the statement that "this prospectus is not an offer to sell the securities and it is not soliciting an offer to buy the securities in any state where offers or sales are not permitted";
- amendment to eliminate examples from the provisions in Regulation S-K that require risk factor disclosure. Following the staff's recommendation, the proposal eliminates the list of examples to eliminate the possibility that companies may feel compelled to address the risks described in such examples even if they do not apply to them. In addition, for technical reasons, the provisions governing risk factor disclosure are moved from item 503 to new item 105 of Regulation S-K;
- amendment to Rule 405 under the Securities Act of 1933, as amended, to define as "sub-underwriter" a dealer that is committed to purchase securities from an underwriter but is not in privity of contract with the issuer of the securities. The term is currently used, without being defined, in item 508(h) of Regulation S-K which, as part of the information regarding the plan of distribution of an offering, requires certain disclosure in the case of dealers that act as sub-underwriters;
- technical amendments to eliminate or update undertakings required by item 512 of Regulation S-K that have become obsolete or outdated.

Amendments regarding the filing of exhibits

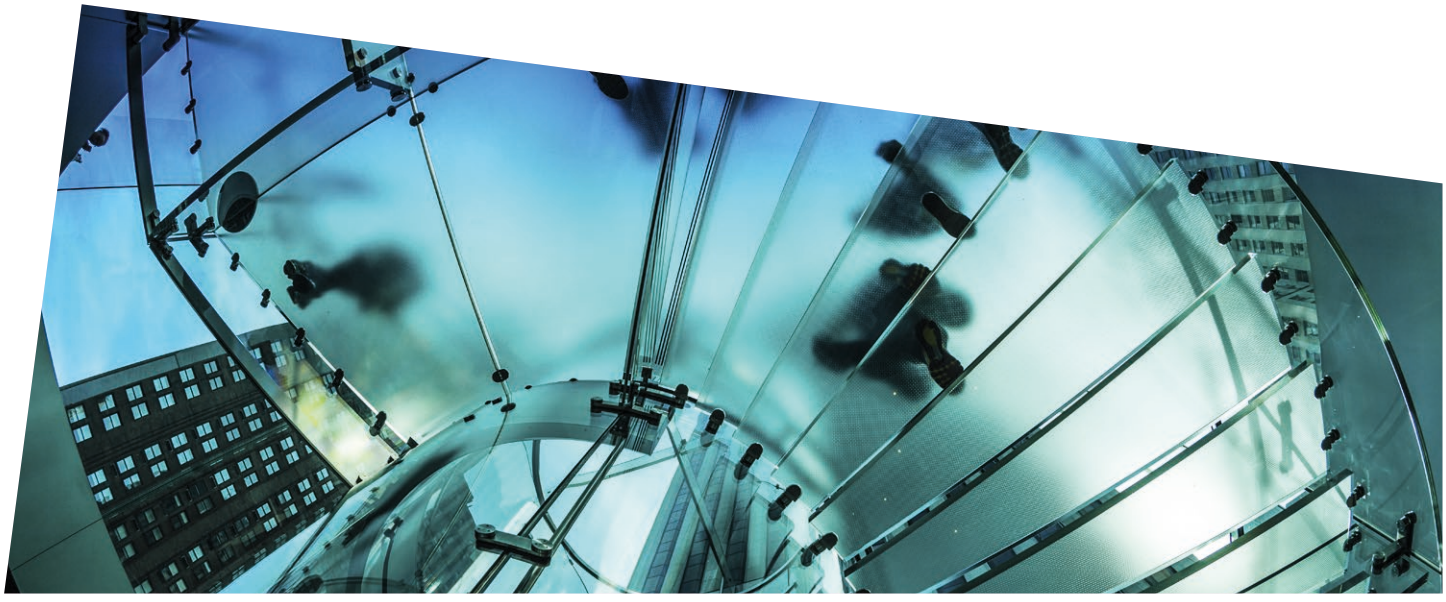
The proposal includes changes to item 601 of Regulation S-K that would:

- require the filing of an additional exhibit with information on each class of a company's securities with annual reports on Form 10-K;
- allow for the omission of schedules and other attachments to documents filed as exhibits (if not material to an investment decision and otherwise disclosed elsewhere) and the redactions of personally identifiable information;
- allow for the redaction from material contracts filed as exhibits, without the need for a request for confidential treatments (as it is currently the case), of information that is both (i) not material, and (ii) competitively harmful if publicly disclosed, provided that certain requirements are satisfied;
- limit the current requirement that companies file as an exhibit to a filing all material contracts not entered into in the ordinary course of business within the two-year period prior to the filing, even if fully performed before the filing date, only to "newly reporting registrants" (which is newly defined as companies that at the time of the filing are not subject to the ongoing reporting requirements of the U.S. federal securities laws and companies that have not filed an annual report since the revival of a previously suspended reporting obligation under such laws);
- require that the list of a company's subsidiaries include the legal entity identifier of each such subsidiary (if one has been obtained);
- the proposed amendments summarized above regarding exhibits would also be applicable to foreign private issuers the reporting requirements of which are governed by Form 20-F.

Incorporation by reference

The proposal seeks to modernize, consolidate and simplify the rules regarding incorporation by reference that are currently dispersed throughout several rules and forms adopted by the SEC under the different statutes it administers. Specifically, the proposed amendments would:

- eliminate provisions (such as the requirement that copies of certain information incorporated by reference be filed as exhibits, or the prohibition on incorporation by reference of information more than five years old) that originated at a time when some of the SEC archives were maintained in physical form



- require hyperlinks to information incorporated by reference into a filing, to the extent that the information so incorporated is available on EDGAR. To accommodate hyperlinks, such filings must be made in HTML format;
- clarify when and how corrections to hyperlinks erroneously filed should be handled;
- Unless expressly authorized by a rule or form, prohibit incorporation by reference of information outside of the financial statements into the financial statements included in a filing. (This provision was included at the request of auditing firms to eliminate ambiguities about what information is reviewed by the auditors in connection with the preparation of their audit reports).

XBRL tagging of cover page information

To enhance investors' ability to access, sort and analyze company information filed with the SEC, the proposal would require that all data presented on the cover page of periodic or current reports (including by foreign private issuers) be in machine-readable form using eXtensible Business Reporting Language (XBRL). In addition, the trading symbol of each class of securities traded on an exchange shall be also included on the cover page of the form.

Although the proposal's suggested changes to the current disclosure requirements, if adopted, would certainly simplify certain aspects of the preparation of companies' filings with the SEC, a comprehensive "modernization" of the disclosure regime would require substantial additional work. Even with the proposed amendments, the revised rules would continue to reflect their ancestral roots in a world in which the delivery of printed information was the only available alternative, and the conveyance of information by issuers to the SEC was critical in the assessment of what information has been provided, and when, to prospective investors. At a time when companies routinely communicate with different constituencies through a variety of means, including multiple social media avenues, it is clear that there is still room for substantial changes to the rules governing how information can be validly conveyed to prospective investors.

In addition, some of the proposed amendments may fail to achieve their objective. For example, if the omission from the MD&A of the comparison of the earliest two-year periods depends, in part, on a finding by the issuer that such comparison is "not material to an understanding of the registrant's financial conditions, changes in financial conditions and results of operations," it is to be expected that many companies, rather than undertaking the complex and time-consuming process involved in any type of materiality analysis, will opt for including the comparison in all filings.

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