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SEC/CORPORATE

SEC Adopts Rules to Modernize and Simplify Disclosure

The Securities and Exchange Commission recently adopted final rules to modernize and simplify the disclosure requirements for public companies under Regulation S-K. This rulemaking was mandated by the Fixing America's Surface Transportation Act (FAST Act), and the final rules are substantially in the forms originally proposed by the SEC in October 2017 (as discussed in the October 20, 2017 edition of the *Corporate and Financial Weekly Digest*).

The final rules make several significant changes to Regulation S-K and related rules and forms. The following are some highlights:

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) (Item 303)

Item 303 of Regulation S-K currently requires reporting companies to discuss the three-year period covered by their financial statements and present year-over-year comparisons of their financial condition, changes in financial condition and operating results. Pursuant to the final rules, Item 303 will now allow a reporting company to omit a discussion and analysis of the earliest of the three-year period so long as the discussion of such year is already included in an earlier SEC filing, and the company includes a statement identifying the location in the prior filing.

The final rules differ from the SEC's proposed rules in that they do not require that any omitted discussion must not be "material to an understanding" of the registrant's financial condition, changes in financial condition and results of operations. The staff found that the proposed explicit condition requiring the omitted discussion to not be material contained superfluous language and may have been interpreted to modify, supplement or alter the materiality analysis that management must conduct with respect to the information it provides investors in the MD&A.

Additionally, reporting companies are no longer required to include year-over-year comparisons of their financial results in the MD&A. Instead, Instruction 1 to Item 303 clarifies that reporting companies may use any presentation that, in their judgment, enhances a reader's understanding of their financial condition and results of operations. The SEC noted that it expects most companies will continue to include year-over-year comparisons, as they are most familiar to investors and, in many cases, an appropriate method of presentation.

Exhibits (Item 601)—Redaction of Confidential Information

Pursuant to the final rules to Regulation S-K, reporting companies will be allowed to redact confidential information from material contracts that are filed as exhibits to SEC filings without submitting a confidential treatment request. Companies may redact this confidential information so long as the information is both (1) not material and (2) would likely cause competitive harm to the reporting company if publicly disclosed. Note, however, that the SEC will selectively review exhibit filings and assess whether redactions appear to satisfy the above requirements. The staff may request that registrants promptly provide supplemental materials, including an unredacted paper copy of the exhibit and the registrant's analysis to support its redaction. If the company's analysis does not support its redactions, the SEC may request that the reporting company file an amendment that includes some, or all, of the previously redacted information.

The final rules also expand to all exhibits (including material contracts) filed under Item 601: the existing accommodation that permits reporting companies to omit immaterial schedules and attachments to acquisition agreements under 601(b)(2). Under the final rules, reporting companies will still be required to provide with each filed exhibit a list that briefly identifies the contents of omitted schedules and attachments and, upon a request by the SEC, furnish a copy of any omitted schedules or attachments. A separate list of omitted schedules and attachments need not be included if the information is already included within the exhibit in a manner that conveys the subject matter of the omitted schedules and attachments. The final rules also codify the staff's current practice that permits reporting companies to redact any personally identifiable information (PII) (e.g., bank account numbers, social security numbers, home addresses and similar information) from filed exhibits without submitting a confidential treatment request.

The SEC added a requirement that a reporting company must file a description of its securities as an exhibit to its Form 10-K (not only as part of a registration statement). However, this requirement can be satisfied by incorporating the description by reference from, and adding a hyperlink to, a previously filed registration statement.

In addition, the final rules prohibit a reporting company from incorporating by reference or cross-referencing from the financial statements to information outside of the financial statements, unless otherwise specifically permitted or required by the SEC's rules, US Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS). In the adopting release the staff noted that such practice of cross-referencing or incorporating by reference could raise questions as to the scope of an auditor's responsibilities.

Incorporation by Reference (Item 10(d))

Previously, Item 10(d) of Regulation S-K had generally prohibited reporting companies from incorporating documents by reference if such document was on file with the SEC for more than five years. The final rules eliminated the five-year limit in Item 10(d). For example, the elimination of the five-year limit allows a reporting company that files an exhibit with the SEC to incorporate such exhibit by reference in a later filing (e.g., in a 10-K), regardless of whether or not the exhibit was filed with the SEC within the last five years. However, a reporting company would not be permitted to incorporate by reference to a destroyed document because it would render its disclosure unclear and confusing.

Form Amendments

The cover pages of annual reports on Forms 10-K, 20-F and 40-F will require disclosure of the reporting company's trading symbol(s), in addition to the (1) title of each class of securities registered under Section 12(b) of the Securities Exchange Act of 1934, and (2) name of each exchange on which such securities are registered, as already required. The same disclosure will also be required on the cover pages of quarterly reports on Form 10-Q and current reports on Form 8-K. In addition, these cover pages will need to be tagged with inline eXtensible Business Reporting Language.

