SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 229, 230, 232, 239, 240 and 249

[Release No. 33–10064; 34–77599; File No. S7–06–16]

RIN 3235–AL78

Business and Financial Disclosure Required by Regulation S–K

AGENCY: Securities and Exchange Commission.

ACTION: Concept release.

SUMMARY: The Commission is publishing this concept release to seek public comment on modernizing certain business and financial disclosure requirements in Regulation S–K. These disclosure requirements serve as the foundation for the business and financial disclosure in registrants' periodic reports. This concept release is part of an initiative by the Division of Corporation Finance to review the disclosure requirements applicable to registrants to consider ways to improve the requirements for the benefit of investors and registrants.

DATES: Comments should be received on or before July 21, 2016.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/concept.shtml*);
- Send an email to *rule-comments@sec.gov*. Please include File Number S7–06–16 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–06–16. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method of submission. The Commission will post all comments on the Commission's Web site (*http://www.sec.gov/rules/concept.shtml*). Comments also are available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Angie Kim, Special Counsel in the Office of Rulemaking, at (202) 551–3430, in the Division of Corporation Finance; 100 F Street NE., Washington, DC 20549.

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I. Introduction

Regulation S–K was adopted to foster uniform and integrated disclosure for registration statements under the Securities Act of 1933 (''Securities Act''), registration statements under the Securities Exchange Act of 1934 (''Exchange Act''), and other Exchange Act filings, including periodic and current reports.[1] Over thirty years ago, the Commission expanded and reorganized Regulation S–K to be the

[1] *See* Item 10(a) of Regulation S–K [17 CFR 229.10].

central repository for its non-financial statement disclosure requirements.[2] When adopting the integrated disclosure system, the Commission's goals were to reduce the costs to registrants and eliminate duplicative disclosures while continuing to provide material information.[3] In this concept release, we revisit the business and financial disclosure requirements in Regulation S–K. We seek to assess whether they continue to provide the information that investors need to make informed investment and voting decisions and whether any of our rules have become outdated or unnecessary.

We focus this release on business and financial disclosures that registrants provide in their periodic reports, which are a subset of the disclosure requirements in Regulation S–K.[4] We focus on these requirements because many of them have changed little since they were first adopted. We are not at this time revisiting other disclosure requirements in Regulation S–K, such as executive compensation and governance, or the required disclosures for foreign private issuers, business development companies, or other categories of registrants. Although the specific scope of this concept release is as indicated, we welcome and encourage comments on any other disclosure topics not specifically addressed in this concept release.

This release begins with a discussion of the regulatory history of the integrated disclosure system and Regulation S–K as well as an overview of prior initiatives to review and modernize our disclosure requirements. We then present the framework for our current disclosure regime and explore potential alternative approaches. We proceed to review the business and financial disclosure requirements that apply to periodic reports. We first consider what financial and business information should be required and whether any of these requirements are appropriate to scale for smaller registrants. We then explore how registrants can most effectively present this information to improve its usefulness to investors. In this release, we consider input we have received from letters submitted in response to disclosure modernization efforts[5] as well as the staff's experience with particular disclosure requirements, regulatory history and changes in the regulatory and business landscape since the rule's adoption.

Through this release, we are reviewing and seeking public comment on whether our business and financial disclosure requirements continue to elicit important information for investors and how registrants can most effectively present this information. We are specifically seeking comment on:

- Whether, and if so, how specific disclosures are important or useful to making investment and voting decisions and whether more, less or different information might be needed;
- whether, and if so how, we could revise our current requirements to enhance the information provided to investors while considering whether the action will promote efficiency, competition, and capital formation;[6]
- whether, and if so how, we could revise our requirements to enhance the protection of investors;
- whether our current requirements appropriately balance the costs of disclosure with the benefits;
- whether, and if so how, we could lower the cost to registrants of providing information to investors, including considerations such as advancements in technology and communications;
- whether and if so, how we could increase the benefits to investors and facilitate investor access to disclosure by modernizing the methods used to present, aggregate and disseminate disclosure; and
- any challenges of our current disclosure requirements and those that may result from possible regulatory responses explored in this release or suggested by commenters.

While we set forth a number of general and specific questions, we welcome comments from investors, registrants and other market participants on any other concerns related to our disclosure requirements. In addition to comments received on this release, we will consider any input from investor focus group studies or surveys, the Investor Advisory Committee and the Advisory Committee on Small and Emerging Companies.

This concept release is part of a comprehensive evaluation of the Commission's disclosure requirements recommended in the staff's Report on Review of Disclosure Requirements in Regulation S–K (''S–K Study''), which was mandated by Section 108 of the Jumpstart Our Business Startups Act (''JOBS Act'').[7] Based on the S–K Study's recommendation and at the request of Commission Chair Mary Jo White,[8] Commission staff initiated a comprehensive evaluation of the type of information our rules require registrants to disclose, how this information is presented, where and how this information is disclosed and how we can leverage technology as part of these efforts (collectively, ''Disclosure Effectiveness Initiative''). The overall objective of the Disclosure Effectiveness Initiative is to improve our disclosure regime for both investors and registrants.

In connection with the S–K Study[9] and the subsequent launch of the Disclosure Effectiveness Initiative,[10] we received public comments on various topics discussed in this release. Below and elsewhere throughout this release, we discuss these comments as further context for the topics under consideration. Comments received in connection with the Disclosure Effectiveness Initiative that are outside the scope of this release are not discussed here. These comment letters are being considered as part of the staff's continued evaluation of Regulation S–K

[2] *See* Adoption of Integrated Disclosure System, Release No. 33–6383 (Mar. 3, 1982) [47 FR 11380 (Mar. 16, 1982)] (''1982 Integrated Disclosure Adopting Release'').

[3] *See id.*

[4] The scope of this release does not include certain disclosure requirements for information other than business and financial disclosures, such as Subpart 400, which requires disclosure about management and certain security holders as well as corporate governance matters. We also have not included offering-specific disclosure requirements under Subpart 500, which generally apply to registration statements and prospectuses but not periodic reports.

[5] *See infra* notes 9 to 10 and accompanying text.

[6] Section 3(f) of the Exchange Act [15 U.S.C. 78c(f)] requires that, whenever the Commission is engaged in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. Section 2(b) of the Securities Act [15 U.S.C. 77b(b)] sets forth this same requirement. *See also* Section 23(a)(2) of the Exchange Act [15 U.S.C. 78w(a)(2)].

[7] Public Law 112–106, Sec. 108, 126 Stat. 306 (2012). Section 108 of the JOBS Act required the Commission to conduct a review of Regulation S–K to determine how such requirements can be updated to modernize and simplify the registration process for emerging growth companies (''EGCs''). For a further discussion of the S–K Study, *see* Section II.C.

[8] *See SEC Issues Staff Report on Public Company Disclosure* (Dec. 20, 2013), *available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540530982*.

[9] In connection with the S–K Study, we received public comments on regulatory initiatives to be undertaken in response to the JOBS Act. *See* Comments on SEC Regulatory Initiatives Under the JOBS Act: Title I—Review of Regulation S–K, *available at http://www.sec.gov/comments/jobs-title-i/reviewreg-sk/reviewreg-sk.shtml*.

Some of the comments received in connection with the S–K Study were specific to EGCs.

[10] To facilitate public input on the Disclosure Effectiveness Initiative, members of the public were invited to submit comments. Public comments we have received to date on the topic of Disclosure Effectiveness are available on our Web site. *See* Comments on Disclosure Effectiveness, *available at https://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness.shtml*.

from which the staff expects to make further recommendations to the Commission for consideration.

The staff is also working on recommendations for our consideration to propose specific revisions to update or simplify certain of our business and financial disclosure requirements, as required by the recently enacted Fixing America's Surface Transportation Act of 2015 (''FAST Act'').[11] Those recommendations relate to specific proposals to help address ''duplicative, overlapping, outdated or unnecessary'' disclosure and are not specifically addressed in this concept release, which seeks to explore both general considerations and specific questions that we believe would benefit from further evaluation and input before proposing any changes to the related rules.[12]

II. Relevant History and Background

A. History of Regulation S–K

Regulation S–K

Enactment of the Securities Act and the Exchange Act resulted in the creation of two separate disclosure regimes. These disclosure regimes remained distinct for approximately thirty years and often resulted in overlapping and duplicative disclosure requirements. Regulation S–K reflects the Commission's efforts to harmonize disclosure required under both the Securities Act and the Exchange Act by creating a single repository for disclosure regulation that applies to filings by registrants under both statutes.

The current integrated disclosure system resulted from a series of efforts triggered by a 1964 amendment to the Exchange Act,[13] which added Section 12(g) to the Exchange Act and extended the Exchange Act's reporting requirements to companies meeting specified thresholds, including those that were not exchange listed.[14] In light of the Exchange Act's broadened reporting requirements, Professor Milton Cohen suggested in a seminal 1966 law review article greater coordination between the Securities Act and Exchange Act.[15] He recommended that the continuous reporting obligations under the Exchange Act serve as the foundation for corporate disclosure while relaxing or eliminating overlapping Securities Act disclosure requirements.[16]

Subsequent to the publication of this article, the Commission initiated several studies that advanced efforts to integrate the Securities Act and Exchange Act disclosure regimes. These efforts included the Disclosure Policy Study led by Commissioner Francis Wheat [17] and the report issued by the Advisory Committee on Corporate Disclosure led by former Commissioner A. A. Sommer, Jr. (''Sommer Report'').[18] In 1969, the Wheat Report concurred with Cohen's proposal for a coordinated disclosure system. It recommended an enhanced degree of coordination between the disclosures required by the Securities Act and the Exchange Act and formulated specific proposals for integrating disclosure between the two Acts.[19] In 1977, the Sommer Report suggested adopting a single, integrated disclosure system and recommended developing one coordinated disclosure form.[20]

Following the Sommer Report, the Commission adopted the first version of Regulation S–K, which included only two disclosure requirements—a description of business and a description of properties.[21] While additional disclosure requirements were added in 1978 and 1980,[22] Regulation S–K was significantly expanded and reorganized in 1982 as the repository for the uniform non-financial statement disclosure requirements under both the Securities Act and Exchange Act.[23] With this expansion and reorganization, the Commission moved much of the guidance in the prior Industry Guides into Regulation S–K and amended the forms and schedules to reference requirements in Regulation S–K.[24]

Many of the disclosure requirements in Regulation S–K originated in Schedule A of the Securities Act, which lists 27 items that must be disclosed in a registration statement and prospectus.[25] Section 7 of the Securities Act provides that the registration statement shall contain the information and be accompanied by the documents specified in Schedule A, except the Commission may exercise its rulemaking authority to prescribe additional information or may permit prescribed information to be omitted as it deems necessary or appropriate in the public interest or for the protection of

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[11] Public Law 114–94, Sec. 72002, 129 Stat. 1312 (2015).

[12] *Id.*

[13] *See, e.g., Disclosure to Investors—A Reappraisal of Federal Administrative Policies under the '33 and '34 Acts, Policy Study,* Mar. 27, 1969, *available at http://www.sechistorical.org/museum/galleries/tbi/gogo_d.php* (''Wheat Report'') (stating that one of the reasons for a broad re-examination of disclosure policy was the 1964 amendment to the Exchange Act). *See also infra* note 15.

[14] 15 U.S.C. 781(g). Congress enacted Section 12(g) of the Exchange Act in 1964, which required an issuer to register a class of securities under Section 12(g) if the securities were ''held of record'' by 500 or more persons and the issuer had total assets exceeding $1 million. Prior to the enactment of Section 12(g), the Exchange Act reporting requirements were applicable only to listed companies. The Commission used its authority under Section 12(h) to raise the asset threshold for Section 12(g) registration from $1 million to $3 million in 1982, $5 million in 1986 and $10 million in 1996.

As a result of amendments made by the JOBS Act and the FAST Act, Section 12(g)(1) of the Exchange Act now requires an issuer that is not a bank, bank holding company, or savings and loan holding company to register a class of equity securities if the securities are held of record by either (i) 2,000 persons, or (ii) 500 persons who are not accredited investors and the issuer has total assets exceeding $10 million. Banks, bank holding companies and savings and loan holding companies with total assets exceeding $10 million must register a class of equity securities if the securities are held of record by 2,000 or more persons. Public Law 112–106, Sec. 501, 126 Stat. 306 (2012) and Public Law 114–94, Sec. 85001, 129 Stat. 1312 (2015).

[15] *See* Milton H. Cohen, *''Truth in Securities'' Revisited,* 79 Harv. L. Rev. 1340, 1350 (1966) (''With the 1934 Act now extended to thousands of additional companies by the 1964 Amendments, the need of a reexamination with an eye to coordination of the 1934 Act with the earlier one is all the greater'').

[16] *See id.* at 1341–42, stating ''[i]t is my thesis that the combined disclosure requirement of these statutes would have been quite different if the 1933 and 1934 Acts (the latter as extended in 1964) had been enacted in opposite order, or had been enacted as a single, integrated statute—that is, if the starting point had been a statutory scheme of continuous disclosures covering issuers of actively traded securities and the question of special disclosures in connection with public offerings had been faced in this setting. Accordingly, it is my plea that there now be created a new coordinated disclosure system having as its basis the continuous disclosure system of the 1934 Act and treating ''1933 Act'' disclosure needs on this foundation.''

[17] *See supra* note 13.

[18] *See Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission,* Cmte. Print 95–29, House Cmte. On Interstate and Foreign Commerce, 95th Cong., 1st. Sess (Nov. 3, 1977) *available at http://opc-ad-ils/InmagicGenie/DocumentFolder/report%20of%20the%20advisory%20committee%20on%20corporate%20disclosure%20to%20the%20sec%2011011977.pdf.*

[19] *See generally* Wheat Report.

[20] *See* Sommer Report at 420–432.

[21] *See* Adoption of Disclosure Regulation and Amendments of Disclosure Forms and Rules, Release No. 33–5893 (Dec. 23, 1977) [42 FR 65554 (Dec. 30, 1977)] (''1977 Regulation S–K Adopting Release'').

[22] *See* S–K Study at 10, footnote 27.

[23] *See id.* at 10, footnote 28.

[24] For a discussion of the Industry Guides, *see infra* notes 639 to 644 and accompanying text.

[25] 15 U.S.C. 77aa. Schedule A requires companies to provide information such as: General information about the company, its business and capital structure; information about the directors, principal officers, promoters and ten percent stockholders and remuneration of officers and directors; information about the offering; financial statements of the company and of any business to be acquired through the proceeds of the issue; and copies of agreements made with underwriters, opinions of counsel on legality of the issue, material contracts, the company's organizational documents and agreements or indentures affecting any securities offered.

investors.[26] Over the years, the Commission has exercised this authority to adopt various registration forms and disclosure requirements. While many of the disclosure requirements currently in Regulation S–K originated in Schedule A, the Commission has amended Regulation S–K numerous times since its adoption.[27]

B. Broad Economic Considerations

The purpose of corporate disclosure is to provide investors with information they need to make informed investment and voting decisions. Lowering information asymmetries between managers of companies and investors may enhance capital formation and the allocative efficiency of the capital markets. In particular, disclosure of information that is important for investment and voting decisions may lead to more accurate share prices, discourage fraud, heighten monitoring of the managers of companies, and increase liquidity. Effective disclosure requirements also should increase the integrity of securities markets, build investor confidence, and support the provision of capital to the market. In addition, such requirements can facilitate the coordination of registrants around consistent disclosure standards, increasing the efficiency with which investors can process the information.

There are potential drawbacks associated with disclosure requirements. Disclosure can be costly for registrants to produce and disseminate, and disclosure of certain sensitive information can result in competitive disadvantages. There is also a possibility that high levels of immaterial disclosure can obscure important information or reduce incentives for certain market participants to trade or create markets for securities. The appropriate choice of disclosure requirements therefore involves certain tradeoffs. These tradeoffs may depend on the nature of the audience for disclosure and the characteristics of registrants.

Markets are composed of a broad spectrum of investors with different information needs. Some investors may be highly sophisticated and have access to substantial resources to process and interpret data, while others may lack sophistication or have fewer resources to process and interpret data. Investors also may differ in their reliance on disclosure or on third-party analyses of disclosure. The breadth of the audience for disclosure may inform choices about what information is important to investment and voting decisions and should therefore be disclosed. The diversity of the audience for disclosure, and how different subsets of this audience access and digest information about registrants, will also affect decisions about how best to format and disseminate disclosure.

The trade-off between the benefits and costs of disclosure requirements may vary across different types of registrants. For example, to the extent that our disclosure requirements impose fixed costs, they may impose a disproportionate burden on smaller registrants. At the same time, these registrants may have relatively simple operations and thus be able to promote an understanding of their business and financial condition with less disclosure than larger, more complex registrants. Accordingly, it may be appropriate to provide disclosure accommodations for certain types of registrants, while remaining cognizant of the potential adverse impacts that reduced disclosure may have on capital formation and the allocative efficiency of the capital markets.

The benefits associated with disclosing certain items of information may be greater in some cases than in others, such as when an item of disclosure reflects an important part of one registrant's operations but an immaterial part of another's. In this context, it may be important to consider various approaches to trigger disclosure where it is more likely to be important, rather than in all cases. It may also be useful to have disclosure requirements, or guidance in fulfilling these requirements, that are specific to certain industries or other subsets of registrants. We seek to understand if disclosure requirements can be more appropriately tailored to registrants given the likely variation across registrants in the benefits and the costs of disclosing certain types of information. We discuss specific economic considerations in more detail below.

C. Prior Regulation S–K Modernization Initiatives and Studies

From time to time, the Commission has assessed its disclosure requirements. Several of these studies focused on modernizing or simplifying disclosure requirements. Other initiatives focused on different aspects of the regulatory framework, such as the securities offering process or the financial reporting system, but had the effect of raising disclosure issues for further consideration or shaping current disclosure requirements. The Disclosure Effectiveness Initiative builds upon these prior studies and initiatives.

Task Force on Disclosure Simplification

The Task Force on Disclosure Simplification (''Task Force''), comprising staff from across the Commission, was formed in 1995 to review regulations affecting capital formation with a view towards ''streamlining, simplifying, and modernizing the overall regulatory scheme without compromising or diminishing important investor protections.'' [28] In its report to the Commission in 1996, the Task Force recommended the Commission ''eliminate or modify many rules and forms, and simplify several key aspects of securities offerings.'' [29] Based on the Task Force's recommendations, the Commission rescinded forty-five rules and six forms and adopted other minor or technical rule changes to eliminate unnecessary requirements and to streamline the disclosure process.[30]

The Task Force also made the following recommendations on Regulation S–K:

- Streamline Item 101's description of business disclosure by eliminating duplication of quantitative information about business segments and foreign operations provided in the financial statements;

[26] 15 U.S.C. 77g.

[27] For a comprehensive discussion of prior revisions to Regulation S–K, please see Sections II and III of the S–K Study at 8–92.

[28] *See Report of the Task Force on Disclosure Simplification, available at www.sec.gov/news/studies/smpl.htm* (Mar. 5, 1996) (''Task Force Report''). To facilitate its review, the Task Force met with issuers, investor groups, underwriters, accounting firms, law firms and other active participants in the capital markets.

[29] *See id.* stating '' . . . recommendations [of the task force] roughly fall into three categories: (1) Weeding out forms and regulations that are duplicative of other requirements or have outlived their usefulness; (2) Requiring more readable and informative disclosure documents; and (3) Reducing the cost of securities offerings and increasing access of smaller companies to the securities markets.''

[30] *See* Phase One Recommendations of Task Force on Disclosure Simplification, Release No. 33–7300 (May 31, 1996) [61 FR 30397 (June 14, 1996)] (''Phase One Recommendations of Task Force on Disclosure Simplification Release''). For example, changes to Regulation S–K included eliminating four infrequently used (or otherwise already available) items from the list of required exhibits in Item 601(b) (opinion regarding discount on capital shares, opinion regarding liquidation preference, material foreign patents, and information from reports furnished to state insurance regulatory authorities).

See also Phase Two Recommendations of Task Force on Disclosure Simplification, Release No. 33–7431 (July 18, 1997) [62 FR 43581 (Aug. 14, 1997)] (''Phase Two Recommendations of Task Force on Disclosure Simplification Release'') (rescinding two forms and one rule and amending a number of rules and forms). The Commission further implemented certain of the recommendations in the Task Force Report relating to accounting disclosure rules that were identified as being largely duplicative of U.S. GAAP or other Commission rules.

• revise Item 102's description of property disclosure to elicit ''more meaningful and material disclosure;'' and

• eliminate Item 103's instruction to replace the $100,000 standard with a general materiality standard for certain environmental legal proceedings to ensure registrants will not be required to disclose non-material information.[31]

While the Commission made a number of changes in response to the Task Force recommendations, the three items identified above were not adopted by the Commission. We revisit some of these issues in the questions presented below.

Report of the Advisory Committee on the Capital Formation and Regulatory Process

Also in 1995, the Commission established the Advisory Committee on the Capital Formation and Regulatory Processes (''1995 Advisory Committee'') to advise on, among other things, the regulatory process and disclosure requirements for public offerings. The 1995 Advisory Committee's primary recommendation was implementing a system of ''company registration.'' [32]

Noting the Task Force Report, the 1995 Advisory Committee did not focus on specific line-item disclosure requirements but suggested disclosure enhancements as part of its recommendations for a system of ''company registration.'' These enhancements included a management certification to the Commission for all periodic and current reports, a management's report to the audit committee to be filed as an exhibit to the Form 10–K, expansion of current reporting obligations on Form 8–K and a risk factor disclosure requirement in Form 10–K.[33]

After receiving reports from both the Task Force and the 1995 Advisory Committee, the Commission issued a concept release on regulation of the securities offering process and also sought input on the 1995 Advisory Committee's proposed disclosure enhancements.[34]

Plain English

In 1998, the Commission adopted rules intended to improve the readability of prospectuses by promoting clear, concise and understandable disclosure (''Plain English Rules'').[35] These rules required registrants to write the cover page, summary and risk factors section of prospectuses in plain English [36] and were extended to Exchange Act reports in 2005.[37]

Advisory Committee on Improvements to Financial Reporting

In 2007, the Commission chartered the Advisory Committee on Improvements to Financial Reporting (''CIFiR Advisory Committee'') to examine the U.S. financial reporting system.[38] While the CIFiR Advisory Committee did not recommend specific changes to Regulation S–K, several of its suggestions sought to improve the usefulness of information in periodic reports.[39] The Commission adopted some of these suggestions, which included updating the Commission's interpretive guidance on use of electronic media for disseminating information on a registrant's financial performance [40] and adopting rules to require filing of interactive data-tagged financial statements.[41]

JOBS Act Report on Review of Disclosure Requirements in Regulation S–K

The JOBS Act required the Commission to review Regulation S–K to determine how its disclosure requirements can be updated to modernize and simplify the registration process for EGCs.[42] In response to this mandate, Commission staff published the S–K Study in December 2013. Although the Congressional mandate

[31] The Task Force also generally recommended adjusting certain dollar thresholds in Regulation S–K and Regulation S–X for inflation since the time of their adoption. The Task Force cited, among other items, the $50,000 threshold in Item 509 of Regulation S–K (relating to disclosure of payments to experts and counsel) [17 CFR 229.509] and the $100,000 threshold in Rule 3–11 of Regulation S–X (relating to the definition of an inactive registrant) [17 CFR 210.3–11]. *See* Task Force Report.

[32] Under a ''company registration'' system, a company would, on a one-time basis, file a registration statement (deemed effective immediately) that includes information similar to that currently provided in an initial short-form shelf registration statement. This registration statement could then be used for all types of securities and all types of offerings. All current and future Exchange Act reports would be incorporated by reference into that registration statement, and around the time of an offering, transactional and updating disclosures would be filed with the Commission and incorporated into the registration statement. As part of this ''company registration'' system, companies would be required to adopt certain disclosure enhancements (and encouraged to adopt others) that seek to improve the quality and timeliness of disclosure provided to investors and the markets. *See* Securities Act Concepts and Their Effects on Capital Formation, Release No. 33–7314 (July 25, 1996) [61 FR 40044 (July 31, 1996)] (''Securities Act Concept Release'').

[33] *See Report of The Advisory Committee on the Capital Formation and Regulatory Processes* (July 24, 1996), *available at http://www.sec.gov/news/studies/capform.htm*.

[34] *See* the Securities Act Concept Release. Many of the issues raised in the concept release were revisited in the Commission's 1998 proposal to modernize the securities offering process (known as the ''Aircraft Carrier'' release), and in the Commission's 2005 Securities Offering Reform rulemaking. Some of the proposals from the Aircraft Carrier release were later adopted. For example, the Aircraft Carrier release recommended inclusion of risk factor disclosure in Exchange Act registration statements and annual reports. This recommendation was adopted as part of Securities Offering Reform. *See* The Regulation of Securities Offerings, Release No. 33–7606A (Nov. 17, 1998) [63 FR 67174 (Dec. 4, 1998)] (''Aircraft Carrier Release'') and Securities Offering Reform, Release No. 33–8591 (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)] (''Securities Offering Reform Release'').

[35] *See* Plain English Disclosure, Release No. 33–7497 (Jan. 28, 1998) [63 FR 6370 (Feb. 6, 1998)] (''Plain English Disclosure Adopting Release'').

[36] *Id.*

[37] *See* Securities Offering Reform Release. As part of the Securities Offering Reform Release, Form 10–K was amended to require risk factor disclosure to be written in accordance with the same Plain English Rules that apply to risk factor disclosure in Securities Act registration statements. *See also* Part I, Item 1A of Form 10–K.

[38] The dual goals of the CIFiR Advisory Committee were ''to examine the U.S. financial reporting system in order to make recommendations intended to increase the usefulness of financial information to investors, while reducing the complexity of the financial reporting system to investors, preparers, and auditors.'' *See Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (Aug. 1, 2008), (''CIFiR Advisory Committee Report''), *available at http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf*.

[39] *See* CIFiR Advisory Committee Report (stating that ''[i]ncreasing the usefulness of information in SEC reports'' was one of five themes underlying the CIFiR Advisory Committee's recommendations).

[40] In 2008, the Commission published interpretive guidance on the use of company Web sites as a means for companies to communicate and provide information to investors in compliance with the federal securities laws and, in particular, the Exchange Act. *See* Commission Guidance on the Use of Company Web sites, Release No. 34–58288 (Aug. 1, 2008) [73 FR 45862 (Aug. 7, 2008)] (''2008 Web site Guidance''). When it published the 2008 Web site Guidance, the Commission noted that the guidance was prompted, in part, by the CIFiR Advisory Committee's efforts.

[41] In 2008, the Commission announced the 21st Century Disclosure Initiative, with the goal of preparing a plan for future action to modernize the Commission's disclosure system. The Initiative's report, issued in 2009, recommended a new disclosure system in which interactive data would replace plain-text disclosure documents while retaining the substantive content and filing schedule of the current system. *See 21st Century Disclosure Initiative: Staff Report, Toward Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System* (Jan. 2009), *available at http://www.sec.gov/spotlight/disclosureinitiative/report.pdf*.

The Commission adopted rules in 2009 requiring companies to provide financial statement information in interactive data format using the eXtensible Business Reporting Language (''XBRL'') format. *See* Interactive Data to Improve Financial Reporting, Release No. 33–9002 (Jan. 20, 2009) [74 FR 6776 (Feb. 10, 2009)] (''Interactive Data Release''). This adopting release notes the CIFiR Advisory Committee's recommendation to require filing of interactive data-tagged financial statements.

[42] Public Law 112–106, Sec. 108, 126 Stat. 306 (2012). For a discussion of EGCs, including the definition of ''emerging growth company,'' see Section IV.H.1.

focused on EGCs, the report was intended to facilitate the improvement of disclosure requirements applicable to companies at all stages of development.[43]

The S–K Study recommended a comprehensive review of disclosure requirements in the Commission's rules and forms, including Regulations S–K and S–X, and identified specific areas for further review.[44] It also recommended the Commission consider the following principles when reviewing and evaluating changes to disclosure requirements:

- Improving and maintaining the informativeness of disclosure;
- historical objectives of the rule and their continued or recurring relevance;
- whether the required information is available on a non-discriminatory basis from reliable sources and, if so, any costs or benefits from obtaining the information other than from the registrant;
- administrative and compliance costs of the requirements;
- any competitive or economic costs of disclosing proprietary information;
- maintenance of the Commission's ability to conduct an effective enforcement program and deter fraud; and
- importance of maintaining investor confidence in the reliability of registrant information, in order to, among other things, encourage capital formation.[45]

FAST Act Disclosure Modernization and Simplification

Under the FAST Act,[46] the Commission is required to carry out a study to determine how best to modernize and simplify the disclosure requirements in Regulation S–K and to propose revisions to those requirements.[47] The FAST Act requires that the study of Regulation S–K:

- Emphasize a company-by-company approach that allows relevant and material information to be disseminated to investors without boilerplate language or static requirements while preserving completeness and comparability of information across registrants; and
- evaluate methods of information delivery and presentation and explore methods for discouraging repetition and the disclosure of immaterial information.

In conducting this study, the Commission is required to consult with the Investor Advisory Committee and the Advisory Committee on Small and Emerging Companies and to issue a report of findings and recommendations to Congress.[48] The FAST Act also requires the Commission to revise Regulation S–K to further scale or eliminate requirements to reduce the burden on EGCs, accelerated filers, smaller reporting companies (''SRCs''), and other smaller issuers, while still providing all material information to investors, and to eliminate duplicative, overlapping, outdated or superseded provisions.[49]

Consistent with the S–K Study's recommendations and the FAST Act mandates, and in furtherance of the Commission's prior modernization studies and initiatives, we seek to evaluate components of our disclosure framework and revisit certain of our business and financial disclosure requirements to assess whether they continue to provide investors with information that is important to making informed investment and voting decisions. We also seek to evaluate whether current disclosure requirements should be revised to include different formats to facilitate the readability and navigability of disclosure, which we discuss in Section V of the release.

III. Disclosure Framework

A. Basis for Our Disclosure Requirements

The Securities Act and the Exchange Act authorize the Commission to promulgate rules for registrant disclosure as necessary or appropriate in the public interest or for the protection of investors.[50] The Commission has used this authority to require disclosure of information it believes is important to investors in both registration statements for public offerings and in ongoing reports.

1. Statutory Mandates

The Securities Act and Exchange Act

A central goal of the federal securities laws is full and fair disclosure.[51] In enacting these laws, Congress recognized that investors must have access to accurate information important to making investment and voting decisions in order for the financial markets to function effectively. Thus, our disclosure rules are intended not only to protect investors but also to facilitate capital formation and maintain fair, orderly and efficient capital markets.

Schedule A of the Securities Act sets forth certain items of disclosure to be included in registration statements filed in public offerings and provides the basis for many of the disclosure requirements currently in Regulation S–K. Items in Schedule A are largely financial in nature and were intended to help investors assess a security's value. According to the House Report that preceded the Securities Act:

> The items required to be disclosed . . . are items indispensable to any accurate judgment upon the value of a security . . . The type of information required to be disclosed is of a character comparable to that demanded by competent bankers from their borrowers, and has been worked out in light of these and other requirements. They are . . . adequate to bring into full glare of publicity those elements of real and unreal values which may lie behind a security.[52]

The Exchange Act requires similar business and financial information to be

[43] *See* S–K Study at 4.

[44] *See id* at 92–104. The S–K Study identified four issues for further study: (1) Generally, any recommended revisions should emphasize a principles-based approach as an overarching component of the disclosure framework while preserving the benefits of a rules-based system; (2) any review of the disclosure requirements should evaluate the appropriateness of current scaled disclosure requirements and consider whether further scaling is appropriate for EGCs or other categories of companies; (3) any review of the disclosure requirements should evaluate methods of information delivery and presentation, both through EDGAR and other means; and (4) any review of disclosure requirements should consider ways to present information to improve the readability and navigability of disclosure and explore methods for discouraging repetition and disclosure of immaterial information. As to this fourth issue, the S–K Study suggested reevaluating quantitative thresholds and other materiality standards in Regulation S–K as well as reassessing requirements for information that is readily accessible, such as historical stock price information. *Id.* at 97–98.

[45] *See id.* at 94–95.

[46] Public Law 114–94, 129 Stat. 1312 (2015).

[47] Public Law 114–94, Sec. 72003, 129 Stat. 1312 (2015).

[48] *Id.*

[49] Public Law 114–94, Sec. 72002, 129 Stat. 1312 (2015). The required revisions would not apply to provisions for which the Commission determines that further study is necessary to determine their efficacy.

[50] *See generally,* Sections 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77g(a)(10), 77j; and 77s(a)]; and Sections 3(b), 12, 13, 14, 15(d), and 23(a) of the Exchange Act [15 U.S.C. 78c(b), 78*l,* 78m(a), 78n(a), 78o(d), and 78w(a)].

[51] *See* Preamble of the Securities Act (stating it is an Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes.). In enacting the mandatory disclosure system under the Exchange Act, Congress sought to promote complete and accurate information in the secondary trading markets. *See* S. Rep. No. 73–1455, 73rd Cong., 2nd Sess., 1934 at 68 (stating ''[o]ne of the prime concerns of the exchanges should be to make available to the public, honest, complete, and correct information regarding the securities listed'') and H.R. Rep. No. 73–1383, 73rd Cong., 2nd Sess., 1934 at 11 (stating ''[t]here cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy.'').

[52] H.R Rep. No. 73–85, 73rd Cong., 1st Sess., 1933.

disclosed in Exchange Act registration statements and periodic reports.[53]

In addition to mandating certain disclosure requirements, the Securities Act and the Exchange Act grant the Commission authority to modify and supplement these requirements as necessary or appropriate to implement the purpose of the statutes.[54] Moreover, whenever it is engaged in rulemaking and is required to consider whether the action is necessary or appropriate in the public interest, the Commission must consider whether the action will promote efficiency, competition, and capital formation.[55]

Business and Financial Legislation

From time to time, Congress has introduced additional disclosure requirements through other statutory mandates. Recent mandates have focused on corporate responsibility, corporate governance and providing enhanced business and financial information to investors. The Sarbanes-Oxley Act of 2002 (''Sarbanes-Oxley Act'') [56] mandated numerous changes to strengthen the accountability of public companies for their financial disclosure and required substantial Commission rulemaking to implement its provisions, many of which resulted in additions to Regulation S–K.[57] In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'') [58] required the Commission to adopt an array of disclosure provisions on corporate governance, executive compensation and specialized disclosure.[59]

Other Legislation

In some instances, Congress has mandated disclosure that is not necessarily financial in nature. These mandates have ranged from broad policy considerations to prescriptive directives. For example, under the National Environmental Policy Act of 1969 (''NEPA''),[60] Congress required all federal agencies to include consideration of the environment in regulatory action. In response to this mandate, the Commission adopted environmental compliance and litigation disclosure requirements.[61] Similarly, Section 1503 of the Dodd-Frank Act required registrants to include information about mine safety and health in their periodic reports. Although the disclosure requirements in Section 1503 were self-executing,[62] the Act authorized the Commission to issue such rules or regulations as necessary for the protection of investors and to carry out the purposes of Section 1503.[63] To facilitate consistent compliance, the Commission adopted rules to codify the statutory disclosure requirements.[64] More recently, the Iran Threat Reduction and Syria Human Rights Act of 2012 (''ITRSHRA'') requires registrants to disclose certain business activities relating to Iran in their periodic reports.[65]

2. Commission Responses to Market Developments

Our disclosure regime includes requirements that we have adopted in response to market developments or advancements in technology. In response to the disorderly markets and damage to investors caused by the hot issue securities markets between 1967 and 1971, the Commission initiated hearings to determine the adequacy of existing disclosure requirements [66] and adopted new disclosure requirements to elicit more meaningful information concerning all registrants and to communicate more effectively the economic realities of new registrants.[67] Similarly, in 1994 in response to significant and sometimes unexpected losses in market risk sensitive instruments due to, among other things, changes in interest rates, foreign currency exchange rates and commodity prices, the Commission adopted Item 305 (quantitative and qualitative disclosures about market risk).[68]

Significant advancements in technology have also prompted some of our disclosure requirements. The

[53] *See* Section 12(b)(1)(A) of the Exchange Act [15 U.S.C. 78l].

[54] *See, e.g.,* Sections 19(a) and 28 of the Securities Act and Sections 3(b), 23(a)(1) and 36(a)(1) of the Exchange Act. [15 U.S.C. 77s(a), 15 U.S.C. 77z–3] and [15 U.S.C. 78c(b), 15 U.S.C. 78w(a)(1), 15 U.S.C. 78mm(a)(1)]. Section 19(a) of the Securities Act and Section 23(a)(1) of the Exchange Act grant the Commission authority to make such rules and regulations as may be necessary to carry out the provisions of each title; Section 3(b) of the Exchange Act provides that the Commission shall have power to define technical, trade, accounting, and other terms used in the Exchange Act, consistently with the provisions and purposes of the Exchange Act; Section 28 of the Securities Act and Section 36(a)(1) of the Exchange Act provide that the Commission may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of each title or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

[55] *See, e.g.,* Section 2(b) of the Securities Act [15 U.S.C. 77b(b)] and Section 3(f) of the Exchange Act [15 U.S.C. 78c(f)]. *See also* Section 23(a)(2) of the Exchange Act [15 U.S.C. 78w(a)(2)].

[56] Public Law 107–204, 116 Stat. 745 (2002).

[57] *See* S–K Study at 21–23, footnotes 57–62 and corresponding text for a discussion of additions made to Regulation S–K as a result of the Sarbanes-Oxley Act.

[58] Public Law 111–203, 124 Stat. 1376 (2010).

[59] *See* S–K Study at 28–29, footnotes 73–77 and corresponding text for a discussion of provisions in the Dodd-Frank Act that impact requirements in Regulation S–K.

[60] 42 U.S.C. 4321–4347.

[61] As a result of NEPA, the Commission issued an interpretive release in 1971 alerting companies to potential disclosure obligations that could arise from material environmental litigation and the material effects of compliance with environmental laws. The Commission later adopted more specific disclosure requirements relating to these matters and, in 1976, the Commission amended its forms to require disclosure of any material estimated capital expenditures for environmental control facilities.

See Disclosures Pertaining to Matters Involving the Environment and Civil Rights, Release No. 33–5170 (July 19, 1971) [36 FR 13989 (July 29, 1971)], Disclosure with Respect to Compliance with Environmental Requirements and Other Matters, Release No. 33–5386 (April 20, 1973) [38 FR 12100 (May 9, 1973)], Disclosure of Environmental and Other Socially Significant Matters, Release No. 33–5569 (Feb. 11, 1975) [40 FR 7013 (Feb. 18, 1975)] (''Notice of Public Proceedings on Environmental Disclosure Release''), Conclusions and Final Action on Rulemaking Proposals Relating to Environmental Disclosure, Release No. 33–5704 (May 6, 1976) [41 FR 21632 (May 27, 1976)] (''1976 Environmental Release''), *Natural Resources Defense Council et al.,* v. *SEC,* 389 F. Supp. 689 (D.D.C. 1974) (''Natural Resources Defense Council'').

[62] *See* Section 1503(f) of the Dodd-Frank Act. The disclosure requirements took effect 30 days after enactment of the Act.

[63] *Id.* at Section 1503(d)(2).

[64] *See* Mine Safety Disclosure, Release No. 33–9286 (Dec. 21, 2011) [76 FR 81762 (Dec. 28, 2011)] (''Mine Safety Disclosure Release'').

[65] Public Law 112–158, 126 Stat. 1214 (2012). Section 219 of ITRSHRA amended Section 13 of the Exchange Act to add subsection (r). This subsection requires a company that files annual and quarterly reports under Section 13(a) of the Exchange Act to provide disclosure if, during the reporting period, it or any of its affiliates knowingly engaged in certain specified activities involving contacts with or support for Iran or other identified persons involved in terrorism or the creation of weapons of mass destruction. ITRSHRA was self-executing and required no substantive rulemaking by the Commission.

[66] Hot issues result when the price of a new issuance of securities rises to a substantial premium over the initial offering price immediately or soon after the securities are first distributed to the public. In 1967–1971, the new issues markets experienced a resurgence. *See Report of the Securities and Exchange Commission Concerning the Hot Issues Markets,* August 1984, *available at http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1980/1984_0801_SECHotIssuesT.pdf.* Between 1968 and 1970, the value of stocks traded on national securities exchanges fell a total of $78.8 billion, from $759.5 billion to $680.7 billion. *See* Securities and Exchange Commission, Thirty-Seventh Annual Report, appendix Table 5 at 221 (1971) *available at https://www.sec.gov/about/annual_report/1971.pdf.*

[67] *See* New Ventures, Meaningful Disclosure, Release No. 33–5395 (June 1, 1973) [38 FR 17202 (June 29, 1973)] (''Hot Issues Adopting Release'').

