Client Alert

October 2017

SEC Continues Disclosure Modernization with Proposed FAST Act Rules

On October 11, 2017, the Securities and Exchange Commission (SEC) proposed new rules pursuant to Section 72003 of the Fixing America's Surface Transportation Act (the FAST Act). The FAST Act directed the SEC to revise Regulation S-K to, among other things, (1) further scale or eliminate requirements of the regulation so as to reduce the burden on emerging growth companies, accelerated filers, smaller reporting companies and other smaller issuers, and (2) eliminate provisions of Regulation S-K that are duplicative, overlapping, outdated or unnecessary. Comments are due 60 days after publication of the SEC's proposing release in the Federal Register.

Overview

The proposed rules would amend various parts of the following items in Regulation S-K:

- Description of Property (Item 102);
- Management's Discussion and Analysis (Item 303);
- Directors, Executive Officers, Promoters, and Control Persons (Item 401);
- Compliance with Section 16(a) of the Exchange Act (Item 405);
- Corporate Governance (Item 407);
- Outside Front Cover Page of the Prospectus (Item 501(b));
- Risk Factors (Item 503(c));
- Plan of Distribution (Item 508);
- Undertakings (Item 512);
- Material Contracts (Item 601(b)(10)); and
- Various rules related to incorporation by reference.

Additionally, some of the proposed amendments would require additional disclosure or incorporation of new technology, including proposed changes to:

- Outside Front Cover Page of the Prospectus (Item 501(b)(4));
- Description of Registrant's Securities (Item 601(b)(4));

- Subsidiaries of the Registrant (Item 601(b)(21)(i)); and

- Various regulations and forms to require all of the information on the cover pages of some Exchange Act forms to be tagged in Inline XBRL format.

Some of the proposed changes would simply renumber existing items or otherwise only require very subtle tweaks to the current Regulation S-K items, whereas others would represent bolder, more substantive changes to the existing rules. The remainder of this Alert focuses on those more substantive amendments.[1]

Description of Real Property

Item 102 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. An instruction to Item 102 provides that, in determining whether properties are material to an understanding of the company's business taken as a whole, registrants should take into account both quantitative and qualitative factors. While disclosure of this kind of information is often useful to investors in companies that own significant mineral or real estate interests, companies in less real-property-intense industries often provide information about their corporate headquarters, office space and other facilities that may not be material to investors.

Accordingly, the proposed rules would revise Item 102 to emphasize materiality in formulating the disclosure, and would require a registrant to, "[t]o the extent material, disclose the location and general character of the registrant's principal physical properties." To this end, an instruction to the proposed rule would be amended to clarify that

> [a] registrant should engage in a comprehensive consideration of the materiality of its properties. If appropriate, descriptions may be provided on a collective basis; detailed descriptions of the physical characteristics of individual properties or legal descriptions by metes and bounds are not required and shall not be given.

In comments at the open meeting in which the proposed rules were considered, SEC personnel indicated that the proposed rules could reduce or eliminate real property disclosure for many companies, particularly when such property is not material to it. The SEC staff cautioned, however, that disclosure would likely continue to be required for companies in the extractive and real estate industries.

MD&A

Public companies are intimately familiar with Item 303(a) of Regulation S-K, which requires registrants to discuss their financial condition, changes in financial condition and results of operations. An instruction to the Item provides that, generally, the discussion must cover the three-year period covered by the financial statements and either use year-to-year comparisons or any other formats that in the company's judgment would enhance a reader's understanding. The instruction further states that reference to the five-year selected financial data may be necessary where trend information is relevant.

The proposed rules would amend Item 303 to eliminate discussion of the earliest year in some situations. Thus, when financial statements included in a filing cover three years, discussion about the earliest year would not be required if (1) that discussion is not material to an understanding of the registrant's financial condition, changes in financial condition, and results of operations, and (2) the registrant has filed its prior year Form 10-K on EDGAR containing MD&A of the earliest of the three years included in the financial

[1] The complete proposing release is available at https://www.sec.gov/rules/proposed/2017/33-10425.pdf.

statements of the current filing. The proposing release emphasizes that this change is consistent with prior SEC guidance intended to encourage companies to re-evaluate disclosures in their prior year MD&A and take a "fresh look" to determine whether such disclosure remains material. Moreover, the proposed rules would also eliminate the reference to five-year selected financial data disclosure on the grounds that trend information is required elsewhere in MD&A.