The cover page of Form 10-K will no longer include a checkbox indicating that there is no (and to the best of the company's knowledge, there will not be) disclosure of late Section 16 filings in the Form 10-K or annual proxy statement. In addition, the final rules amend Rule 405 of Regulation S-K, which requires registrants to disclose in their Form 10-K or proxy statement certain information regarding Section 16 reporting persons. In particular, the final rules modify the current heading required under Item 405, "Section 16(a) Beneficial Ownership Reporting Compliance," to "Delinquent Section 16(a) Reports." The final rules also include an instruction encouraging companies to omit such heading to the extent late Section 16 filings are not required to be reported, thereby minimizing unnecessary disclosure.

Executive Officers

The SEC clarified that information about the identity and background of an SEC reporting company's directors, executive officers and significant employees required by Item 401 of Regulation S-K does not need to be duplicated in the proxy statement if it is included in the 10-K. A reporting company can choose where to present the information.

If a reporting company chooses to include information about its executive officers in its 10-K instead of its proxy statement, the caption for that information must read, “Information about our Executive Officers” (instead of “Executive officers of the registrant”).

Description of Property (Item 102)

Item 102 of Regulation S-K requires disclosure of the location and general character of the principal plants, mines and other materially important physical properties of the reporting company and its subsidiaries. The staff believes that this item may demand disclosure that is not material. The final rules amend Item 102 to state that a description of property is only required when the physical properties are material to the reporting company. However, these final rules will not modify the Item 102 requirements for companies in the mining, real estate, oil and gas industries.

Timing

The amendments to Item 601(b)(2) discussed herein governing the redaction of confidential information in material contracts became effective as of April 2. The remaining amendments discussed herein will be effective on May 2.

For a copy of the SEC’s adopting release, please click here.

BROKER-DEALER

FINRA Proposes Rule Extending the Market-Wide Circuit Breakers in NMS Stocks Pilot Program

On April 5, the Financial Industry Regulatory Authority filed with the Securities and Exchange Commission a proposed rule change to extend the pilot program related to FINRA Rule 6121.02 (Market-wide Circuit Breakers in NMS Stocks), which provides a methodology for determining when to halt trading in all national market system stocks due to extraordinary market volatility, i.e., market-wide circuit breakers. The original term of the pilot program was intended to coincide with the pilot period for the Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of Regulation NMS (Limit Up-Limit Down Plan). The rule change is intended to (1) untie the pilot program’s effectiveness from that of the Limit Up-Limit Down Plan, and (2) extend its effectiveness to the close of business on October 18. The rule change was effective upon filing.

FINRA intends to file a separate proposed rule change with the SEC to adopt the rule on a permanent basis.

The text of the rule change is available here.

FINRA Proposes Rule to Adopt the Remaining Legacy NASD and Incorporated NYSE Rules as FINRA Rules

On April 8, the Financial Industry Regulatory Authority filed with the Securities and Exchange Commission a proposed rule change to adopt the remaining National Association of Securities Dealers (NASD) Rules and Incorporated NYSE Rules as FINRA Rules in the Consolidated FINRA Rulebook without any substantive changes. The rule change covers areas such as membership rules, foreign members, customer account statements, discretionary accounts, approvals of changes in exempt status under Rule 15c3-3 of the Securities Exchange Act of 1934, reporting requirements for clearing firms and interpretations of the Incorporated NYSE Rules. Corresponding cross-references and technical updates will also be made in the Consolidated FINRA Rulebook to reflect the aforementioned changes. The rule change is intended to (1) eliminate the Transitional Rulebook, and (2) provide member firms with greater clarity and regulatory efficiency. The rule change was effective upon filing.

The text of the rule change is available here.

FINRA Proposes Rule Extending the Pilot Program Related to Exchange-Listed Securities

On April 5, the Financial Industry Regulatory Authority filed with the Securities and Exchange Commission a proposed rule change to extend the pilot program related to FINRA Rule 11892 (Clearly Erroneous Transactions in Exchange-Listed Securities).

In September 2010, the SEC approved, on a pilot basis, changes to the rule that, among other things: (i) provided for the uniform treatment of clearly erroneous execution reviews in multi-stock events involving 20 or more securities, and (ii) reduced FINRA's discretion to deviate from such standards. Since 2010, FINRA has proposed a series of additional provisions that are currently scheduled to operate for a pilot period that coincides with the pilot period for the Limit Up-Limit Down Plan (including any extensions to such pilot period).

The SEC recently published the proposed Eighteenth Amendment to the Limit Up-Limit Down Plan (Proposed Amendment) to allow the Limit UP-Limit Down Plan to operate on a permanent basis. The rule change is intended to (1) untie the pilot program's effectiveness from that of the Limit Up-Limit Down Plan, and (2) extend the pilot program's effectiveness to the close of business on October 18, (which is six months after the expiration of the current pilot period for the Limit Up-Limit Down Plan). FINRA noted that, in connection with the rule change, national securities exchanges also will file similar proposals to extend their respective clearly erroneous execution pilot programs, the substance of which are identical to the rule.