[68] *See* Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments, Release No. 33–7386 (Jan. 31, 1997) [62 FR 6044 (Feb. 10, 1997)] (''Disclosure of Market Risk Sensitive Instruments Release'').

Commission's efforts in Securities Offering Reform recognized the impact of technology on market demand for more timely corporate disclosure and the ability of issuers to capture, process, and disseminate this information.[69] Similarly, modernization of our oil and gas rules was intended to update oil and gas disclosure requirements to align them with current practices and changes in technology.[70]

We are considering changes to our disclosure requirements and seeking public input on how our disclosure requirements could be improved for the benefit of investors and registrants and whether the requirements could be revised to adapt to future changes in market conditions and advancements in technology. We also are seeking input on the utility of mechanisms such as sunset provisions or temporary rules.

a. Comments Received

S–K Study. One commenter stated that a sunset provision would require the Commission to consider changes in the economic, business and regulatory landscape in assessing whether new disclosure requirements should be made permanent.[71] For significant new disclosure requirements, this commenter suggested a sunset provision of five or ten years and that formal Commission action should be required to indefinitely extend or modify any significant new disclosure requirement.

Disclosure Effectiveness Initiative. We received a few comment letters that discussed potential regulatory mechanisms to review and update our disclosure requirements.[72] To determine the continuing need for disclosures in light of the then current economic, business and regulatory landscape, one commenter suggested a formal, post-adoption review process for significant new disclosure requirements.[73] This review process, or ''sunset review,'' would require formal Commission action to make a new disclosure requirement permanent. Another commenter recommended that the Commission develop a mechanism to timely update disclosure requirements to address new topical issues and to delete existing disclosure when the informational value for investors is diminished.[74] One commenter generally recommended sunset rules and finding a means to evaluate user demand and disclosure effectiveness for potentially outdated requirements.[75]

b. Discussion

When adopting disclosure requirements that have departed from traditional disclosure concepts, the Commission has historically taken an incremental approach to change by first adopting modest revisions and then expanding their application after observing and evaluating the rules' effectiveness. For example, the initial adoption of simplified registration and reporting requirements for smaller businesses on Form S–18 were ''in the nature of an experiment'' [76] and a departure from traditional disclosure concepts.[77] After observing relative, widespread acceptance of Form S–18 and the absence of significant disclosure or enforcement problems, the Commission expanded the form's availability,[78] and it eventually served as a model for our current system of scaled disclosure for SRCs.[79]

The Commission has, on occasion, adopted temporary rules or rules with automatic sunset provisions to better assess the effect of or necessity for a particular rule before adopting the rule on a permanent basis. For example, Securities Act Rule 415, which permits delayed and continuous offerings under certain circumstances, was initially adopted on a temporary basis for a period of nine months during which the Commission monitored the operation and impact of the new rule.[80] Following public hearings and comment on Rule 415, the Commission determined additional experience with the rule was necessary to study its operation and impact [81] and extended the temporary nature of this rule.[82] The Commission permanently adopted Rule 415 following 18 months of monitoring the operation and impact of the rule.[83]

While the Commission acted to permanently adopt Rule 415, it has allowed other temporary rules to expire. The Commission adopted on a temporary basis Securities Act Rules 702 and 703. Rule 702 required the filing of a Form 701 after sales under Rule 701 exceeded a particular threshold. Rule 703 disqualified registrants from relying on the Rule 701 exemption from registration where the registrant failed to make the filing required by Rule 702.[84] In adopting Rules 702 and 703, the Commission noted the importance of monitoring new exemptive provisions and stated that it would use Form 701 to ''assess the utility of the exemption and, oversee

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[69] *See* Aircraft Carrier Release; Securities Offering Reform Release.

[70] *See* Modernization of Oil and Gas Reporting, Release No. 33–8995 (Dec. 31, 2008) [74 FR 2157 (Jan. 14, 2009)] (''Oil and Gas Release'').

[71] *See* letter from Ernst & Young (Sept. 11, 2012) (''Ernst & Young 1'').

[72] *See, e.g.,* letters from the Society of Corporate Secretaries and Governance Professionals (Sept.10, 2014) (''SCSGP''), Securities Industry and Financial Markets Association (Oct. 13, 2014) (''SIFMA''), and letter and articles referenced therein from Arthur J. Radin (May 29, 2015) (''A. Radin'').

[73] *See* SCSGP. This commenter also suggested that the staff issue ''closing guidance'' when topics on which the staff had previously focused are no longer areas of primary concern. The commenter cited 2003 MD&A guidance on disclosure of critical accounting policies estimates as an example of guidance that could be considered closed. *See* Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operation, Release No. 33–8350 (Dec. 19, 2003) (''2003 MD&A Interpretive Release'') [68 FR 75056 (Dec. 29, 2003)]. This commenter stated ''it is not clear that investors are unaware of the uncertainties associated with the methods, assumptions and estimates underlying a company's critical accounting measurements.''

[74] *See* SIFMA. This commenter did not propose a particular mechanism that the Commission should use.

[75] *See* A. Radin.

[76] *See* Simplified Registration and Reporting Requirements for Small Issuers, Release No. 33–6049 (Apr. 3, 1979) [44 FR 21562 (Apr. 10, 1979)] (''Form S–18 Release'') at 21564.

[77] *Id.* at 21562 (''The Commission will monitor closely the use of Form S–18 for an appropriate period . . .'').

[78] *See* Availability of Simplified Registration Form to Certain Mining Companies, Release No. 33–6299 (Mar. 27, 1981) [46 FR 18947 (Mar. 27, 1981)]. *See also* Revisions to the Optional Form for the Registration of Securities to Be Sold to the Public by the Issuer for an Aggregate Cash Price Not To Exceed $5,000,000, Release No. 33–6406 (June 4, 1982) [47 FR 25126 (June 10, 1982)] (expanding Form S–18's availability to non-corporate registrants and registrants engaged, or to be engaged, in oil and gas related operations).

[79] *See* Smaller Reporting Company Regulatory Relief and Simplification, Release No. 33–8876 (Dec. 19, 2007) [73 FR 934 (Jan. 4, 2008)] (''SRC Adopting Release''). In adopting the current scaled disclosure regime, the Commission stated ''[t]he amendments that we are adopting address the need to revisit and adjust the Commission's small company policies to reflect changes in our securities markets as well as changes to the regulatory landscape since 1992, when the Commission first adopted an integrated scaled disclosure system for small business in Regulation S–B. The Commission adopted Regulation S–B and its associated Forms SB–1 and SB–2 based upon the success of Form S–18 . . .''

[80] *See* 1982 Integrated Disclosure Adopting Release.

[81] *See* Delayed or Continuous Offering and Sale of Securities, Release No. 33–6423 (Sept. 2, 1982) [47 FR 39799 (Sept. 10, 1982)].

[82] *Id.* In June 1983, the Commission published the shelf registration rule for comment again in order to provide all interested parties another opportunity to share their views and experience under the Rule before the Commission made its final determination. *See* Delayed or Continuous Offering and Sale of Securities, Release No. 33–6470, (June 9. 1983) [48 FR 27768 (June 17, 1983)].

[83] *See* Shelf Registration, Release No. 33–6499 (Nov. 17, 1983) [48 FR 52889 (Nov. 23, 1983)].

[84] *See* Compensatory Benefit Plans and Contracts, Release No. 33–6768 (Apr. 14, 1988) [53 FR 12918 (Apr. 20, 1988)] (adopting Rule 701, an exemption from registration for certain offers and sales made pursuant to the terms of compensatory benefit plans or written compensation agreements for issuers that are not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, and adopting rules 702 and 703 on a temporary basis of five years).

any abuses.'' [85] The Commission did not extend Rules 702 and 703 based on its belief that the sunset of these rules had not compromised investor interests and that their reinstitution of the rules would serve little purpose.[86]

Even in the absence of a temporary rule or sunset provision, the Commission has undertaken efforts to study the effects of new rules or amendments. The Commission uses these studies to guide future amendments or rulemaking. For example, our staff has examined the effects on capital formation through private placements after adoption of amendments to Regulation D in accordance with the JOBS Act.[87] In adopting amendments to Rule 506 of Regulation D [88] to eliminate the prohibition against general solicitation for a subset of Rule 506 offerings, the Commission stated that the staff will monitor developments in the market for these offerings.[89] In addition, in connection with recently adopted amendments to Regulation A, an exemption from registration for smaller issues of securities, and the adoption of Regulation Crowdfunding, a new exemption for smaller securities offerings using the Internet through crowdfunding, the Commission stated, in each case, that the staff will study and submit a report to the Commission on the impact of the regulation on capital formation and investor protection.[90]

Requiring affirmative Commission action to extend or make permanent certain requirements, the utility of which may change over time, could require us to more frequently consider the effectiveness of our requirements. Alternatively, the Commission could commit to studying the impact of certain rule changes on a specified schedule, without making the rules temporary or applying automatic sunset provisions. Any such review would be in addition to the periodic review currently required by the Regulatory Flexibility Act (''RFA''),[91] under which the Commission reviews its rules that have a significant economic impact on a substantial number of small entities within ten years of their publication as final rules.[92] These approaches would, however, require significant Commission resources and could compete with other Commission priorities.

c. Request for Comment

1. Should the Commission consider including automatic sunset provisions in new disclosure requirements? If so, what types of disclosure requirements should include these provisions? What factors should we consider in identifying them? What would be an appropriate length of time for any sunset provisions? Would this length of time vary with the nature of the rule in question?

2. What are the advantages and disadvantages of automatic sunset provisions? Would automatic sunset provisions result in unnecessary regulatory uncertainty for investors or registrants?

3. How would the use of automatic sunset provisions affect registrants, investors and other users of disclosure? Would registrants, investors or other users incur increased costs associated with the use of automatic sunset provisions?

4. Should we consider requiring the staff to study and report to the Commission on the impact of new disclosure requirements when adopting them, in addition to the review the Commission performs under the RFA? For what type of disclosure requirements would such an approach be appropriate? What are the advantages and disadvantages of such a study and report on a new rule?

5. Are there other ways our disclosure requirements could be revised to adapt more easily to future market changes and technological advancements?

B. Nature of Our Disclosure Requirements

The concept of materiality has been described as ''the cornerstone'' of the disclosure system established by the federal securities laws.[93] Schedule A to the Securities Act identifies certain categories of information that are generally viewed as material to investors.[94] Those categories are incorporated and expanded upon in the categories of information that registrants are required to disclose under Regulation S–K.

In creating and implementing our system of integrated disclosure, identification of material information was one of two principal objectives. In the 1982 Integrated Disclosure Adopting Release, the Commission stated:

> The Commission's program to integrate the disclosure systems has focused on two principal objectives: First, a comprehensive evaluation of the disclosure policies and procedures under both Acts to identify the information which is material to security holders and investors in both the distribution process and the trading markets . . . and, second, a determination of the circumstances under which information should be disseminated to security holders, investors and the marketplace.[95]

The Commission adopted line-item requirements in Regulation S–K and its predecessors to provide investors with specific disclosure within broad categories of material information.[96] Through its disclosure requirements, the Commission has adopted different approaches to guide registrants in

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[85] *See* Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Release No. 33–6683 (Jan. 16, 1987) [52 FR 3015 (Jan. 30, 1987)] at 3021.

[86] *See* Phase One Recommendations of Task Force on Disclosure Simplification Release.

[87] Scott Bauguess, Rachita Gullapalli, and Vladimir Ivanov, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2014,* Oct. 2015, *available at https://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf.*

[88] 17 CFR 230.506.

[89] *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33–9415 (July 20. 2013) [78 FR 44771 (July 24, 2013)].

[90] *See* Amendments to Regulation A, Release No. 33–9741 (Mar. 25, 2015) [80 FR 21805 (Apr. 20, 2015)] (''2015 Regulation A Release''); *See* Crowdfunding, Release No. 33–9974 (Oct. 30, 2015) [80 FR 71387 (Nov. 16, 2015)] (''Crowdfunding Adopting Release''). When proposing the crowdfunding rules, the Commission directed the staff to develop a work plan to review and monitor use of the crowdfunding rules, focusing on the types of issuers using the exemption, level of compliance by issuers and intermediaries, and whether the exemption is promoting new capital formation while providing key protections for investors. *See* Crowdfunding, Release No. 33–9470 (Oct. 23, 2013) [78 FR 66427 (Nov. 5, 2013)].

[91] [5 U.S.C. 610(a)].

[92] Each year, since 1981, the Commission provides the public with notice that these rules are scheduled for review and invites public comment on whether the rules should be continued without change, or should be amended or rescinded to minimize any significant economic impact of the rules upon a substantial number of such small entities. As a matter of policy, the Commission reviews all final rules that are published for notice and comment to assess not only their continued compliance with the RFA, but also to assess generally their continued utility. *See, e.g.,* List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act, Release No. 33–9965 (Oct. 22, 2015) [80 FR 65973 (Oct. 28, 2015)]. In the past, the Commission has received little or no comment on the rules that it publishes for review.

[93] *See* Sommer Report at 320.

[94] *See id.* at 324.

[95] *See* 1982 Integrated Disclosure Adopting Release at 11382. *See also* Proposed Comprehensive Revision to System for Registration of Securities of Securities Offerings, Rel. No. 33–6235 (Sept. 2, 1980) [45 FR 63693 (Sept. 25, 1980)] (''1980 Proposed Revisions'') at 63694. This proposing release states ''[t]he shape of the [Commission's integrated disclosure] program will be influenced by the answer to two fundamental questions: (1) What information is material to investment decisions in the context of public offerings of securities; and (2) Under what circumstances and in what form should such material information be disseminated and made available by companies making public offerings of securities to the various participants in the capital market system? The task of identifying what information is material to investment and voting decisions is a continuing one in the field of securities regulation.''

[96] *See* Sommer Report at 324.

evaluating materiality for purposes of disclosure, including in some cases using quantitative thresholds to address uncertainty in the application of materiality.

1. Principles-Based and Prescriptive Disclosure Requirements

Principles-based disclosure requirements. Many of our rules require disclosure when information is material to investors.[97] These rules rely on a registrant's management to evaluate the significance of information in the context of the registrant's overall business and financial circumstances and determine whether disclosure is necessary.[98] The requirements are often referred to as ''principles-based'' because they articulate a disclosure objective and look to management to exercise judgment in satisfying that objective.[99]

For example, Item 303(a)(2) requires registrants to disclose material commitments for capital expenditures, known material trends in the registrant's capital resources, and expected material changes in the mix and relative cost of such resources.[100] Similarly, Item 101(c)(1)(xi) requires registrants to disclose the estimated amount spent during each of the last three fiscal years on company-sponsored research and development activities, if material.[101]

Prescriptive disclosure requirements. Some of our rules employ objective, quantitative thresholds to identify when disclosure is required, or require registrants to disclose information in all cases. These requirements are sometimes referred to as ''prescriptive'' or ''rules-based'' because they rely on bright-line tests rather than management's judgment to determine when disclosure is required.

For example, disclosure requirements specific to environmental proceedings in Item 103 enumerate thresholds for disclosure based on a percentage of current assets (10%) or a specified dollar amount ($100,000).[102] Meeting or exceeding the applicable thresholds necessitates disclosure. Similarly, Item 101(c)(1)(i), requires registrants to disclose for each of the last three fiscal years the amount or percentage of total revenue contributed by any class of similar products or services which accounted for ten percent or more of consolidated revenue in any of the last three fiscal years or fifteen percent or more of consolidated revenue, if total revenue did not exceed $50 million during any of such fiscal years.[103] As another example, Item 703 establishes a requirement for registrants to disclose all repurchases of equity securities by issuers and affiliated purchasers.[104]

Materiality. The concept of materiality is used throughout the federal securities laws. The Commission has used a definition of materiality since at least 1937. Previously, the Commission defined ''material,'' when used to qualify a requirement for the furnishing of information, as ''those matters as to which an average prudent investor ought reasonably to be informed before buying or selling the security registered.'' [105] In 1982, the Commission revised Rule 12b–2, which defines ''material'' when used to qualify a requirement for the furnishing of information, to adopt the Supreme Court's definition of materiality.[106]

The Court has held that 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.[107] The Court further explained that information is material if there is a substantial likelihood that disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ''total mix'' of information available.[108]

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[97] On several occasions, the Commission has reiterated that its requirements seek disclosure of material information. *See, e.g.,* Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33–9106 (Feb. 8, 2010) [75 FR 6290 (Feb. 8, 2010)] (''Climate Change Release'') at 6292–6293 (stating ''During the 1970s and 1980s, materiality standards for disclosure under the federal securities laws also were more fully articulated. Those standards provide that information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or, put another way, if the information would alter the total mix of available information.''); Statement of the Commission Regarding Disclosure of Year 2000 Issues and Consequences by Public Companies, Investment Advisers, Investment Companies, and Municipal Securities Issuers, Release No. 33–7558 (Jul. 29, 1998) [63 FR 41394 (Aug. 4, 1998)] (''Year 2000 Release'') at 41395 (stating ''Our disclosure framework requires companies to disclose material information that enables investors to make informed investment decisions.''); Timely Disclosure of Material Corporate Events, Release No. 33–5092 (Oct. 15, 1970) [35 FR 16733 (Oct. 29, 1970)] at 16733–16734 (''Notwithstanding the fact that a company complies with such [annual, semi-annual and current] reporting requirements, it still has an obligation to make full and prompt announcements of material facts regarding the company's financial condition . . . Corporate managements are urged to review their policies with respect to corporate disclosure and endeavor to set up procedures which will insure that prompt disclosure be made of material corporate developments . . .''). *See also infra* note 107.

[98] *See* Sommer Report at 322 (''Although the initial materiality determination is management's, this judgment is, of course, subject to challenge or question by the Commission or in the courts.'').

[99] *See Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption of a Principles-Based Accounting System,* July 2003, *available at https://www.sec.gov/news/studies/principlesbasedstand.htm* (''Section 108 Study'').

[100] Item 303(a)(2) of Regulation S–K [17 CFR 229.303(a)(2)].

[101] Item 101(c)(1)(xi) of Regulation S–K [17 CFR 229.101(c)(1)(xi)].

[102] Instructions 5.B and 5.C to Item 103 of Regulation S–K [17 CFR 229.103]. *See also infra* note 120.

[103] Item 101(c)(1)(i) of Regulation S–K [17 CFR 229.101(c)(1)].

[104] Item 703 of Regulation S–K [17 CFR 229.703].

[105] Proposed Revisions of Regulation C, Registration and Regulation 12B, Registration and Reporting, Release No. 33–6333 (August 6, 1981) [46 FR 41971 (Aug. 18, 1981)] (''1981 Proposed Revisions''). The proposing release notes that, prior to proposing this definition, the definition of ''material'' was the same as adopted in 1937. This definition provided ''[t]he term 'material', when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before buying or selling the security registered.'' *See, e.g.,* Adoption of Amendments to General Rules and Regulations, Release No. 34–4194 (Dec. 17, 1948) [*not published in the* **Federal Register**] (''1948 Adoption of Amendments to General Rules and Regulations Release'').

[106] *See* 1982 Integrated Disclosure Adopting Release. Rule 12b–2 of the Exchange Act provides that the term ''material,'' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered. [17 CFR 240.12b–2].

In addition to the information required to be disclosed, Exchange Act Rule 12b–20 requires registrants to disclose such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. Rule 12b–20 of the Exchange Act [17 CFR 240.12b–20].

[107] *See Basic Inc.* v. *Levinson,* 485 U.S. 224 (1988) (''Basic'' or ''Basic v. Levinson'') at 231, quoting *TSC Industries, Inc.* v. *Northway, Inc.,* 426 U.S. 438 (1976) (''TSC Industries'') at 449. In *TSC Industries,* the Supreme Court adopted a standard for materiality in connection with proxy statement disclosure under Schedule 14A and Rule 14a–9 of the Exchange Act. This standard was supported by the Commission. *See TSC Industries* at footnote 10 (''. . . the SEC's view of the proper balance between the need to insure adequate disclosure and the need to avoid the adverse consequences of setting too low a threshold for civil liability is entitled to consideration . . . The standard we adopt is supported by the SEC.''). In *Basic,* the Court reaffirmed this standard of materiality and applied it in the Section 10(b) and Rule 10b–5 context. Exchange Act Rule 10b–5(b) prohibits any person from making an untrue statement of material fact or omitting a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading in connection with the offer or sale of any security. Rule 10b–5 of the Exchange Act [17 CFR 240.10b–5].

[108] *See Matrixx Initiatives, Inc.* v. *Siracusano,* 131 U.S. 1309 (2011) (''Matrixx Initiatives'') at 1318, quoting *TSC Industries* at 449. In *Matrixx Initiatives,* the Court applied the materiality standard, as set forth in *TSC Industries* and *Basic.* In articulating these standards, the Supreme Court recognized that setting too low of a materiality standard for purposes of liability could cause management to ''bury shareholders in an avalanche

Continued

In proposing to revise Rule 12b–2 to adopt the Court's definition of ''material,'' the Commission noted the trend to apply the Court's definition in every type of federal securities law violation and concluded that the same test would be applied for any purpose under the Securities Act and the Exchange Act.[109] Although some commenters recommended retaining the current definition or modifying the proposed one, the Commission adopted the definition as proposed because it was based on the definition set forth by the Court.[110]

From time to time, the Commission has provided guidance to assist management in the types of assessments to make and issues to consider in determining whether information is material.[111] For example, based on a review of MD&A disclosure to evaluate the adequacy of disclosure practices and identify any common deficiencies, the Commission provided interpretive guidance on assessments management should make to determine whether disclosure of forward-looking information is required under Item 303 of Regulation S–K.[112] Similarly, in the context of determining whether financial statements must be restated, Commission staff has expressed the view that materiality determinations cannot be reduced to a numerical formula and evaluations of materiality require both quantitative and qualitative considerations.[113]

a. Comments Received

S–K Study. We received three comment letters that discussed principles-based requirements or made recommendations about quantitative disclosure thresholds.[114] Two commenters suggested that we move towards a more principles-based disclosure regime in which ''companies [would be] expected to take the initiative to identify material information rather than simply respond to an extensive list of potentially relevant line-item disclosure requirements.'' [115] Another commenter stated that it is counterintuitive to define disclosure requirements using a ''one-size-fits-all quantitative thresholds.'' [116]

Disclosure Effectiveness Initiative. Several commenters addressed whether disclosure requirements should be principles-based or prescriptive.[117] The majority of these commenters supported a principles-based system.[118] Some of these commenters suggested revising or eliminating existing prescriptive disclosure requirements.[119] One of these commenters stated that the ''touchstone for any disclosure requirement must be materiality as seen through the eyes of a reasonable investor'' and suggested reviewing the quantitative disclosure thresholds in Items 103 and 404 of Regulation S–K [120] to consider whether they are appropriate.[121] Another one of these commenters suggested amending Item 10 [122] of Regulation S–K to permit registrants to omit information otherwise required by Regulation S–K if the information is not material and if the inclusion of the information is not necessary to make any required statements not materially misleading.[123] However, this commenter noted that this provision should not apply in all instances.[124] This commenter also suggested revisions to some of the quantitative disclosure thresholds in Regulation S–K to ''better calibrate'' such requirements [125] and recommended that the Commission determine whether disclosure standards other than materiality should be harmonized to ''lessen ambiguity as to how these undefined disclosure standards should be applied.'' [126]

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of trivial information.'' *Id.* at 1318, quoting *TSC Industries* at 448–449.

[109] *See id.*

[110] *See* 1982 Integrated Disclosure Adopting Release.

Article 1–02(o) of Regulation S–X retains the definition of ''material'' prior to *TSC Industries.* In Staff Accounting Bulletin No. 99, the staff indicated that it views this definition in Regulation S–X to be similar to the definitions of ''material'' in Rule 12b–2 of the Exchange Act and Rule 405 of the Securities Act, which are consistent with *TSC Industries. See* footnote 6 of Staff Accounting Bulletin No. 99, Release No. SAB 99 (Aug. 12, 1999) [64 FR 45150 (Aug. 19, 1999)] (''SAB 99''). As with any staff guidance referenced in this release, the views of the staff are not rules or interpretations of the Commission. The Commission has neither approved nor disapproved the views of the staff.

[111] *See, e.g.,* Climate Change Release (providing guidance as to how registrants should evaluate climate change-related issues when considering what information to disclose to investors under existing disclosure requirements and confirming that, if material, registrants should provide climate change-related disclosure); 2003 MD&A Interpretive Release (providing guidance on MD&A and emphasizing that registrants should focus on materiality).

[112] *See, e.g.,* Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Release No. 33–6835 (May 18, 1989) [54 FR 22427 (May 24, 1989)] (''1989 MD&A Interpretive Release'') (setting forth a two-step analysis for disclosure of material forward-looking information in MD&A). For a discussion of the Commission's forward-looking guidance under Item 303 of Regulation S–K and recent court of appeals decisions, *see* Section IV.B.3.c.

[113] *See* SAB 99.

[114] *See* letters from Fenwick & West LLP, Cooley LLP and Wilson Sonsini Goodrich & Rosati, PC (June 19, 2012) (''Silicon Valley''), Mike Liles (Apr. 10, 2013) (''M. Liles'') (endorsing the comments expressed in the Silicon Valley letter) and Ernst & Young 1.

[115] *See* Silicon Valley and M. Liles.

[116] *See* Ernst & Young 1.

[117] *See, e.g.,* letters from Center for Capital Markets Competitiveness, U.S. Chamber of Commerce (July 29, 2014) (''CCMC'') (expressing support for a more principles-based approach to disclosure); SCSGP (recommending that we eliminate line-item disclosure requirements that apply without regard to materiality or that contain quantitative disclosure thresholds that do not appropriately reflect materiality); Standards & Financial Market Integrity Division, CFA Institute (Nov. 12, 2014) (''CFA Institute'') (stating that a principles-based system could lead to standards that are inconsistently applied); Shearman & Sterling LLP (Nov. 26, 2014) (''Shearman'') (stating that a principles-based approach would better withstand the pace at which the business environment changes); letter from the Federal Regulation of Securities Committee, Business Law Section, American Bar Association (Mar. 6, 2015) (''ABA 2''); UK Financial Reporting Council (Mar. 10, 2015) (''UK Financial Reporting Council''); Corporate Governance Committee of the Business Roundtable (Apr. 5, 2015) (''Business Roundtable''); A. Radin.

[118] *See, e.g.,* CCMC; SCSGP; ABA 2; Shearman; UK Financial Reporting Council; Business Roundtable.

[119] *See, e.g.,* CCMC; SCSGP; Shearman; ABA 2.

[120] Item 103 of Regulation S–K requires disclosure of material pending legal proceedings. Instruction 2 specifies that no information need be given with respect to a proceeding that involves primarily a claim for damages if the amount involved, exclusive of interest and costs, does not exceed ten percent of current assets of the registrant and its subsidiaries on a consolidated basis.

Instruction 5 to Item 103 requires disclosure of proceedings related to federal, state, or local environmental protection laws when (i) the proceeding is material to the registrant's business or financial condition; (ii) the proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds ten percent of current assets of the registrant and its subsidiaries on a consolidated basis; or (iii) a governmental authority is a party to a proceeding involving monetary sanctions, unless the registrant believes that the proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interests and costs, of less than $100,000. [17 CFR 229.103].

Item 404 requires disclosure of transactions with related parties where the related party had or will have a direct or indirect material interest and the amount involved exceeds $120,000 or, in the case of SRCs, where the amount involved exceeds the lesser of $120,000 or one percent of the average of the SRC's total assets at year end for the last two completed fiscal years. [17 CFR 229.404].

[121] *See* CCMC (noting that quantitative thresholds similar to the ones in Item 103 ''may not in fact be set at levels material for all, or even most companies'').

[122] Item 10 of Regulation S–K contains general requirements on the application of Regulation S–K, Commission policies on projections and security ratings, incorporation by reference and the use of non-GAAP financial measures in Commission filings. [17 CFR 229.10].

[123] *See* ABA 2.

[124] *See id.* (citing the $120,000 threshold in Item 404 as an example of an instance in which the use of a quantitative disclosure threshold is appropriate).

[125] *See id.* For example, this commenter suggested increasing the quantitative threshold in Instruction 5.C to Item 103 from $100,000 to $1,000,000.

[126] *Id.* As an example, this commenter noted that ''major'' is used as a standard in Items 101(h)(4)(vi), 102, and 601(b)(10)(ii)(B).

Two commenters stated that a principles-based approach would provide additional flexibility to registrants by allowing them to disclose material information based on all relevant facts and circumstances.[127] One commenter, in lieu of creating new item requirements, encouraged greater staff guidance through disclosure guidance topics or staff bulletins to provide companies with factors to consider when making materiality determinations.[128] One commenter stated that using materiality as a guiding principle ''carries with it the recognition that what is important to a reasonable investor may change over time.'' [129] Another commenter suggested that accounting professionals should readdress the concept of materiality and this would help reduce the volume of unnecessary disclosure.[130]

One commenter opposed a principles-based system, stating such a system could result in inconsistent application of the principles-based threshold and thus non-comparable information across companies.[131] This commenter also stated that the use of prescriptive disclosure requirements does not prevent companies from including additional principles-based disclosure if the company would like to do so.[132]

b. Discussion

In 2003, the staff prepared a study on the adoption of a principles-based accounting system.[133] Although it did not address disclosure requirements under Regulation S–K, many of the study's conclusions may be relevant to our general consideration of principles-based disclosure standards. The study found drawbacks to establishing accounting standards on either a rules-based or a principles-based approach.[134] The study noted that principles-only standards may present enforcement difficulties because they are, by their nature, imprecise.[135] They can also result in a significant loss of comparability among reporting entities. Prescriptive standards, on the other hand, can be circumvented more easily by structuring around the bright-line requirements of the standard.[136]

In the S–K Study, the staff stated that any recommended revisions to Regulation S–K should emphasize a principles-based approach as an overarching component of the disclosure framework while preserving the benefits of a rules-based system, which affords consistency, completeness and comparability across registrants.[137] In assessing this recommendation, we recognize the merits and drawbacks of our principles-based and prescriptive disclosure requirements.

Limiting prescriptive disclosure requirements and emphasizing principles-based disclosure could improve disclosure by reducing the amount of information that may be irrelevant, outdated or immaterial. Because prescriptive disclosure requirements may result in disclosure that is not necessarily material or important to investors, greater use of principles-based disclosure requirements may allow registrants to more effectively tailor their disclosure to provide only the information about their specific business and financial condition that is important to investors. A principles-based approach also may allow registrants to readily adapt their disclosure to facts and circumstances that may change over time.

On the other hand, reducing prescriptive disclosure requirements and shifting towards more principles-based disclosure requirements may limit the comparability, consistency and completeness of disclosure. Also, in the absence of clear guidelines for determining when information is material, registrants may have difficulty applying principles-based disclosure requirements,[138] and the disclosure provided may not give investors sufficient insight into how registrants apply different principles-based disclosure thresholds. Potentially important information that may be disclosed in response to a prescriptive disclosure requirement might not be included in response to a principles-based disclosure requirement. In the context of accounting standards, some have noted practical challenges associated with principles-based standards as ''auditors and accountants may be less able to predict how regulators or courts will apply these principles in particular contexts.'' [139] Additionally, the use of prescriptive disclosure requirements does not prevent registrants from including additional, principles-based disclosures that the registrant deems important.

The Section 108 Study proposed a third alternative for developing new accounting standards, which the staff referred to as an ''objectives-oriented'' approach.[140] Under this approach, standard setters would develop new rules by clearly articulating the accounting objective of the standard and providing sufficient detail and structure so that the standard can be applied on a consistent basis. The staff further recommended that such standards should be based on a consistently-applied conceptual framework, minimize exceptions and avoid the use of bright-line tests.[141] We are soliciting comment below on whether such an approach might be appropriate for business and financial disclosures.

c. Request for Comment

6. Should we revise our principles-based rules to use a consistent disclosure threshold? If so, should a materiality standard be used or should a different standard, such as an ''objectives-oriented'' approach or any other approach, be used? If materiality should be used, should the current definition be retained? Should we consider a different definition of materiality for disclosure purposes? If so, how should it be defined?

7. Should we limit prescriptive disclosure requirements and emphasize a principles-based approach? If so, how? How can we most effectively balance the benefits of a principles-based approach while preserving the benefits of prescriptive requirements?

8. What are the advantages and disadvantages of a principles-based approach? Would a principles-based approach increase the usefulness of disclosures? What would be the costs and benefits of such an approach for investors and registrants?

[127] *See* SCSGP; Shearman.

[128] *See* SCSGP.

[129] *See* Business Roundtable.

[130] *See* A. Radin.

[131] *See* CFA Institute (also citing MD&A disclosure during the financial crisis as evidence that principles-based reporting requirements alone are not sufficient).

[132] *Id.*

[133] *See* Section 108 Study. Section 108(d) of the Sarbanes-Oxley Act directed the Commission to conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

[134] *See* Section 108 Study.

[135] *See id.*

[136] *See id.*

[137] *See* S–K Study at 98.

[138] *See* Financial Reporting Council, *Cutting Clutter, available at https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Cutting-Clutter-Combating-clutter-in-annual-report.pdf.* In this report, the Financial Reporting Council, the United Kingdom's independent regulator responsible for corporate governance and reporting, refers to a ''threshold'' problem, and lists the many words used to describe when disclosure is required. The report listed the following descriptors triggering disclosure: Critical, essential, fundamental, important, key, main, major, primary, principal, and significant. *Id.* The Financial Reporting Council's report pertains to the requirements of companies listed in the United Kingdom, but there are similarly several disclosure ''thresholds'' used in Regulation S–K.

[139] *See* C. Coglianese, E. Keating, M. Michael and T. Healey, *The Role of Government in Corporate Governance,* NYU Journal of Law & Business 1: 233–251 (2004).

[140] *See* Section 108 Study.

[141] *See id.*

9. Do registrants find it difficult to apply principles-based requirements? Why? If they are uncertain about whether information is to be disclosed, do registrants err on the side of including or omitting the disclosure? If registrants include disclosure beyond what is required, does the additional information obfuscate the information that is important to investors? Does it instead provide useful information to investors?

10. Do registrants find quantitative thresholds helpful in preparing disclosure? Do such thresholds elicit information that is important to investors? Do they require registrants to provide some disclosure that investors do not need? To the extent our rules contain quantitative thresholds, how should we define them? Are specified dollar amounts more or less effective than amounts based on a registrant's financial condition, such as a percentage of revenues or assets?

11. Should we develop qualitative thresholds for disclosure? Should there be a combination of quantitative and qualitative thresholds?

12. Do registrants find principles-based disclosure requirements helpful in preparing disclosure? Do such requirements elicit information that is important to investors?

13. Would principles-based disclosure affect corporate compliance and governance structures? If so, how?

2. Audience for Disclosure

The Securities Act and the Exchange Act require registrants to provide information prescribed by the Commission as necessary or appropriate in the public interest or for the protection of investors.[142] The legislative history of the federal securities laws speaks broadly to the ''buying public,'' [143] without addressing variation in the needs or sophistication of investors.

Nearly fifty years ago, the Wheat Report recognized variation among the investor audience for disclosure and suggested that the Commission's disclosure requirements should strike a ''pragmatic balance . . . between the needs of unsophisticated investors and those of the knowledgeable student of finance.'' [144] The Sommer Report also recognized the broad spectrum of investors but recommended that the Commission should not expect corporate filings ''to be readily understandable in total by uninformed investors.'' [145] Instead, the Sommer Report concluded that the Commission's rules should ''emphasize disclosure of information useful to reasonably knowledgeable investors willing to make the effort needed to study the disclosures, leaving to disseminators the development of simplified formats and summaries usable by less experienced and less knowledgeable investors.'' [146]

When adopting format and content changes to Form 10–K and the annual report to security holders as part of integrated disclosure, the Commission characterized users of Form 10–K as different from users of the annual report to security holders.[147] Specifically, the Commission viewed annual reports to shareholders as readable documents designed to be delivered to shareholders [148] and stated that the disclosure requirements in these reports ''evolved in the context of shareholders making voting decisions.'' [149] Meanwhile, the Commission noted that Form 10–K was a more technical document,[150] and the Form 10–K disclosure was developed for ''investors and other users making economic decisions about the company.'' [151] The Commission further noted that the most frequent users of Form 10–K disclosure were institutional investors, professional security analysts and sophisticated individual investors.

In the adopting release for these changes, the Commission stated its belief that focusing primarily on these frequent users is appropriate in formulating Form 10–K disclosure requirements, but ''such a focus would not be appropriate in formulating requirements for annual reports to security holders.'' [152] While the Commission acknowledged the benefit of uniformity of certain minimum disclosures in the annual report to security holders and the Form 10–K, it stated that not all disclosure requirements would be identical between the Form 10–K and the annual report to security holders, which potentially served different purposes and user constituencies.

a. Comments Received

S–K Study. Two commenters noted that, in some contexts, customers, vendors and competitors of registrants typically understand certain disclosures, but that the same information is likely to be less meaningful to investors who typically would lack the necessary industry-specific knowledge and interest.[153]

Disclosure Effectiveness Initiative. Two commenters discussed the profile of the investor contemplated by our disclosure requirements and the intended audience for public company disclosures.[154] Both commenters recommended that we should assume that investors using registrants' disclosures have some level of sophistication. One of these commenters suggested that a contributing factor to increased disclosure is the current assumption that the typical investor is a novice.[155] The other commenter

[142] *See* Section 7(a) of the Securities Act [15 U.S.C. 77g(a)(1)] and Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)].

[143] *See* H.R. Rep. No. 85, 73d Cong., 1st Sess. 4 (1933) (broadly referring to the ''public,'' ''buying public'' or ''investing public'').

[144] Wheat Report at 10.

[145] Sommer Report at D–9. *See also* A.A. Sommer Jr.,. *The U.S. SEC Disclosure Study,* 1 U. Pa. J. Int'l L. 145, 148 (1978) (''[T]he Committee did not believe that the Commission should design a variety of formats and degrees of summarization to serve the diverse needs of various investors. It is evident that the sophistication and knowledge of investors varies broadly, from the small, occasional [investor] through the sophisticated portfolio managers. The Committee believed that by having the Commission concentrate on the needs of sophisticated investors, the needs of other types of investors would be adequately served through the many private services which collect, synthesize, summarize and comment upon data concerning issuers.'').

[146] Sommer Report at D–9. The Advisory Committee on Corporate Disclosure identified as information disseminators the ''organizations commonly thought of as the financial press,'' *id.* at 163, that ''condense, summarize and disseminate available information and thereby assist analysts and investors in obtaining investment decision making information in forms suitable to their respective needs and abilities to use it.'' *Id.* at D–5.

[147] *See* Amendments to Annual Report Form, Related Forms, Rules, Regulations and Guides; Integration of Securities Act Disclosure Systems, Release No. 33–6231, (Sept. 2, 1980) [45 FR 63630 (Sept. 25, 1980)] (''1980 Form 10–K Adopting Release'').

[148] *See* Proposed Amendments to Annual Report Form; Integration of Securities Acts Disclosure Systems, Release No. 33–6176 (Jan. 15, 1980) [45 FR 5972 (Jan. 24, 1980)] (''1980 Form 10–K Proposing Release''). *See also* 1980 Form 10–K Adopting Release, citing Annual Reports—Information Required in Proxy Statement, Release No. 34–10591 (Jan. 10, 1974) [39 FR 3820 (Jan. 30, 1974)] for the statement that ''[t]he annual report to security holders has long been recognized as the most effective means of communication between management and security holders. Such reports are readable because they generally avoid legalistic and technical terminology and present information in an understandable, and often innovative, form . . . The Commission believes it is in the public interest that all security holders be provided with meaningful information regarding the business, management, operations and financial position of the issuer and that the annual report to security holders is the most suitable vehicle presently available for providing this information.'' *See also* Annual Reports, Release No. 34–11079 (Oct. 31, 1974) [39 FR 40766 (Nov. 20, 1974)] at 40766.

[149] 1980 Form 10–K Adopting Release at 63630.

[150] *See* 1980 Form 10–K Proposing Release.

[151] 1980 Form 10–K Adopting Release at 63630.