Confidential Treatment of Exhibits

Item 601 requires the disclosure of a myriad of exhibits (including various material contracts) to filings made under the Securities Act and Exchange Act. Companies may, under certain narrow circumstances, request confidential treatment in order to redact limited amounts of information from public filing of exhibits. But doing so requires a cumbersome process in which an affected company must marshal legal arguments for doing so in a letter to the SEC staff and request the staff's permission in advance of a filing, which can be problematic when a filing deadline is imminent.

Proposed Item 601(a)(5) would permit companies to omit entire schedules and similar attachments to exhibits unless they contain material information and unless that information is not otherwise disclosed in the exhibit or the disclosure document. This exception, which is similar to the existing accommodation in Item 601(b)(2) for plans of acquisition, reorganization, arrangement, liquidation or succession, would be expanded to all exhibits under the proposed amendments. Similar to the current provisions in Item 601(b)(2), proposed Item 601(a)(5) would require registrants to provide with each exhibit a list briefly identifying the contents of any omitted schedules and attachments. In addition, registrants would be required to provide, on a supplemental basis, a copy of any omitted schedules or attachments to the SEC staff upon request.

Item 601(a)(6), as proposed, would permit registrants to omit personally identifiable information (PII) without submitting a confidential treatment request. Similarly, proposed revisions to Item 601(b)(10) would permit companies to omit confidential information from material contracts filed pursuant to that item where such information is both (1) not material and (2) competitively harmful if publicly disclosed, even where the company has not submitted a confidential treatment request. Consistent with current practice, companies availing themselves of this relief would still be required to mark the exhibit index and affected documents to indicate that portions of the exhibit or exhibits have been omitted. Likewise, SEC staff would continue the selective review of registrant filings and would selectively assess whether redactions from exhibits appear to be limited to information that is not material and that would subject the company to competitive harm if publicly disclosed. As is currently the case, the proposing release warns that redacted information should include no more text than necessary to prevent competitive harm to the company. Upon request, companies would be required to provide supplemental materials to the staff similar to those currently required in a confidential treatment request, including an unredacted paper copy of the exhibit and an analysis of why the redacted information is both not material and would cause competitive harm if publicly disclosed. Eliminating the need to seek staff preapproval before submitting the most common kinds of confidential treatment requests will likely be helpful to public companies and time saving, and in light of the recent hack of the SEC's EDGAR database, it may be prudent for registrants to make more liberal use of confidential treatment to mitigate the risk of competitive harm due to future intrusions into the SEC's systems.

Legal Entity Identifiers and XBRL

Item 601(b)(21) requires a registrant to list as an exhibit all of its subsidiaries, the state or other jurisdiction of incorporation or organization of each, and the names under which those subsidiaries do business. The proposed amendments to Item 601(b)(21)(i) would require companies to include in the exhibit the legal entity identifier (LEI), if one has been obtained, of the registrant and each subsidiary listed. An LEI is a 20-character, alpha-numeric code that allows for unique identification of entities engaged in financial transactions. According to the SEC, LEIs are intended to improve market transparency by providing clear identification of participants, and the SEC has begun requiring their

disclosure in other contexts, such as for registered investment companies under the Investment Company Act. In her remarks at the open meeting, Commissioner Stein heralded LEI disclosure as a way for investors and regulators to have greater visibility into corporate structures and interconnectedness, particularly in times of crisis. Nevertheless, the proposing release makes clear that disclosure of LEIs would be required only for those companies and their subsidiaries that choose to obtain this identifier number voluntarily.

Consistent with the theme of enhancing technological reporting, the proposed rules would also require Inline XBRL tagging of all of the information on the cover pages of Form 10-K, Form 10-Q, Form 8-K, Form 20-F and Form 40-F. On a related note, the proposed rules would also require the cover pages of these forms to include the trading symbol for each class of registered securities.

Prospects for Adoption

With the change in presidential administrations, the SEC's disclosure effectiveness initiative had begun to stall over the past year. SEC Chairman Jay Clayton has made disclosure reform and revival of the IPO market a central tenet of his agenda. Thus, we expect that this proposal will mark the first of several future rulemakings on disclosure reform to come during Clayton's term.

This open meeting also marked Clayton's first as SEC chairman. Each of the three sitting commissioners struck a positive tone at the SEC open meeting and seemed genuinely supportive of the proposal, which was approved by a unanimous vote. We are hopeful that this spirit of cooperation foreshadows a return to consensus-based rulemaking at the SEC and a departure from the partisan rancor that pervaded many SEC rulemakings during the prior administration. With upcoming confirmation hearings for nominees to the two vacant commissioner seats, it now appears as if the five-person Commission will be back at full strength by the time the agency considers whether to adopt any of the proposed amendments. We are cautiously optimistic that the SEC will ultimately approve many of these sensible and long-overdue measures.

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