Extending the effectiveness of the rule for an additional six months is intended to provide FINRA and national securities exchanges additional time to consider further amendments to the clearly erroneous execution rules in light of the Proposed Amendment. Assuming the SEC approves the permanent adoption of the Limit Up-Limit Down Plan, FINRA intends to assess whether additional changes also should be made to the operation of the clearly erroneous execution rules. The rule change was effective upon filing.

The text of the rule change is available here.

FINRA Announces Updates of the Interpretations of Financial and Operational Rules

On April 9, the Financial Industry Regulatory Authority issued Regulatory Notice 19-11 informing member firms that FINRA has updated its Interpretations of Financial and Operational Rules to add a new interpretation related to Rule 15c3-1(c)(2)(viii)(C)/06 of the Securities Exchange Act of 1934 (Open Contractual Commitments). The new interpretation relates to the conditions under which an underwriting backstop agreement in a firm commitment underwriting would not give rise to an open contractual commitment charge.

The Notice is available here.

The text of the interpretation is available here.

FINRA Issues Regulatory Notice Regarding Departing Registered Representatives

On April 5, the Financial Industry Regulatory Authority issued Regulatory Notice 19-10 addressing the responsibilities of member firms when communicating with customers about the departure of registered representatives who have direct contact with customers in the conduct of such member firm's securities sales. The Notice reinforces two key expectations related to such communications.

First, in the event of a registered representative's departure, member firms are expected to promptly and clearly communicate to affected customers how their accounts will continue to be serviced so that customers can make informed decisions about their accounts. Second, member firms are expected to communicate clearly when asked questions by customers about the departing registered representative. Such communications should, for example, clarify that the customer has the choice to (1) retain his or her assets at the current firm and be serviced by a new registered representative assigned by the firm or chosen by the customer, or (2) transfer such assets to another firm. As with all customer communications, FINRA expects that the information provided by member firms about the departing registered representative is fair, balanced and not misleading.

The Notice is available here.

FINRA Proposes Rule Addressing Regulation NMS and Extraordinary Market Volatility

On April 11, the Financial Industry Regulatory Authority filed with the Securities and Exchange Commission a proposed rule change to adopt FINRA Rules 6190 (Compliance with Regulation NMS Plan to Address Extraordinary Market Volatility) and 6121.01 (Resumption of Trading in Securities Subject to the Regulation NMS Plan to Address Extraordinary Market Volatility), which implement the Plan to Address Extraordinary Market

Volatility Pursuant to Rule 608 of Regulation NMS (Limit Up-Limit Down Plan), on a permanent basis, consistent with the recent approval of the Limit Up-Limit Down Plan to operate on a permanent basis. The rule change was effective upon filing.

The text of the rule change is available here.

FINRA Proposes Rule Making Substantive, Organizational and Terminology Changes to the Corporate Financing Rule

On April 11, the Financial Industry Regulatory Authority filed with the Securities and Exchange Commission a proposed rule change to make certain substantive, organizational and terminology changes to FINRA Rule 5110 (Corporate Financing Rule – Underwriting Terms and Arrangements), which requires member firms that participate in a public offering to file documents and information with FINRA about the underwriting terms and arrangements.

The proposed rule change includes a range of amendments to Rule 5110, including reorganizing and improving its readability. In addition, FINRA proposes changes to the following areas: (1) filing requirements; (2) filing requirements for shelf offerings; (3) exemptions from filing and substantive requirements; (4) underwriting compensation; (5) venture capital exceptions; (6) treatment of non-convertible or non-exchangeable debt securities and derivatives; (7) lock-up restrictions; (8) prohibited terms and arrangements; and (9) defined terms. These changes are intended to lessen the regulatory costs and burdens incurred when complying with the Rule.

If the SEC approves the rule change, FINRA will announce the implementation date in a Regulatory Notice to be published no later than 90 days following such approval. The implementation date will be no later than 180 days following publication of the Regulatory Notice announcing the SEC's approval.

The text of the rule change is available here.

DIGITAL ASSETS AND VIRTUAL CURRENCIES

FSB Publishes Directory of Cryptoassets Regulators

On April 5, the UK Financial Stability Board (FSB) published a directory of regulators and other authorities in FSB jurisdictions who cover cryptoasset issues.

The FSB delivered the directory to the April 2019 G20 Finance Ministers and Central Bank Governors meeting. It notes that the directory's purpose is to provide information only—it does not define the regulatory scope or perimeter of the bodies it lists. The publication also summarizes the scope of the FSB's interest.

The FSB's publication forms part of the ongoing work on cryptoassets conducted by the FSB and standard-setting bodies, including its report on cryptoassets that it published in July 2018 (as reported in the July 20, 2018 edition of the *Corporate & Financial Weekly Digest*).

The directory is available here.

UK DEVELOPMENTS

See "FSB Publishes Directory of Cryptoassets Regulators" in the Digital Assets and Virtual Currencies section.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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