[152] *Id.*

[153] *See* Silicon Valley and M. Liles.

[154] *See, e.g.,* CFA Institute; Shearman.

[155] *See* Shearman (stating ''it seems that disclosure if often premised on the assumption that the reasonable investor has little or no knowledge of a company's business, its industry or the merits or risks associated with its business. We believe

recommended an empirical study of the audience for financial statements and a review of who makes investment decisions and how such decisions are made.[156] This commenter stated that sophisticated investors are likely the most appropriate audience for Commission filings, as they are generally the investors performing detailed analysis and acting as price-makers. This commenter also stated that most of these investors do not express concern about the volume of disclosure.

One commenter suggested that current disclosure is too complicated for the everyday person to read and that it should be less duplicative and more straightforward.[157] Another commenter noted the diversity of the investor community and that the Commission's mandate is to protect all investors.[158] This commenter acknowledged that some disclosures may not be useful to retail investors but may be useful to institutional investors or vice versa and that in such circumstances, disclosure should still be required. This commenter also stated that each segment of the investor community is ''entitled to have access to all necessary and relevant information.'' Additionally, this commenter noted that broad based disclosure improves transparency and builds public trust, confidence and understanding of capital markets.

b. Discussion

We recognize the diverse composition and varied informational needs, sophistication and financial resources of investors and that some investors may obtain their analysis or advice from or through third parties who use registrant disclosures. Investors using registrant disclosure directly may include both individual investors and institutional investors, such as banks, insurance companies, mutual funds, exchange traded funds, pension funds, hedge funds and managed accounts. These investor types may also use registrant disclosure indirectly through professional data aggregators, financial advisors, proxy advisors, professional analysts, journalists, and other third parties who process and synthesize disclosures for end user investors.

Different investor types and third parties may focus on different filings or items of disclosure.[159] Accordingly, the audience for disclosure is an important consideration in determining the means for disclosure, and specifically, in which filings or locations certain information should be directly provided and where cross-references, hyperlinks or incorporating by reference to information elsewhere is appropriate.[160]

Similarly, as different investors and third parties use disclosure in different ways and seek varying degrees of information, the audience for disclosure is also an important consideration in determining what information is disclosed. Institutional investors, their financial advisors and some third parties often use, and have supported requiring complex information and interactive data.[161] These types of investors are likely to use disclosures of large numbers of registrants and therefore, may be relatively more interested in standardized disclosure formats well-suited for large-scale processing and analysis, including machine-readable formats.

Other investors may seek disclosure that emphasizes, within the universe of information that is disclosed, the information and analysis that management believes is most important.[162] To the extent some investors rely on market prices to efficiently incorporate all public information, rather than relying on disclosures directly, it could be argued that disclosures should be tailored to those users most likely to actively follow a registrant, transact in the registrant's securities and set the market price.[163] Investors in registrants that do not have a public trading market for their securities, however, may rely more directly on disclosure to evaluate their investments.

c. Request for Comment

14. Should registrants assume some level of investor sophistication in preparing their disclosures? If so, what level or levels of sophistication? How should investor sophistication be measured? What are the risks or other disadvantages to investors if registrants either underestimate or overestimate the level of investor sophistication and resources when preparing their disclosures? Does disclosure protect all investors if it is tailored to a subset of the investor community?

15. Should we revise our rules to require disclosure that is formatted to provide information to various types of investors in a manner that will facilitate their use of disclosure for investment and voting decisions?

16. Commenters have suggested that disclosure should be written for a more sophisticated investor than current disclosure appears to contemplate,[164] and that tailoring disclosure to less sophisticated investors contributes to excessive disclosure.[165] Should our disclosure requirements be revised to address these views? If so, how could we revise our disclosure requirements, and which requirements should we revise, to encourage more appropriately targeted disclosure? If we revised our disclosure requirements to address these views, would there be any harm or costs to investors?

17. How do investors and other users of disclosure currently access and use this information? How does this vary across different subsets of the audience for the disclosure?

18. Should we use investor testing, such as focus groups or electronic surveys, to provide input on investors' use of and access to disclosure?

19. To what extent should the reliance of certain investors on market prices or third-party analyses, rather than using

that the profile of the reasonable investor has devolved to the 'neophyte investor' . . .'').

[156] *See* CFA Institute.

[157] *See* letter from Carrie Devorah (Sept. 25, 2015).

[158] *See* letter from the American Federation of Labor and Congress of Industrial Organizations (Nov. 20, 2015) (''AFL–CIO'').

[159] *See, e.g.,* 1980 Form 10–K Adopting Release. *See also, e.g.,* M. Drake, D. Roulstone, and J. Thornock, *The Determinants and Consequences of Information Acquisition via EDGAR,* 32 Contemp. Acct. Res. 1128, at 1128–1161 (2015) (documenting that, of the 9.8 million users who directly searched the EDGAR database from 2008 to 2011, 86% are infrequent users accessing the database less than three times a quarter and generally accessing only one filing, although there is a small percentage of users accessing EDGAR at least every other trading day).

[160] For a further discussion of cross-referencing, incorporation by reference and hyperlinks, *see* Sections V.A., V.B., and V.C., respectively.

[161] *See, e.g.,* CFA Institute, *Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust, and Volume,* July 2013, (''CFA Report''), *available at http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2013.n12.1; see also* Interactive Data Release at footnote 98.

[162] For a discussion of tailoring disclosure to meet the diverse or potentially competing needs of the investor audience, *see* SectionV.F.

[163] The efficient market theory suggests that under certain assumptions, most investors, when making investment decisions, could rely on market prices to incorporate all available information. According to this theory, most investors would not need to individually examine much of the information in disclosures. *See, e.g.,* Stephen J. Choi, *Company Registration: Towards a Status-Based Antifraud Regime,* 64 U. Chi. L. Rev. 567, 569–70 (1997); Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work,* 25 J. Fin. 383, 383–417 (1970). The Sommer Report stated that the efficient market theory is silent as to the optimum amount of information required or whether the optimum should be achieved on a mandatory or voluntary basis. The Sommer Report also stated that market forces alone are insufficient to cause all material information to be disclosed. *See* Sommer Report at D–6. Other studies have noted the limitations of the efficient market theory. *See, e.g.,* Robert J. Shiller, *From Efficient Markets Theory to Behavioral Finance,* J. Econ. Persp. 83, 83–104 (2003).

[164] *See* CFA Institute.

[165] *See* Shearman.

disclosure directly, be a factor in determining the type of investor to which disclosures should be targeted?

20. To what extent should we consider the needs of other market participants, such as professional securities analysts and other third parties, in revising our disclosure requirements? What would be their needs?

3. Compliance and Competitive Costs

When the Commission is engaged in rulemaking it is statutorily required to consider, in addition to the protection of investors, whether an action will promote efficiency, competition, and capital formation.[166] Disclosure requirements can help reduce information asymmetries from management to investors,[167] improving the allocative efficiency of the capital markets and enhancing capital formation by lowering the cost of capital.[168] Lack of information may affect investors' willingness to invest and may decrease the allocative efficiency of the capital markets. Thus, requiring an appropriate level of disclosure is critical to a well-functioning capital market.

Disclosure may also have costs to registrants that could negatively affect these factors, although advances in technology and communications have the potential to reduce these costs. As disclosure costs rise, registrants' costs of capital may increase, which can reduce investment, lower the value of a company and impede economic growth. Registrants may also choose to exit the Commission's reporting system, when eligible, or remain private if the disclosure requirements are sufficiently costly.[169]

a. Comments Received

S–K Study. One commenter stated its belief that ''certain Regulation S–K disclosures impose unnecessary costs while not providing concomitant value to investors . . . because the original purposes of the disclosure requirements have been achieved or are no longer as important.'' [170] Two commenters stated that potential first-time registrants evaluate Exchange Act reporting and compliance costs in weighing the costs and benefits of an initial public offering.[171]

Disclosure Effectiveness Initiative. Some commenters expressed general support for changes in disclosure requirements that would reduce costs for registrants while still providing needed information to investors.[172] Other commenters, in making specific recommendations, acknowledged compliance costs of these recommendations [173] or suggested ways to minimize the cost of such recommendations.[174] One commenter noted the high cost of regulations, especially those promulgated by the Commission.[175]

b. Discussion

We are sensitive to the costs of disclosure, including the administrative and compliance costs of preparing and disseminating disclosure as well as the potential costs of disclosing sensitive information to competitors. While the S–K Study did not specifically consider costs to investors, the staff identified economic principles that should be given consideration when reviewing and considering changes to our disclosure requirements, including: (1) The extent to which a given disclosure requirement entails high administrative and compliance costs; and (2) the extent to which disclosure of a company's proprietary information may have competitive or other economic costs.[176]

To address the potential negative effects that would result from disclosing sensitive information, our rules permit registrants to request confidential treatment of proprietary information, if disclosure of such information would cause competitive harm to the registrant.[177] The Commission generally does not consider confidential treatment to be appropriate for information that is necessary for the protection of investors.[178] If the Commission grants a request for confidential treatment, the registrant may redact the proprietary information from its public filings.

The Commission also has addressed the costs of disclosure through regulatory relief in the form of scaled disclosure requirements for certain smaller registrants. These accommodations are intended to promote capital formation and provide relief where the fixed costs of compliance may be particularly high relative to the size of the company while also considering investor protection.[179]

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[166] *See supra* note 6.

[167] *See* Robert Verrecchia, *Essays on Disclosure,* 32 J. Acct. Econ. 91, 91–180 (2001) (demonstrating that a credible commitment to disclosure reduces uncertainty and information asymmetries between a firm and its investors or among investors).

[168] *See, e.g.,* Richard Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital,* 45 J. Acct. Res. 385, 385–420 (May 2007) ; Luzi Hail and Christian Leuz, *Cost of Capital Effects and Changes in Growth Expectations around U.S. Cross-Listings,* 93 J. Fin. Econ. 428, 428–454 (2009). Lambert, Leuz, and Verrecchia (2007) demonstrate theoretically that the quality of accounting information can influence the cost of capital. Hail and Leuz (2009) find empirical evidence that firms, especially firms from countries with weaker institutional structures that cross-list securities on U.S. exchanges, experience a decrease in their costs of capital.

[169] *See* Brian J. Bushee & Christian Leuz, *Economic Consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board,* 39 J. Acct. Econ. 233, 233–264 (2005). Bushee and Leuz find seventy-six percent of firms trading on the OTC Bulletin Board (''OTCBB''), many of which tended to be on average significantly smaller by market capitalization, left the market after the OTCBB eligibility rule required registrants whose securities were quoted on the OTCBB to file updated financial reports with the Commission or with their banking or insurance regulators.

[170] *See* Ernst & Young 1.

[171] *See* Silicon Valley and M. Liles.

[172] *See, e.g.,* letters from Ernst & Young, dated Nov. 20, 2015 (''Ernst & Young 2''); letter from the Federal Regulation of Securities Committee, Business Law Section, American Bar Association (Nov. 14, 2014) (''ABA 1''); ABA 2; Business Roundtable; Arthur Mboue (Jun 24, 2015); and the Biotechnology Industry Organization (July 14, 2015) (''Biotech Industry Organization'').

[173] *See, e.g.,* SCSGP at 14 (acknowledging that seeking repeal of requirements only a few years after their enactment would impose ''an additional layer of costs''); ABA 2 (stating that, in its review of specific Regulation S–K items, it considered whether certain requirements could be better calibrated to provide investors with relevant and useful disclosure while balancing compliance costs to companies); letter from Allianz Global Investors (Aug. 13, 2015) (''Allianz'') (stating that its goal in requesting certain additional environmental data is to improve disclosure while minimizing any additional reporting burden) and letter from Data Transparency Coalition (Oct. 29, 2015) (''Data Transparency Coalition'').

[174] *See* letter from Sustainability Accounting Standards Board (Nov. 12, 2014) (''SASB'').

[175] *See* A. Radin.

[176] *See* S–K Study at 94.

[177] Rule 80(b)(4) [17 CFR 200.80(b)(4)] (adopted under the Freedom of Information Act [5 U.S.C. 552] (''FOIA'')) (identifying as ''nonpublic'' records those that disclose trade secrets and commercial or financial information obtained from a person and privileged or confidential); Securities Act Rule 406 [17 CFR 230.406]; Exchange Act Rule 24b–2 [17 CFR 240.24b–2] *See also National Parks and Conservation Association* v. *Morton,* 547 F.2d 673 (D.C. Cir. 1974) (holding that information is confidential for purposes of FOIA if it is of the type not usually released to the public and, if released, would cause substantial competitive harm) and *National Parks and Conservation Association* v. *Kleppe,* 547 F.2d 673 (D.C. Cir. 1976) (holding that information is confidential if its release is likely to cause substantial competitive harm and that actual competitive harm need not be shown).

[178] Securities Act Rule 406(b)(2)(iii) [17 CFR 230.406(b)(2)(iii)]. The staff has provided guidance that, except in unusual circumstances, disclosure required by Regulation S–K or any other applicable disclosure requirement is not an appropriate subject for confidential treatment. *See* Staff Legal Bulletin 1A, Confidential Treatment Requests (July 11, 2001) (''Staff Legal Bulletin 1A''), *available at http://www.sec.gov/interps/legal/slbcf1r.htm.*

[179] *See, e.g.,* SRC Adopting Release at 942 (stating that the SRC definition ''is appropriately scaled in that it reduces costs to smaller companies caused by unnecessary information requirements, consistent with investor protection''); Smaller Reporting Company Regulatory Relief and Simplification, Release No. 33–8819 (July 5, 2007) [72 FR 39670 (July 19, 2007)] at 39678 (stating the Commission's objective to ''provide maximum flexibility for [SRCs] without disadvantaging investors [by] establishing a baseline of required disclosure, [while encouraging SRCs] to determine for themselves the proper balance and mix of

Throughout this concept release, we seek comment on changes to specific disclosure requirements that could reduce costs for registrants, while still providing investors with information that is important or useful to making informed investment and voting decisions. Separately, we address the effectiveness of our scaled disclosure requirements.[180] In addition to those discussions, we are interested in public comment on other methods we could consider to reduce costs for registrants that would not compromise investors' access to important information.

c. Request for Comment

21. Do current disclosure requirements appropriately consider the costs and benefits of disclosure to registrants and investors? How should the Commission evaluate benefits, such as those arising from disclosure, that cannot be easily quantified?

22. In addition to scaled disclosure and confidential treatment, are there other accommodations that we could make to reduce costs for registrants while still providing investors with the information that is important or useful to making informed investment and voting decisions?

23. Are there other benefits and costs that we should consider when evaluating disclosure effectiveness?

IV. Information for Investment and Voting Decisions

A. Core Company Business Information

Disclosure about a registrant's business lays the groundwork for understanding and assessing a company, its operations and financial condition. Information about a registrant's industry, business environment and other factors affecting the business helps inform investment and voting decisions by placing other disclosure in context. Schedule A of the Securities Act requires disclosure of the general character of the business transacted or to be transacted by the registrant. Item 101 of Regulation S–K similarly requires a description of a registrant's business. Item 102 requires disclosure about a registrant's materially important physical properties. We are reviewing the disclosure required by Item 101(a)(1) and (c) [181] and Item 102 of Regulation S–K to determine whether they continue to provide investors with the information they need to understand the nature of a registrant's business and properties. We are seeking public input on whether there are any disclosure requirements that should be eliminated or modified and whether we should add any new disclosure requirements to these Items.

1. General Development of Business (Item 101(a)(1))

Item 101(a) of Regulation S–K 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.[182] In describing the general development of the business, Item 101(a)(1) requires disclosure such as the following: The year in which the registrant was organized and its form of organization; the nature and results of any bankruptcy, receivership or similar proceedings with respect to the registrant or any of its significant subsidiaries; the nature and results of any other material reclassification, merger or consolidation of the registrant or any of its significant subsidiaries; the acquisition or disposition of any material amount of assets otherwise than in the ordinary course of business; and any material changes in the mode of conducting the business.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter, as part of a general recommendation to limit disclosure requirements asking for the same or very similar information on multiple occasions, noted redundancies between current reports on Form 8–K and annual reports on Form 10–K and recommended that redundant disclosure in reports subsequent to disclosure in a Form 8–K should not be required.[183] For example, and as noted by this commenter, Items 1.03 (Bankruptcy or Receivership) and 2.01 (Completion of Acquisition or Disposition of Assets) of Form 8–K require disclosure similar to the disclosure required under Item 101(a)(1). This commenter also recommended making a distinction under Item 101(a)(1) for new registrants, which may be disclosing the general development of their business for the first time in a registration statement, and established reporting registrants, which would have disclosed such information in a previous filing.

b. Discussion

A requirement to provide a brief outline of the general development of the business for the preceding five years was included in the earliest forms of registration statements and annual reports.[184] The first version of Regulation S–K adopted in 1977 included Item 101(a)(1) as part of the description of business disclosure requirements.[185] At that time, the Commission amended Item 101(c) to delete a requirement to discuss specific business changes during the past three fiscal years noting ''[a]ny material changes would be described pursuant to paragraph (a) of the item.'' [186]

Business developments and other disclosure called for by Item 101(a)(1) are often reflected elsewhere in the filing, such as in the financial statements or MD&A. Additionally, in 2004, the Commission expanded the number of reportable events on Form 8–K to include items that may result in disclosure that overlaps with the requirements of Item 101(a)(1), such as disclosure of entry into a material definitive agreement, including business combination agreements.[187]

c. Request for Comment

24. Does the current requirement in Item 101(a)(1) to describe the general development of a registrant's business during the past five years provide useful disclosure that is not available either elsewhere in the current filing (*e.g.,* MD&A or the notes to the financial

disclosure . . . given the costs of compliance and the market demand for information'').

[180] For a discussion of our scaled disclosure requirements, *see* Section IV.H.

[181] The staff is separately considering certain aspects of Item 101 in developing recommendations for potential changes to update or simplify certain disclosure requirements. For a description of this project, *see supra* Section I.

[182] 17 CFR 229.101(a)(1). Item 101(a)(1) states information shall be disclosed for earlier periods if material to an understanding of the general development of the business.

[183] *See* CCMC (also noting redundancies between Item 4.01 of Form 8–K (Changes in Registrant's Certifying Accountant) and Item 304 of Regulation S–K (disclosure of changes in and disagreements with accountants) and Item 3.02 of Form 8–K (Unregistered Sales of Equity Securities) and Item 701 of Regulation S–K (disclosure of recent sales of unregistered securities)).

[184] *See, e.g.,* Item 6 of Form A–2 adopted in 1935, which required registrants to outline briefly ''the general development of the business for the preceding five years.'' *See* Release No. 33–276 (Jan. 14, 1935) [*not published in the* **Federal Register**]. Additionally, Item 5 of Form A–1, adopted in 1933, required registrants to briefly describe the length of time the registrant had been engaged in its business. *See* Release No. 33–5 (July 6, 1933) [*not published in the* **Federal Register**]. *See also* S–K Study at 32, footnote 88.

[185] *See* 1977 Regulation S–K Adopting Release.

[186] *Id.* at 65553. (''The disclosure requirement relating to descriptions of products or services has also been amended to delete the requirement that changes in the kinds of products produced or services rendered or in the markets or methods of distribution during the past three fiscal years be discussed. Any material changes would be required to be described pursuant to paragraph (a) of the item.'').

[187] *See* Additional Form 8–K Disclosure Requirements and Acceleration of Filing Date, Release No. 33–8400 (Mar. 16, 2004) [69 FR 15594 (Mar. 25, 2004)] (''2004 Form 8–K Adopting Release'').

statements) or in any prior filing, including current reports on Form 8–K? Should we require additional or more specific information under Item 101(a)(1) and, if so, what type of information and why?

25. How could we improve Item 101(a)(1)? For example, is the five-year time frame for this disclosure appropriate? Would a shorter or longer time frame be more appropriate? If so, what time frame would be appropriate and why?

26. Does this disclosure continue to be useful for registrants with a reporting history? Once a registrant has disclosed this information in a registration statement should we allow registrants to omit this disclosure from subsequent periodic reports unless material changes occur? Alternatively, should we require registrants to describe its business as currently conducted as well as any material changes that have occurred in the last five years?

27. Should we revise Item 101(a)(1) to require disclosure of a registrant's business strategy? Would investors find such a disclosure important or useful? If so, should this requirement be included in a registrant's MD&A? Should we define ''business strategy''? If so, how?

28. Should we permit a summary disclosure of the general development of a registrant's business in all filings except the initial filing? For example, should we require a more detailed discussion of a registrant's business in the initial filing, and in subsequent filings only require a summary of the registrant's business along with a discussion of material changes in the business as previously disclosed in the registrant's Form 10–K? Alternatively, should we require a more detailed discussion of a registrant's business on a periodic basis, such as every three years, and a summary disclosure in other years? Should any such requirement be conditioned on timely reporting or some other consideration?

29. What types of investors or audiences are most likely to value the information required by Item 101(a)(1)?

30. What is the cost of providing the disclosure required by Item 101(a), including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 101(a).

2. Narrative Description of Business (Item 101(c))

While Item 101(a) requires disclosure of the general development of the business, Item 101(c) requires a narrative description of a registrant's business and identifies thirteen specific items that must be disclosed: [188]

(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.

a. Comments Received

S–K Study. Two commenters recommended eliminating the requirement in Item 101(c) to disclose the amount of backlog orders believed to be firm for EGCs, stating the concept of backlog is not a ''meaningful metric'' for most of these companies.[189] These commenters stated that eliminating this requirement for EGCs would not ''compromise the delivery of meaningful disclosure to investors.'' These commenters also raised the question of whether the concept of backlog (or for businesses other than industrials, some other measure of committed revenue that is not yet reflected in the financial statements) would be addressed more appropriately in MD&A. Another commenter recommended eliminating disclosure requirements that no longer apply due to market or other changes and noted backlog as an example.[190] This commenter recommended eliminating this requirement for all registrants, not only EGCs, or moving this requirement to MD&A.

Disclosure Effectiveness Initiative. One commenter stated that many of the subsections of Item 101(c) would be more appropriately addressed elsewhere in the filing, stating that when such information is material to a registrant, investors would be better served by having the registrant address that information in its MD&A or risk factors.[191]

b. Discussion

Consistent with Schedule A of the Securities Act, the earliest forms of registration statements and annual reports required a brief outline of the general character of the business done and intended to be done by a registrant.[192] Many of the disclosure requirements that currently appear in Item 101(c) were adopted in 1973 following investigation of the hot issues markets.[193] The adopting release notes that, in making investment decisions, venture capitalists and underwriters typically obtain specific information from companies about their competitive position and the methods of competition in their respective industries, and accordingly, the new requirements were expected to provide similar information to the investing public.[194] At the same time, the Commission also added requirements for the disclosure of the amount of backlog orders, the sources and availability of raw materials essential to the business, the number of employees and working capital practices.[195]

In the S–K Study, the staff recommended reviewing the description of business for continuing relevance in

[188] 17 CFR 229.101(c). Item 101(c)(1) specifies that, to the extent material to an understanding of the registrant's business taken as a whole, the description of each segment must include the information specified in subsections (i) through (x). Information in subsections (xi) to (xiii) is required to be discussed for the registrant's business in general; where material, the segments to which these matters are significant also must be identified.

[189] *See* Silicon Valley and M. Liles. Item 101(c)(1)(viii) requires disclosure of the dollar amount of backlog orders believed to be firm, as of a recent date and as of a comparable date in the preceding fiscal year, together with an indication of the portion thereof not reasonably expected to be filled within the current fiscal year, and seasonal or other material aspects of the backlog.

[190] *See* Ernst & Young 1.

[191] *See* SCSGP (stating that the following subsections of Item 101 would be more useful if included in MD&A: backlog ((c)(1)(viii)), working capital practices ((c)(1)(vi)), sources and availability of raw materials ((c)(1)(iii)), dependence on certain customers ((c)(1)(vii)), competitive conditions ((c)(1)(x)), compliance with environmental laws ((c)(1)(xii)) and risks attendant to foreign operations ((d)(3))).

[192] *See, e.g.,* Item 5 of Form A–2 adopted in 1935, which required registrants to outline briefly ''the general character of the business done and intended to be done by the registrant and its subsidiaries.'' *See* Release No. 33–276 (Jan. 14, 1935) [*not published in the* **Federal Register**]. Additionally, Items 3 through 5 of Form A–1, adopted in 1933, required registrants to briefly describe the ''character of business done or intended to be done,'' disclose a list of states where the issuer owned property and was qualified to do business, and the length of time the registrant had been engaged in its business. *See* Release No. 33–5 (July 6, 1933) [*not published in the* **Federal Register**]. *See also* S–K Study at 32, footnote 88.

[193] *See* Hot Issues Adopting Release. *See also* Hot Issues; Meaningful Disclosure, Release No. 33–5274 (July 26, 1972) [37 FR 16005 (Aug. 9, 1972)].

[194] *See* Hot Issues Adopting Release.

[195] *See id.*

light of changes that have occurred in the way businesses operate, which may make other disclosures relevant that are not expressly addressed under current requirements.[196] As an example, the S–K Study noted that requirements could be more specific as to additional disclosure that would be necessary where a business relies heavily on intellectual property owned by a third party or relies on a service agreement with third parties to perform necessary business functions.[197]

c. Request for Comment

31. Do the disclosure requirements in Item 101(c) continue to provide useful information to investors? How could we improve Item 101(c)'s requirements?

32. How could we update Item 101(c) to better reflect changes in the way businesses operate? Are there particular categories or types of registrants for which these disclosure requirements are more or less relevant?

33. Are there additional line-item disclosure requirements about a registrant's business that would improve the quality and consistency of disclosure? Are there any categories of information that certain registrants voluntarily provide, and are not required to disclose under Item 101(c), that we should include in Item 101(c)? [198] What would be the benefits and challenges of requiring disclosure of additional categories of information?

34. Currently, some registrants include in their business section a general description of their industry. Should industry disclosure be a separate requirement? If so, would this requirement be more useful to investors in the business section or in MD&A?

35. Should we require additional specific disclosure relevant to particular industries, such as manufacturing or technology companies? If so, which industries and why? What are the benefits and challenges of requiring industry-specific disclosure? [199]

36. What is the impact on disclosure of listing the thirteen item requirements in Item 101(c)? In practice, do registrants view Item 101(c) as a checklist? Do the prescriptive items result in disclosure of information that is not important by some registrants?

37. Should we require Item 101(c) disclosure only in the initial filing with follow-up disclosure of any material changes for subsequent years? Should any such requirement be conditioned on timely reporting or some other consideration? Should the requirements differ for registration statements and periodic reports?

38. Is there any information currently disclosed in the description of business that should be presented in a different context such as MD&A or risk factors? Why?

39. In some circumstances, disclosure is required under Item 101(c)(1) if material. The item specifies that, to the extent material to an understanding of the registrant's business taken as a whole, the description of each segment shall include the information in (c)(1)(i) through (x) and that matters in (c)(1)(xi) through (xiii) shall be discussed for the registrant's business in general; where material, the segments to which these matters are significant shall be identified. Additionally, some sub-items of Item 101(c)(1) require disclosure if material, such as (c)(1)(ii) and (c)(1)(ix),[200] while others do not.[201] Should we require disclosure of all line items in Item 101(c) in all circumstances, regardless of materiality? Why or why not? Alternatively, would a principles-based approach to disclosure about a registrant's business and operations allow flexibility to disclose information that is important to investors? If so, how should such a disclosure requirement be structured? What factors should we consider in developing such a requirement?

40. What types of investors or audiences are most likely to value the information required by Item 101(c)? Would an alternative format or presentation of the information improve the value of such disclosure to a particular type of investor or audience? If so, what type of format or presentation?

41. What is the cost of providing the disclosure required by Item 101(c), including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 101(c).

3. Technology and Intellectual Property Rights (Item 101(c)(1)(iv))

Item 101(c)(1)(iv) requires disclosure of the importance to the segment and the duration and effect of all patents, trademarks, licenses, franchises and concessions held.[202]

a. Comments Received

S–K Study. None

Disclosure Effectiveness Initiative. None.

b. Discussion

A broad range of industries benefit from intellectual property, both directly and indirectly,[203] and intellectual property has become increasingly important to business performance.[204] Certain industries produce or use significant amounts of intellectual property or rely more heavily on these rights.[205] Accordingly, certain registrants provide detailed disclosure in response to Item 101(c)(1)(iv), and disclosure varies among registrants and across industries.

In the biotechnology and pharmaceutical industries, registrants that provide detailed patent disclosure often disclose the jurisdiction in which the patent was filed, year of expiration, type of patent (*e.g.,* composition of

[196] *See* S–K Study at 99–100.

[197] Below, and in other parts of this release, we discuss other areas where our requirements could be revised to reflect changes in the way businesses operate.

[198] For example, the staff has observed that many registrants provide disclosure about the regulatory environment in which their business operates although no specific line-item disclosure requirement for this exists.

[199] For a discussion of industry-specific disclosures, *see* Section IV.E.

[200] For example, Item 101(c)(1)(ii) requires a description of the status of a product or segment (*e.g.,* whether in the planning stage, whether prototypes exist, the degree to which product design has progressed or whether further engineering is necessary), if there has been a public announcement of, or if the registrant otherwise has made public information about, a new product or segment that would require the investment of a material amount of the assets of the registrant or that otherwise is material. In addition, Item 101(c)(1)(ix) requires a description of any material portion of the business that may be subject to renegotiation of profits or termination of contracts or subcontracts at the election of the Government.

[201] For example, Item 101(c)(1)(xiii) requires disclosure of the number of persons employed by the registrant.

[202] 17 CFR 229.101(c)(1)(iv).

[203] *See* Economics and Statistics Administration and United States Patent and Trademark Office, *Intellectual Property and the U.S. Economy: Industries in Focus* (March 2012) at iv, *available at http://www.uspto.gov/sites/default/files/news/publications/IP_Report_March_2012.pdf* (''Intellectual Property and the U.S. Economy'').

[204] *See, e.g.,* Kelvin W. Willoughby, *What impact does intellectual property have on the business performance of technology firms?,* Int. J. Intellectual Property Management, Vol. 6, No. 4 (2013).

[205] *See* Intellectual Property and the U.S. Economy. This report identifies seventy-five industries as ''IP-intensive.'' In this report, patents, trademarks and copyrights were the categories of intellectual property assessed. The methodology for designating each of these subcategories as ''IP-intensive'' is outlined further in this report. For patent intensive industries, the report utilized the North American Industry Classification System (NAICS) codes and identified, as the four most patent-intensive industries, those industries classified in computer and electronic product manufacturing (NAICS 334). This three-digit NAICS industry includes computer and peripheral equipment; communications equipment; other computer and electronic products; semiconductor and other electronic components; and navigational, measuring, electro-medical, and control instruments.

matter, method of use, method of delivery or method of manufacturing), products or technologies to which the patent relates and how the patent was acquired (*e.g.,* licensed from another entity or owned and filed by the registrant). Some registrants in these industries aggregate patent disclosure by groups of patents, potentially making disclosure about individual material patents difficult to discern. As registrants in the biotechnology and pharmaceutical industries regularly sell one or a few patented products that generate substantial revenue, disclosure of ''patent cliffs,'' [206] which often result in material adverse financial effects, may be required in the risk factors section or MD&A.

In the information technologies and services industry, registrants protect their intellectual property through the use of patents, trademarks, copyrights, trade secrets, licenses and confidentiality agreements.[207] Registrants with large portfolios of intellectual property often disclose that their products, services and technologies are not dependent on any specific patent, trademark, copyright, trade secret or license. As a result, these registrants often provide only high-level discussions of their intellectual property portfolios, which include general statements of a registrant's development, use and protection of its intellectual property. Registrants with smaller intellectual property portfolios tend to provide slightly more detailed discussions, including, for example, disclosure of their total number of issued patents, a range of years during which those patents expire and their total number of pending patent applications.

In general, registrants in the information technologies and services industry use copyrights to protect against the unauthorized copying of software programs [208] and trade secrets to protect proprietary and confidential information that derives its value from continued secrecy.[209] Since Item 101(c)(1)(iv) does not require disclosure about copyrights or trade secrets, registrants currently make disclosure about such matters voluntarily.

c. Request for Comment

42. Should we retain the current scope of Item 101(c)(1)(iv), which requires disclosure of a registrant's patents, trademarks, licenses, franchises and concessions? Should we expand the rule to include other types of intellectual property, such as copyrights? Should we remove the individual categories and instead require disclosure of ''intellectual property''? If so, should we define that term and what should it encompass?

43. What, if any, additional information about a registrant's reliance on or use of technology and related intellectual property rights should we require and why? Should we revise Item 101(c)(1)(iv) to require more detailed intellectual property disclosure, similar to the disclosure currently provided by some biotechnology and pharmaceutical registrants? If so, should we require such detailed disclosures for all or only some of a registrant's intellectual property, such as those that are material to the business?

44. For registrants with large intellectual property portfolios, does aggregate disclosure of the total number of patents, trademarks and copyrights and a range of expiration dates provide investors with sufficient information? If not, what additional information do investors need about a company's portfolio of intellectual property? Would tabular disclosure or an alternate format or presentation of a registrant's intellectual property portfolio make the information more useful to investors? What would be the benefits and challenges of requiring disclosure of this information in this format?

45. Should we limit these disclosure requirements to registrants in particular industries? If so, which industries should we specify and why? Is disclosure about a registrant's intellectual property most useful in the context of the description of business, disclosure about trends and developments affecting results of operations, or in a discussion of risk and risk management?

46. What are the competitive costs of disclosure under Item 101(c)(1)(iv)?

4. Government Contracts and Regulation, Including Environmental Laws (Items 101(c)(1)(ix) and (c)(1)(xii))

Item 101(c)(1)(ix) requires disclosure of 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.[210] Item 101(c)(1)(xii) requires disclosure of 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 for the remainder of the fiscal year, the succeeding fiscal year, and such future periods that the registrant deems material.[211] There is no separate line-item requirement to discuss government regulation that may be material to a registrant's business.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter suggested including an instruction to Item 101(c)(1)(ix) to specify that, to the extent disclosure responsive to this item is included in the notes to the financial statements, cross-references should be used to avoid duplicative disclosure.[212] Another commenter stated that registrants in the pharmaceutical industry noted that high levels of regulatory disclosure and other issues common to all pharmaceutical registrants have become commonplace and have detracted from meaningful disclosure.[213] Two commenters sought

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[206] The term ''patent cliff'' as used in the biotechnology and pharmaceutical industry refers to a future loss of patent protection and consequential loss of revenue. These potential future losses are known to registrants far in advance of their onset. When they occur, they often precipitate material adverse financial effects. *See, e.g.,* Andrew Jack, *Pharma tries to avoid falling off 'patent cliff,'* Financial Times, May 6, 2012 and *Cliffhanger,* Economist, Dec. 3, 2011. *See also* Ed Silverman, *Big Pharma Faces Some Big Patent Losses, but Pipelines are Improving,* Wall St. J.: L. Blog, *available at http://blogs.wsj.com/pharmalot/2015/02/09/big-pharma-faces-some-big-patent-losses-but-pipelines-are-improving/.*

[207] *See* Bruce Abramson, *Promoting Innovation in the Software Industry: A First Principles Approach to Intellectual Property Reform,* 8 B.U. J. Sci. & Tech. L. 75 (2002) (discussing the software industry's use of intellectual property law).

[208] *See* Dennis S. Karjala, *Copyright Protection of Operating Software, Copyright Misuse, and Antitrust,* 9 Cornell J.L. & Pub. Pol'y 161, 172 (1999) (discussing the dependence of software technology companies on copyright).

[209] *See* Raymond T. Nimmer & Patricia Ann Krauthaus, *Software Copyright: Sliding Scales and Abstracted Expression,* 32 Hous. L. Rev. 317, 325 (1995) (distinguishing between the software industry's use of trade secret law, patent law and copyright law).

[210] 17 CFR 229.101(c)(1)(ix).

[211] 17 CFR 229.101(c)(1)(xii).

[212] *See* ABA 2.

U.S. government contracts generally contain provisions that enable the contract to be terminated, in whole or in part, without prior notice, at the government's convenience (due to lack of funding or for other reasons) or for default based on performance. ASC 912–275–50–1 requires footnote disclosure of renegotiation uncertainties, their significance, and renegotiation discussions relating to the current year. In addition, ASC 912–275–50–6 states that if there are indications that a contract termination may occur and the termination would have a material effect on the contractor's operations, disclosure of the circumstances and the potential effects shall be made in the notes to financial statements. The staff has observed that, rather than provide duplicative disclosure, some government contractors cross-reference their discussion of the government's right to terminate a contract under Item 101(c)(1)(ix) to either their accounting policy disclosure for revenue recognition in the critical accounting estimates disclosure in MD&A or to their significant accounting policies in the notes to the financial statements.

[213] *See* Shearman.

increased disclosure of a registrant's corporate structure and tax strategy.[214] One of these commenters recommended specific disclosures such as a list of each country of operation and the name of each entity of the issuer group domiciled in each country of operation and the total pre-tax gross revenues of each member of the issuer group in each country of operation.[215]

b. Government Contracts (Item 101(c)(1)(ix))

i. Discussion

Business contracts with agencies of the U.S. government and the various laws and regulations relating to procurement and performance of U.S. government contracts impose terms and rights that are different from those typically found in commercial contracts. In a 1972 Notice to Registrants, the Commission noted that government contracts are subject to renegotiation of profit and to termination for the convenience of the government.[216] At any given time in the performance of a government contract, an estimate of its profitability is often subject not only to additional costs to be incurred but also to the outcome of future negotiations or possible claims relating to costs already incurred.[217]

Registrants with U.S. government contracts tend to disclose that the funding of these contracts is subject to the availability of Congressional appropriations and that, as a result, long-term government contracts are partially funded initially with additional funds committed only as Congress makes further appropriations. These registrants disclose that they may be required to maintain security clearances for facilities and personnel in order to protect classified information. Additionally, these registrants state that they may be subject to routine government audits and investigations, and any deficiencies or illegal activities identified during the audits or investigations may result in the forfeiture or suspension of payments and civil or criminal penalties.

ii. Request for Comment

47. Is disclosure about government contracts important to investors? Why? Is there any additional information about a registrant's contracts with the government that would be important to investors?

48. Rather than focusing specifically on government contracts, should we require registrants to briefly describe all material contracts? Would such a requirement elicit disclosure not otherwise provided in MD&A or the description of business?

c. Compliance with Environmental Laws (Item 101(c)(1)(xii))

i. Discussion

Pursuant to NEPA, which mandated consideration of the environment in regulatory action, the Commission adopted Item 101(c)(1)(xii) in 1973 to require disclosure of the material effects compliance with federal, state and local environmental laws may have on the capital expenditures, earnings and competitive position of the registrant.[218] Subsequent litigation concerning both the denial of a rulemaking petition and adoption of the 1973 environmental disclosure requirements resulted in the Commission initiating public proceedings in 1975 primarily to elicit comments on whether the provisions of NEPA required further rulemaking.[219] As a result of these proceedings, the Commission in 1976 amended the requirements to specifically require disclosure of any material estimated capital expenditures for environmental control facilities for the remainder of the registrant's current and succeeding fiscal years, and for any further periods that are deemed material.[220]

ii. Request for Comment

49. Should we increase or reduce the environmental disclosure required by Item 101(c)(1)(xii)? Why? What kind of information should we add to or remove from this requirement?

50. Is disclosure about the material effects that compliance with provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon a registrant's capital expenditures, earnings and competitive position important to investors? If so, should we require registrants to present this disclosure in a specific format? Would this disclosure be more appropriate in MD&A or the business section?

51. Should we require specific disclosure about the material effects that other regulations may have on a registrant's capital expenditures, earnings and competitive position? If so, are there specific laws and regulations that our rules should cover?

d. Government Regulation

i. Discussion

Although not referenced in Item 101, many registrants discuss government regulations relevant to their business.[221] Healthcare and insurance providers regularly disclose the registrant's collection, use and protection of individually-identifiable information and its compliance with the Health Insurance Portability and Accountability Act of 1996,[222] as well as the impact of the Patient Protection and Affordable Care Act [223] on its business. Biotechnology or medical device companies often disclose the status of and process for FDA approval of significant new drugs or medical devices. Public utilities typically discuss regulation by various federal, state and local authorities and include information about state ratemaking procedures, which determine the rates utilities charge and the return on invested capital they earn.

Registrants in the financial services industry regularly describe federal and state regulation as well as supervision by the Federal Reserve Board, while registrants with a material amount of U.S. government contracts disclose the laws and regulations for government contracts. Registrants with tax strategies involving foreign jurisdictions typically disclose that they are subject to income taxes in both the U.S. and numerous foreign jurisdictions, and that future changes to U.S. and non-U.S. tax law could adversely affect their anticipated financial position and results. Some disclose the impact on their business of tax treaties between the U.S. and one or more foreign jurisdictions.

[214] *See* letter from US SIF and US SIF Foundation (Sept. 18, 2014) (''US SIF 1'') (stating that a lack of information about a registrant's subsidiaries ''prevent investors from accurately assessing corporate tax structure and tax strategy and the attendant contingent liabilities, as well as exposures to political risks in these countries''), and AFL–CIO (''Even minor changes to US or foreign tax policy could lead to major changes in the issuer's financial performance.'').

[215] *See* AFL–CIO.

[216] *See* Defense and Other Long Term Contracts; Prompt and Accurate Disclosure of Information, Release No. 33–5263 (June 22, 1972) [37 FR 21464 (Oct. 11, 1972)].

[217] *Id.*

[218] *See supra* note 61.

[219] *See* Notice of Public Proceedings on Environmental Disclosure Release.

[220] *See* 1976 Environmental Release.

[221] However, the disclosure requirements applicable to SRCs do require some of this information, to the extent material. Item 101(h)(4)(viii) requires disclosure of the need for any government approval of principal products or services. If government approval is necessary and the SRC has not yet received that approval, SRCs are required to discuss the status of the approval within the government approval process. The staff has observed that biotechnology or medical device companies that are not SRCs also provide this disclosure. Additionally, Item 101(h)(4)(ix) requires disclosure of the effect of existing or probable governmental regulations on the business. For a discussion of scaled disclosure requirements, *see* Section IV.H.2.

[222] Public Law 104–191, 110 Stat. 1936 (1996).

[223] Public Law 111–148, 124 Stat. 119 (2010).

ii. Request for Comment

52. Given that many registrants provide disclosure of material government regulations without a specific line-item requirement, are the current disclosure requirements sufficient? Would a specific requirement seeking this disclosure provide additional information that is important to investors? If so, what specific information and level of detail should we require and why? What would be the costs of requiring disclosure of this information?

53. Foreign regulations, including foreign tax rates and treaties, may have a material impact on a registrant's operations. Should we specifically require registrants to describe foreign regulations that affect their business? If so, what specific information and level of detail should we require? How would any additional information inform investment and voting decisions? Would there be challenges for registrants to provide such disclosure?

5. Number of Employees (Item 101(c)(1)(xiii))

Item 101(c)(1)(xiii) requires disclosure of the number of persons employed by the registrant. The Division of Corporation Finance (''Division'') has provided interpretive guidance on this requirement stating that, in industries where the general practice is to hire independent contractors rather than employees, companies should disclose the number of persons retained as independent contractors as well as the number of regular employees.[224]

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter suggested requiring disclosure of the number of employees for each of a registrant's subsidiaries along with other information about the subsidiaries, to provide investors with the information necessary to understand the structure of the registrant and its international strategy.[225] This commenter stated that disclosure of a subsidiary in a known tax haven with ''zero employees and billions in profits, for example, would signal to investors the use of a particularly aggressive and potentially risky strategy to hide profits from regulators.''

b. Discussion

The number of persons employed by the registrant can help investors assess the size and scale of a registrant's operations. Changes in the number or type of persons employed can also be indicative of trends or shifts in a registrant's operations. Disclosure of the number of employees varies among registrants. Some registrants distinguish between the number of full-time and part-time employees, and others specify the number of employees in each department or division. Registrants with large numbers of employees often disclose the approximate number of employees and discuss their employees' membership in a union or similar organization. Other registrants characterize the state of their employee relations and disclose whether their employees are covered by a collective bargaining agreement or represented by a labor union.

c. Request for Comment

54. Does disclosure of the number of persons employed by the registrant help investors assess the size, scale and viability of a registrant's operations and any trends or shifts in operations? Is this disclosure important to investors and why? Is there any additional information about employees that would be important to investors? If so, what information?

55. For new registrants filing a registration statement that have not had revenue from operations during each of the preceding three fiscal years, Item 101(a)(2)(iii) requires disclosure of any anticipated material changes in the number of employees in the various departments such as research and development, production, sales or administration.[226] Is this information useful to investors? Should we include a similar requirement for all registrants in periodic and current reports? Should this requirement be in addition to or in lieu of the current requirement to disclose the number of employees?

56. Should we require registrants to distinguish among their total number of persons employed, such as by distinguishing between:

- Full-time and part-time or seasonal employees;
- Employees and independent contractors; or
- Domestic and foreign employees?

Why or why not?

57. Rather than requiring registrants to disclose the number of employees or independent contractors, should we require or permit registrants to provide a range? Why? Should we allow for different ranges based on the size of the registrant? Would reporting a range rather than a specific number reduce the costs of producing this disclosure?

58. Should we require disclosure of additional information about a registrant's employees or employment practices? What would be the challenges of requiring disclosure of any additional information, and what would be the benefits to investors?

59. As outsourcing and subcontracting have become more prevalent in the last few decades,[227] what, if any, additional information about a registrant's outsourcing or subcontracting arrangements should we require? Would this information be most useful in the context of the description of the registrant's business, disclosure about trends and developments affecting results of operations, or in a discussion of risk and risk management? What would be the challenges of requiring disclosure of this information?

6. 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 registrant and its subsidiaries. Item 102 also requires registrants to identify the segments, as reported in the financial statements, that use the properties described. Instruction 1 states that registrants must disclose such information as reasonably will inform investors as to the suitability, adequacy, productive capacity and extent of utilization of the facilities by the registrant.[228] Instruction 2 provides that, in determining whether properties should be described, registrants should take into account both quantitative and qualitative factors.[229]

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[224] *See* Regulation S–K Compliance and Disclosure Interpretations Question 203.01, *available at http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm.*

[225] *See* US SIF 1.

[226] Item 101(a)(2) applies to registrants filing a registration statement on Form S–1 or Form 10 that are not subject to Sections 13(a) or 15(d) of the Exchange Act and have not received revenue from operations during each of the three fiscal years immediately before the filing of such registration statement.

[227] *See, e.g.,* Deloitte, *Deloitte's 2014 Global Outsourcing and Insourcing Survey* (2014), *available at http://www2.deloitte.com/content/dam/Deloitte/us/Documents/strategy/us-2014-global-outsourcing-insourcing-survey-report-123114.pdf* (noting a significant rise in offshoring in the last two decades but also a small but growing reversal where companies that had previously offshored functions are bringing them back to their home country); *Here, there and everywhere,* Economist, Jan. 19, 2013 (discussing offshoring trends in the last several decades, but also noting such trends are ''maturing, tailing off and to some extent being reversed'').

[228] Detailed descriptions of the physical characteristics of individual properties or legal descriptions by metes and bounds are not required. *See* Instruction 1 to Item 102.

[229] Disclosure specific to the mining industry in Item 102—Instructions 3, 5 and 7 refer to the mining industry—is outside of the scope of this release. Commission staff is undertaking a separate review of disclosure requirements for mining activities. Instructions 4, 6 and 8 apply to the oil

a. Comments Received

S–K Study. One commenter recommended that property disclosure should not be required for entities where physical plant or properties are not a significant element of enterprise value.[230]

Disclosure Effectiveness Initiative. Two commenters noted that if material to a registrant's business, MD&A would require a discussion of the importance of a property or facility and, in these instances, Item 102 may result in immaterial or duplicative disclosure.[231] One commenter recommended eliminating Item 102 disclosure, stating that disclosure of physical properties does not, in most cases, provide investors meaningful information, particularly for registrants not engaged in manufacturing.[232] Another commenter cautioned against disclosing only material properties and eliminating requirements to list locations, capacity and ownership.[233] This commenter stated that investors need a complete understanding of the scope of a registrant's operations and assets in order to evaluate the scope of its risks and opportunities. One commenter noted different triggers for disclosure in Item 102 such as the item's reference to ''materially'' important physical properties and ''major'' encumbrance. This commenter recommended a Commission study to determine whether these varied formulations should be harmonized to lessen ambiguity on their application.[234]

b. Discussion

Since 1935, we have required disclosure similar to that required under Item 102.[235] The predecessor to Item 102 called for a brief description of the general character and location of ''principal plants and other important units'' of the registrant and its subsidiaries and, for property not held in fee, a description of how the property was held.[236] In 1977, a similar requirement was one of two original requirements in Regulation S–K and additionally, required registrants to identify the segments that use the properties described.[237]

In 1996, the Task Force on Disclosure Simplification recommended the Commission revise Item 102 to more effectively elicit disclosure of material facts about a registrant's principal properties, rather than lists of properties and their immaterial characteristics.[238] The S–K Study recommended reviewing Item 102 for continuing relevance given that many businesses no longer require or depend on physical locations.[239] For businesses that do have material properties, the S–K Study suggested refocusing disclosure on the significance of the property to the business and any trends or uncertainties in connection with that property, rather than requiring a list of locations, capacity and ownership.[240]

In response to Item 102, registrants typically disclose information about their headquarters such as the location, size and whether they own or lease the property, as well as information about other properties material to the business. In addition to this disclosure, some registrants cross-reference to the discussion in the notes to the financial statements such as to the note on purchase and lease commitments or to the note on property, plant and equipment.

Registrants in certain industries may provide more specific disclosures. For example, registrants with retail stores often disclose the number of their stores, location, size and lease termination dates. Registrants in the hotel and lodging industry tend to disclose the location and number of rooms at each of their properties. Some registrants with casino operations disclose the number of table games and slot machines at each location. Registrants in the restaurant industry tend to disclose the number of their restaurants, location and whether they are registrant-operated or franchisee-operated stores. In the paper mill or paper production industry, registrants typically provide tabular disclosure for facilities including their geographic location and related products or use. By contrast, some registrants, such as those that provide services or information technology, may not have material physical properties and tend to disclose information about their corporate headquarters, office space and other facilities.

c. Request for Comment

60. Should we retain or eliminate Item 102? Why or why not? How could Item 102 be improved?

61. Would any additional disclosure about a registrant's properties be important to investors? If so, what additional disclosure would be important? What would be the challenges to registrants of requiring disclosure of any such additional information, and what would be the benefits to investors?

62. For registrants that may not have material physical properties, is the disclosure that registrants typically provide about their corporate headquarters, office space and other facilities important to investors?

63. Should we require property disclosure only for registrants in certain industries? If so, how should we identify these industries?

64. Should the disclosure requirements focus instead on the risks to a registrant's business resulting from the availability and cost of properties it needs for its operations?

65. What types of investors or audiences are most likely to value the information required by Item 102?

66. What is the cost of providing the disclosure required by Item 102, including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 102.

B. Company Performance, Financial Information and Future Prospects

Financial information is essential to understanding a registrant's performance, financial condition and future prospects. The Commission has long recognized the need for a narrative explanation of the financial statements, as a numerical presentation and accompanying footnotes alone may be insufficient for an investor to assess the quality of the earnings and the likelihood that past performance is indicative of future performance.[241]

Regulation S–X requires companies to provide annual and quarterly financial statements,[242] while several items in Regulation S–K require additional disclosure about a registrant's financial condition and results of operations:

- Item 301 requires disclosure of selected financial data;

and gas industry. Disclosure specific to the oil and gas industry was considered in 2008 and is also outside of the scope of this release. *See* Oil and Gas Release. Instruction 9 applies to the real estate industry. For a general discussion of Industry Guides, *see* Section IV.E.

[230] *See* Ernst & Young 1.

[231] *See* CCMC; SCSGP.

[232] *See* Shearman.

[233] *See* US SIF 1.

[234] *See* ABA 2.

[235] *See* Release No. 33–276 (January 14, 1935) [*not published in the* **Federal Register**].

[236] *Id.*

[237] *See* 1977 Regulation S–K Adopting Release.

[238] *See* Task Force Report.

[239] *See* S–K Study at 99–100.

[240] *See id.*

[241] *See, e.g.,* 1989 MD&A Interpretive Release.

[242] Articles 3, 8 and 10 of Regulation S–X [17 CFR 210.3, 210.8 and 210.10].

• Item 302(a) requires disclosure of selected quarterly financial data; [243] and

• Item 303 requires disclosure of management's discussion and analysis of financial condition and results of operations.

We are reviewing these disclosure requirements to determine whether they continue to provide investors with information that is important to evaluating a registrant's performance, financial condition and prospects for the future and what, if any, aspects of the disclosure requirements are duplicative. We are seeking public input on whether we should consider any new disclosure requirements and whether we should eliminate or modify any existing disclosure requirement related to such matters.

1. Selected Financial Data (Item 301)

Item 301 requires registrants to disclose selected financial data that highlight significant trends in the registrant's financial condition and results of operations.[244] Disclosure must be provided in comparative columnar form for each of the registrant's last five fiscal years and any additional fiscal years necessary to keep the information from being misleading. Instruction 2 to Item 301 lists specific items that must be included, subject to appropriate variation to conform to the nature of the registrant's business, and provides that registrants may include additional items they believe would enhance an understanding of and would highlight other trends in their financial condition and results of operations.[245] Registrants must include selected financial data in their annual reports but this is not a requirement for quarterly reports.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. Two commenters suggested eliminating Item 301.[246] One of these commenters noted that readers can discern trends from a registrant's financial statements and MD&A,[247] while the other commenter stated the information required by this item can be readily obtained from sources other than Commission filings.[248]

Two commenters suggested revising Item 301 to allow registrants to omit the earliest two of the last five fiscal years where the information cannot be provided without unreasonable cost or expense.[249] One of these commenters suggested limiting the required disclosure to the last three fiscal years, unless all five years are necessary to illustrate a material trend in the registrant's business.[250] The other commenter also noted challenges to registrants in recasting annual periods prior to those presented in the financial statements to reflect a retrospective accounting change and suggested allowing registrants to present a retrospective accounting change only for the periods presented in the financial statements if the earlier periods cannot be recast without unreasonable effort and cost.[251] To inform investors why this information is unavailable, this commenter suggested ''clear disclosure about the unreasonable effort'' that would be required to recast these earliest periods.[252]

b. Five-Year Trend Data (Instruction 1)

i. Discussion

Item 301 is intended to provide selected financial data in a convenient and readable format that highlights significant trends in the registrant's financial condition and results of operations.[253] In adopting this requirement, the Commission stated that Item 301 was relevant primarily where it related to trends in the registrant's continuing operations.[254] When adopted, this item replaced a previous requirement that called for a summary of operations.[255]

Most of the items required by Item 301 are also required in the annual financial statements. Unlike the financial statements required in a Form 10–K, however, Item 301 information covers each of the registrant's last five fiscal years. Accordingly, Item 301 disclosure for items such as net sales and income or loss from continuing operations in the income statement [256] and total assets and redeemable preferred stock in the balance sheets,[257] overlaps with disclosure in the financial statements for the most recent three and two years, respectively.[258]

Earlier years required to be disclosed under Item 301 are typically available in prior annual reports. When the precursor to Item 301 was adopted in 1970, prior annual reports were not readily accessible.[259] Today, these reports can be readily accessed through EDGAR and other public sources, including company Web sites.

Despite some overlap with current and prior financial statements, Item 301 disclosure can provide information that might not be available to investors for all five years. Specifically, retrospective changes to the annual financial statements would typically be reflected in the selected financial data table across all five years instead of the three years covered in the financial statements.[260] For example, a registrant that retrospectively revises its annual financial statements to reflect discontinued operations typically may need to consider whether it should adjust years four and five in its selected financial data table in addition to the three most recent years covered in the annual audited financial statements.

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[243] The staff is separately considering Item 302(b), which requires certain disclosures of oil and gas activities, as part of its work to develop recommendations for the Commission for potential changes to update or simplify certain disclosure requirements. For a description of this project, *see* Section I.

[244] Item 301 of Regulation S–K [17 CFR 229.301].

[245] Instruction 2 to Item 301 of Regulation S–K lists the following items that must be included in the table of financial data: net sales or operating revenues; income (loss) from continuing operations; income (loss) from continuing operations per common share; total assets; long-term obligations and redeemable preferred stock (including long-term debt, capital leases, and redeemable preferred stock); and cash dividends declared per common share.

[246] *See* Shearman; SCSGP.

[247] *See* Shearman.

[248] *See* SCSGP.

[249] *See* ABA 2 (stating this accommodation should be allowed where the information is unavailable or not obtainable without unreasonable cost or expense as long as information (qualitative and, if reasonably available without unreasonable cost or expense, quantitative) about a material trend is otherwise provided for such two fiscal years) and Ernst & Young 2 (noting Item 3.A of Form 20–F provides this accommodation for foreign private issuers and that EGCs are also allowed a similar accommodation).

[250] *See* ABA 2.

[251] *See* Ernst & Young 2.

[252] *Id.*

[253] Instruction 1 to Item 301 [17 CFR 229.301]. *See also* 1980 Form 10–K Adopting Release.

[254] *See* 1980 Form 10–K Adopting Release. *See also* 1980 Form 10–K Proposing Release.

[255] *See* 1980 Form 10–K Adopting Release. While the item in its current form was not adopted until 1980, the concept of providing a five-year presentation of certain significant line items was suggested as early as 1967. *See* Wheat Report at 338–39 (recommending that the Commission require registrants to provide a five-year earnings summary annually).

In October 1970, the Commission expanded Form 10–K to include ''Item 2—Summary of Operations,'' which required registrants to furnish in comparative columnar form a five-year summary of operations and any additional fiscal years necessary to keep the summary from being misleading. *See* Annual Reports by Certain Companies Having Registered Securities, Release No. 34–9000 (Oct. 21, 1970) [35 FR 16919 (Nov. 3, 1970)] (''1970 Revised Form 10–K Adopting Release'').

[256] Rule 5–03 of Regulation S–X [17 CFR 210.5–03].

[257] Rule 5–02 of Regulation S–X [17 CFR 210.5–02].

[258] SRCs are not subject to the requirements of Item 301. Item 301(c) of Regulation S–K [17 CFR 229.301(c)].

[259] Before adopting the precursor to Item 301, the Commission implemented a microfiche system in 1968 that supplemented its hard copy reproduction service and was intended to ''facilitate wider, more economical and more rapid distribution'' of Exchange Act reports. *See* Wheat Report at 313.

[260] *See* Division of Corporation Finance Financial Reporting Manual, Section 1610.1.

Item 301 disclosure reflecting the discontinued operations for these earlier two years would not be available in either the current or prior financial statements.

ii. Request for Comment

67. Is the Item 301 disclosure that is not otherwise available or readily accessible important to investors? Are there benefits to having the five-year information in one table?

68. Should we retain, modify or eliminate Item 301? Why? Does it achieve the goal of highlighting significant trends in a registrant's financial condition and results of operation? Does it also achieve the goal of providing selected financial data in a convenient and readable format? How would the elimination of Item 301 affect investors? Would elimination of this requirement increase costs to investors because they would then need to obtain this information from prior filings?

69. If we retain Item 301, should we modify this requirement and, if so, how? Should we modify the item to require additional disclosure and, if so, what additional disclosure would be important to investors and why?

70. Instruction 1 to Item 303(a) specifies that, where trend information is relevant, reference to the five-year selected financial data pursuant to Item 301 may be necessary.[261] Despite this instruction, registrants generally do not discuss or analyze trends outside the three-year timeframe of Item 303. Does selected financial data effectively highlight significant trends that are not described elsewhere? If so, is five years an appropriate period or should we modify the number of fiscal years required to be included in the selected financial data? If selected financial data does not effectively highlight significant trends that are not described elsewhere, how could we modify our requirements to best achieve the objective of highlighting significant trends in registrants' financial condition and results of continuing operations?

71. EGCs are not required to present selected financial data for any period prior to the earliest audited period presented in connection with its first effective registration statement.[262] Should we revise Item 301 to provide a similar accommodation for all registrants? Why or why not?

72. Should we require Item 301 disclosure for the full five years only in certain instances such as when a registrant revises its annual financial statements or if information on the earliest two of the last five years is available without unreasonable cost or expense?

73. Currently, Item 301 disclosure is required in comparative columnar form. If we continued to require this disclosure, should we consider other presentation or format requirements?

74. What types of investors or audiences are most likely to value the information required by Item 301?

75. What is the cost of providing the disclosure required by Item 301, including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 301.

c. Items Included in Selected Financial Data (Instruction 2)

i. Discussion

When proposing the requirement for selected financial data, the Commission sought to strike a reasonable balance between specified content and a flexible approach that permits registrants to select the data that best indicates performance.[263] The Commission noted that commenters requested increased flexibility in the form and content of this disclosure in response to an advanced notice of proposed rulemaking.[264] Accordingly, while Instruction 2 to Item 301, as adopted, contains prescriptive requirements, such as disclosure of total assets and income (loss) from continuing operations, it also permits registrants the flexibility to include additional items they believe would enhance an understanding of and would highlight other trends in their financial condition and results of operations.[265]

For registrants that provide additional items in their selected financial data, disclosure varies. Financial institutions commonly provide additional metrics that may include return on average assets and capital ratios. Registrants in the telecommunications industry may include the number of subscribers while retailers may include the number of stores or average store size. While such information is not required under U.S. GAAP, it is not considered a ''non-GAAP financial measure'' such that reconciliation under Item 10(e) of Regulation S–K would be required.[266] Additionally, some registrants include non-GAAP financial measures in their Item 301 disclosures.

ii. Request for Comment

76. Does Instruction 2 provide a reasonable balance between specified content and a flexible approach that permits registrants to select the data that best indicates performance? Why or why not? If not, how should we modify Instruction 2? For example, should we modify Instruction 2 to be more prescriptive or provide for a more flexible approach? If a flexible approach should be used, should we require registrants to disclose their reasons for the items it included?

77. Should we require auditor involvement (*e.g.,* audit, review or specified procedures) for this disclosure, and if so, what should the nature of the involvement be? What would be the benefits and costs to registrants and to investors?

78. What is the impact of listing specific items of disclosure in Instruction 2? Do registrants view the items listed in Instruction 2 as a checklist? Should additional items be considered?

2. Supplementary Financial Information (Item 302)

Item 302(a)(1) requires certain registrants to disclose quarterly financial data of selected operating results [267] and Item 302(a)(2) requires

[261] Instruction 1 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)].

[262] Public Law 112–106, Sec. 102, 126 Stat. 306 (2012).

[263] *See* 1980 Form 10–K Proposing Release.

[264] *See* 1980 Form 10–K Proposing Release; see also Annual Report Form, Release No. 34–15068 (Aug. 16, 1978) [43 FR 37460 (Aug. 23, 1978)].

[265] Instruction 2 to Item 301 of Regulation S–K [17 CFR 229.301].

[266] Item 10(e)(4) states that, for purposes of paragraph (e), non-GAAP financial measures exclude operating and other statistical measures; and ratios or statistical measures calculated using exclusively one or both of (i) financial measures calculated in accordance with GAAP, and (ii) operating measures or other measures that are not non-GAAP financial measures. [17 CFR 229.10(e)(4)]. *See also* Conditions for Use of Non-GAAP Financial Measures, Release No. 33–8176 (Jan. 22, 2003) [68 FR 4819 (Jan. 30, 2003)] (''Non-GAAP Measures Release'') (stating that operating and other statistical measures such as unit sales, numbers of employees, numbers of subscribers, or numbers of advertisers are not non-GAAP financial measures).

[267] Item 302(a)(1) of Regulation S–K [17 CFR 229.302(a)(1)]. Item 302(a)(1) specifies disclosure of net sales, gross profit (net sales less costs and expenses associated directly with or allocated to products sold or services rendered), income (loss) before extraordinary items and cumulative effect of a change in accounting, per share data based upon such income (loss), net income (loss) and net income (loss) attributable to the registrant, for each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included or are required to be included by Article 3 of Regulation S–X.

The staff is separately considering Item 302(b), which requires certain disclosures of oil and gas activities, as part of its work to develop

Continued

disclosure of variances in these results from amounts previously reported.[268] Registrants must provide quarterly information for each full quarter within the two most recent fiscal years and any subsequent period for which financial statements are included or required by Article 3 of Regulation S–X. Under Item 302(a)(3), registrants must describe 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.[269] If a registrant's financial statements have been reported on by an accountant, Item 302(a)(4) requires that accountant to follow appropriate professional standards and procedures regarding the data required by Item 302(a).[270]

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter recommended eliminating Item 302(a)(1), stating that this disclosure has been previously reported.[271]

b. Discussion

A few years after adopting Form 10–Q, in 1974, the Commission noted that quarterly data was still being ''reported on an extremely abbreviated basis and annual financial statements [had] generally been presented without regard for or disclosure of trends occurring within a year.'' [272] To help remedy this information deficiency, the Commission adopted the precursor to Item 302(a), Rule 3–16(t) of Regulation S–X. This rule required, for certain registrants, disclosure of selected quarterly financial data in the notes to the annual financial statements.[273]

The Commission recognized that numerous commenters opposed the requirements, suggesting that interim results are materially affected by random events and that including such data in annual financial statements would lend them an appearance of reliability that could be misleading.[274] The Commission nevertheless adopted the disclosure requirement, stating its belief that this disclosure would ''materially assist investors in understanding the pattern of corporate activities throughout a fiscal period'' by disclosing trends over segments of time that are sufficiently short to reflect business turning points.[275] By contrast, the Commission stated that annual periods ''may obscure such turning points and may reflect a pattern of stability and growth which is not consistent with business reality.'' [276] The Commission also noted that quarterly data would reflect seasonal patterns. Recognizing the costs of providing quarterly data, the Commission provided an exemption for smaller registrants and registrants whose shares were not actively traded.[277] Because the selected quarterly financial data was unaudited, and recognizing that information contained within the financial statements should be audited, the Commission moved the requirement to Regulation S–K in 1980.[278]

While most of the disclosure required by Item 302(a) is required in prior quarterly reports, Item 302(a)(1) also requires a separate presentation of certain items for a registrant's fourth quarter, which is not otherwise required. Although there is no similar requirement for disclosing the fourth fiscal quarter, U.S. GAAP typically allows investors to infer fourth quarter data by requiring disclosure of disposals of components of an entity and unusual or infrequently occurring items recognized in the fourth quarter.[279]

Additionally, as Item 302(a)(2) requires disclosure of variances in results from amounts previously reported for the two most recent fiscal years, the effect of a retrospective change in any quarter for which a Form 10–Q was filed in the more recent of the two fiscal years will be disclosed in the selected quarterly data. Absent Item 302(a)(2), this variance would not be disclosed until the following year in the corresponding fiscal quarter in which the retrospective change occurred. Disclosure in the Form 10–Q for this corresponding fiscal quarter would not include the effects of this change in the earliest of the two years presented in the Form 10–K, as this Form 10–Q would be limited to the current and prior-year interim periods.

c. Request for Comment

79. Should we retain or eliminate Item 302(a)? Why? If we retain Item

recommendations for the Commission for potential changes to update or simplify certain disclosure requirements. For a description of this project, *see* Section 0.

[268] Item 302(a)(2) of Regulation S–K [17 CFR 229.302(a)(2)]. When disclosure in Item 302(a) varies from amounts previously reported on the Form 10–Q filed for any quarter, such as if a combination between entities under common control occurs or where an error is corrected, the registrant must disclose a reconciliation of the amounts given with those previously reported and describe the reason for the difference.

[269] Item 302(a)(3) of Regulation S–K [17 CFR 229.302(a)(3)]. The requirement applies to items recognized in each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included or are required to be included.

[270] Item 302(a)(4) of Regulation S–K [17 CFR 229.302(a)(4)].

[271] *See* letter from Gregg L. Nelson, VP Accounting Policy & Financial Reporting, IBM Corporation (Aug. 7, 2014) (''IBM'').

[272] *See* Interim Financial Data; Proposals to Increase Disclosure, Release No. 34–11142 (Dec. 19, 1974) [40 FR 1079 (Jan. 6, 1975)] (''Proposals to Increase Disclosure of Interim Results by Registrants'') at 1080.

[273] *See* Interim Financial Reporting: Increased Disclosures, Release No. 33–5611 (Sept. 10, 1975) [40 FR 46107 (Oct. 6, 1975)] (''1975 Interim Financial Reporting Release''). Rule 3–16(t) of Regulation S–X required disclosure in a note to the financial statements of net sales, gross profit, income before extraordinary items and cumulative effect of a change in accounting, per share data based upon such income, net income for each full quarter within the two most recent fiscal years and any subsequent interim period for which income statements are presented. It also required registrants to describe 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 which are material to the results of that quarter. Furthermore, it required a reconciliation of amounts previously reported on Form 10–Q to the quarterly data included in the note to financial statements if the amounts differ. *See id.*

[274] *Id.*

[275] *Id.* at 46107.

[276] *Id.* at 46108.

[277] *See id.* at 46107 (''The Commission believes that the greatest investor need for these data exists in the case of such companies whose activities are most closely followed by analysts and investors. Accordingly, registrants whose shares are not actively traded or whose size is below certain limits have been exempted from this rule at the present time.'').

See also Audit Committee Disclosure, Release No. 34–42266 (Dec. 22, 1999) [64 FR 73389 (Dec. 30, 1999)] (summarizing the requirements for application of Item 302(a) that had been in effect since 1980). The requirements only applied to registrants who met certain tests, including but not limited to: (1) Two of the three following requirements: (a) Shares outstanding have a market value of at least $2.5 million; (b) the minimum bid price is at least $5 per share; or (c) the registrant has at least $2.5 million of capital, surplus, and undivided profits; and (2) the registrant and its subsidiaries: (a) Have had net income after taxes but before extraordinary items and the cumulative effect of a change in accounting of at least $250,000 for each of the last three fiscal years; or (b) had total assets of at least $200 million for the last fiscal year end. *See id.*

[278] *See* General Revision of Regulation S–X, Release No. 33–6233 (Sept. 2, 1980) [45 FR 63660 (Sept. 25, 1980)]. *See also* General Revision of Regulation S–X, Release No. 33–6178 (Jan. 15, 1980) [45 FR 5943 (Jan. 24, 1980)] at 5945 (''Based upon the premise that information contained within the financial statements should be audited, the proposed rules would remove from [Regulation] S–X the requirement relating to unaudited information concerning selected quarterly financial data and place this requirement under Regulation S–K.'').

[279] ASC 270–10–50–2 requires the disclosure of certain information if interim data and disclosures are not separately reported for the fourth quarter. This information includes ''disposals of components of an entity and unusual, or infrequently occurring items recognized in the fourth quarter, as well as the aggregate effect of year-end adjustments that are material to the results of that quarter.''

302(a), should we modify the item and, if so, how? For example, should we modify the item to require additional disclosure and, if so, what additional disclosure would be important to investors and why?

80. Is fourth quarter information, which is required under Item 302(a) but not in the annual financial statements, important to investors? Do the other instances where disclosure required by Item 302(a) is not duplicative of previously provided disclosure merit retaining the item? Why or why not?

81. The disclosure required by Item 302(a) was originally intended to help investors understand the pattern of corporate activities throughout a fiscal period by disclosing trends over segments of time that are sufficiently short to reflect business turning points.[280] Does this objective remain important today? If so, does the item achieve this objective? If the item does not achieve this objective, how could we modify it to do so?

82. Should we require auditor involvement (*e.g.,* audit, review or specified procedures) on the reliability of the disclosure, and if so, what should the nature of the involvement be? What would be the benefits and costs to registrants and to investors?

83. Item 302(a) disclosure is commonly provided either as an unaudited note to the financial statements in Form 10–K [281] or separately outside of the financial statements. To the extent a registrant's Item 302(a) disclosure is provided in the notes to the financial statements, it must be tagged as XBRL data. Registrants' financial statements and footnotes presented in quarterly reports must also be tagged in XBRL.[282] Given some of Item 302(a) disclosure is available in prior quarterly reports and also tagged in XBRL, do investors use the disclosure required by Item 302(a)?

84. What types of investors or audiences are most likely to value the information required by Item 302?

85. What is the cost of providing the disclosure required by Item 302, including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 302.

86. Would costs to investors increase if Item 302 was eliminated and if so, how?

87. What are the benefits of providing the disclosure required by Item 302? How could the benefits change if we made any of the changes contemplated here? Please provide quantified or qualitative estimates where possible relating to disclosure under Item 302.

3. Content and Focus of MD&A (Item 303—Generally)

Item 303 of Regulation S–K requires disclosure of information relevant to assessing a registrant's financial condition, changes in financial condition and results of operations.[283] Item 303(a) contains three core components that registrants must analyze in their MD&A disclosures: Liquidity, capital resources, and results of operations.[284] Item 303(a) also requires disclosure of off-balance sheet arrangements and contractual obligations.[285]

Overall, these MD&A requirements are intended to satisfy three principal objectives:

- Provide a narrative explanation of a registrant's financial statements that enables investors to see the registrant through the eyes of management;
- enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and
- provide information about the quality of, and potential variability of, a registrant's earnings and cash flow, so investors can ascertain the likelihood that past performance is indicative of future performance.[286]

The Commission has provided substantial guidance in the past intended to improve the quality of MD&A disclosures.[287] Much of this guidance has focused on the following topics:

- Quality and focus of analysis;
- forward-looking information; and
- use of key performance indicators.[288]

To help achieve the principal objectives of MD&A, and before evaluating specific subsections of Item 303(a), we seek public input on these topics and how we could improve the overall quality of MD&A disclosure.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter stated that MD&A requirements are too principles-based.[289] Another commenter stated that MD&A's principles-based approach results in disclosure that is ''among the most meaningful disclosure contained in periodic reports.'' [290] Another commenter recommended reexamining MD&A to, among other things, reinforce the guiding principle of materiality so that MD&A is more useful for investors.[291] One commenter recommended, in addition to MD&A, adopting a rule requiring registrants to provide an overview of their performance in the most recent year as well as expectations and concerns for the coming year, similar to what a CEO might report to the Board of Directors.[292] This commenter suggested placing the disclosure at the beginning of annual reports on Forms 10–K and 20–F. One commenter stated there should be ''greater clarity'' between the type of forward-looking information required in MD&A versus the ''future-oriented'' information that the Financial Accounting Standards Board (''FASB'') believes is appropriate.[293]

One commenter suggested consolidating Commission and staff guidance on MD&A, stating that consolidation would reduce the time and effort necessary to identify and read all applicable sources and improve the

[280] *See* Interim Reporting Amendments Release.

[281] This may be due to the fact that the requirements to provide annual financial statements and Item 302 disclosure are both in Item 8(a) of Form 10–K [17 CFR 249.310].

[282] Rule 405 of Regulation S–T [17 CFR 232.405]. *See also* Interactive Data Release.

[283] Instruction 2 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)].

[284] Item 303(a)(1), (a)(2) and (a)(3) of Regulation S–K [17 CFR 229.303(a)(1), (a)(2) and (a)(3)].

[285] Item 303(a)(4) and (a)(5) of Regulation S–K [17 CFR 229.303(a)(4) and (a)(5)].

See also Disclosure in Management's Discussion and Analysis About Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, Release No. 33–8182 (Jan. 28, 2003) [68 FR 5982 (Feb. 5, 2003)] (''Off-Balance Sheet and Contractual Obligations Adopting Release'').

[286] *See* 2003 MD&A Interpretive Release.

[287] *See, e.g.,* Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis, Release No. 33–9144 (Sept. 17, 2010) [75 FR 59894 (Sept. 28, 2010)] (''2010 Liquidity and Capital Resources Interpretive Release''); 2003 MD&A Interpretive Release; Commission Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No. 33–8056 (Jan. 22, 2002) [67 FR 3746 (Jan. 25, 2002)] (''2002 Commission Statement about MD&A''); 1989 MD&A Interpretive Release.

[288] *See generally* 2003 MD&A Interpretive Release (addressing each of these topics throughout).

[289] *See* CFA Institute. This commenter also stated that disclosure effectiveness efforts should prioritize improving financial statement presentation and enhancing challenging disclosures, such as estimates, judgments, and choices; risks and uncertainties; off-balance sheet items; commitments and contingencies; intangible assets; and going concern issues.

[290] *See* Shearman.

[291] *See* CCMC.

[292] *See* letter from Committee on Financial Reporting, New York City Bar (Sept. 3, 2014) (''NYC Bar'').

[293] *See* SCSGP.

quality of MD&A disclosure.[294] This commenter recommended consolidating all applicable guidance in a single, electronically-accessible location with hyperlinks to relevant sources, or alternatively, revising Item 303 to codify prior staff guidance.[295] This commenter also recommended adding instructions throughout Item 303 indicating that, to the extent disclosure in response to the item is included in the notes to the financial statements, registrants should use cross-references to avoid duplicative disclosure.[296]

b. Quality and Focus of Analysis

i. Discussion

MD&A requires not only a discussion but also an analysis of known material trends and uncertainties and should not reiterate financial statement information in a narrative form.[297] The Commission has previously stated that a thorough analysis should assess both the effects of known material trends and uncertainties and the reasons underlying those effects.[298] The Commission has also stated that, if there is a reasonable likelihood that reported financial information is not indicative of a registrant's future financial condition or future operating performance, then registrants should disclose the underlying reasons.[299]

The Commission has focused on improving the analysis in MD&A for many years. For example, the 1989 MD&A Interpretive Release explained that MD&A is intended to give investors an opportunity to look at a registrant through the eyes of management by providing both a short and long-term analysis of the business of the registrant.[300] Despite Item 303(a)'s instruction to the contrary,[301] many registrants simply recite the amounts of changes from year to year which are readily computable from their financial statements. In 2003 guidance, the Commission added that such recitation of financial statements in narrative form fails to provide the unique perspective available to management that MD&A is meant to capture.[302] An effective analysis of known material trends, events, demands, commitments and uncertainties should include an explanation of the underlying reasons or implications, interrelationships between constituent elements, or the relative significance of those matters.[303]

Prior to 1980, Commission rules required registrants to provide a summary of earnings, including a discussion of unusual conditions that affected the appropriateness of the earnings presentations.[304] The rules also required registrants to discuss items of revenue or expense that changed more than ten percent from the prior period or changed more than two percent of the average net income or loss for the most recent three years presented. In adding MD&A to Regulation S–K in 1980, the Commission replaced the percentage thresholds with a principles-based approach that primarily focused on materiality.[305] The Commission noted that the percentage tests applied without regard to any concept of materiality or significance to the registrant's business, resulting in meaningful discussion often being obscured by information of little relevance.[306]

Commission guidance has continued to stress the importance of materiality in MD&A and stated that disclosure should emphasize material information and de-emphasize or, if appropriate, delete immaterial information.[307] The text of Item 303 ties several specific requirements to materiality. For example, disclosure of known trends in liquidity is required if such trends are reasonably likely to affect liquidity ''in any material way.'' [308] Commitments for capital expenditures that are material must be described as of the end of the latest fiscal period.[309] Registrants also must describe certain events, transactions, or economic changes that ''materially affected'' reported income from continuing operations.[310]

In addition to emphasizing materiality, the Commission has also recommended a ''layered approach'' as a way to improve the quality of analysis in MD&A.[311] A layered approach requires registrants to present information in a manner that emphasizes, within the universe of material information that is disclosed, the information and analysis that is most important.[312] While not required by Item 303, providing an executive-level overview to MD&A may be one way of taking a layered approach.

Executive-level overviews should discuss the most important matters to MD&A, and the Commission has cautioned that this overview should not be a duplicative layer of disclosure repeated elsewhere.[313] Rather than summarize information already disclosed, the executive overview should provide a balanced, high-level discussion that identifies the most important themes or other significant matters with which management is concerned primarily in evaluating the registrant's financial condition and operating results. The overview should provide insight into material opportunities, challenges and risks, such as those presented by known material trends and uncertainties, on which the registrant's executives are most focused for both the short and long term, as well as the actions they are taking to address these opportunities, challenges and risks.[314]

ii. Request for Comment

88. What requirements in Item 303 are important to investors? How could Item 303 be improved?

89. Do the current requirements of Item 303 result in disclosure that

[294] *See* ABA 2. *See also* letter from Henry T. C. Hu (Oct. 7, 2015) (''Hu'') (referencing a ''bewildering stream of guidance of varying degrees of formality and legal import'' since Item 303's adoption in 1980).

[295] *See* ABA 2.

[296] *See id.* (specifying Items 303(a)(1), (a)(4), (a)(5) and disclosure of critical accounting estimates).

[297] *See* 2003 MD&A Interpretive Release.

[298] *See id.*

[299] *See id.* As an example, the Commission stated that if a change in an estimate has a material favorable impact on earnings, the change and the underlying reasons should be disclosed so that readers do not incorrectly attribute the effect to operational improvements.

[300] *See* 1989 MD&A Interpretive Release.

[301] Instruction 4 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)].

[302] *See* 2003 MD&A Interpretive Release.

[303] *See id.*

[304] *See* Guidelines for Registration and Reporting, Release No. 33–5520 (Aug. 14, 1974) [39 FR 31894 (Sept. 3, 1974)] (''Guidelines Adopting Release''). These guidelines, known as Guide 22, were the precursor to MD&A that predated Regulation S–K. *See infra* note 344.

[305] *See* 1980 Form 10–K Adopting Release.

[306] *See id.* at 63636 (''The changes in Management's Discussion and Analysis were proposed as the result of the Commission's concerns that the disclosure elicited by the present requirement of Guides 1 and 22 is not fulfilling originally contemplated objectives. Instead, existing percentage tests are applied without regard to any concept of materiality or significance to the registrant's business. Accordingly, although some portions of the resulting discussion may be meaningful, the meaningful discussion is often obscured by the inclusion of material which is of little relevance.''). The Commission also clarified that causes of material changes in line items must be described only to the extent necessary to an understanding of a company's business as a whole.

[307] *See* 2003 MD&A Interpretive Release.

[308] Item 303(a)(1) of Regulation S–K [17 CFR 229.303(a)(1)].

[309] Item 303(a)(2) of Regulation S–K [17 CFR 229.303(a)(2)].

[310] Item 303(a)(3) of Regulation S–K [17 CFR 229.303(a)(3)].

[311] *See* 2003 MD&A Interpretive Release at 75059 (''While all required information must of course be disclosed, companies should consider using a 'layered' approach. [. . .] This presentation would assist readers in identifying more readily the most important information. Using an overview or introduction is one example of a layered approach.'').

[312] *See id.* For further discussion of layered disclosure, *see* SectionV.F.

[313] *See* 2003 MD&A Interpretive Release.

[314] *See id.*

highlights the most significant aspects of the registrant's financial condition and results of operations? Are there any requirements in Item 303(a) and (b) that result in immaterial disclosures that may obscure significant information? If so, how? Should we consider a qualitative or quantitative threshold rather than materiality for requiring MD&A disclosure? If so, what threshold would be appropriate and why? Would adopting a different standard impede the flexibility of analysis and assessment under the current materiality standard? If so, how?

90. There are various sources of Commission and Division guidance on MD&A. These include Commission releases, sections of the Division's Financial Reporting Manual and staff Compliance and Disclosure Interpretations.[315] Given the amount of Commission and staff guidance on MD&A, should we consolidate guidance in a single source? If so, which guidance remains helpful, and is there guidance that we should not include in a consolidation? Would consolidation of this guidance facilitate registrants' compliance with the item's requirements, or is the existing form of this guidance sufficient?

91. Should we revise our rules to require registrants to provide an executive-level overview? If so, should our rules prescribe the information that must be covered? What would be the benefits and challenges of prescribing the content of the overview and what content should we require? For example, should we require an executive-level overview to discuss the most significant accounting estimates and judgments? Should any requirement for an executive-level overview be limited to registrants of a certain size?

92. If we were to require an executive-level overview, how could we encourage registrants to provide an overview that does not simply duplicate disclosure provided elsewhere?

93. Are there other methods that registrants could employ or new rules that we should consider that would result in more meaningful analysis in MD&A?

94. What types of investors or audiences are most likely to value the information required by Item 303 and does the audience for disclosure vary across the different parts of Item 303 disclosure? If so, how? Would the manner of presentation affect how various types of investors benefit from Item 303 disclosure?

95. Should we require a different format or presentation of MD&A such as a requirement for the discussion to be tagged or presented in a structured manner?

96. Should we require auditor involvement (*e.g.,* audit, review or specified procedures) regarding the reliability of MD&A disclosure, and if so, what should the nature of the involvement be? What would be the benefits and costs to registrants and to investors?

97. What is the cost of providing the disclosure required by Item 303, including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 303.

98. What are the benefits of providing the disclosure required by Item 303? How could the benefits change if we made any of the changes contemplated here? Please provide quantified or qualitative estimates where possible relating to disclosure under Item 303.

c. Forward-Looking Information

i. Discussion

Discussion and analysis of known trends, demands, commitments, events and uncertainties requires disclosure of forward-looking information.[316] This information is significant to understanding a registrant's expected future performance. The Commission previously has provided guidance relating to the standard for disclosure of forward-looking information and encouraged registrants to provide such forward-looking disclosure.[317]

In 1987, the Commission distinguished between required and optional forward-looking disclosure: Required forward-looking disclosure is based on currently known trends, events and uncertainties that are reasonably expected to have material effects, while optional forward-looking disclosure involves either anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty.[318] In 1989, the Commission articulated a two-step test (''two-step test'') for assessing when forward-looking disclosure is required in MD&A:

> Where a trend, demand, commitment, event or uncertainty is known, management must make two assessments:
>
> (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
>
> (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur.[319]

For forward-looking information, the Commission distinguished the standard for disclosure under Item 303 from the standard for disclosure necessary to avoid liability for fraud under Rule 10b–5 and stated that the ''probability/magnitude test for materiality approved by the Supreme Court in *Basic, Inc.,* v. *Levinson* . . . is inapposite to Item 303 disclosure.'' [320] The Commission has

[315] *See* ABA 2 (providing a six-page exhibit illustrating the various sources of guidance on MD&A).

[316] For example, the following provisions in Item 303 require disclosure of prospective information: Item 303(a)(1) (any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way); Item 303(a)(2)(ii) (any known material trends in capital resources and any expected material changes in the mix and relative cost of capital resources); Item 303(a)(3)(ii) (any known trends or uncertainties that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations); and Instruction 3 to Item 303(a) (descriptions and amounts of matters that would have an impact on future operations and have not had an impact in the past and matters that have had an impact on reported operations and are not expected to have an impact upon future operations.).

[317] *See* 2003 MD&A Interpretive Release at 75059 (''In addressing prospective financial condition and operating performance, there are circumstances, particularly regarding known material trends and uncertainties, where forward-looking information is required to be disclosed. We also encourage companies to discuss prospective matters and include forward-looking information in circumstances where that information may not be required, but will provide useful material information for investors that promotes understanding.'').

[318] Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, Release No. 33–6711 (Apr. 17, 1987) [52 FR 13715 (Apr. 24, 1987)].

In 1989, the Commission also explained that the safe harbors of Securities Act Rule 175(c) and Exchange Act Rule 3b–6(c) apply to required statements concerning the future effect of known material trends and uncertainties. *See* 1989 MD&A Interpretive Release.

The Commission adopted the foregoing rules in 1979 to encourage the disclosure of projections and forward-looking information as recommended by the Sommer Report. *See* Safe Harbor Rule for Projections, Release No. 33–6084 (June 25, 1979) [44 FR 38810 (July 2, 1979)].

[319] *See* 1989 MD&A Interpretive Release at 22430.

[320] *Id.* In *Basic,* the Supreme Court framed the issue of materiality of forward-looking disclosure as depending upon a balancing of both ''the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'' 485 U.S. at 231

Continued

also stated that this ''reasonably likely'' standard is a lower threshold than ''more likely than not.'' [321]

Several federal courts of appeals have since referenced the Commission's two-step test and addressed its role in potential liability under Exchange Act Section 10(b) and Rule 10b–5 thereunder. Although the courts are divided on the issue of whether Item 303 requirements create a general duty to disclose in the Rule 10b–5 context, these courts have agreed that the Supreme Court's standard in *Basic* v. *Levinson* is the appropriate standard for determining liability under Rule 10b–5 rather than the Commission's two-step test.[322]

ii. Request for Comment

99. Does the two-step test for disclosure of a known trend, demand, commitment, event or uncertainty result in the most meaningful forward-looking disclosure? Why or why not? How do registrants determine when something is ''reasonably likely'' to occur?

100. Should we revise the two-step test to apply a different standard in the first prong and if so, how? For example, should we require disclosure when a trend, event or uncertainty is more likely than not, probable, or reasonably possible to occur, rather than ''reasonably likely'' to occur? [323]

101. Should we eliminate the two-step test in favor of a different standard for identifying required and optional forward-looking disclosure and, if so, what test would be appropriate? For example, should we revise Item 303 to incorporate the probability/magnitude standard from *Basic* v. *Levinson*? [324] Which standard—the two-part test, *Basic's* probability/magnitude standard, or some other standard—should we require, and why? Would any particular formulation be more or less burdensome for registrants?

102. We have stated previously that quantification of the material effects of known material trends and uncertainties can promote understanding and may be required to the extent material.[325] Should we revise Item 303 to specifically require registrants, to the extent practicable, to quantify the material effects of known trends and uncertainties as well as the factors that contributed to those known trends and uncertainties? Why?

d. Key Indicators of Financial Condition and Operating Performance

i. Discussion

The Commission has previously stressed that registrants should identify and address those key variables and other qualitative and quantitative factors that are peculiar to and necessary for an understanding and evaluation of the individual registrant.[326] Key performance indicators include both financial and non-financial measures. Non-financial measures may relate to external or macro-economic matters as well as those specific to a registrant or industry.[327] The Commission has also encouraged registrants to consider whether disclosure of all key variables and other factors that management uses to manage the business would be material to investors or would promote an understanding of MD&A.[328]

Some registrants discuss industry-specific key performance indicators in MD&A, although there is not a specific requirement for this disclosure. For example, electronic gaming or social media companies typically discuss their numbers of monthly active users; numbers of unique users; numbers of unique payers; and other metrics relating to usage. Software service companies typically discuss their numbers of subscribers; customer renewal rates; and customer retention rates. Hospitals typically discuss their numbers of admissions; numbers of beds; the average length of inpatient stays; and occupancy rates. Retailers typically discuss comparable store sales, sales per square foot or gross merchandise value. Recent academic studies find that the industry-specific key factors disclosed by retailers and manufacturers provide incremental information that can help to predict registrants' future performance beyond traditional financial statement variables.[329]

Where there is no commonly accepted method of calculating a particular non-financial metric, the Commission has said that the registrant should provide an explanation of the calculation of the metric to promote comparability across registrants within the industry.[330] In addition, key performance indicators, where disclosed, should be included in a format that will enhance the understanding of the discussion and analysis.[331]

(quoting *SEC* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833, 849 (2d Cir. 1968)).

[321] *See* 2002 Commission Statement about MD&A at 3748.

[322] *See Stratte-McClure* v. *Morgan Stanley,* 776 F.3d 94, 100–104 (2d Cir. 2015) (holding that Item 303 requirements do give rise to a duty to disclose that may serve as the basis for liability under Rule 10b–5, but indicating that the *Basic* test for materiality of forward-looking disclosures controls instead of the Commission's two-step test); *In re NVIDIA Corp. Sec. Lit.,* 768 F.3d 1046, 1054–56 (9th Cir. 2014) (holding that Item 303 does not create a duty to disclose for Rule 10b–5 purposes and distinguishing the two-step test from the *Basic* materiality standard for forward-looking disclosure); *Oran* v. *Stafford,* 226 F.3d 275, 287–288 (3d Cir. 2000) (leaving open the question of whether an Item 303 violation could ever serve as the basis for liability under Rule 10b–5, but holding that *Basic* supplied the applicable standard for testing 10b–5 liability for forward-looking disclosures).

[323] *See* ASC 450–20–25–1. Under U.S. GAAP, when a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. The areas within that range are: Probable (the future event or events are likely to occur), reasonably possible (the chance of the future event or events occurring is more than remote but less than likely) and remote (the chance of the future event or events occurring is slight).

In the context of Item 303(a)(4) (off-balance sheet arrangements), the Commission previously considered whether the ''reasonably likely'' threshold was appropriate for prospective information. Most commenters supported the ''reasonably likely'' standard. Many commenters opposed a ''remote'' threshold stating it would be difficult for management to apply, yield voluminous disclosures; attribute undue prominence to information that is not important to investors; confuse or mislead investors; and elicit information that would not be comparable among firms. The Commission adopted the ''reasonably likely'' threshold concluding that it focused on the information most important to an understanding of a registrant's off-balance sheet arrangements and their material effects. The Commission also noted potential difficulty in attempting to comply with the ''remote'' threshold and that use of a consistent threshold throughout MD&A would preclude the potential confusion that could result from disparate thresholds. *See* Off-Balance Sheet and Contractual Obligations Adopting Release.

[324] *See supra* note 320.

[325] *See* 2003 MD&A Interpretive Release.

[326] *See id.* (quoting the 1989 MD&A Interpretive Release, which quotes Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No. 33–6349 (Sept. 28, 1981) [*not published in the* **Federal Register**]).

[327] External or macro-economic matters, such as interest rates or economic growth rates, and their anticipated trends can be important variables for many registrants. The Commission has further encouraged registrants to consider disclosing information that may be peripheral to the accounting function, but is integral to the business or operating activity. Examples of such measures, depending on the circumstances of a particular registrant, can include those based on units or volume, customer satisfaction, time-to-market, interest rates, product development, service offerings, throughput capacity, affiliations/joint undertakings, market demand, customer/vendor relations, employee retention, business strategy, changes in the managerial approach or structure, regulatory actions or regulatory environment, and any other pertinent macroeconomic measures. *See* 2003 MD&A Interpretive Release at note 27 and accompanying text.

[328] *See id.*

[329] *See, e.g.,* C. Cole and C. Jones, *The Usefulness of MD&A Disclosures in Retail Industry,* 30 J. Acct. Auditing Fin. 127, 127–149 (2015). *See also* Y. Sun, *Do MD&A Disclosures Help Users Interpret Disproportionate Inventory Increases?,* 85 Acct. Rev. 1411, 1411–1440 (2010) (measuring the informativeness of this disclosure by measuring to what degree the information in the disclosure can help to predict variables such as future revenues and earnings or contemporary stock returns, beyond financial statement variables or other factors that can help to predict these variables).

[330] *See* 2003 MD&A Interpretive Release.

[331] *See id.*

ii. Request for Comment

103. Should we revise Item 303 to include a principles-based requirement for all registrants to disclose performance metrics and other key variables important to their business? Why or why not?

104. Should we require disclosure of any commentary, analysis, performance indicators or business drivers related to a registrant's key indicators? If so, why? For example, would it be feasible to adopt prescriptive requirements for discussion of specific performance metrics that are applicable to an entire industry and are easily comparable between registrants?

105. What types of investors or audiences are most likely to value industry-specific key performance indicators?

106. What would be the costs and benefits of requiring registrants in certain industries to disclose standardized performance metrics? How could we identify which performance metrics should be standardized across an industry?

4. Results of Operations (Item 303(a)(3))

Item 303(a)(3) requires a discussion and analysis of a registrant's results of operations and specifies four areas of disclosure:

- Any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations and the extent to which income was so affected; [332]
- known trends or uncertainties that have had, or that the registrant reasonably expects will have, a material impact on net sales or revenues or income from continuing operations; [333]
- material increases in net sales or revenues, including the extent such increases are attributable to increases in prices, increases in the volume or amount of goods or services being sold, or to the introduction of new products or services; [334] and
- for the three most recent fiscal years, a discussion of the impact of inflation and changing prices on the registrant's net sales and revenues, and on income from continuing operations.[335]

Instruction 1 to Item 303(a) states that the discussion and analysis shall cover the three-year period covered by the financial statements and use year-to-year comparisons or any other format that in the registrant's judgment would enhance a reader's understanding.[336] Instruction 4 to Item 303(a) provides that registrants need not recite the amounts of changes from year to year that are readily computable from the financial statements.[337]

a. Comments Received

S–K Study: One commenter recommended that we eliminate the requirement to include prior-period results in MD&A as this information is readily available in prior filings.[338] This commenter added that the existing requirements in Item 303 should be sufficient to result in a comprehensive discussion of a three-year trend without a year-to-year comparison.

Disclosure Effectiveness Initiative: A few commenters recommended eliminating prior period results in MD&A as this information is readily available in previous filings.[339] One of these commenters stated it would be more appropriate to require a discussion of only the most recently completed annual or quarterly period and that discussion of prior periods ''can create more confusion and distraction than elucidation among investors.'' [340] Another one of these commenters stated its belief that two years of financial statements is sufficient disclosure as the five-year selected financial data would provide multiyear trend information.[341] This commenter also stated its belief that a two year financial statement requirement would eliminate ''clutter'' in MD&A and ''allow users to focus on new, material information about the latest fiscal year.''

One commenter disagreed with eliminating the requirement to include prior-period results in MD&A because doing so would require investors to look for the information elsewhere.[342] One commenter suggested revising Instruction 4 to Item 303(a) to allow registrants to omit a discussion of changes in line items on the financial statements, to the extent those changes are not material and such omission would not materially impair an investor's understanding of the registrant's results of operations.[343]

b. Discussion

Prior to the Commission's adoption of the MD&A disclosure requirements, Guide 22 and Guide 1 called for a summary of earnings and operations, as well as a full narrative explanation of the summary. The Guides also called for a separate discussion and analysis of the summary, including explanations of material changes from period to period in revenues and expenses.[344] This discussion was intended to enable investors to compare periodic results of operations and to assess the source and probability of recurrence of earnings or losses.[345] When adding MD&A to Regulation S–K in 1980, the Commission eliminated the summary of operations disclosure in favor of new requirements for a discussion ''focused on the financial statements'' with an emphasis on favorable or unfavorable trends and the identification of significant events or uncertainties.[346] The Commission also expressed its view that a three-year financial statement requirement provides the minimum data necessary for an understanding of the changes in performance for two years.[347]

In 2003, the staff conducted a review of annual reports filed by all Fortune 500 registrants and issued a significant number of comments seeking, among other things, greater analysis of

[332] Item 303(a)(3)(i) of Regulation S–K [17 CFR 229.303(a)(3)(i)].

[333] Item 303(a)(3)(ii) of Regulation S–K [17 CFR 229.303(a)(3)(ii)].

[334] Item 303(a)(3)(iii) of Regulation S–K [17 CFR 229.303(a)(3)(iii)].

[335] Item 303(a)(3)(iv) of Regulation S–K [17 CFR 229.303(a)(3)(iv)].

[336] SRCs may limit their disclosure to the two-year period covered by their financial statements. Instruction 1 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)].

[337] Instruction 4 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)].

[338] *See* Ernst & Young 1.

[339] *See, e.g.,* CCMC; IBM; SCSGP (noting that the existing requirements in Item 303 are sufficient to elicit a discussion of trends over the relevant three-year period, if such a trend exists and is material); A. Radin; Ernst & Young 2.

[340] *See* CCMC.

[341] *See* Ernst & Young 2 (also noting that financial statements covering three years are more voluminous and costly to prepare and that most foreign jurisdictions only require two years of financial statements).

[342] *See* CFA Institute.

[343] *See* ABA 2.

[344] Guide 22 applied only to registration statements under the Securities Act. Guide 1, applicable to Exchange Act filings, was adopted in 1974 to require disclosure similar to that of Guide 22. While Guide 22 focused on a summary of earnings, Guide 1 required a discussion and analysis of a registrant's summary of operations. Both Guides were eliminated in 1980 when their requirements were merged into a single requirement, now Item 303, calling for discussion and analysis of financial condition and results of operations. This represented a shift in focus towards the financial statements rather than upon a summary of operations. *See* Guidelines Adopting Release. When eliminating the Guides, the Commission noted that the ''narrow approach'' set forth in Guides 1 and 22 did not ordinarily produce a discussion that focused upon the financial condition of a registrant as a whole. The Commission also noted that ''there is a growing need to analyze an enterprise's liquidity and capital resources, in addition to its revenues and income.'' *See* 1980 Form 10–K Adopting Release at 63636.

[345] *See* Guidelines Adopting Release.

[346] 1980 Form 10–K Adopting Release at 63636.

[347] *See* Uniform Instructions as to Financial Statements—Regulation S–X, Release No. 33–6179 (Jan. 15, 1980) [45 FR 5963 (Jan. 24, 1980)].

registrants' results of operation.[348] The staff also discouraged registrants from providing rote calculations of percentage changes of financial statement items and boilerplate explanations of immaterial changes to these figures, encouraging them to include instead a detailed analysis of material year-to-year changes and trends.[349] The staff continues to seek greater analysis of material year-to-year changes and trends by encouraging registrants to quantify components of material changes in financial statement line items and provide additional explanation of the underlying factors that cause such changes.

c. Request for Comment

107. Should we retain, eliminate or modify the period-to-period comparisons provided in MD&A? Why?

108. How could Item 303(a)(3) be improved? Would any additional disclosure about a registrant's results of operations be important to investors? If so, what additional disclosure would be important and why?

109. Does the three-year comparison provide material information about trends or uncertainties that would not be reflected in filings for prior periods? Should we permit registrants to omit the earliest period in the three-year comparison when the earliest of the three years does not provide information that is important to investors? What would be the advantages and disadvantages of limiting the period-to-period comparisons in MD&A to the most recent two fiscal periods?

110. Should we allow registrants to eliminate the earliest of the two periods discussed so long as they cross-reference or include a hyperlink to the prior periods discussion in earlier Forms 10–K and 10–Q? Why or why not?

111. In complying with Item 303(a)(3), registrants almost exclusively rely on period-to-period comparisons even though our rules permit ''any other format that in the registrant's judgment would enhance a reader's understanding.'' [350] Why do registrants rely almost exclusively on year-to-year comparisons? Would formats or presentations other than period-to-period comparisons enhance a reader's understanding of results of operations or encourage greater analysis of the income statement? If so, how? What other formats or presentations could result in a discussion and analysis of the material information necessary to an understanding of a registrant's performance, financial condition and prospects for the future? Should we require registrants to provide the comparison in a standardized tabular format or any other format?

112. Does the disclosure required by Item 303(a)(3) provide useful information about registrants that have not yet generated revenue or begun operations? Would additional disclosure about these registrants, such as a description of their plans of operations be more useful to investors? If so, what additional information, if any, that is not already required under Item 101(a)(2) would be useful to investors? [351]

5. Liquidity and Capital Resources (Item 303(a)(1) and (a)(2))

Analysis of a registrant's liquidity and capital resources is critical to assessing a registrant's future prospects.[352] Item 303(a)(1) requires a registrant to identify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way.[353] If a material deficiency is identified, a registrant must indicate the course of action it has taken or proposes to take to remedy the deficiency.[354] Item 303(a)(1) also requires a registrant to identify and separately describe its internal and external sources of liquidity and briefly discuss any material unused sources of liquid assets.[355]

Item 303(a)(2) requires discussion and analysis of a registrant's capital resources. A registrant must describe its material commitments for capital expenditures and indicate the general purpose of those commitments and the anticipated source of funds needed to fulfill those commitments.[356] A registrant also must describe any known material trends, favorable or unfavorable, in its capital resources, including changes in equity, debt and any off-balance sheet financing arrangements.[357]

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter generally suggested requiring increased disclosure of liquidity funding gaps.[358]

b. Analysis of ''Liquidity'' and ''Capital Resources''

i. Discussion

The Commission first adopted requirements for disclosure of liquidity and capital resources in 1980 to address what it viewed as a growing need to analyze enterprise liquidity and capital resources in addition to revenues and income.[359] More recently, the Commission has observed that disclosure about liquidity and capital resources is critical to an assessment of a registrant's prospects for the future and even the likelihood of its survival.[360] The Commission also has provided guidance regarding the type of information that a registrant should disclose about its liquidity and capital resources.[361] In determining appropriate disclosure, registrants should evaluate separately their ability to meet upcoming cash requirements over both the short and long term.[362] Registrants are expected to use the statement of cash flows and other indicators in analyzing their liquidity and to present a balanced discussion dealing with cash

[348] *See Summary by the Division of Corporation Finance of Significant Issues Addressed in the Review of the Periodic Reports of the Fortunate 500 Companies* (2003), *available at https://www.sec.gov/divisions/corpfin/fortune500rep.htm.*

[349] *See id.* The staff also commented on boilerplate analyses that did not provide any insight into registrants' past performance or business prospects as understood by management.

[350] Instruction 1 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)] states the discussion must cover the three-year period covered by the financial statements and use year-to-year comparisons or any other format that in the registrant's judgment would enhance a reader's understanding.

[351] Item 101(a)(2) requires first-time registrants that have not generated revenues from operations in each of the last three fiscal years and are offering securities to the public to provide a plan of operations. The item requires disclosure relating to the registrant's ability to fund its operations, research and development, anticipated material acquisition of plant and equipment, and any anticipated material changes in number of employees.

[352] *See* 2003 MD&A Interpretive Release.

[353] Item 303(a)(1) of Regulation S–K [17 CFR 229.303(a)(1)]. The two-step test for disclosure of prospective information set forth in the 1989 MD&A Interpretive Release also applies to disclosure of a known trend, demand, commitment, event or uncertainty materially affecting liquidity and capital resources. *See supra* note 319 and accompanying text.

[354] Item 303(a)(1) of Regulation S–K [17 CFR 229.303(a)(1)].

[355] *Id.*

[356] Item 303(a)(2)(i) of Regulation S–K [17 CFR 229.303(a)(2)(i)].

[357] Item 303(a)(2)(ii) of Regulation S–K [17 CFR 229.303(a)(2)(ii)].

[358] *See* CFA Institute.

[359] *See* 1980 Form 10–K Adopting Release.

[360] *See* 2003 MD&A Interpretive Release. *See also* 2010 Liquidity and Capital Resources Interpretive Release (stating that as financing activities undertaken by registrants become more diverse and complex, it is increasingly important that the discussion and analysis of liquidity and capital resources provided by registrants meet the objectives of MD&A).

[361] *See, e.g.,* 1989 MD&A Interpretive Release and 2003 MD&A Interpretive Release.

[362] *See id.*

flows from investing and financing activities as well as from operations.[363]

Despite the Commission's guidance, the staff has observed that discussions of liquidity and capital resources often recite various changes in line items from the statement of cash flows without a detailed analysis. Although registrants generally discuss their liquidity needs and the sources of cash available to meet those needs as of the end of the reporting period, disclosure of known trends and uncertainties affecting their future needs and availability of cash often is less detailed.

When adopting disclosure requirements for liquidity and capital resources, the Commission recognized that the terms ''liquidity'' and ''capital resources'' lacked precision in definition but stated that ''additional specificity would decrease the flexibility needed by management for a meaningful discussion.'' [364] The Commission stated its intent for management to use ''whatever liquidity parameters they deem to be most appropriate.'' [365] To that end, Item 303 does not define ''capital resources'' and defines ''liquidity'' only in general terms, as the ability of an enterprise to generate adequate amounts of cash to meet its needs for cash.[366]

ii. Request for Comment

113. How could we revise Item 303(a) to elicit a more meaningful analysis of a registrant's liquidity and capital resources while retaining the flexibility of registrants to analyze liquidity and capital resources in the context of their business and the way they manage liquidity?

114. Item 303(a) provides that discussions of liquidity and capital resources may be combined whenever the two topics are interrelated. Would it lead to more useful analysis if we required registrants to provide separate disclosure of these two topics? Why? Would doing so encourage greater disclosure of trends, events and uncertainties affecting capital resources?

115. When drafting MD&A, how do registrants currently interpret the term ''capital resources''? Would defining the term ''capital resources'' be helpful for registrants or, alternatively, is the plain meaning of the term sufficiently clear? In light of the reference to capital expenditures and the sources of funds needed to fulfill those expenditures in Item 303(a)(2)(i), do registrants currently interpret the term ''capital resources'' as including mostly funds committed for material capital expenditures and the source of those funds?

116. Should we modify the definition of ''liquidity'' in Instruction 5 to Item 303(a) and, if so, how?

117. For what periods should we require discussion and analysis of liquidity and capital resources and why? Should our requirements include more periods than what is required by the statement of cash flows? Why? Are developments in the most recent fiscal year sufficient to constitute a ''trend'' as the term is used in Item 303?

118. Should we require registrants to provide a sensitivity analysis in the discussion and analysis of liquidity and capital resources? If so, what should be the nature of such an analysis? If not, why not?

119. Should the registrant provide additional measures of intra-period liquidity and capital resources? For example, should the registrant provide measures of average daily liquidity, average quarterly liquidity, or other measures? Should the registrant provide a chart or graph of intra-period liquidity? How should such information be considered in connection with the information provided at the end of the quarter?

120. Should we consider more detailed disclosure requirements for liquidity, such as liquidity risks and maturity mismatches?

c. Short-Term Borrowings

i. Discussion

Access to short-term borrowings for working capital and to fund operations can be an important component of a registrant's liquidity and capital resources.[367] Short-term borrowings include federal funds purchased and securities sold under agreements to repurchase,[368] commercial paper,[369] borrowings from banks, borrowings from factors or other financial institutions, and any other short-term borrowings reflected on the registrant's balance sheet.[370]

Short-term borrowings are common among financial institutions and industrial companies alike.[371] In the last few years, low interest rates have prompted many non-financial registrants to take advantage of lower borrowing costs and use short-term borrowings to, among other things, buy back stock and pay off longer-term debt.[372] For one type of short-term borrowing, repurchase agreements, advancements in technology and changes in the regulatory landscape have made it more efficient for parties to engage in these transactions, likely increasing the amount of activity in this market.[373]

Short-term borrowings can be affected, sometimes severely and rapidly, by illiquidity in the markets as a whole.[374] This market illiquidity can

[363] *See* 1989 MD&A Interpretive Release.

[364] 1980 Form 10–K Adopting Release at 63636.

[365] *Id.* at 63636.

[366] Instruction 5 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)]. *See also* 1980 Form 10–K Adopting Release.

[367] *See* D. Booth & J. Renier, *Fed Policy in the Financial Crisis: Arresting the Adverse Feedback Loop,* FRBD Economic Letter, Sept. 2009, *available at https://www.dallasfed.org/assets/documents/research/eclett/2009/el0907.pdf* (''Many businesses were hampered by the squeeze on short-term financing, a key source of working capital needed to prevent deeper reductions in inventories, jobs and wages.'').

[368] ASC 860–10 defines a repurchase agreement as an arrangement under which the transferor (repo party) transfers a security to the transferee (repo counterparty or reverse party) in exchange for cash and concurrently agrees to reacquire the security at a future date for an amount equal to the cash exchanged plus a stipulated interest factor.

[369] Commercial paper consists of short-term promissory notes issued primarily by corporations. Maturities range up to 270 days but average about 30 days.

[370] *See* Rules 5–19 and 9–03.13(3) of Regulation S–X [17 CFR 210.5–19 and 210.9–03.13(3)].

[371] For example, the Federal Reserve Board reported that domestic outstanding commercial paper balances at the end of December 2015 were $174.5 billion for non-financial issuers and $206.6 billion for financial issuers respectively. *See Commercial Paper Outstanding* (last visited March 21, 2016) *available at https://www.federalreserve.gov/releases/cp/outstanding.htm.*

[372] *See, e.g.,* David Randall, *Fed Delay Could Spur More Debt Issues to Fund Share Buybacks,* Reuters, Sept. 23, 2015, *available at http://www.reuters.com/article/2015/09/23/us-usa-fed-buybacks-analysis-idUSKCN0RN0D320150923* (suggesting the Federal Reserve's decision to delay raising interest rates will likely encourage companies to incur more debt to repurchase their own shares); Serena Ng and Vipal Monda *Companies Use Short-Term Debt to Advantage,* The Wall Street Journal, Sept. 11, 2013, *available at http://www.wsj.com/articles/SB10001424127887323893004579059473557078830* (noting that the low cost of short-term funds due to low interest rates has prompted companies to engage in short-term borrowings to repurchase stock, fund acquisitions, pay off longer-term debt, or profit from the gap between short and long-term interest rates); John Atkins, *Economy: Short-term Business Borrowing Hits Highest Level Since 2001,* Forbes, Feb. 22, 2013, *available at http://www.forbes.com/sites/spleverage/2013/02/22/economy-short-term-business-borrowing-hits-highest-level-since-2001.*

[373] *See* Victoria Baklanova, Adam Copeland, and Rebeca McCaughrin, *Reference Guide to U.S. Repo and Securities Lending Markets,* Federal Reserve Bank of NY Staff Report, Sept. 2015, *available at https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr740.pdf,* at 16 (noting that, while dealers appear to represent the largest participants in the market for repurchase agreements, non-dealer activity has likely increased such as through service providers that allow non-dealer counterparties to engage directly in a repurchase agreement without an intermediary).

[374] *See* Philip E. Strahan, *Liquidity Risk and Credit in the Financial Crisis,* FRBSF Economic Letter (May 14, 2012), *available at http://www.frbsf.org/economic-research/publications/economic-letter/2012/may/liquidity-risk-credit-financial-crisis/. See also,* Adonis Antoniades, *Liquidity Risk and the Credit Crunch of 2007–2008: Evidence from Micro-Level Data on Mortgage Loan Applications,* Dec. 2014, *available at http://www.bis.org/publ/*

Continued

present increased risks to registrants who rely on short-term borrowings.[375] Due to their short-term nature, a registrant's use of such arrangements can fluctuate significantly during a reporting period. As a result, presentation of period-end amounts of short-term borrowings alone may not accurately capture a registrant's funding needs or use of such borrowings during the relevant period.[376]

Our rules require a liquidity analysis on both a long-term and short-term basis.[377] The Commission has stated that registrants should consider describing the sources of short-term funding and the circumstances that are reasonably likely to affect those sources of liquidity.[378] In addition, the Commission and its staff have provided guidance that certain registrants should disclose short-term borrowings to the extent relevant and material to the operations of the entity.[379]

The Commission has previously considered the applicability of short-term borrowing disclosure requirements for all registrants. In 1994, in connection with the elimination of various financial statement disclosure schedules, the Commission eliminated a short-term borrowings disclosure requirement for registrants that were not bank holding companies.[380] Former Rule 12–10 of Regulation S–X required those registrants to include with their financial statements a schedule of short-term borrowings that disclosed the maximum amount outstanding during the year, the average amount outstanding during the year, and the weighted-average interest rate during the period, with amounts broken out into specified categories of short-term borrowings.[381] In proposing to eliminate this schedule, the Commission noted ''the disclosures concerning the registrant's liquidity and capital resources that are required in the MD&A would appear to be sufficiently informational to permit elimination of the short term borrowing schedule.'' [382] In repealing Rule 12–10, the Commission ''concluded that the costs of furnishing the information outweigh[ed] its usefulness.'' [383]

In 2010, the Commission proposed new disclosure requirements for short-term borrowings.[384] When proposing these rules, the Commission stated its belief that they differed from former Rule 12–10 by, among other things, requiring short-term borrowings disclosure in MD&A, in tabular form, alongside a discussion and analysis to provide context for the quantitative data.[385] Some commenters expressed concern about these proposed rules and emphasized the costs associated with compliance, which they asserted would outweigh the usefulness of the disclosure. A significant number of commenters were financial institutions [386] and related organizations,[387] with only a small number of investors submitting comments.[388] While the Commission did not adopt these rules, there have been other regulatory actions relating to short-term borrowings disclosure.[389]

While a number of commenters generally supported the proposed rules' objectives of greater transparency of short-term borrowings as part of a registrant's overall liquidity profile, they also expressed numerous concerns about the quantitative requirements of the proposed rule. For example, commenters were opposed to the

work473.pdf; Marcia Millon Cornett, Jamie John McNutt, Philip E. Strahan, Hassan Tehranian, *Liquidity Risk Management and Credit Supply in the Financial Crisis,* 101 J. Fin. Econ. (2011), 297–312; Jose Berrospide, *Bank Liquidity Hoarding and the Financial Crisis: An Empirical Evaluation,* Federal Reserve Board Finance and Economics Discussion Series, Nov. 29, 2012; A. Martin et al., Repo Runs, FRBNY Staff Report No. 444 (Apr. 2010) (demonstrating that institutions funded by short-term collateralized borrowings are subject to the threat of runs similar to those faced by commercial banks).

[375] For instance, financing rates may increase or terms may become unfavorable, it may become more costly or impossible to roll over short-term borrowings, or for financial institutions, demand depositors may withdraw funds. *See, e.g.,* Gary B. Gorton, Andrew Metrick, Lei Xie, *The Flight from Maturity,* Yale School of Management May 2015–, *available at http://www.nber.org/papers/w20027.pdf.*; M. Brunnermeier, *Deciphering the Liquidity and Credit Crunch 2007–2008,* 23 J. Econ. Persp. 77 (2009), at 79–80, *available at https://www.princeton.edu/~markus/research/papers/liquidity_credit_crunch.pdf.*

[376] *See* Short-Term Borrowings Disclosure, Release No. 33–9143 (Sept. 17, 2010) [75 FR 59866 (Sept. 28, 2010)] (''Short-Term Borrowings Proposing Release'').

[377] Instruction 3 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)].

[378] *See* 2002 Commission Statement about MD&A at 3748 (''MD&A disclosures should not be overly general. For example, disclosure that the registrant has sufficient short-term funding to meet its liquidity needs for the next year provides little useful information. Instead, registrants should consider describing the sources of short-term funding and the circumstances that are reasonably likely to affect those sources of liquidity.'').

[379] *See* 2010 Liquidity and Capital Resources Interpretive Release at 59895 (stating that, ''if the registrant's financial statements do not adequately convey the registrant's financing arrangements during the period, or the impact of those arrangements on liquidity, because of a known trend, demand, commitment, event or uncertainty, additional narrative disclosure should be considered and may be required to enable an understanding of the amounts depicted in the financial statements''); Industry Guide 3, Statistical Disclosure by Bank Holding Companies (''Industry Guide 3''), *available at https://www.sec.gov/about/forms/industryguides.pdf*; and Staff Accounting Bulletin, Topic 11:K (Application of Article 9 and Industry Guide 3), *available at https://www.sec.gov/interps/account/sabcodet11.htm* (''In the staff's view, Article 9 [of Regulation S–X] and Guide 3, while applying literally only to bank holding companies, provide useful guidance to certain other registrants . . . Thus, to the extent particular guidance is relevant and material to the operations of an entity, the staff believes the specified information, or comparable data, should be provided.'').

[380] *See* Financial Statements of Significant Foreign Equity Investees and Acquired Foreign Businesses of Domestic Issuers and Financial Schedules, Release No. 33–7118 (Dec. 13, 1994) [59 FR 65632 (Dec. 20, 1994)] (''Financial Schedules Adopting Release'').

[381] The categories in former Rule 12–10 were amounts payable to: Banks for borrowings; factors or other financial institutions for borrowings; and holders of commercial paper.

[382] *See* Financial Statements of Significant Foreign Equity Investees and Acquired Foreign Businesses of Domestic Issuers and Financial Schedules, Release No. 33–7055 (Apr. 19, 1994) [59 FR 21814 (Apr. 26, 1994)] at 21818.

[383] *See* Financial Schedules Adopting Release at 65635.

[384] *See* Short-Term Borrowings Proposing Release. As proposed, these rules would have codified the provisions in Industry Guide 3 for disclosure of short-term borrowings in Regulation S–K for all registrants. These proposed rules were intended to provide important information so investors could better understand the role of short-term financing and the related risks to the registrant. At that time, the Commission proposed amending its MD&A requirements to include a new section that would provide tabular information of a registrant's short-term borrowings, as well as a discussion and analysis of these borrowings. These proposed amendments would have (i) expanded the Industry Guide 3 provisions for disclosure of short-term borrowings in Regulation S–K, (ii) required disclosure on an annual and quarterly basis, and (iii) expanded Industry Guide 3 disclosure to all registrants that provide an MD&A. If the proposals had been adopted, the Commission would have authorized the staff to eliminate the corresponding provisions of Industry Guide 3 to avoid redundant disclosure requirements. *See id.* at 59868, footnote note 21 and accompanying text.

[385] *See id.*

[386] *See, e.g.,* comment letters to File No. S7–22–10 from Credit Suisse Group AG (Nov. 29, 2010), Barclays Bank PLC (Nov. 29, 2010), JP Morgan Chase & Co. (Nov. 29, 2010), Morgan Stanley (Nov. 29, 2010) and Citigroup Inc. (Nov. 29, 2010) *available at http://www.sec.gov/comments/s7-22-10/s72210.shtml.*

[387] *See, e.g.,* comment letters to File No. S7–22–10 from the American Bankers Association (Nov. 29, 2010) and British Bankers' Associations (Dec. 1, 2010).

[388] *See* comment letters to File No. S7–22–10 from Fidelity Management & Research Company (Nov. 29, 2010), Doug Morgan (Sept. 20, 2010) and Yong Zheng (Dec. 13, 2010). Fidelity supported the proposed requirements and recommended ''more granular disclosure on repo portfolios.'' Some of Fidelity's recommendations have since been addressed by revised FASB guidance on accounting for repurchase financings. Registrants currently are required to disclose information on transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, registrants must provide increased transparency about the types of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. *See* ASU 2014–11 ''Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures.''

[389] *See supra* note 388. *See also* 2010 Liquidity and Capital Resources Interpretive Release.

proposed requirement to further disaggregate amounts in the table by currency, interest rate or other meaningful category [390] as well as the proposed requirement to disclose all categories of short-term borrowings by eliminating a threshold for allowing aggregation into categories.[391]

ii. Request for Comment

121. Do current disclosure requirements under Item 303 elicit adequate disclosure of a registrant's reliance on short-term borrowings?

122. Should we revise Item 303 to require specific line-item disclosure of a registrant's use and analysis of short-term borrowings as a source of funding? Are there aspects of the 2010 proposal we should revisit? Would doing so lead to any additional disclosure or analysis that registrants do not already provide under current requirements and guidance? Should we consider other qualitative or quantitative measures for disclosure of short-term borrowings? If so, what measures should we consider?

123. Should we consider different disclosure requirements for financial institutions versus non-financial institutions? If so, which disclosure should we require and why?

124. Should we require registrants to provide chart or graph of its short-term borrowings?

6. Off-Balance Sheet Arrangements (Item 303(a)(4))

Item 303(a)(4) requires, in a separately-captioned section, disclosure of a registrant's off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on a registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.[392] To the extent necessary to an understanding of such arrangements and effect, registrants must disclose the following items and such other information that the registrant believes is necessary for such an understanding:

- The nature and business purpose of such off-balance sheet arrangements;
- the importance to the registrant of such off-balance sheet arrangements in respect of its liquidity, capital resources, market risk support, credit risk support or other benefits;
- the amounts of revenues, expenses and cash flows arising from such arrangements; the nature and amounts of any interests retained, securities issued and other indebtedness incurred in connection with such arrangements; and the nature and amounts of any other obligations or liabilities (including contingent obligations or liabilities) of the registrant arising from such arrangements that are or are reasonably likely to become material and the triggering events or circumstances that could cause them to arise; and
- any known event, demand, commitment, trend or uncertainty that will result in or is reasonably likely to result in the termination, or material reduction in availability of a registrant's off-balance sheet arrangements that provide material benefits, and the course of action that the registrant has taken or proposes to take in response to any such circumstances.

Item 303(a)(4)(ii) defines off-balance sheet arrangements as certain guarantees, retained or contingent interests in assets transferred to an unconsolidated entity, obligations under certain derivative instruments,[393] and variable interests in an unconsolidated entity.

a. Comments Received

S–K Study. One commenter stated that disclosure of off-balance sheet arrangements was redundant with financial statement disclosure requirements.[394]

Disclosure Effectiveness Initiative. A few commenters stated that disclosure of off-balance sheet arrangements was redundant of disclosure in the financial statements.[395] These commenters suggested either eliminating this requirement or expressly allowing registrants to cross-reference to the disclosure in the financial statements. One of these commenters also noted that disclosures under this item are ''generally boilerplate and/or redundant'' and recommended a more ''principles-based'' approach to this disclosure.[396] One commenter listed off-balance sheet disclosure as ''some of the most challenging disclosures'' that could be improved.[397]

b. Discussion

The Sarbanes-Oxley Act required the Commission to adopt rules providing that each annual and quarterly financial report required to be filed with the Commission must include disclosure about off-balance sheet arrangements.[398] Earlier in 2002, prior to enactment of the Sarbanes-Oxley Act, the Commission issued a statement on the desirability of enhanced disclosure in MD&A of off-balance sheet arrangements.[399] Much of the language and many of the concepts in the Sarbanes-Oxley Act were consistent with the language and concepts in this Commission statement.[400]

In its 2002 statement, the Commission noted that off-balance sheet arrangements often are integral to both liquidity and capital resources and that registrants should ''consider all of these items together, as well as individually,''

[390] *See* comment letters to File No. S7–22–10 from the American Bar Association (Dec. 17, 2010), American Bankers Association (Nov. 29, 2010), Barclays Bank PLC (Nov. 29, 2010), Citigroup Inc. (Nov. 29, 2010), Cleary Gottlieb Steen & Hamilton LLP (Nov. 29, 2010), Chevron Corp. (Nov. 16, 2010), Credit Suisse Group AG (Nov. 29, 2010), Institute of Management Accountants (Nov. 16, 2010), New York City Bar Association (Nov. 29, 2010), Regions Financial Corp. (Nov. 29, 2010), UBS AG (Nov. 29, 2010).

[391] *See* comment letters to File No. S7–22–10 from the American Bankers Association (Nov. 29, 2010), Barclays Bank PLC (Nov. 29, 2010), Cleary Gottlieb Steen & Hamilton LLP (Nov. 29, 2010), Davis Polk & Wardwell LLP (Nov. 29, 2010), Institute of Management Accountants (Nov. 16, 2010), Morgan Stanley (Nov. 29, 2010), Regions Financial Corp. (Nov. 29, 2010), Barclays Bank PLC (Nov. 29, 2010), Ford Motor Company (Nov. 29, 2010), BDO USA LLP (Nov. 22, 2010) and American Bar Association (Dec. 17, 2010).

The proposed rule was a change from existing Industry Guide 3 instructions, which allows categories of short-term borrowings to be aggregated where they do not exceed thirty percent of the company's stockholders' equity at the end of the period. Instruction to Item VII of Industry Guide 3.

[392] Item 303(a)(4) of Regulation S–K [17 CFR 229.303(a)(4)].

[393] For registrants whose financial statements are prepared in accordance with U.S. GAAP, the definition includes a contract that would be accounted for as a derivative instrument, except that it is both indexed to the registrant's own stock and classified in the registrant's statement of stockholders' equity. *See* ASC 815–10–15–74. For other registrants, the definition includes derivative instruments that are both indexed to the registrant's own stock and classified in stockholders' equity, or not reflected, in the company's statement of financial position.

[394] *See* Ernst & Young 1.

[395] *See, e.g.,* CCMC, SCSGP, ABA 1, and ABA 2.

[396] *See* ABA 1. For example, this commenter suggested requiring registrants to disclose the potential impact on the registrant of the acceleration or increase of material off-balance sheet arrangements.

[397] *See* CFA Institute. This commenter did not provide specific recommendations on how to improve this disclosure.

[398] Section 401(a) of the Sarbanes-Oxley Act added Section 13(j) to the Exchange Act [15 U.S.C. 78m(j)], which directed the Commission to adopt rules requiring each annual and quarterly financial report filed with the Commission to disclose ''all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.''

[399] *See* 2002 Commission Statement about MD&A.

[400] *See id. See also* Disclosure in Management's Discussion and Analysis About Off-Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments, Release No. 33–8144, Nov. 4, 2002 [67 FR 68054 (Nov. 8, 2002)] (''Off-Balance Sheet and Contractual Obligations Proposing Release'').

when drafting MD&A disclosure.[401] The Commission further noted that off-balance sheet arrangements and transactions with unconsolidated, limited purpose entities should be discussed pursuant to Item 303(a) when they are ''reasonably likely to affect materially liquidity or the availability of or requirements for capital resources.'' [402]

The 2002 statement was consistent with Commission rules and guidance existing at the time. For example, Item 303(a)(2)(ii) specifically required registrants to disclose off-balance sheet financing arrangements in their discussion of capital resources.[403] Similarly, the 1989 MD&A Interpretive Release indicated that a registrant's discussion of long-term liquidity and long-term capital resources must address demands or commitments, including any off-balance sheet items.[404]

In response to the Sarbanes-Oxley Act, the Commission adopted more specific disclosure requirements for off-balance sheet arrangements in 2003.[405] When adopting these rules, the Commission reiterated that, while only one item in its MD&A rules specifically identifies off-balance sheet arrangements,[406] other requirements ''clearly require disclosure of off-balance sheet arrangements if necessary to an understanding of a registrant's financial condition, changes in financial condition or results of operations.'' [407] The new rules were intended to clarify the disclosures that registrants must make about off-balance sheet arrangements and required registrants to provide those disclosures in a separately designated section of MD&A.[408]

In 2004, as part of a broader effort to expand the events that registrants must report on a current basis, the Commission adopted additional requirements for disclosing off-balance sheet arrangements on Form 8–K.[409] These new provisions of Form 8–K, which remain in effect today, require registrants to file a report upon the creation of a direct financial obligation or an obligation under an off-balance sheet arrangement (Item 2.03) and to file a report if a triggering event occurs that causes the increase or acceleration of a such an obligation and the consequences of the event are material to the registrant (Item 2.04).[410] While the Form 8–K requirements rely on the definition of ''off-balance sheet arrangement'' in Item 303(a)(4)(ii), the substance of the disclosure is different. Unlike Item 303(a)(4), Form 8–K does not require registrants to provide an analysis of off-balance sheet arrangements or their importance to the registrant.

In the proposing release for Item 303(a)(4), the Commission recognized that parts of the proposed off-balance sheet disclosure requirements might overlap with disclosure presented in the footnotes to the financial statements. The Commission stated that the proposed rules were designed to provide more comprehensive information and analysis in MD&A than what was provided in the footnotes.[411]

Since the adoption of Item 303(a)(4), the FASB has issued additional requirements that further overlap with this item.[412] Currently, U.S. GAAP requires disclosure about transactions or arrangements that overlap with Item 303(a)(4)'s definition of off-balance sheet arrangements. For example, U.S. GAAP requires disclosure in the notes to the financial statements of the nature and amount of a guarantee,[413] retained or contingent interests in assets transferred to unconsolidated entities,[414] pertinent information of derivative instruments that are classified as stockholder's equity under U.S. GAAP,[415] and obligations under variable interests in unconsolidated entities.[416]

Because of this overlap, in response to Item 303(a)(4), registrants often provide cross-references to the relevant notes to their financial statements or provide disclosure that is duplicative of information in the notes. While many of the requirements in Item 303(a)(4) overlap with U.S. GAAP, some of the requirements related to the location, presentation and nature of the disclosure are not the same. Additionally, Item 303(a)(4) disclosure is not audited.

Location of Disclosure. In its 2002 statement, the Commission observed that investors will often find information relating to a particular matter more meaningful if it is disclosed in a single location, rather than presented in a fragmented manner throughout the filing.[417] In proposing the off-balance sheet disclosure requirements, the Commission identified as one of its objectives to provide investors with information necessary to understand a registrant's off-balance sheet arrangements that are neither readily apparent nor easily understood from reading the financial statements alone.[418]

Item 303(a)(4)(i) specifies that off-balance sheet arrangements should be discussed in a separately-captioned section. The instructions to Item 303(a)(4) permit that discussion to cross-reference to information provided in the footnotes to the financial statements, rather than repeat it, provided that the MD&A disclosure integrates the substance of the footnotes in a manner designed to inform readers of the significance of the information that is cross-referenced.[419] By contrast, U.S. GAAP does not prescribe the location of these disclosures, which may be dispersed throughout the notes to the financial statements. However, interactive data allows investors to isolate disclosures about off-balance sheet arrangements even when it is dispersed within the notes to the financial statements.

Presentation of Disclosure. Item 303(a)(4) requires disclosure for the most recent period and a discussion of changes from the previous year where necessary to an understanding of the disclosure.[420] U.S. GAAP does not

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[401] *See* 2002 Commission Statement about MD&A at 3748.

[402] *See id.* at 3748.

[403] Item 303(a)(2)(ii) of Regulation S–K [17 CFR 229.303(a)(2)(ii)]. The item specifies that the discussion shall consider changes between equity, debt and any off-balance sheet financing arrangements.

[404] *See* 1989 MD&A Interpretive Release at 22431 (''The discussion of long-term liquidity and long-term capital resources must address material capital expenditures, significant balloon payments or other payments due on long-term obligations, and other demands or commitments, including any off-balance sheet items, to be incurred beyond the next 12 months, as well as the proposed sources of funding required to satisfy such obligations.'').

[405] *See* Off-Balance Sheet and Contractual Obligations Adopting Release.

[406] Item 303(a)(2)(ii) of Regulation S–K [17 CFR 229.303(a)(2)(ii)].

[407] *See* Off-Balance Sheet and Contractual Obligations Adopting Release at 5983.

[408] *See id.*

[409] *See* 2004 Form 8–K Adopting Release.

[410] 17 CFR 249.308.

[411] *See* Off-Balance Sheet and Contractual Obligations Proposing Release.

[412] In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140,* which requires enhanced disclosures about transfers of financial assets and a transferor's continuing involvement with transfers of financial assets accounted for as sales. Also in June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R),* which requires enhanced disclosures about an enterprise's involvement in a variable interest entity, including unconsolidated entities. SFAS No. 166 and 167 have been codified as ASC Topics 860 (Transfers and Servicing) and 810 (Consolidation), respectively.

[413] *See* ASC 460–10–50.

[414] *See* ASC 860–10–50–3, ASC 860–20–50.

[415] *See* ASC 815–40–50–5, ASC 505–10–50.

[416] *See* ASC 810–10–50–4.

[417] *See* 2002 Commission Statement about MD&A.

[418] *See* Off-Balance Sheet and Contractual Obligations Proposing Release.

[419] Instruction 5 to Item 303(a)(4) of Regulation S–K [17 CFR 229.303(a)(4)].

[420] Instruction 4 to Item 303(a)(4) [17 CFR 229.303(a)(4)].

require discussion of changes from the previous year.

Nature of Disclosures. While Item 303(a)(4) and U.S. GAAP both require disclosure of the nature and amounts associated with off-balance sheet arrangements, Regulation S–K requires additional disclosure about the business purpose of the off-balance sheet arrangement [421] and the importance of the off-balance sheet arrangement to the registrant's liquidity, capital resources, market risk support, credit risk support, and other benefits.[422] Item 303(a)(4) also requires disclosure of any known event, demand, commitment, trend, or uncertainty that will result in or is reasonably likely to result in the termination or material reduction in the availability of material off-balance sheet arrangements to the registrant and the course of action the registrant has taken or proposes to take to address such circumstances. U.S. GAAP does not require this disclosure.

c. Request for Comment

125. Does Item 303(a)(4) elicit disclosure that is important to investors? Is this information otherwise available in Commission filings?

126. If we retain the disclosure requirements in Item 303(a)(4), should we expand the disclosure required by this item? If so, what additional disclosure would be important to investors and why? For example, should we revise our rules to require registrants to analyze the risks and financial potential associated with its off-balance sheet arrangements?

127. If we retain the disclosure requirements in Item 303(a)(4), should this information be located in MD&A, the notes to the financial statements, or both? Is the location of the disclosure important? Are there challenges associated with auditing this information?

128. If we eliminate Item 303(a)(4), do the other requirements in Item 303 and the requirements in U.S. GAAP require adequate disclosure in terms of the location, presentation and nature of information about off-balance sheet arrangements? Would eliminating Item 304(a)(4) result in costs to investors?

129. In the adopting release for Item 303(a)(4), the Commission noted that ''[t]he MD&A rules already require disclosure regarding off-balance sheet arrangements and other contingencies.'' [423] Do the disclosure requirements in Item 303 regarding liquidity and capital resources require adequate disclosure about matters that will result in or is reasonably likely to result in the termination or material reduction in the availability of material off-balance sheet arrangements to the registrant and the course of action the registrant has taken or proposes to take to address such circumstances?

130. Should we require additional disclosure of off-balance sheet arrangements that occurred during a reporting period, such as an exhibit identifying all such arrangements?

7. Contractual Obligations (Item 303(a)(5))

Item 303(a)(5) requires tabular disclosure of a registrant's known contractual obligations for long-term debt, capital leases, operating leases, purchase obligations and other long-term liabilities reflected on the registrant's balance sheet under U.S. GAAP.[424] The Commission has defined the first three categories of obligations (long-term debt, capital leases and operating leases) by reference to the relevant U.S. GAAP accounting pronouncements that require disclosure of these obligations in the financial statements or notes thereto.[425]

For purchase obligations, the Commission defined this term as an agreement to purchase goods or services that is enforceable, legally binding on the registrant and specifies all significant terms.[426] The Commission stated that the definition of ''purchase obligations'' is designed to capture the registrant's capital expenditures for purchases of goods or services over a five-year period.[427] Some purchase obligations are executory contracts, and therefore are not recognized as liabilities in accordance with U.S. GAAP.[428]

The fifth category of contractual obligations, ''Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet under GAAP,'' captures all other long-term liabilities that are reflected on the registrant's balance sheet under the registrant's applicable U.S. GAAP. Common examples of other obligations disclosed in this line-item of the table include postretirement benefits, interest on debt, and tax liabilities for uncertain tax positions.

Item 303(a)(5) requires registrants to disclose the amounts of payments due by specified time periods, aggregated by the type of contractual obligation.[429] Registrants must disclose payments due in less than 1 year, 1–3 years, 3–5 years and more than 5 years, as well as the total, aggregate amount of obligations in each category. Amounts are required to be set forth in the aggregate and there is no materiality qualifier.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter called for improvements in the ability to contextualize the table of contractual obligations, but did not provide additional details.[430] Another commenter recommended that we add an instruction to Item 303(a)(5) indicating that, to the extent disclosure in response to the item is included in the notes to the financial statements, registrants should use cross-references to avoid duplicative disclosure.[431]

b. Discussion

In response to a 2001 petition for an interpretive release,[432] the Commission issued a statement in 2002 recommending that registrants present information about contractual obligations and commercial commitments in a single location within the filing.[433] The statement included a recommended table of contractual obligations resembling that of current Item 303(a)(5).[434] This recommended table became a line-item requirement when the Commission adopted Item 303(a)(5) in 2003.[435]

When adopting Item 303(a)(5), the Commission recognized that much of the disclosure required by this item is addressed under U.S. GAAP requirements.[436] Similarly, disclosure

[421] Item 303(a)(4)(i)(A) of Regulation S–K [17 CFR 229.303(a)(4)(i)(A)].

[422] Item 303(a)(4)(i)(B) of Regulation S–K [17 CFR 229.303(a)(4)(i)(B)].

[423] *See* Off-Balance Sheet and Contractual Obligations Adopting Release at 5982.

[424] 17 CFR 229.303(a)(5) of Regulation S–K [17 CFR 229.303(a)(5)].

[425] Item 303(a)(5)(ii) of Regulation S–K [17 CFR 229.303(a)(5)(ii)] (referring to ASC Topics 470–10–50–1 and 840 in defining the terms ''long-term debt obligation,'' ''capital lease obligation'' and ''operating lease obligation'').

[426] Item 303(a)(5)(ii) of Regulation S–K [17 CFR 229.303(a)(5)(ii)].

[427] *See* Off-Balance Sheet and Contractual Obligations Adopting Release.

[428] *See id.*

[429] Item 303(a)(5)(i) of Regulation S–K. Registrants may disaggregate the categories specified in the item and use other categories suitable to their businesses, so long as the presentation includes all of the registrant's obligations that fall within the specified categories.

[430] *See* CFA Institute.

[431] *See* ABA 2.

[432] *See* Petition for Issuance of Interpretive Release Concerning MD&A under Regulation S–K, Item 303, (Dec. 31, 2001), *available at https://www.sec.gov/rules/petitions/petndiscl-12312001.htm.*

[433] *See* 2002 Commission Statement about MD&A.

[434] *See id.* The recommended table included long-term debt, capital lease and operating lease obligations and covered similar periods.

[435] *See* Off-Balance Sheet and Contractual Obligations Adopting Release.

[436] *See* Off-Balance Sheet and Contractual Obligations Adopting Release at 5986 (''The

Continued

about other obligations not required by U.S. GAAP, ''such as purchase contracts, may or may not be disclosed, but if disclosed, it is usually dispersed throughout the filing and may not be presented in a consistent manner among registrants.'' [437]

By providing aggregated information of contractual obligations in a single location and appropriate context for investors to assess the impact of off-balance sheet arrangements with respect to liquidity and capital resources, Item 303(a)(5) was intended to improve transparency of a registrant's short- and long-term liquidity and capital resource needs. This disclosure was also intended to ''improve an investor's ability to compare registrants.'' [438]

The Commission has issued guidance on Item 303(a)(5) on one occasion since its adoption.[439] In a 2010 interpretive release, the Commission noted that registrants and industry groups had raised questions about how to treat a number of items under the contractual obligations requirement, including: interest payments, repurchase agreements, tax liabilities, synthetic leases, and obligations that arise under off-balance sheet arrangements.[440] Because the questions tended to be fact-specific and closely related to a registrant's particular business and circumstances, the Commission declined to provide specific guidance about these items or the presentation of the contractual obligations table. Instead, the Commission noted that the requirement itself permits flexibility and encouraged registrants to develop a presentation method that is clear, understandable and appropriately reflects the categories of obligations that are meaningful in light of its capital structure and business.[441]

The Commission's guidance also explained that tabular disclosure of contractual obligations should be prepared with the goal of presenting a meaningful snapshot of cash requirements arising from contractual payment obligations. Registrants were instructed to highlight any changes in presentation that are made so that investors may use the information to make comparisons from period to period. The Commission suggested that footnotes should be used to provide information necessary for an understanding of the timing and amount of specified contractual obligations. Registrants also should consider additional narrative discussion outside of the table to promote understanding of the tabular data.[442] In practice, however, registrants typically do not include additional narrative with their contractual obligations table.

c. Request for Comment

131. Does the table of contractual obligations present a meaningful snapshot of a registrant's cash requirements for contractual obligations? How could the format of the disclosure in the table be improved? Should we consider an alternative presentation or format for this disclosure?

132. Should we require narrative disclosure to accompany the tabular disclosure? For example, should we require registrants to discuss how they plan to meet current and future obligations disclosed in the table? If so, what additional narrative disclosure would be useful to investors?

133. Item 303(a)(5) was intended to provide aggregated information of contractual obligations in a single location and appropriate context for investors to assess the impact of off-balance sheet arrangements with respect to liquidity and capital resources. Would narrative disclosure improve readers' ability to compare registrants by reconciling the information in the table to information elsewhere in MD&A and financial statements? Should comparability among registrants continue to be a goal? Should we continue to require this disclosure in a single location or is disclosure elicited under U.S. GAAP, in various parts of a registrant's filings, sufficient?

134. Item 303(a)(5) requires disclosure of five categories of contractual obligations. Should we expand the rule to include other categories of contractual obligations and if so, what categories should we consider?

135. Would additional guidance or instructions about how to treat certain types of obligations, such as interest payments, repurchase agreements or tax liabilities, be helpful to registrants in preparing this disclosure? Would such guidance limit the intended flexibility of the rule?

136. In the 2010 Liquidity and Capital Resources Interpretive Release, the Commission suggested that separating amounts in the table into those that are reflected on the balance sheet and those arising from off-balance arrangements might be useful to a clear understanding of the information presented. Should we revise Item 303(a)(5) to require registrants to separate amounts in the table of contractual obligations into those that are reflected on the balance sheet and those arising from off-balance sheet arrangements? Should we require this disclosure pursuant to some threshold amount?

8. Critical Accounting Estimates

A registrant's results of operations, financial condition, and changes to financial condition often depend on estimates involved in applying accounting policies that entail uncertainties and subjectivity. Critical accounting estimates are those accounting judgments and estimates that relate to the items that are material to the financial statements, taken as a whole, and that management believes are most critical—that is, those that are most important to portraying the registrant's financial condition and results and require management's most difficult, subjective or complex judgments.[443] While U.S. GAAP requires financial statement footnote disclosure about accounting policies,[444] Item 303 requires disclosure of trends, events or uncertainties known to management that could materially affect reported financial information. Item 303 does not specifically address critical accounting estimates.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter recommended amending Item 303 to require disclosure about management's significant

preparation of financial statements in accordance with GAAP already requires registrants to assess payments under all of the above categories of contractual obligations, except for purchase obligations.'').

Item 303(a)(5) directly refers to ASC Topics in defining three of the five required categories of contractual obligations that must be included within the table. *See supra* note 425 and accompanying text.

[437] *See* Off-Balance Sheet and Contractual Obligations Adopting Release at 5990.

[438] *Id.* at 5990.

[439] In the 2003 MD&A Interpretive Release, the Commission stated that it was not addressing specifically disclosures of contractual obligations because it had had little experience with companies' application of the new rule, adopted a few months earlier. Nevertheless, the Commission noted that the overall guidance in the 2003 MD&A Interpretive Release is applicable to all MD&A discussions. *See* 2003 MD&A Interpretive Release.

[440] *See* 2010 Liquidity and Capital Resources Interpretive Release.

[441] *See id.* The Commission noted that the staff has observed that divergent practices have developed in connection with Item 303(a)(5) disclosure, with registrants drawing different conclusions about the information to be included in the table, but also acknowledged that the rule permits flexibility so the presentation can reflect company-specific information suitable to a company's business.

[442] *See id.*

[443] *See* Accounting Policies; Cautionary Advice Regarding Disclosure, Release No. 33–8040 (Dec. 12, 2001) [66 FR 65013 (Dec. 17, 2001)] (''Cautionary Advice Release'').

[444] *See* ASC Topic 235–10–50–1.

judgments and assumptions underlying its use of critical accounting estimates.[445] This commenter also recommended amending Item 303 to explain that the disclosure about critical accounting estimates required in MD&A is meant to supplement, not duplicate, the information provided in the notes to the financial statements.[446] In addition, this commenter suggested that we consider whether requiring independent auditor negative assurance would enhance the quality of the recommended disclosures by imposing more rigor in its preparation.[447] Another commenter recommended that the Commission work with accounting standard-setters to improve financial statement presentation and related disclosures, such as estimates, judgments and choices.[448] One commenter also suggested that the Commission work with the auditing profession to eliminate descriptions of recent accounting changes for pronouncements that have no effect on a registrant.[449] Another commenter recommended that the Commission coordinate with the FASB to review and clarify the disclosure objectives of critical accounting estimates in MD&A and significant accounting policies in the financial statements to determine whether they provide distinct and useful information and provide guidance on how both requirements should work best.[450]

b. Discussion

In 2001, the Commission encouraged registrants to explain in their MD&A the judgments and uncertainties affecting the application of their critical accounting policies, as well as the likelihood that materially different amounts would be reported under different conditions or using different assumptions.[451] The Commission also stated its intent to consider new rules to elicit more precise disclosures about the critical accounting policies.[452]

In 2002, the Commission proposed new rules that would have required, among other things, disclosure of accounting estimates resulting from the application of critical accounting policies.[453] The proposed rules would have defined a ''critical accounting estimate'' as an accounting estimate that meets the following two criteria: (i) The accounting estimate must require the registrant to make assumptions about matters that are highly uncertain at the time the accounting estimate is made; and (ii) it must be the case that different estimates that the registrant reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on the presentation of the registrant's financial condition, changes in financial condition or results of operations.[454] As proposed, registrants would have been required to:

- Describe the critical accounting estimates (including the methodology underlying each critical accounting estimate, assumptions about highly uncertain matters and other assumptions that are material) and identify where and how they affect the registrant's reported financial results, financial condition and changes in financial condition;[455]
- provide a better understanding of the sensitivity of the reported operating results and financial condition to changes in the critical accounting estimates or their underlying assumptions;[456] and
- state whether or not senior management discussed the development, selection and disclosure of those critical accounting estimates with the registrant's audit committee.[457]

The Commission did not adopt these rules, but subsequently provided interpretive guidance on disclosure of critical accounting estimates.[458] In the 2003 MD&A Interpretive Release, the Commission stated that registrants should provide disclosure about critical accounting estimates or assumptions in MD&A where:

- The nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and
- the impact of the estimates and assumptions on financial condition or operating performance is material.[459]

The Commission also clarified that this disclosure should supplement, not duplicate, the description of accounting policies that are already disclosed in the notes to the financial statements.[460] While accounting policy notes in the financial statements generally describe the method used to apply an accounting principle, the discussion in MD&A should present a registrant's analysis of the uncertainties involved in applying the principle.[461]

Despite Commission guidance, many registrants repeat the discussion of significant accounting policies from the notes to the financial statements in their discussion of critical accounting estimates in MD&A and provide limited additional discussion of the critical accounting estimates. We are seeking public input on how to revise our requirements to improve the discussion of critical accounting estimates in MD&A.

[445] *See* ABA 1.

[446] *See id. See also* ABA 2. The Commission has also stated that critical accounting estimates should supplement and not duplicate the description of accounting policies in the notes to the financial statements. *See, e.g.,* 2003 MD&A Interpretive Release.

[447] *See* ABA 1.

[448] *See* CFA Institute.

[449] *See* A. Radin.

[450] *See* SCSGP.

[451] *See* Cautionary Advice Release. The Commission alerted registrants to the need for greater investor awareness of the sensitivity of financial statements to the methods, assumptions and estimates underlying their preparation and stated that the objective of this disclosure is consistent with the objective of MD&A.

[452] *See id.*

[453] *See* Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies, Release No. 33–8098 (May 10, 2002) [67 FR 35620 (May 20, 2002)] (''Critical Accounting Proposing Release''). The Commission also proposed rules requiring a registrant that has initially adopted an accounting policy with a material impact on its financial presentation to disclose information that includes: what gave rise to the initial adoption; the impact of the adoption; the accounting principle adopted and method of applying it; and the choices it had among accounting principles. *See id.*

[454] *See id.*

[455] Disclosure would have been required, if applicable, regarding why the accounting estimate was reasonably likely to change in future periods with a material impact on the registrant's financial presentation. In certain situations, disclosures would have been required for individual segments of the registrant's business.

[456] More specifically, the rules would have required, for each critical accounting estimate, discussion of changes that would result either from (i) making reasonably possible, near-term changes in the most material assumptions underlying the estimate, or (ii) using in place of the recorded estimate the ends of the range of reasonably possible amounts that the registrant likely determined when formulating its recorded estimate.

[457] *See* Critical Accounting Proposing Release.

[458] This interpretive guidance was provided based on the Division staff's review of registrant disclosures, including its Fortune 500 review. The Commission concluded that additional guidance would be especially useful in a few areas of MD&A, including disclosure of critical accounting estimates. *See* 2003 MD&A Interpretive Release.

[459] *See id.*

[460] *See id.* The Commission further stated that ''[e]qually important, companies should address the questions that arise once the critical accounting estimate or assumption has been identified, by analyzing, to the extent material, such factors as how they arrived at the estimate, how accurate the estimate/assumption has been in the past, how much the estimate/assumption has changed in the past, and whether the estimate/assumption is reasonably likely to change in the future.'' *See id.* at 75065.

The FASB has also stated that distinguishing between a change in an accounting principle and a change in an accounting estimate is sometimes difficult, and in some cases, a change in accounting estimate is effected by a change in accounting principle. *See* ASC Topic 250–10–45–18.

[461] *See* 2003 MD&A Interpretive Release.

c. Request for Comment

137. Should we revise Item 303 to require disclosure about critical accounting estimates? If so, what information would be important to investors?

138. Should we define ''critical accounting estimates''? If so, should the definition be based on our 2001 guidance,[462] the definition proposed in 2002,[463] or something else? Why? Are there any other elements to a ''critical accounting estimate'' that have not been captured in prior definitions?

139. Why do registrants repeat the discussion of accounting policies presented in the notes to the financial statements? How can we encourage registrants to eliminate repetition in MD&A of the discussion of accounting policies provided in the notes to the financial statements?

140. Do registrants find the guidance for disclosing critical accounting estimates from the 2003 MD&A Interpretive Release helpful in determining whether such disclosure is required? Would it be helpful for registrants if we incorporated this or other elements of our guidance on critical accounting estimates into Regulation S–K?

141. Should we revise our requirements to elicit more comparable disclosure among registrants? If so, how? Should we adopt prescriptive requirements relating to critical accounting estimates? Are there any accounting estimates common to a particular industry that are ''critical'' to all participants in that industry?

142. Should we require the disclosure of management's judgments and estimates that form the basis for MD&A disclosure? For example, should we require registrants to disclose the quantitative and qualitative factors that form its assessment of materiality? Should we require registrants to disclose how they assessed materiality?

143. Should we require management to disclose the nature of its assessment of errors that it determined to be immaterial and therefore were not corrected?

144. Should we require disclosure of other critical accounting estimates, such as those that impact other metrics or measures, such as the number of new customers or the number of subscribers?

C. Risk and Risk Management

Disclosure of a registrant's most significant risks provides investors with important context for assessing the registrant's financial potential. Risk-related disclosure is required by multiple items of Regulation S–K and certain financial reporting requirements.[464] In this section, we focus on:

- Item 503(c), which requires disclosure of the most significant factors that make an investment in a registrant's securities speculative or risky; [465] and
- Item 305, which requires quantitative and qualitative disclosure about market risk.[466]

Also in this section, we explore different approaches to risk-related disclosure. Specifically, we consider whether requiring additional disclosure of management's approach to risk and risk management and consolidating risk-related disclosure would, on balance, be beneficial to investors and registrants. We also seek to better understand how our disclosure requirements could be updated to enhance investors' ability to evaluate a registrant's risk exposures. We are especially interested in feedback on how we can improve the content and readability of the risk factors included in a filing as well as the potential advantages and disadvantages of different approaches to risk-related disclosure.

1. Risk Factors (Item 503(c))

Item 503(c) requires disclosure of the most significant factors that make an investment in a registrant's securities speculative or risky and specifies that the discussion should be concise and organized logically.[467] Although the requirement is principles-based, it includes the following specific examples as factors that may make an offering speculative or risky:

- A registrant's lack of an operating history,
- a registrant's lack of profitable operations in recent periods,
- a registrant's financial position,
- a registrant's business or proposed business, or
- the lack of a market for a registrant's common equity securities or securities convertible or exercisable for common equity securities.[468]

Additionally, Item 503(c) directs registrants to explain how each risk affects the registrant and discourages disclosure of risks that could apply to any registrant.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. We received several comment letters with recommendations on risk factor disclosure.[469] One commenter suggested a comprehensive default framework for risk factor disclosure that would classify risk factors based upon relative likelihood and relative impact.[470] This proposed framework would require registrants to classify both relative likelihood and relative impact into one of three tiers based on the risk's probable occurrence and the relative seriousness of the consequences if a risk materializes.

One commenter stated that risk factors should be more entity-specific and connected to financial results.[471] Another commenter noted that registrants disclose risk factors that ''go well beyond those that make an investment 'speculative''' and stated that any new risk factor disclosure requirements should be principles-based. This commenter suggested revising Item 503(c) to include examples of generic disclosure that need not be included as risk factors.[472] One commenter generally recommended reducing lengthy, unnecessary risk factor disclosure.[473] Another commenter urged that any such requirement be grounded in the principle of materiality, suggesting that we consider whether a

[462] *See* Cautionary Advice Release.

[463] *See* Critical Accounting Proposing Release.

[464] Although we focus on Items 503(c) and 305 of Regulation S–K, risk-related disclosure may be provided in response to other requirements, such as Items 101(d)(3) (risk attendant to foreign operations), 103 (legal proceedings), or 303 (MD&A). For financial reporting requirements, risk-related disclosure may be included in the financial statements in response to ASC Topics 275 (risks and uncertainties), 450 (contingencies), or 825 (financial instruments), among others. The staff is separately considering Items 101(d)(3) and 103 in developing recommendations for the Commission for potential changes to update or simplify certain disclosure requirements. For a description of this project, *see* Section I. For a discussion of Item 303, *see* Section IV.B.3 to IV.B.7.

[465] Item 503(c) of Regulation S–K [17 CFR 229.503(c)].

[466] Item 305 of Regulation S–K [17 CFR 229.305].

[467] Item 503(c) of Regulation S–K [17 CFR 229.503(c)].

[468] *Id.*

[469] *See, e.g.,* letter from Tom C.W. Lin and attached law review article, (July 30, 2014) (''Lin''); CFA Institute; Shearman; A. Radin; CCMC; letters from Reps. Langevin and Himes (June 17, 2015) (''Reps. Langevin and Himes''); Reps. Grijalva, Waters and Lowenthal (July 24, 2015) (''Reps. Grijalva, Waters and Lowenthal''); Sens. Cardin, et al. (Aug. 18, 2015) (''Sens. Cardin, et al.'').

[470] *See* Lin.

[471] *See* CFA Institute (stating that the ability to price risk is important to disclosure effectiveness).

[472] *See* Shearman. The commenter suggested the following factors could be included in a revised Item 503(c) as examples of generic risks that do not need to be disclosed as risk factors: macro-economic risks that effect all businesses in a particular industry; general stock market risks, such as volatility in a company's stock price; summaries of regulation; and risk disclosure that repeats disclosure provided in response to other specific requirements or financial disclosures, such as risks related to key management, legal proceedings and the payment of dividends.

[473] *See* A. Radin (noting the ''excessive volume'' of disclosures required by Regulations S–K and S–X).

reformulated risk discussion should highlight the risks that management views as most significant.[474]

Several comment letters stated there should be additional risk-related disclosure on specific topics.[475] One set of commenters encouraged us to require additional disclosure about cybersecurity and related risks.[476] Another group of commenters focused on additional disclosure of risks associated with oil and gas exploration, including drilling in the Arctic Ocean.[477]

We received two comment letters on the impact of the Private Securities Litigation Reform Act (''PSLRA'') on risk-related disclosure. One commenter acknowledged that liability concerns may contribute to the length of Exchange Act documents but expressed concern about any effort to require issuers to reduce the length or number of risk factors included in a filing.[478] Another commenter attributed the growing length of risk factor disclosure to liability concerns and noted that any efforts to reduce risk factor disclosure, without concomitant changes to the relevant rules or the protection of a safe harbor, are unlikely to be effective because there is little incentive for registrants to scale-back risk factor disclosure.[479]

b. Discussion

The five factors specified in Item 503(c) as factors that may make an offering speculative or risky have not changed since the Commission published its initial guidance on risk factor disclosure in 1964. These factors were derived from previous stop order proceedings under Section 8(d) of the Securities Act where the Commission suspended the effectiveness of previously filed registration statements due, in part, to inadequate disclosure about speculative aspects of the registrant's business.[480]

Since the Commission first published guidance on risk factor disclosure in 1964,[481] it has been reiterated that this disclosure should be:

- Focused on the ''most significant'' or ''principal'' factors that make a registrant's securities speculative or risky, [482]
- placed in the forefront of the filing,[483] and
- organized and concise.[484]

Commission and Division guidance also has emphasized that registrants should avoid ''boiler plate'' risk factors, and that a discussion of risk in purely generic terms does not indicate how a risk may affect an investment in a particular registrant.[485] When adding risk factor requirements to annual and quarterly reports and Exchange Act registration statements on Form 10, the Commission discouraged the unnecessary restatement of risk factors in quarterly reports, emphasizing that quarterly reports need only disclose material changes from risk factors previously disclosed in other Exchange Act reports.[486]

The length and number of risk factors disclosed by registrants varies. Although Item 503(c) directs registrants to provide a concise risk factors discussion, one study found that registrants include an average of 22 different risk factors in disclosure spanning an average of 8 pages.[487] Another study found that registrants increased the length of risk factor disclosures from 2006 to 2013 by more than eighty-five percent in terms of word count relative to the total word count of Form 10–K filings, and that this increase in quantity may not be associated with better disclosure.[488] A third study found that the average number of risk factors disclosed in certain sectors of the energy industry ranged between twelve and fifty-one.[489] For quarterly reports, it is not unusual for registrants to repeat the entire risk factor discussion from their previously filed annual reports,[490] even though registrants are required to disclose only material changes from previously disclosed risks.[491]

Although Item 503(c) instructs registrants not to present risks that could apply to any registrant, risk factor disclosure typically includes generic risk factors. Registrants often use risk factors that are similar to those used by others in their industry or circumstances as the starting point for risk disclosure, and the disclosure is not always tailored to each registrant's particular risk profile. Examples of generic disclosures include risk factors about a registrant's failure to compete successfully, the effect of general economic conditions on a registrant's business, changes in regulation, and dependence upon a registrant's

[474] *See* CCMC.

[475] *See, e.g.,* Reps. Langevin and Himes; Reps. Grijalva, Waters and Lowenthal; Sens. Cardin, et al.

[476] *See, e.g.,* Reps. Langevin and Himes.

[477] *See, e.g.,* Reps. Grijalva, Waters and Lowenthal; Sens. Cardin, et al.

[478] *See* SCSGP (referencing the Commission's proposal to limit the number of risk factors included in a filing in connection with the Commission's Plain English initiative and comments received in connection with that initiative, one of which states ''no issuer should ever be put in the position of choosing significant material risks in order to satisfy a numerical limitation.'').

[479] *See* Shearman (stating that the PSLRA's safe harbor, which requires issuers that disclose forward-looking information to also disclose cautionary information, contributes to lengthy risk factors disclosures).

[480] *See* Guides for Preparation and Filing of Registration Statements, Release No. 33–4936 (Dec. 9, 1968) [33 FR 18617 (Dec. 17, 1968)] (''1968 Guides'') (citing In the Matter of Doman Helicopters, Inc., 41 SE.C. 431 (Mar. 27, 1963); In the Matter of Universal Camera Corporation, 19 SE.C. 648 (June 28, 1945)).

[481] *See* Guides for Preparation and Filing of Registration Statements, Release No. 33–4666 (Feb. 7, 1964) [29 FR 2490 (Feb. 15, 1964)] (''1964 Guides'').

[482] ''Principal'' was the term used in the 1982 Integrated Disclosure Adopting Release and ''most significant'' was the term used in the Plain English Disclosure Adopting Release.

[483] *See* 1964 Guides; 1968 Guides; and 1982 Integrated Disclosure Adopting Release.

[484] *See* 1964 Guides; 1968 Guides; 1982 Integrated Disclosure Adopting Release; and Securities Offering Reform Release.

[485] *See* Plain English Disclosure Adopting Release. *See also* Updated Staff Legal Bulletin No. 7: Plain English Disclosure (June 7, 1999), *available at https://www.sec.gov/interps/legal/cfslb7a.htm* (''Updated Staff Legal Bulletin No. 7'').

[486] *See* Securities Offering Reform Release. In adopting new item requirements in Forms 10–K, 10–KSB, and 10 to require risk factor disclosure, the Commission noted that, though not previously required, many registrants had included for several years risk factor disclosure in their Exchange Act reports, perhaps to take advantage of the safe harbor in Securities Act Section 27A and the judicially-created ''bespeaks caution'' defense.

[487] *See* Investor Responsibility Research Center Institute, *The Corporate Risk Factor Disclosure Landscape,* Jan. 2016, *available at http://irrcinstitute.org/wp-content/uploads/2016/01/FINAL-EY-Risk-Disclosure-Study.pdf.*

[488] *See* Anne Beatty et al., *Sometimes Less is More: Evidence from Financial Constraints Risk Factor Disclosures,* Mar. 2015, *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2186589* (''Beatty et al.''). To examine the ''informativeness'' of risk factor disclosures, the authors of this study analyzed risk factor disclosures about financial constraints and argue that as litigation risk increased during and after the financial crisis, registrants were more likely to disclose immaterial information, resulting in a deterioration of disclosure quality.

[489] *See* PricewaterhouseCoopers LLP, *Stay Informed, 2012 Financial Reporting Survey: Energy industry current trends in SEC reporting,* Feb. 2013, *available at http://www.pwc.com/en_GX/gx/oil-gas-energy/publications/pdfs/pwc-sec-financial-reporting-energy.pdf.* This report reviewed financial reporting trends of 87 registrants with market capitalizations of at least $1 billion that apply U.S. GAAP in the following subsectors of the energy industry: downstream, drillers, independent oil and gas, major integrated oil and gas, midstream and oil field equipment and services. Based on this study, the average number of risk factors in the major integrated oil and gas sector was 12 while the average number of risk factors in the midstream sector was 51. In one sector, the maximum number of risk factors was 95.

[490] *See* PricewaterhouseCoopers LLP, *Stay Informed: 2014 technology financial reporting trends,* Aug. 2014, *available at http://www.pwc.com/en_US/us/technology/publications/assets/pwc-2014-technology-financial-reporting-trends.pdf.* This report reviewed the annual and periodic filings of 135 registrants in the software and Internet, computers and networking, and semiconductors sectors. Based on this study, over half of the registrants surveyed repeated all of their risk factors in their quarterly filings.

[491] *See* Item 1A of Part II of Form 10–Q.

management team. Despite the inclusion of generic risks, however, academic studies find that risk factor disclosure is informative and that the public availability of this information decreases information asymmetry among investors.[492]

c. Request for Comment

145. How could we improve risk factor disclosure? For example, should we revise our rules to require that each risk factor be accompanied by a specific discussion of how the registrant is addressing the risk?

146. Should we require registrants to discuss the probability of occurrence and the effect on performance for each risk factor? If so, how could we modify our disclosure requirements to best provide this information to investors? For example, should we require registrants to describe their assessment of risks?

147. How could we modify our rules to require or encourage registrants to describe risks with greater specificity and context? For example, should we require registrants to disclose the specific facts and circumstances that make a given risk material to the registrant? How should we balance investors' need for detailed disclosure with the requirement to provide risk factor disclosure that is ''clear and concise''? Should we revise our rules to require registrants to present their risk factors in order of management's perception of the magnitude of the risk or by order of importance to management? Are there other ways we could improve the organization of registrants' risk factors disclosure? How would this help investors navigate the disclosure?

148. What, if anything, detracts from an investor's ability to gain important information from a registrant's risk factor disclosure? Do lengthy risk factor disclosures hinder an investor's ability to understand the most significant risks?

149. How could we revise our rules to discourage registrants from providing risk factor disclosure that is not specific to the registrant but instead describes risks that are common to an industry or to registrants in general? Alternatively, are generic risk factors important to investors?

150. Should we specify generic risks that registrants are not required to disclose, and if so, how should we identify those risks? Are there other ways that we could help registrants focus their disclosure on material risks?

151. Should we retain or eliminate the examples provided in Item 503(c)? Should we revise our requirements to include additional or different examples? Would deleting these examples encourage registrants to focus on their own risk identification process?

152. Should we require registrants to identify and disclose in order their ten most significant risk factors without limiting the total number of risk factors disclosed?[493] If so, should other risk factors be included in a separate section of the filing or in an exhibit to distinguish them from the most significant risks? Alternatively, should we require registrants to provide a risk factors summary in addition to the complete disclosure? Would a summary help investors better understand a registrant's risks by highlighting certain information? Are there challenges associated with requiring a summary of the most significant risks?

153. Are there ways, in addition to those we have used in Item 503, our Plain English Rules and guidance on MD&A, to ensure that registrants include meaningful, rather than boilerplate, risk factor disclosure?

154. Risk profiles of registrants are constantly changing and evolving. For example, registrants today face risks, such as those associated with cybersecurity, climate change, and arctic drilling,[494] that may not have existed when the 1964 Guides and 1968 Guides were published. Is Item 503(c) effective for capturing emerging risks? If not, how should we revise Item 503(c) to make it more effective in this regard?

155. What types of investors or audiences are most likely to value the Item 503(c) disclosures?

156. What is the cost of providing the disclosure required by Item 503(c), including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 503(c).

2. Quantitative and Qualitative Disclosures About Market Risk (Item 305)

Item 305 requires quantitative and qualitative disclosure of market risk sensitive instruments that affect a registrant's financial condition.[495] Item 305(a) requires registrants to provide quantitative disclosure about market risk sensitive instruments using one or more of three disclosure alternatives:

(1) Tabular presentation of fair value information and contract terms relevant to determining future cash flows, categorized by expected maturity dates;

(2) Sensitivity analysis expressing the potential loss in future earnings, fair values, or cash flows from selected hypothetical changes in market rates and prices; or

(3) Value at risk (''VaR'') disclosures expressing the potential loss in future earnings, fair values, or cash flows from market movements over a selected period of time and with a selected likelihood of occurrence.[496]

Registrants are required to categorize market risk sensitive instruments into instruments entered into for trading purposes and instruments entered into for purposes other than trading.[497] To the extent material, within both the trading and other than trading portfolios, registrants must provide separate quantitative information for each market risk exposure category (*e.g.,* interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market risks, such as equity price risk).[498]

Item 305(b) requires qualitative information about market risk. Registrants must describe, to the extent material, their primary market risk exposures, how those exposures are managed, and any changes to either the primary market risk exposures or the way that risk exposures are managed.[499]

[492] *See, e.g.,* John Campbell et al., *The Information Content of Mandatory Risk Factor Disclosures in Corporate Filings,* 19 Rev. Acct. Stud. 396, 396–455 (Sept. 2010); Beatty et al.

[493] The Commission has previously considered proposals to either limit the number of risk factors included in a filing or require registrants to list risk factors in the order of priority to the registrant. The Commission did not adopt either of these requirements in response to comments received from investors. *See* Plain English Disclosure Adopting Release at 6370 (''In response to comments, the new rules will not require issuers to limit the length of the summary, limit the number of risk factors, or prioritize risk factors.'').

[494] For a discussion of some emerging risks that registrants may face, *see* Section 0.

[495] Item 305 of Regulation S–K [17 CFR 229.305]. For the purposes of Item 305(a) and (b), market risk sensitive instruments include derivative financial instruments, other financial instruments, and derivative commodity instruments. Each of these terms is defined in General Instruction 3 to Items 305(a) and (b). *See* Disclosure of Market Risk Sensitive Instruments Release.

[496] Item 305(a) of Regulation S–K [17 CFR 229.305(a)].

[497] *Id.*

[498] *Id.* In their materiality assessment, registrants are required to evaluate both the materiality of the fair values of derivative financial instruments, other financial instruments, and derivative commodity instruments as of the end of the latest fiscal year and the materiality of potential, near-term losses in future earnings, fair values, and/or cash flows from reasonably possible near-term changes in market rates or prices. *See* General Instruction 5 to Items 305(a) and (b) of Regulation S–K [17 CFR 229.305(a) and (b)].

[499] Item 305(b) of Regulation S–K [17 CFR 229.305(b)].

One of Item 305's primary objectives is to provide investors with forward looking information about a registrant's potential market risk exposure.[500] To specifically cover the forward-looking aspects of disclosure provided in response to Item 305, the Commission adopted a safe harbor as part of the rule.[501]

a. Comments Received

S–K Study. A few commenters suggested that EGCs should be exempt from Item 305 disclosure.[502] Another commenter expressed concern that the FASB's 2012 Exposure Draft on liquidity risk and interest rate risk disclosures could have created redundancies with some of the disclosures currently required in Items 305 and 303.[503]

Disclosure Effectiveness Initiative. Several commenters noted that, while financial reporting in accordance with evolving accounting standards has greatly expanded since the adoption of Item 305, including the adoption of ASC Topic 815, Item 305 and other disclosure requirements in Regulation S–K have not been revisited to identify and eliminate redundancies.[504] One of these commenters suggested eliminating Item 305 in light of current U.S. GAAP requirements, or, alternatively, re-focusing Item 305 to permit principles-based disclosure of market risk.[505] Another commenter stated that improving market risk disclosures should be a high priority and that there should be a better linkage among the financial statements and other risk-related disclosure.[506] One commenter asserted that there is confusion in the marketplace about what specific disclosure is required under Item 305.[507] Another commenter stated that updating Item 305 should be a ''central aspect'' of disclosure effectiveness efforts and included specific suggestions for revisions, including improving VaR.[508] Though not commenting on Item 305 specifically, one commenter stated its belief that standardized disclosure of common exposures to derivatives is warranted.[509]

b. Discussion

i. Disclosure Objective

The adequacy of market risk disclosure emerged as an important financial reporting issue in the 1990s following a substantial increase in the use of derivatives and other instruments subject to market risk and the significant, sometimes unexpected, losses registrants experienced from their use of these instruments.[510] The Commission adopted Item 305 in 1997 to improve disclosures about market risk and help investors better understand and evaluate a registrant's market risk exposures.[511] The required disclosures were also intended, where applicable, to provide a mechanism for registrants to disclose that their use of derivatives represents risk management rather than speculation.[512]

To achieve these goals, the Commission used the following guiding principles in adopting Item 305:

- Disclosures should make transparent the impact of derivatives on a registrant's statements of financial position, cash flows, and results of operations;
- Disclosures should provide information about a registrant's exposures to market risk;
- Disclosures should explain how market risk sensitive instruments are used in the context of the registrant's business;
- Disclosures about market risk exposures should not focus on derivatives in isolation, but rather should reflect the risk of loss inherent in all market risk sensitive instruments;
- Market risk disclosure requirements should be flexible enough to accommodate different types of registrants, different degrees of market risk exposure, and alternative ways of measuring market risk;
- Disclosures about market risk should address, where appropriate, special risks relating to leverage, option, or prepayment features; and
- New disclosure requirements should build on existing requirements, where possible, to minimize compliance costs.[513]

Item 305 was designed to address concerns that market risks associated with derivatives and other market-sensitive instruments were not adequately disclosed.[514] In the adopting

[500] *See* Disclosure of Market Risk Sensitive Instruments Release.

[501] Item 305(d) of Regulation S–K [17 CFR 229.305(d)].

[502] *See, e.g.,* Silicon Valley and M. Liles.

[503] *See* Ernst & Young 1 (referring to Proposed Accounting Standards Update on FASB's Web site, *Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risk*). The 2012 Exposure Draft is no longer on the FASB's active agenda. *See FASB Technical Agenda* (last visited Mar. 2, 2016), *available at http://www.fasb.org/jsp/FASB/Page/TechnicalAgendaPage&cid=1175805470156#tab_1175805486413.*

The 2012 Exposure Draft aimed to provide more useful information on exposures to liquidity risk and to interest rate risk by requiring, among other things, tabular disclosure of liquidity risk related to financial assets and financial liabilities or cash flow obligations, disaggregated by expected maturities; carrying amounts of classes of financial assets and financial liabilities, segregated according to time intervals based on contractual repricing; an interest rate sensitivity table showing the effects on net income and shareholder equity of specific hypothetical shifts of interest rates; and quantitative or narrative disclosure as necessary to understand exposures to liquidity risk and interest rate risk. For a discussion of the 2012 Exposure Draft, *see* Section IV.C.2.b.iii.

[504] *See, e.g.,* CCMC (noting that ASC Topic 815 provides substantial guidance about hedge accounting and also stating there is some redundancy between Item 305 and Item 303, evidenced by the fact that some public companies do not provide stand-alone disclosure in response to Item 305); SCSGP (noting overlap between certain market risk disclosures required by S–K Item 305, ASC 820 Fair Value Measurements, and ASC 815 Derivatives and Hedging); ABA 2.

[505] *See* ABA 2 (citing ASC 820 Fair Value Measurements and ASC 815 Derivatives and Hedging and suggesting that any such principles-based disclosure of market risk could be included in MD&A). The degree of overlap between Item 305 and U.S. GAAP depends on which of Item 305's presentations is chosen and on whether information that is encouraged to be provided by ASC 820, including qualitative disclosure on risk management, is actually provided. Using a tabular presentation under Item 305 generally results in greater overlap with ASC 820 and ASC 815. Item 305 also requires that disclosure be made outside the financial statement footnotes.

[506] *See* CFA Institute. This commenter did not provide a suggestion as to how to better link financial statement disclosures with risk-related disclosure provided elsewhere in a filing.

[507] *See* CCMC. This commenter stated Item 305 is ''one of the most complicated disclosure requirements to parse in all of Regulation S–K.''

[508] *See* Hu. In research cited in the comment letter, this commenter perceived three problems with Item 305's VaR presentation: (i) Too much ''latitude as to (a) the models, assumptions, and parameters used, as well as (b) the confidence level and time horizon [registrants can] choose to report at;'' (ii) no evidence as to the quality of the VaR model is required; and (iii) VaR ''is not intended to gauge possible losses in times of high economic stress.'' *See* Henry T. C. Hu, *Disclosure Universes and Modes of Information: Banks, Innovation, and Divergent Regulatory Quests,* 31 Yale J. on Reg. 565, 598 (2014) (''Hu 2014'').

[509] *See* AFL–CIO. As an example of common exposures, this commenter cited credit triggers under swaps contracts where ''banks may require companies to fully collateralize credit exposures under certain conditions.''

[510] *See* Disclosure of Market Risk Sensitive Instruments Release.

[511] *See id.* In conjunction with adopting Item 305, the Commission amended Rule 4–08 of Regulation S–X and Item 310 of Regulation S–B, which is no longer in effect, to require enhanced descriptions of accounting policies for derivatives in the footnotes to the financial statements. These revisions were designed to address footnote disclosures of accounting policies that were often too general to convey adequately the diversity in accounting that exists for derivatives. In contrast to Item 305, which applies to all financial instruments, the new disclosure requirements under Rule 4–08 and Item 310 applied only to derivatives; disclosure requirements for other financial instruments were addressed by existing U.S. GAAP and Commission guidance. *Id.* (citing Accounting Principles Board Opinion No. 22 (April 1972)). SRCs are not required to provide Item 305 information. Item 305(e) of Regulation S–K [17 CFR 229.305(e)].

[512] *See* Disclosure of Market Risk Sensitive Instruments Release.

[513] *See id.*

[514] *See id.* The disclosure issues were noted as part of the staff's review of more than 500 annual

Continued

release for Item 305, the Commission noted that disclosure about reported items in the footnotes to the financial statements, MD&A, schedules and selected financial data may not have adequately reflected the effect of derivatives on such reported items.[515] In addition, disclosures about different types of market risk sensitive instruments were often reported separately, making it difficult to assess a registrant's aggregate market risk exposures.[516] Accordingly, Item 305 was intended to help investors understand a registrant's risk management activities and to help place those activities in the context of the registrant's business by requiring enhanced disclosure about specific market risk sensitive instruments.[517]

Division staff has observed that the instructions to Item 305 may inadvertently discourage some disclosure. For example, a sensitivity analysis requires disclosure of the potential loss to the future earnings, fair values, or cash flows of market risk sensitive instruments from a hypothetical change in rates or prices.[518] The instructions to Item 305(a) state that registrants should select hypothetical changes in market rates or prices that are expected to reflect reasonably possible near-term changes in those rates and prices; however, absent economic justification for the selection of a different amount, ''registrants should use changes that are not less than ten percent of end of period market rates or prices.'' [519] Many registrants apply the ten percent threshold even when market conditions, such as persistently low interest rates or volatile exchange rates, may suggest that a different threshold, or even multiple thresholds, would be more appropriate.[520]

Considering commenters' differing views on the efficacy of Item 305 and the complexity of Item 305's required disclosures, we seek input on whether, and how, changes to Item 305 would be beneficial to both investors and registrants.

(a) Request for Comment

157. Is Item 305 effective in eliciting disclosure about market risks and risk management practices that investors consider important? If not, how could Item 305 be improved?

158. Does Item 305 result in information that allows investors to effectively assess (1) a registrant's aggregate market risk exposure, and (2) the impact of market risk sensitive instruments on a registrant's results of operations and financial condition? If not, how could we revise Item 305 to achieve these goals?

159. Do the disclosure alternatives in Item 305(a) elicit adequate quantitative disclosure about market risk? Do the rules or the instructions discourage registrants from fully evaluating and disclosing their market risk exposures, such as in a sensitivity analysis? Should the rules be more prescriptive? If so, in what ways should we revise the rules and instructions to Item 305(a)?

160. Should additional or different principles guide the market risk disclosure requirements? Should we expand our definition of ''market risk sensitive instruments'' to require registrants to provide additional disclosure about other risks, including credit risk, liquidity and funding risk and operational risk?

161. Should we limit the quantitative disclosure requirement to certain registrants such as financial institutions or registrants engaged in financial services? Why or why not?

162. What types of investors or audiences are most likely to value the information required by Item 305?

163. What is the cost of providing the disclosure required by Item 305, including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 305.

ii. Disclosure Alternatives and Coordination With Financial Statement Disclosures

Item 305(a) specifies three disclosure alternatives for registrants to present quantitative information about market risk: Tabular disclosure, sensitivity analysis, and VaR.[521] In adopting Item 305, the Commission recognized the evolving nature of market risk sensitive instruments, market risk measurement systems, and market risk management strategies.[522] The Commission stated that it expected to ''continue considering how best to meet the information needs of investors.'' [523] Accordingly, we are seeking input on whether and how we should revise Item 305 to reflect changes in market risk exposures and methods for measuring market risk.

In response to the proposing release for Item 305, some commenters suggested greater flexibility and recommended a ''management approach'' to disclosure. As suggested by the commenters, this disclosure would focus on the information and methods that management actually uses internally to evaluate, monitor, and manage market risk.[524] The Commission did not adopt this approach, believing that a presentation of market risk using a management approach outside of the framework articulated in Item 305 could make it difficult for investors to assess market risk across registrants.[525] We are interested in whether a ''management approach'' to disclosure is preferable to the alternatives specified in the current rule.

We are also interested in whether we should modify Item 305 given accounting developments since the item's adoption. When the Commission adopted Item 305 in 1997, minimal authoritative literature on the accounting for options and complex derivatives existed.[526] Since that time, accounting requirements have evolved to provide for greater disclosure of market risk sensitive instruments.[527] As a result, there may be redundancies

reports in 1994 and 1995 to evaluate the adequacy of market risk disclosure and assess the effect of new FAS 119 on market risk disclosure. *See id.*

[515] *See id.*

[516] *See id.*

[517] *See id.*

[518] Item 305(a)(1)(ii) of Regulation S–K [17 CFR 229.305(a)(1)(ii)].

[519] Instruction 3A to paragraph 305(a).

[520] For example, the prime rate in the U.S. has been 3.5% or 3.25% for a number of months. *See http://online.wsj.com/mdc/public/page/2_3020-moneyrate.html?mod=mdc_bnd_pglnk.* Many registrants present their interest rate risk under the sensitivity analysis showing only a shift of 10% of this amount, or 35 or 33 (rounded) basis points. Financial services and financial institution registrants, on the other hand, often provide analyses of various shifts in interest rates and evaluate shifts of 50, 100, and 200 basis points, both up and down. This more comprehensive presentation may provide investors with a better understanding of how various shifts in market risk, both more moderate and more pronounced, might impact the registrant.

[521] Item 305(a)(1) of Regulation S–K [17 CFR 229.305(a)(1)].

[522] *See* Disclosure of Market Risk Sensitive Instruments Release.

[523] *See id.* at 6046.

[524] *See id.* at 6055. Commenters believed that ''the approaches in the proposing release (i) do not appear to allow gap and duration analyses, which are currently used by some to measure market risk, and (ii) may become outdated as new measurement approaches are developed in the market place.'' *Id.* at 6055.

[525] *See id.* The Commission noted that, in adopting Item 305, it sought to strike a balance between those seeking a ''management approach'' and those supporting a more consistent reporting framework for the sake of comparability. *See id.*

[526] *See* Disclosure of Market Risk Sensitive Instruments Release.

[527] FASB Accounting Standards Update No. 2011–04, May 2011, Fair Value Measurement (Topic 820). ASC 820 requires the disclosure of fair value of all financial instruments, including derivatives and non-derivative financial instruments, but does not require any expected maturity information.

between the disclosure provided in response to Item 305 and U.S. GAAP. Commission staff has observed that, the degree of repetition in the disclosure depends on which Item 305 disclosure alternative a registrant utilizes and whether a registrant provides information that is encouraged by U.S. GAAP in addition to the disclosure that is required.[528]

Item 305 disclosure also tends to vary among registrants. Many registrants provide a sensitivity analysis to present market risk information, while others rely on tabular presentation or VaR. For large financial institutions, it is not unusual to use some combination of the three to capture different market risk sensitive instruments.

(a) Request for Comment

164. How have standard risk management practices and methods of reporting market risk evolved since the adoption of Item 305 in 1997? Should we revise Item 305 to reflect those changes and if so, how? Should we provide for new disclosure alternatives in addition to, or in lieu of, existing alternatives?

165. What revisions should we consider to better link disclosure that identifies, quantifies, and analyzes a registrant's material market risks to its: (a) Market risk sensitive instruments, (b) financial statements, (c) capital adequacy, and (d) any other metrics important to an understanding of market risk exposures?

166. Should we eliminate the prescribed disclosure alternatives and allow registrants to discuss market risk according to the methods used by management to manage the risk? Would allowing a ''management approach'' provide investors with more insight about the way management actually assesses market risks, or would this approach unduly hinder investors' ability to compare market risk disclosures across registrants?

167. Is the disclosure required by Item 305 repetitive of the disclosure required by U.S. GAAP and Rule 4–08 of Regulation S–X? Conversely, does Item 305 result in disclosure that is important to investors and is not found elsewhere in a registrant's filing? Even considering any repetition, do investors benefit from disclosure about market risk exposure outside of the audited financial statements?

iii. Comparability of Disclosure

In adopting Item 305, the Commission acknowledged the tension between approaches to market risk disclosure that favor comparability and approaches that favor flexibility.[529] The approach taken in the final rules sought to strike a balance between different commenters' perspectives.[530]

The Commission designed Item 305 to be flexible by prescribing three disclosure alternatives without stipulating standardized methods and procedures specifying how to comply with each alternative.[531] Registrants may choose which methods, model characteristics, assumptions, and parameters they use in complying with the item, and registrants may use more than one disclosure alternative across each market risk exposure category.[532]

To address comparability, the Commission included a requirement that registrants describe the characteristics of the model and the assumptions used to prepare the quantitative market risk disclosures. By requiring a description of the model and its assumptions, the Commission intended to assist investors in evaluating the potential effect of variations in the model's characteristics and assumptions.[533]

In 2012, the FASB examined the question of comparability and considered standardizing liquidity and interest rate risk disclosure as part of a project that is currently in Exposure Draft form.[534] The Exposure Draft would have required all reporting entities to provide standardized quantitative disclosure about liquidity risk, but only financial institutions would have been required to provide additional, standardized quantitative disclosure about interest rate risk.

Although initiated, in part, as a response to comments received from financial statement users to an earlier FASB release on financial statements, the majority of respondents to the Exposure Draft, eighty-four percent of whom were preparers, did not support the proposed disclosures.[535] Most respondents stated that standardizing information about liquidity and interest rate risk is not appropriate and not achieved by the proposals.[536] Some commenters questioned whether standardization is an appropriate objective and if it could ever be achieved.[537]

(a) Request for Comment

168. Should we revise Item 305 to provide for more standardized disclosure that would enhance comparability among registrants? How should we balance standardization with different methods and assumptions that registrants may use to evaluate, monitor, and manage market risk? How would standardization affect investors and registrants?

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[528] For example, ASC 815 encourages but does not require that disclosure about a registrant's objectives and strategies for using derivatives be described in the context of the entity's overall risk exposures. The standard indicates that if these additional qualitative disclosures are made, they should include a discussion of those risk exposures even though the registrant does not manage some of those risk exposures using derivatives.

[529] *See* Disclosure of Market Risk Sensitive Instruments Release at 6048 (''The Commission has provided flexibility in the quantitative and qualitative disclosure requirements . . . even though such flexibility is likely to reduce the comparability of disclosures.'').

[530] *See id.*

[531] *See id.* For example, the terms used to describe two of the three disclosure alternatives—''sensitivity analysis'' and ''value at risk''—describe a general class of models. They are not meant to refer to any one model for quantifying market risk. In addition, Item 305 permits registrants to change disclosure alternatives or key model characteristics, assumptions, and parameters used in providing quantitative information about market risk, with disclosure if the effects of such a change are material. The Commission also noted that two methods of measuring market risk then in use, gap analysis and duration analysis, would, with minor revisions, satisfy the tabular and sensitivity analysis disclosure requirements respectively. *Id.*

[532] *See id.;* Item 305(a)(1)(i)(B) of Regulation S–K [17 CFR 229.305(a)(1)(i)(B)]; Item 305(a)(1)(ii)(B) of Regulation S–K [17 CFR 229.305(a)(1)(ii)(B)]; Item 305(a)(1)(iii)(B) of Regulation S–K [17 CFR 229.305(a)(1)(iii)(B)].

[533] *See* Disclosure of Market Risk Sensitive Instruments Release.

[534] *See* Proposed Accounting Standards Update 2012–200 *Disclosure about Liquidity Risk and Interest Rate Risk—Financial Instruments (Topic 825),* Financial Accounting Standards Board (Issued June 27, 2012), *available at http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176160135003.*

This Exposure Draft was partly in response to demand by users for audited, standardized, and consistent disclosures by public companies. The Exposure draft noted that, as part of a May 2010 proposed Accounting Standards Update (Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)), the FASB performed extensive outreach and received feedback that the risks inherent in a class of financial instruments and the way in which an entity manages those risks through its business operations should be instrumental in developing the reporting model for financial instruments. The important risks identified by users of financial statements during the FASB's outreach efforts were credit risk, liquidity risk, and interest rate risk. *See also supra* note 503.

[535] *See Accounting for Financial Instruments Disclosures About Liquidity Risk and Interest Rate Risk Comment Letter Summary,* Financial Accounting Standards Board, *available at http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176160500931.*

[536] *See id.* These respondents also asserted that institutions are required by regulation to ensure that risks are monitored using processes that are commensurate with the complexity of their business. *See id.*

[537] *See id.*

3. Disclosure of Approach to Risk Management and Risk Management Process

Item 503(c) focuses exclusively on disclosure of significant risks and does not address disclosure of a registrant's strategy for managing risk. Item 305(b), however, requires disclosure about a registrant's primary market risks and how those risks are managed. In the past, Commission staff has discouraged registrants from including mitigating language in their Item 503 risk factor disclosure because of concern that mitigating language could dilute investors' perception of the magnitude of the risk. As a result, registrants typically do not discuss their efforts to mitigate risk in connection with their risk factors disclosure, although some registrants describe their risk management practices elsewhere in their filings, such as in MD&A and as required by Item 305 for market risk.

Disclosure about a registrant's approach to risk management could enhance investor understanding of the possible impact of a disclosed risk and the registrant's overall risk profile. Division staff has observed that most large financial institutions have implemented enterprise risk management programs and currently include detailed disclosure about those programs in their filings. Additional disclosure about changes to, or significant deviations from, the stated policies could provide investors with important information about the registrant's exposure to risk.[538] Registrants that do not provide disclosure about a formal enterprise risk management program may instead provide disclosure about management's general approach to risk management as well as specific efforts to mitigate individual significant risks.

We are mindful of the potential drawbacks of requiring registrants to provide risk management or risk mitigation disclosure. Disclosure of management's efforts to mitigate risk may suggest to investors that the registrant's risk exposure is not significant. In addition, risk management strategies could include confidential or proprietary information and disclosure could result in competitive harm to the registrant. For example, a registrant may develop and rely on a proprietary method for hedging financial risk, and disclosure of the method could allow others to exploit or trade against the method such that it is no longer effective or becomes too expensive.[539]

a. Request for Comment

169. Should we require registrants to describe their risk management processes? If so, what level of detail would be appropriate? If a registrant has no formal risk management approach or process, should we require it to describe how it monitors and evaluates risk?

170. Should we require registrants also to describe their assessment of any risk management process? If so, how often should such disclosure be required?

171. Should we require registrants with complex risk management approaches or processes to provide only an enterprise-level description, or is a more granular description appropriate for these registrants?

172. Should we require registrants to disclose when risk tolerance limits or other fundamental aspects of its risk management approach are waived or changed, including any assumptions or relevant changes in business strategy that underlies the new limits or policies?

173. Should we require registrants to identify, if material, other ''primary risk exposures'' not already addressed and to disclose actions taken to manage those risks?

174. How could we facilitate a more integrated discussion of risk exposure and risk mitigation? Should we require registrants to disclose management's view of how material risk exposures are related and how risk mitigation actions are connected?

175. To the extent we require disclosure of risk management and risk management processes, should we move the disclosure about the extent of a board of directors' oversight of risk from Item 407(h) to this new requirement? Similarly, should we move compensation risk disclosure to this new requirement, or should we otherwise provide an option for compensation risk disclosure to be given in the risk management discussion rather than in the compensation discussion?

176. Should we require registrants to disclose their efforts to manage or mitigate each risk factor disclosed, similar to the risk management disclosure required for market risk under Item 305(b)(1)(ii)? What are the challenges, including those associated with preparation and competitive harm, with this disclosure?

177. Would additional disclosure about risk mitigation inhibit investors' ability to fully appreciate the significance of the risk? Would requiring a registrant to explain how it addresses a disclosed risk discourage registrants from disclosing generic or insignificant risks? Alternatively, would registrants provide boilerplate disclosure about how they address less meaningful risks, thereby resulting in even longer risk factor disclosure?

178. Should we require registrants to address mitigation or management of each risk factor as part of the risk management discussion? If so, should we also clarify that, although references to the general risk management discussion will not satisfy this requirement, cross-references to appropriate portions of MD&A or the financial statements will, if disclosure otherwise would be redundant?

179. Should we require registrants to disclose their known uncertainties about their risk management and risk management policies and how these might affect the registrant?

4. Consolidating Risk-Related Disclosure

Outside of Items 503(c) and 305, a number of Items in Regulation S–K elicit risk-related disclosures. These include Item 103, related to material litigation and certain environmental proceedings; Item 101(d)(3), in connection with risk related to foreign operations; Item 303(a), in that material trends, uncertainties, or events that are required to be described may also speak to certain risks; and Item 407(h), regarding the extent of a board's role in risk oversight. In the S–K Study, the staff recommended that we consider whether to consolidate requirements relating to risk factors, legal proceedings, and other quantitative and qualitative information about risk and risk management into a single requirement.[540] We seek input on whether investors would benefit from such a consolidation of risk-related disclosures and whether such a requirement would present any challenges to registrants.

[538] For an example of a registrant deviating from its stated risk management policies, *see Report of Anton R. Valukas, Examiner,* In Re Lehman Brothers Holdings Inc., et al., Vol. I at 167–168 (discussing evidence that management disregarded its risk controls with respect to bridge equity and bridge debt).

[539] Commission concern for protecting proprietary strategies in connection with Item 305 disclosures is reflected in four provisions addressing proprietary concerns. *See* Disclosure of Market Risk Sensitive Instruments Release. The four provisions are: (i) The sensitivity analysis and VaR alternatives for quantitative information; (ii) the option to report average, high, and low sensitivity analysis and VaR instead of year end information; (iii) for interim reports, the need for disclosure of material changes since the end of the most recent fiscal year; and (iv) requiring a combined, not separate, sensitivity or VaR disclosures for voluntarily disclosed instruments, positions, or transactions.

[540] *See* S–K Study at 99.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One comment letter supported the suggestion to consider consolidating all risk-related requirements, positing that consolidation would reduce redundant disclosure and provide investors with a ''holistic view of risk through the eyes of management.'' [541] Another commenter recommended requiring better integration among the financial statements, business description, risk disclosures, market risk disclosures and the discussion of results in MD&A.[542]

b. Request for Comment

180. Should we require registrants to provide a consolidated discussion of risk and risk management, including legal proceedings, in a single section of a filing? If so, what information should be included? How should this information be presented?

181. How could investors benefit from a consolidated discussion of risk factors, legal proceedings and other quantitative and qualitative information about market risk and risk management? What would be the challenges of requiring such a presentation?

182. How would a consolidation of risk-related disclosure affect the cost of preparing a filing, if at all?

D. Securities of the Registrant

Disclosure about a registrant's capital stock and transactions by registrants in their own securities helps inform investment and voting decisions by providing investors with information about a security that can be useful in assessing its value. Several items in Regulation S–K require this and related disclosure about a registrant's securities:

- Item 202 requires a description of the terms and conditions of securities that are being registered; [543]
- Item 701 requires disclosure of recent sales of unregistered securities and use of proceeds from registered offerings of securities; [544] and
- Item 703 requires tabular disclosure of shares of equity securities purchased by the registrant and affiliated purchasers.[545]

Additionally, Item 201(b)(1) requires disclosure of the number of holders of each class of a registrant's common equity.[546] We are seeking public input on the disclosure requirements of Items 201(b)(1),[547] 202, 701 and 703 to help assess whether any of the disclosure requirements should be modified and whether we should add any new disclosure requirements. In addition, we welcome comment on the challenges for registrants related to complying with these disclosure requirements or any new disclosure requirements.

1. Related Stockholder Matters—Number of Equity Holders (Item 201(b))

Item 201(b)(1) requires disclosure of the approximate number of holders of each class of common equity as of the latest practicable date.[548] Instruction 3 to Item 201 specifies that the number of holders may be based upon the number of record holders or also may include individual participants in security position listings, as provided under Rule 17Ad–8 [549] of the Exchange Act.[550] Instruction 3 to Item 201 provides that the method of computation chosen shall be indicated.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter recommended eliminating the requirement to disclose the number of security holders under Item 201(b), stating that it does not provide meaningful information since many stockholders hold their securities through a nominee.[551]

b. Discussion

Several decades ago, most investors of U.S. publicly traded registrants owned their securities in registered form, meaning that the securities were directly registered in the name of a specific investor on the record of security holders maintained by or on behalf of the registrant. Today, the vast majority of investors own their securities as a beneficial owner [552] through a securities intermediary,[553] such as a broker-dealer or bank.[554] This is often referred to as holding securities in nominee or ''street name.'' The Commission first adopted a requirement to disclose the number of record holders of a class of securities in 1938, when it adopted the requirement that registrants submit proxy statements to each shareholder whose proxy is being solicited.[555]

In 1964, the Commission proposed amending Form 10–K to require registrants to disclose, in addition to the number of record holders, the amount of each class of equity securities known by the registrant to be held ''in street names.'' [556] Commenters generally opposed the proposal on the grounds that the required information would be difficult to obtain and of little use to investors, and the Commission decided

[541] *See* CCMC.

[542] *See* CFA Institute.

[543] Item 202 of Regulation S–K [17 CFR 229.202]. Item 202 disclosure is not required in Forms 10–Q or 10–K.

[544] Item 701 of Regulation S–K [17 CFR 229.701].

[545] Item 703 of Regulation S–K [17 CFR 229.703].

[546] Item 201(b)(1) of Regulation S–K [17 CFR 229.201(b)(1)].

[547] As part of its work to develop recommendations for the Commission for potential changes to update or simplify the requirements, the staff is separately considering paragraphs (a), (c) and (d) of Item 201 relating to market information, the effect of an offering or business combination on shareholder ownership, dividends and securities authorized for issuance under equity compensation plans. For a description of this project, *see* Section I. Item 201(e) (performance graph) falls outside the scope of this release because this disclosure is required only in proxy statements.

[548] *Id.*

[549] Exchange Act Rule 17Ad–8 [17 CFR 240.17Ad–8]. The rule defines ''securities position listing,'' with respect to the securities of any issuer held by a registered clearing agency in the name of the clearing agency or its nominee, as a list of those participants in the clearing agency on whose behalf the clearing agency holds the issuer's securities and of the participants' respective positions in such securities as of a specified date. The rule also states that, upon request, a registered clearing agency must furnish a securities position listing promptly to each issuer whose securities are held in the name of the clearing agency or its nominee.

[550] Item 201 of Regulation S–K [17 CFR 229.201].

[551] *See* Shearman.

[552] We recognize the term ''beneficial owner'' and ''beneficial ownership'' are defined in certain of our rules, such as under Exchange Act Rules 13d–3, 16a–1 and 14b–2. Our use of the term here is not intended to suggest that individuals holding in ''street name'' are, or should be, ''beneficial owners'' for purposes of these Exchange Act rules. [17 CFR 240.13d–3; 17 CFR 240.16a–1; 17 CFR 240.14b–2].

[553] For purposes of Commission rules pertaining to the transfer of certain securities, a ''securities intermediary'' is defined under Exchange Act Rule 17Ad–20 [17 CFR 240.17Ad–20] as a clearing agency registered under Exchange Act Section 17A [15 U.S.C. 78q–1] or a person, including a bank, broker, or dealer, that in the ordinary course of its business maintains securities accounts for others in its capacity as such.

[554] In 1976, the Commission reported to Congress on the effects of the practice of registering securities in other than the name of the beneficial owner. In its report the Commission stated that 23.7% of shares were held in nominee and street name in 1964 and 28.6% of shares were held in nominee and street name in 1975. *Final Report of the Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities Pursuant to Section 12(m) of the Securities Exchange Act of 1934,* Dec. 3, 1976. Based on an analysis of available data over the period 2008 through 2010, the Commission's Division of Economic and Risk Analysis (''DERA'') estimates that over 85% of the holders of securities in the U.S. markets hold through a broker-dealer or a bank that is a DTC participant. More recently, and according to one study, shares held in street name continue to account for over 80% of all shares outstanding of U.S. publicly listed companies. *See* PricewaterhouseCoopers LLP, *Proxy Pulse,* Third Edition 2015 at 8.

[555] *See* Amended Proxy Rules, Release No. 34–1823 (Aug. 11, 1938) [3 FR 1991 (Aug. 13, 1938)]. This rule required registrants to furnish, upon written request of the record holder being solicited, the approximate number of record holders of any specified class of securities of which any of the holders had been or were being solicited.

[556] *See* Annual Reports; Notice of Proposed Amendments, Release No. 34–7494 (Dec. 31, 1964) [30 FR 346 (Jan. 12, 1965)].

not to require disclosure of this information.[557] In 1980, the Commission adopted Item 4 to Form 10–K, which consolidated disclosures relating to the market for the registrant's securities, including the number of holders of common stock, into a single item.[558] As adopted, Item 4 to Form 10–K integrated the disclosure requirements of a new Item 9 in Regulation S–K, which the Commission adopted concurrently.[559]

Item 201(b)'s reference to record holders is consistent with Section 12(g) of the Exchange Act. Section 12(g) requires issuers that are not banks, bank holding companies or savings and loan holding companies and have total assets exceeding $10 million to register a class of equity securities if the securities were ''held of record'' by either (i) 2,000 persons, or (ii) 500 persons who are not accredited investors.[560] When Congress enacted Section 12(g) in 1964, most security holders in the United States owned their securities as record holders.

c. Request for Comment

183. Should we retain or eliminate Item 201(b)(1)? Why? If retained, should we modify the item and if so, how?

184. As the vast majority of investors now hold their shares in street name, does disclosure about the number of record holders continue to be important to investors? Should we require registrants to disclose the amount of each class of equity securities held in street name? Should we require registrants to disclose the number of beneficial owners? If so, how should we define ''beneficial owner'' for purposes of Item 201(b)(1)? How would investors benefit from this additional information? What would be the challenges registrants might face in tracking the number of beneficial owners?

185. What types of investors or audiences are most likely to value the information required by Item 201(b)(1)?

2. Description of Capital Stock (Item 202)

Item 202(a)–(d) and (f) requires a brief description of the capital stock, debt, warrants, rights, American Depositary Receipts or any other securities that are being registered.[561]

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. None.

b. Discussion

Item 202 derives from Schedule A of the Securities Act, which requires disclosure of the capitalization of the registrant, including a description of the classes of capital stock and funded debt and any securities covered by options.[562] These requirements were included in the earliest forms of registration statements.[563] As part of revision and simplification efforts in 1947, the Commission amended this requirement to eliminate the description of securities that are not being registered, except to the extent material to an evaluation of the securities being registered.[564] In 1982, Item 202 was included in Regulation S–K [565] as part of the ''offering-oriented items'' [566] and is currently required only in registration statements and some proxy statements.[567]

While registrants are required to file as exhibits complete copies of their articles of incorporation and bylaws as currently in effect, registrants are not required to describe these documents or their registered securities in their periodic filings.[568] A summary description of the material terms and conditions of the registrant's securities, as provided under Item 202, is not required in periodic reports and most registrants do not include such disclosure. To find this information, investors typically must locate this disclosure either in the registrant's exhibits, as amended, or in the registrant's Form 8–A, which often incorporates by reference from a prior Form S–1.

Changes in the terms and conditions of registered securities are disclosed in Form 8–K and Schedule 14A, which require discussion of modifications to the rights of any class of securities and amendments to the articles of incorporation or bylaws.[569] Frequently, these disclosures report discrete and specific changes to the overall terms and conditions of the registered securities such as individual amendments to the articles of incorporation to increase the number of shares authorized. A Form 8–K filed to report an amendment to the articles of incorporation or bylaws may be limited to the text of the amendment, however, the registrant must file a

[557] *See* General Form for Annual Reports, Release No. 34–7545 (Mar. 5, 1965) [30 FR 3430 (Mar. 16, 1965)] (''1965 Amendments to Form 10–K Adopting Release'').

[558] *See* 1980 Form 10–K Adopting Release (noting that the new item to Form 10–K constituted ''an amalgam'' of various other existing requirements.).

[559] *Id.* Among other things, Item 9 of Form 10–K required registrants to ''[s]et forth the approximate number of holders of common stock securities of the registrant as of the latest practicable date.'' Instruction 1 to Item 9 provided that the computation of the approximate number of holders ''may be based upon the number of record holders or may also include individual participants in security position listing.'' *Id.*

[560] 15 U.S.C. 781(g). *See also supra* note 14.

[561] Items 202(a)–(d) and (f) of Regulation S–K [17 CFR 229.202(a)–(d) and (f)]. Item 202(e) is outside the scope of this release. This item requires that if securities other than common stock are to be registered and there is an established trading market for such securities, registrants are required to provide market information for such securities comparable to that required by Item 201(a) of Regulation S–K. The staff is separately considering Item 201(a) in developing its recommendations for potential changes to update or simplify certain disclosure requirements. For a description of this project, see Section I.

[562] Paragraphs 9–12 of Schedule A of the Securities Act [15 U.S.C. 77aa(9)–(12)].

[563] *See* Form A–2, Items 9 through 20. Tabular disclosure included details about amounts authorized, amounts outstanding, related balance sheet information, amounts held in treasury, amounts held by subsidiaries and parent companies, amounts reserved for officers and employees and amounts reserved for options and warrants. *See* S–K Study at footnote 238.

[564] *See* Miscellaneous Amendments, Release No. 33–3186 (Jan. 8, 1947) [12 FR 224 (Jan. 15, 1947)]. *See also* Notice of Proposed Rules and Form and Proposed Repeal of Certain Forms, Release No. 33–3171 (Nov. 18, 1946) [11 FR 13764 (Nov. 22, 1946)].

[565] *See* 1982 Integrated Disclosure Adopting Release. In adding Item 202 of Regulation S–K, the Commission revised the item to require registrants to discuss the effect on control of the company of certain charter and bylaw antitakeover provisions. Item 202(a)(5) of Regulation S–K [17 CFR 229.202(a)(5)].

[566] *See* Reproposal of Comprehensive Revision to System for Registration of Securities Offerings, Release No. 33–6331 (Aug. 6, 1981) [46 FR 41902 (Aug. 18, 1981)] at 41917.

[567] *See, e.g.,* Item 9 of Form S–1, Item 9 of Form S–3 and Item 1 of Form 8–A. Item 202 disclosure is also required in proxy statements with respect to the authorization or issuance of securities or the modification or exchange of any class of securities of a registrant. *See* Items 11 and 12 of Schedule 14A [17 CFR 240.14a–101].

[568] *See* Item 601(b)(3) of Regulation S–K [17 CFR 229.601(b)(3)]. Under ASC 505–10–50–3, registrants are required to summarize the ''pertinent rights and privileges of the various securities outstanding.''

[569] Item 3.03 of Form 8–K requires disclosure of material modifications to rights of security holders while Item 5.03 requires disclosure of amendments to the articles of incorporation or bylaws for amendments not disclosed in a proxy or information statement. Item 5.03 of Form 8–K also requires disclosure of changes in fiscal year other than by means of a submission to a vote of security holders through the solicitation of proxies (or otherwise) or an amendment to the articles of incorporation or bylaws [17 CFR 249.308].

Item 12 of Schedule 14A requires disclosure if action is to be taken regarding the modification of any class of securities of the registrant, or the issuance or authorization for issuance of securities of the registrant in exchange for outstanding securities. Section (b) of Item 12 requires disclosure of any material differences between the outstanding securities and the modified or new securities in respect of any of the matters concerning which information would be required in the description of the securities in Item 202 of Regulation S–K. Item 19 of Schedule 14A requires disclosure of amendments to the charter, bylaws or other documents.

complete copy of the articles of incorporation or bylaws with its next Securities Act registration statement or periodic report.[570] We are seeking public input on whether a comprehensive discussion of registered securities in periodic reports would facilitate access to important disclosure for investors in the secondary market.

c. Request for Comment

186. How do investors in the secondary market access information about the terms and conditions of a registrant's securities? Do investors rely only on the bylaws and articles of incorporation filed as exhibits to the registrant's Form 10–K?

187. In addition to the disclosure requirements in registration statements and certain proxy statements, should we require registrants to provide Item 202 disclosure each year in Form 10–K? Would requiring this information in the annual report facilitate investor access to important disclosure? Should we require registrants to disclose in their quarterly and annual reports whether changes have been made to the terms and conditions of their securities during the reporting period? Why? Are the Form 8–K requirements sufficient?

188. What types of investors or audiences are most likely to value the information required by Item 202?

189. What is the cost of providing the disclosure required by Item 202, including the administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates where possible and include only those costs associated with providing disclosure under Item 202.

190. What are the benefits of providing the disclosure required by Item 202? How could the benefits change if we made any of the changes contemplated here? Please provide quantified or qualitative estimates where possible relating to disclosure under Item 202.

3. Recent Sales of Unregistered Securities (Items 701(a)–(e))

Item 701(a)–(e) requires disclosure of all sales of unregistered securities sold by the registrant within the past three years and specifies disclosure of: The date, title and amount of securities sold; the principal underwriters and other purchasers, if the securities were not publicly offered; the aggregate offering price for securities sold for cash and the nature of the transaction and the nature and aggregate amount of consideration received by the registrant; the exemption from registration claimed; and the terms of conversion or exercise.[571] These disclosure requirements also apply to securities issued in exchange for property, services, or other securities.[572]

a. Comments Received

S–K Study. Two commenters stated that disclosure of Item 701 information is not meaningful for investors.[573] They also stated that such disclosure should not be required in registration statements because, to the extent recent sales of securities are material to investors, registrants would be required to disclose that information in their discussion of liquidity and capital resources under MD&A pursuant to Items 303(a)(1) and (2).[574]

Disclosure Effectiveness Initiative. One commenter recommended that the disclosure of sales of unregistered securities be limited to sales that are material to the issuer.[575] This commenter also suggested reconciling the disclosure requirements of Item 701, which requires disclosure of *all* unregistered sales of common equity, with those of Item 3.02 of Form 8–K, which does not require disclosure of sales of less than one percent of the number of shares outstanding of the equity securities being sold. Another commenter recommended eliminating Item 701, noting overlap with Form 8–K and also stating that, for a material sale of securities, registrants typically discuss the transaction in MD&A.[576]

b. Discussion

Item 701's requirement to disclose recent sales of unregistered securities is based, in part, on Schedule A.[577] A disclosure requirement in Form S–1 [578] of sales of unregistered securities for the past three years predated Regulation S–K.[579] The requirement was moved to Regulation S–K in connection with adoption of the integrated disclosure system, but it continued to apply only to certain registration statements.[580]

In 1996, the Commission adopted amendments to require timely disclosure of unregistered equity offerings and amended Forms 10–K and 10–Q to include Item 701(a)–(e).[581] This amendment was intended to address concerns that unregistered offerings were frequently undisclosed and such offerings could materially affect the financial condition of registrants or result in significant dilution to existing shareholders.[582] The Commission also expanded Item 701 to require registrants to disclose terms of conversion or exercise for convertible or exchangeable equity securities.[583]

In 2004, the Commission sought more timely disclosure of unregistered equity offerings and added Item 3.02 to Form 8–K. Item 3.02 requires registrants to

[570] *See* Item 601(b)(3) of Regulation S–K [17 CFR 229.601(b)(3)].

[571] Item 701(a)–(e) of Regulation S–K [17 CFR 229.701(a)–(e)]. For a discussion of Item 701(f), *see* Section IV.D.4.

[572] *Id.*

[573] *See* Silicon Valley and M. Liles (also stating that cash flow statements would contain ''more detailed information'' about the proceeds of securities issuances in those periods, as would the statements of stockholders' equity for the sales of equity securities).

[574] *See id.* Both commenters also noted that registrants would be required to disclose the terms of any material sales of securities made to related persons pursuant to Item 404.

[575] *See* SCSGP.

[576] *See* CCMC.

[577] Paragraph 19 of Schedule A of the Securities Act is broader than Item 701 because it calls for the net proceeds derived from any security sold by the issuer during the two years preceding the filing of the registration statement, including the price at which such security was offered. *See* Securities Act of 1933 Schedule A Paragraph 19 [15 U.S.C. 77aa(19)]. Other differences include Item 701's three-year timeframe, as opposed to two years in Schedule A, and the fact that Item 701 is limited to unregistered sales of equity securities while Schedule A contains neither of these limitations.

[578] 17 CFR 239.11.

[579] *See, e.g.,* Adoption of Amendments to Form S–1, Release No. 33–3434 (Jan. 31, 1952) [17 FR 1177 (Feb. 7, 1952)] (adopting disclosure requirements to Form S–1 substantially similar to current Item 701(a)–(e) of Regulation S–K). *See also* 1980 Proposed Revisions (noting that the requirement to disclose sales of unregistered securities during the past three years in proposed Form C was the same as in Item 25 of Form S–1 at that time).

[580] *See* 1982 Integrated Disclosure Adopting Release. When Item 701 was moved to Regulation S–K, this disclosure was required in Forms 10–Q, S–1, S–11 and 10. The Commission had adopted a similar requirement for Forms 10–K and 10–Q in 1972. *See* Adoption of Amendments to Annual Report Form 10–K and Quarterly Report Form 10–Q Under the Securities Exchange Act of 1934, Release No. 34–9443 (Jan. 10, 1972) [37 FR 601 (Jan. 14, 1972)]. The Commission eliminated this requirement from Form 10–K in 1980, consistent with recommendations by the Sommer Report. *See* 1980 Form 10–K Adopting Release. According to the Sommer Report, the requirement was unnecessary in Form 10–K because the same information was available in the financial statements and required to be disclosed in Form 10–Q. *See* Sommer Report at 486.

[581] *See* Periodic Reporting of Unregistered Equity Sales, Release No. 34–37801 (Oct. 10, 1996) [61 FR 54506 (Oct. 18, 1996)] (''Periodic Reporting of Unregistered Equity Sales Release'').

[582] *See, e.g.,* Streamlining Disclosure Requirements Relating to Significant Business Acquisitions and Requiring Quarterly Reporting of Unregistered Equity Sales, Release No. 33–7189 (Jun. 27, 1995) [60 FR 35656 (July 10, 1995)] (expressing concern about the lack of disclosure in the context of addressing issues with Regulation S offerings); Periodic Reporting of Unregistered Equity Sales Release.

[583] *See id. See also* Item 701(e) of Regulation S–K [17 CFR 229.701(e)].

disclose, within four business days,[584] the information specified in paragraphs (a) and (c) through (e) of Item 701[585] when aggregate equity securities sold are equal to or exceed one percent of the number of shares outstanding of the class of equity securities sold.[586] The Commission initially proposed to move the Item 701 disclosure requirement out of Forms 10–Q and 10–K and into Form 8–K.[587] This proposal was based on the Commission's belief that more timely disclosure of this information would benefit investors due to the potentially significant dilutive effect on existing investors' holdings.[588] In response to comments on the proposing release, the Commission adopted the one percent threshold for disclosure on Form 8–K, noting that registrants would still be required to report all other unregistered sales of equity securities in their periodic reports.[589] Concurrently, the Commission revised Forms 10–K and 10–Q to require disclosure only of unregistered sales of equity securities not previously disclosed on Form 8–K.[590]

[584] *See* Item 3.02(a) of Form 8–K (stating the registrant has no obligation to disclose information under this Item 3.02 until the registrant enters into an agreement enforceable against the registrant, whether or not subject to conditions, under which the equity securities are to be sold. If there is no such agreement, the registrant must provide the disclosure within four business days after the occurrence of the closing or settlement of the transaction or arrangement under which the equity securities are to be sold).

[585] *See* 2004 Form 8–K Adopting Release.

[586] Item 3.02(b) of Form 8–K. SRCs are not required to file a Form 8–K if the securities sold, in the aggregate, constitute less than five percent of the number of shares outstanding of the class of equity securities sold.

[587] Additional Form 8–K Disclosure Requirements and Acceleration of Filing Date, Release No. 33–8106 (June 17, 2002) [67 FR 42914 (June 25, 2002)] (''2002 Form 8–K Proposing Release'').

[588] *See id.* The Commission solicited comment on whether there was value to requiring the ''aggregate listing'' of sales made during quarterly and annual periods even though Form 8–K would report each sale as it occurred. The Commission also solicited comment on the question of whether the Form 8–K disclosure should be limited to large unregistered sales and suggested possible disclosure thresholds equal to a percentage of the company's outstanding shares or a percentage of the company's market float. *See id.* at 42923.

[589] *See* 2004 Form 8–K Adopting Release at 15603 (''In response to concerns raised by commenters, we have limited the disclosure of sale of unregistered equity securities required to be filed on Form 8–K. Under the new item, no Form 8–K need be filed if the equity securities sold in the aggregate since the company's last report filed under this item or last periodic report, whichever is more recent, constitute less than 1% of the company's outstanding securities of that class.'').

[590] *See id.* Item 701 information need not be disclosed in a Form 10–K if it has been previously included in a Form 10–Q or Form 8–K. *See* Item 5(a) of Form 10–K. Similarly, Item 701 information need not be disclosed in a Form 10–Q if it has been previously disclosed in a Form 8–K. *See* Item 2(a) of Part II of Form 10–Q.

Some of the disclosure required by Item 701(a)–(e) may overlap with disclosure in the statement of stockholders' equity, which is required in the annual financial statements,[591] or in the notes to the financial statements. For example, under U.S. GAAP, registrants must disclose the number of shares sold, title of class of stock sold and net proceeds.[592] Registrants are also required to discuss the rights and privileges of the securities outstanding, such as conversion or exercise prices and pertinent dates.[593] On the other hand, U.S. GAAP does not require disclosure of underwriters, underwriting discounts, the exemption claimed or the identity of the purchasers, as required by Item 701. In addition, accounting standards do not distinguish between registered and unregistered sales of securities.

c. Request for Comment

191. Should we retain or eliminate Item 701(a)–(e)? Why? Does the disclosure required under Item 701(a)–(e) provide important information that is not available in either MD&A or the financial statements?

192. Does the Item 3.02 of Form 8–K disclosure requirement for issuances of one percent or greater and the Item 701 requirement for all issuances strike the right balance between disclosing larger issuances promptly and all others quarterly? Is one percent an appropriate threshold? If not, what would be an appropriate threshold and why?

193. Should we revise Forms 10–K and 10–Q to require disclosure of all unregistered sales of securities during the reporting period, including those already reported on Form 8–K? What would be the benefits to investors? Alternatively, should we require registrants to cross-reference or include a hyperlink to any previously filed Form 8–K containing Item 701 information for the reporting period or incorporate such forms by reference? What would be the advantages or disadvantages associated with either of these approaches?

194. Should we remove the Item 701 disclosure requirement from Forms 10–K and 10–Q? If so, should we revise Item 3.02 of Form 8–K to remove the one percent threshold and require registrants to disclose all unregistered sales of securities on Form 8–K? Alternatively, should we eliminate Item 3.02 of Form 8–K and instead require disclosure only in Forms 10–K and 10–Q?

195. Disclosure provided in response to Item 701(a)–(e) can range from a single paragraph to multiple pages. In Form 10–K, this disclosure is provided as part of Item 5 of Part II (Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities) while in Form 10–Q this disclosure is provided as Item 2 of Part II (Unregistered Sales of Equity Securities and Use of Proceeds). Should we require this disclosure where it currently appears, in the context of the liquidity discussion in MD&A, or elsewhere?

196. Do registrants face any particular challenges in complying with the item's disclosure requirements?

4. Use of Proceeds From Registered Securities (Item 701(f))

Item 701(f) requires a registrant to disclose the use of proceeds from its first registered offering.[594] The registrant must provide the following disclosure in its first Exchange Act periodic report after effectiveness of the Securities Act registration statement:

- The effective date of the Securities Act registration statement;
- the offering date or an explanation of why the offering has not commenced;
- if the offering terminated before any securities were sold, an explanation of the termination;
- if the offering did not terminate before any securities were sold, registrants must disclose (i) whether the offering has terminated and, if so, whether it terminated before the sale of all securities registered; (ii) the names of the managing underwriters, if any; (iii) the title of each class of securities registered; (iv) for each class of securities, the amount registered, the aggregate offering price of the amount registered, the amount sold, and the aggregate offering price of the amount sold to date; (v) the amount of expenses incurred by the registrant in connection with the issuance and distribution of the securities registered; (vi) net offering proceeds after deducting expenses; (vii) the amount of net offering proceeds used for certain enumerated purposes; and (viii) a brief description of any material change from the prospectus disclosure about the use of proceeds.[595]

Item 701(f) requires registrants to provide disclosure in each subsequent

[591] Rule 3–04 of Regulation S–X [17 CFR 210.3–04]. Registrants are not required to provide a statement of stockholders' equity with their interim financial statements.

[592] *See* ASC Topic 505–10–50–2. Registrants are not required to disclose the aggregate offering price.

[593] *See* ASC Topic 505–10–50–3. ASC Topic 470–10–50–5 requires the same information for debt securities. While the date of sale is not required, registrants usually include it in their discussions of the rights and privileges of securities sold.

[594] Item 701(f) of Regulation S–K [17 CFR 229.701(f)].

[595] *Id.*

periodic report to the extent it has changed since the last periodic report filed. Registrants must continue to provide this disclosure until the application of all of the offering proceeds or termination of the offering.

a. Comments Received

S–K Study. Two commenters recommended eliminating Item 701(f), indicating the requirement does not result in useful information for investors since companies cannot necessarily determine whether a dollar spent was derived from revenue or from the net proceeds of a securities offering, and that the discussion of cash flow in MD&A should already address material uses of cash.[596]

Disclosure Effectiveness Initiative. None.

b. Discussion

The precursor to Item 701(f) originated in Rule 463 of the Securities Act, which was adopted with related Form SR in 1971.[597] In proposing this rule, the Commission noted that disclosure about the progress of an offering of registered securities would enable the Commission to know whether the registrant is required to file and use an updated Section 10(a)(3) prospectus and whether ''dealers effecting transactions in the registered security must furnish a copy of the prospectus to purchasers.'' [598] The Commission further noted that, if registrants have used offering proceeds for purposes different from those stated in the prospectus, investors may have been misled as to the purposes for which the funds supplied by them would be applied. Information about the actual use of proceeds following the offering would indicate whether statements in the prospectus were borne out by the registrant's subsequent actions.[599]

In 1980, the Commission proposed revisions to Rule 463 and Form SR to require, among other things, disclosure of use of proceeds beyond first-time registered offerings.[600] After considering comments on the proposal, the Commission concluded it was not clear that the benefits from such an extension would outweigh the additional reporting burdens imposed on registrants.[601] At the same time, the Commission affirmed the use of Form SR for first-time issuers and noted that commenters generally did not object to the use of Form SR to elicit information about use of proceeds from first-time issuers.[602]

In 1997, the Commission eliminated Form SR and adopted Item 701(f) to require disclosure about the use of offering proceeds in periodic reports.[603] The Commission stated its belief that relocating the disclosure to periodic reports would make it more accessible to investors, since periodic reports were more commonly monitored by the public than Form SR.[604] The adoption of Item 701(f) led to use of proceeds information being reported on a quarterly basis instead of semi-annually through Form SR.

Other disclosure requirements may elicit information about the use of offering proceeds. For example, registrants may disclose the proceeds from initial public offerings as a material source of cash in the liquidity discussion within MD&A.[605] Changes in a registrant's statement of cash flow and statement of stockholders' equity in the financial statements may also indicate the progress of its initial registered offering. However, certain information about the progress of an offering, such as when a registrant has not commenced an offering or the offering is terminated before any securities were sold, may not be available to investors outside of disclosures required by Item 701(f).

c. Request for Comment

197. Should we retain or eliminate disclosure about the use of offering proceeds required by Item 701(f)? Why? If we retain this requirement, how could we improve it? For example, should we modify the item, such as by expanding it to offerings other than a registrant's first registered offering or by requiring other additional disclosure? Why?

198. In Form 10–K, this disclosure is provided as part of Item 5 of Part II (Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities) while in Form 10–Q this disclosure is provided as Item 2 of Part II (Unregistered Sales of Equity Securities and Use of Proceeds). Should we require this information in its current location, in the context of liquidity or elsewhere? Should we require disclosure only if the actual use of proceeds differs materially from the description of the offering?

5. Purchases of Equity Securities by the Issuer and Affiliated Purchasers (Item 703)

Item 703 requires tabular disclosure of purchases of registered equity securities by the registrant or any affiliated purchaser including:

- Total number of shares repurchased;
- average price paid per share;
- total number of shares purchased as part of publicly announced plans or programs; and
- maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs.[606]

Item 703 also requires footnote disclosure of (1) the date each plan or program was announced, (2) the dollar amount (or share amount) approved, (3) the expiration date (if any) of each plan or program, (4) each plan or program that has expired during the period covered by the table, and (5) each plan or program the registrant has determined to terminate prior to expiration, or under which the issuer does not intend to make further purchases.[607]

Item 703 requires disclosure for each month included in the period covered by the report. Form 10–Q requires this information for any equity repurchase made in the quarter covered by the

[596] *See* Silicon Valley; M. Liles.

[597] *See* Adoption of Rule 463 and Form SR Requiring Reports by First-Time Registrants of Sales of Registered Securities and Use of Proceeds Therefrom, Release No. 33–5141 (Apr. 19, 1971) [36 FR 7896 (Apr. 28, 1971)] (''Rule 463 Adopting Release''). Form SR was a stand-alone report required to be filed once every six months following the effective date of a registrant's first Securities Act registration statement.

[598] Notice of Proposal to Require Reports by First-Time Registrants of Sales of Registered Securities and Use of Proceeds Therefrom, Release No. 33–5130 (Feb. 8, 1971) [36 FR 3429 (Feb. 24, 1971)] at 3430.

[599] *See id.* As adopted, Rule 463 did not require a Form SR to be filed with respect to any offering of securities issued by any investment company registered under the Investment Company Act of 1940; any public utility company or public utility holding company required to file reports with any state or federal authority; or with respect to American depositary receipts for foreign securities. *See* Rule 463 Adopting Release.

[600] *See* Report of Sales of Securities, Release No. 33–6251 (Oct. 23, 1980) [45 FR 71811 (Oct. 30, 1980)]. The proposed requirement was intended to facilitate the determination of whether an issuer of a direct distribution or a best efforts underwritten offering that was not a first-time offering was complying with the prospectus delivery and updating requirements of Sections 4(3) and 10(a)(3) of the Securities Act.

[601] *See* Report of Sales of Securities and Use of Proceeds, Release No. 33–6346 (Sept. 21, 1981) [46 FR 48137 (Oct. 1, 1981)].

[602] *See id.*

[603] *See* Phase Two Recommendations of Task Force on Disclosure Simplification Release.

[604] *See id.* The Commission also noted that consolidating the disclosure requirements into the periodic report forms should ease reporting burdens on registrants by reducing the number of forms required to be filed.

[605] *See* Item 303(a)(1) of Regulation S–K [17 CFR 229.303(a)(1)] (requiring registrants to discuss and analyze ''internal and external sources of liquidity'') and Item 303(a)(2)(ii) of Regulation S–K (requiring registrants to discuss and analyze any known material trends, favorable or unfavorable, in capital resources, including changes between equity, debt and any off-balance sheet financing arrangements).

[606] Item 703 of Regulation S–K [17 CFR 229.703].

[607] Instruction 2 to paragraphs (b)(3) and (b)(4) of Item 703 of Regulation S–K [17 CFR 229.703].

report,[608] while Form 10–K requires this disclosure for repurchases made in the fourth fiscal quarter of the registrant's fiscal year.[609]

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter recommended the Commission and the FASB coordinate efforts to review and clarify the different disclosure objectives of Item 703 and U.S. GAAP to determine whether both requirements continue to provide distinct and useful information.[610] This commenter also recommended, alternatively, that if the Commission and the FASB determine that the requirements are still useful, that they issue joint guidance on how both requirements should work together.

Another commenter recommended enhanced disclosure of the ''pros'' and ''cons'' of share repurchase programs by addressing, among other things, (i) the time period specified for each program, (ii) the maximum number of shares authorized by the board to be repurchased, (iii) the cash (including any borrowings) spent on repurchases and dividends compared to that spent on reinvestment, and (iv) the impact of repurchase programs on corporate indebtedness.[611] This commenter also recommended that companies consider disclosing the sources of funds to finance stock buybacks.

b. Discussion

In 2003, the Commission adopted Item 703 to increase the transparency of security repurchases by registrants and their affiliates and to inform investors of registrants' stated repurchasing intentions and subsequent repurchases.[612] The Commission noted in the adopting release that public announcement of a repurchase is often followed by a rise in the registrant's stock price, and that studies have shown some registrants publicly announce repurchase programs but either do not repurchase shares or only repurchase a small portion of the publicly disclosed amount. Item 703 was intended to inform investors whether, and to what extent, registrants follow through on their original repurchase plans and to provide investors with information that could affect a registrant's stock price.[613]

In recent years, stock repurchases by registrants have increased significantly.[614] According to media reports, since 2004 U.S. companies have spent nearly $7 trillion repurchasing their own shares.[615] Common reasons for engaging in repurchases include returning excess cash to shareholders,[616] boosting earnings per share [617] and offsetting share dilution resulting from employee benefit plans.[618] Repurchases typically affect earnings per share by reducing the amount of shares outstanding,[619] except when repurchased shares are distributed to employees as compensation. Recent studies have found that, since the Commission adopted Item 703, registrants have announced smaller open market repurchases [620] and have completed announced open market repurchases at a higher rate.[621]

The staff has observed that registrants generally comply with the item requirements but often do not analyze the impact of stock repurchases in the context of MD&A. Even when the amount used to repurchase shares exceeds a registrant's net income or cash generated from operating activities for the reporting period, registrants do not always analyze these repurchases in MD&A.

While some of the disclosure required under Item 703 overlaps with requirements under U.S. GAAP,[622] there are differences between the two standards. Item 703 disclosure is required on a quarterly basis while U.S. GAAP requires annual disclosure. Additionally, disclosure requirements under U.S. GAAP vary depending on the type of transaction through which shares are repurchased, and in some situations U.S. GAAP disclosures are more extensive than those required under Item 703.[623] Disclosure provided

[608] Item 2(c) of Part II of Form 10–Q [17 CFR 249.308a].

[609] Item 5(c) of Form 10–K [17 CFR 249.310].

[610] *See* SCSGP (specifying overlap between Item 703 and ASC Topic 505).

[611] *See* letter from William J. Klein and Thomas J. Amy (May 12, 2015) (''Klein and Amy 3'').

[612] *See* Purchases of Certain Equity Securities by the Issuer and Others, Release No. 33–8335 (Nov. 10, 2003) [68 FR 64952 (Nov. 17, 2003)].

[613] *See id.*

[614] *See, e.g.,* Oliver Renick and Michael P. Regan, *Getting High on Their Own Supply,* Bloomberg Businessweek, July 16, 2015, *available* at *http://www.bloomberg.com/news/articles/2015-07-16/corporate-stock-buybacks-make-earnings-look-better* (citing data that companies in the S&P 500 spent more than $550 billion in stock repurchases in 2014); John Waggoner, *Beware the Stock-Buyback Craze,* The Wall Street Journal, June 19, 2015, *available at http://www.wsj.com/articles/beware-the-stock-buyback-craze-1434727038* (noting that stock repurchases are returning to pre-financial crisis levels and citing research indicating that companies in the S&P 500 repurchased about $148 billion of their own shares in the first quarter of 2015); Audit Analytics, *Research and Development Up Despite Stock Buybacks,* June 15, 2015, *available* at *http://www.auditanalytics.com/blog/research-and-development-up-despite-stock-buybacks* (citing research that stock buybacks have surpassed $2.1 trillion since the beginning of the first quarter of 2009 among S&P 500 companies).

[615] *See* Andrew Ross Sorkin, *Stock Buybacks Draw Scrutiny from Politicians,* The New York Times, Aug. 10, 2015, *available at http://www.nytimes.com/2015/08/11/business/stock-buybacks-draw-scrutiny-from-politicians.html* (citing data from Mustafa Erdem Sakinc of the Academic-Industry Research Network).

[616] *See, e.g.,* Maxwell Murphy and John Kester, *Buybacks Can Juice Per-Share Profit, Pad Executive Pay,* The Wall Street Journal, Oct. 19, 2014, *available at http://www.wsj.com/articles/buybacks-can-juice-per-share-profit-executive-pay-1414453356* (''Murphy and Kester'').

[617] *See, e.g.,* Maxwell Murphy, *The Big Number,* The Wall Street Journal, Apr. 6, 2015, *available athttp://www.wsj.com/articles/the-big-number-1428362150* (''Murphy'').

[618] *See, e.g.,* Gerrit De Vynck, *BlackBerry Plans Share Buyback to Offset Employee Incentives,* Bloomberg Business, May 21, 2015, *available at http://www.bloomberg.com/news/articles/2015-05-21/blackberry-planning-share-buyback-to-offset-employee-incentives; Ford Announces $1.8 Billion Share Buyback Program, Can Reduce Debt,* Chicago Tribune, May 7, 2014, *available at http://articles.chicagotribune.com/2014-05-07/marketplace/sns-rt-us-ford-stocks-buyback-20140507_1_ford-motor-co-ford-stock-103-million-shares. See also* Karen Brettell, David Gaffen and David Rohde, *The Cannibalized Company,* Reuters, Nov. 16, 2015, *available at http://www.reuters.com/investigates/special-report/usa-buybacks-cannibalized* (stating that the prevalence of share repurchases is the result of several factors: Pressure from activist investors; executive compensation programs that tie pay to earnings per share and share prices; increased global competition; and ''fear of making long-term bets on products and services that may not pay off'').

[619] *See* E.S. Browning, *Is the Surge in Stock Buybacks Good or Evil?,* The Wall Street Journal, Nov. 22, 2015, *available at http://www.wsj.com/articles/is-the-surge-in-stock-buybacks-good-or-evil-1448188684*; Murphy and Kester. *See also* Murphy (noting that 22 companies in the S&P 500 reported lower profits but still posted flat or positive earnings per share in 2014 solely from share repurchases, and that 308 companies in the index ended the year with fewer shares outstanding).

[620] *See* Alice A. Bonaimé, *Mandatory Disclosure and Firm Behavior: Evidence from Share Repurchases,* 90 Accounting Review 4, 1333 (2015) (''Bonaimé 2015'').

[621] *See* Michael Simkovic, *The Effect of Mandatory Disclosure on Open Market Repurchases,* 6 Berkley Bus. L.J. 1, 96 (2009) (comparing a sample of post-2003 open market repurchases with literature on open market repurchases predating Item 703); Bonaimé 2015.

[622] The dollar amount and the number of shares repurchased are disclosed in the annual Statement of Shareholders' Equity, because U.S. GAAP requires the repurchase of stock to be deducted from capital stock, additional paid-in capital, and retained earnings. *See* ASC Topics 505–10–50, 505–30–30 and Rule 3–04 of Regulation S–X. This financial statement presents shareholders' equity activity in a roll forward of each of the shareholders' equity components from the beginning to the end of the annual period. Article 10 of Regulation S–X does not require an interim period statement of shareholders equity. Instead, Rule 10–01(a)(5) requires disclosure of events subsequent to the end of the most recent fiscal year that have occurred which have a material impact on the registrant.

[623] For example, for shares repurchased through accelerated share repurchase programs, registrants must disclose the nature and terms of the arrangement with the seller from which the registrant is acquiring its shares, including the number of shares subject to the contract, per share price terms and settlement options available. *See* ASC Topic 815–40–50–5.

under U.S. GAAP is also audited, unlike Item 703 disclosure. Typically, registrants provide disclosure about share repurchases in both the notes to the financial statement and in non-financial statement disclosures.

While Item 703 requires disclosure of all monthly repurchases on a quarterly basis,[624] other jurisdictions require this disclosure more frequently.[625] We seek comment on whether we should require more frequent or more granular information about repurchases or whether the current disclosure requirements are sufficient.

c. Request for Comment

199. Is the information required under Item 703 about repurchases of a registrant's equity securities important to investors? If so, are there any revisions we could make to Item 703 to improve the disclosure provided to investors?

200. Should we require more granular information on repurchases of a registrant's equity securities? If so, what additional detail or more granular information should we require? For example, should we require disclosure about incurrence of indebtedness to fund repurchases or the impact repurchases had on performance measures, such as earnings per share or other items? If so, how should this information be formatted and presented?

201. Does Item 703 provide important information that is not also disclosed in a registrant's financial statements? Are there benefits to investors in providing this information in both the financial statements and in non-financial statement disclosure?

202. Item 703 requires disclosure of all repurchases of registered securities and does not have a de minimis requirement. Do investors find disclosure of all repurchases of securities during a registrant's fiscal quarter important to making a voting or investment decision? Should we adopt a general materiality standard or specify a monetary threshold for Item 703 disclosure in periodic reports?

203. Item 703 disclosure is required on a quarterly basis, while relevant U.S. GAAP disclosure is required on an annual basis. Should we require more frequent Item 703 disclosure? If so, what timeframe for reporting repurchases would be appropriate?

204. Should we require registrants to report repurchases on Form 8–K? For example, should we require Form 8–K disclosure only of repurchases that exceed a certain threshold, similar to Item 3.02 of Form 8–K, which requires registrants to disclose sales of equity securities that constitute more than one percent of the shares outstanding of the class of equity securities? If so, what should this threshold be and why?

E. Industry Guides

The Industry Guides express the disclosure policies and practices of the Division and are intended to assist registrants and their counsel in preparing disclosure for their filings.[626] Currently, there are five Industry Guides that address disclosures by: (i) Bank holding companies,[627] (ii) oil and gas programs,[628] (iii) real estate limited partnerships,[629] (iv) property-casualty insurance underwriters,[630] and (v) mining companies.[631] All five of the Industry Guides apply to disclosure in Securities Act registration statements. The Industry Guides for bank holding companies, property-casualty insurance underwriters, and mining companies also apply to disclosure in Exchange Act filings.[632]

We are seeking public input on whether the Industry Guides elicit disclosure that is important to investment and voting decisions. We are interested in commenters' views on

[624] *See* Item 2(c) of Part II of Form 10–Q and Item 5(c) of Form 10–K.

[625] For example, exchange listing requirements in Australia require disclosure of share repurchases by the next business day. *See* Australian Securities Exchange Listing Rule 3.8A, *available at http://www.asx.com.au/documents/rules/Chapter03.pdf.*

[626] Although the Commission published the Industry Guides, they do not constitute Commission rules and instead are statements of staff policy. *See* Rescission of Guides and Redesignation of Industry Guides, Release No. 33–6384 (Mar. 3, 1982) [47 FR 11476 (Mar. 16, 1982)] (''Industry Guide Release'') (''These guides remain as an expression of the policies and practices of the Division of Corporation Finance and their status is unaffected by [the listing of the Industry Guides in Regulation S–K].'' Id. at 11476).

[627] Securities Act and Exchange Act Industry Guide 3—Statistical Disclosure by Bank Holding Companies. Industry Guide 3 was first published in 1976 as Securities Act Guide 61 and Exchange Act Industry Guide 3. *See* Guides for Statistical Disclosure by Bank Holding Companies, Release No. 33–5735 (Aug. 31, 1976) [41 FR 39007 (Sept. 14, 1976)]. There have been only minor revisions to the text of Industry Guide 3 since its re-designation as an Industry Guide in 1982. Revisions relating to non-performing loan disclosure requirements were implemented in 1983, and revisions relating to exposures to borrowers in certain foreign countries were implemented in 1986. *See* Revision of Industry Guide Disclosures for Bank Holding Companies, Release No. 33–6478 (Aug. 11, 1983) [48 FR 37609 (Aug. 19, 1983)]; Amendments to Industry Guide Disclosures by Bank Holding Companies, Release No. 33–6677 (Nov. 25, 1986) [51 FR 43594 (Dec. 3, 1986)].

[628] Securities Act Industry Guide 4—Prospectuses Relating to Interests in Oil and Gas Programs. Industry Guide 4 was first published in 1970 as Guide 55, which was redesignated as Securities Act Industry Guide 4 in 1982. *See* Definitive Guide for the Preparation of Prospectuses Relating to Interests in Oil and Gas Programs, Release No. 33–5036 (Jan. 19, 1970) [35 FR 1233 (Jan. 30, 1970)]. While the disclosure requirements for oil and gas producing activities were modernized in 2008 (at which time Industry Guide 2 was eliminated), the changes did not affect Securities Act Industry Guide 4. Securities Act Industry Guide 4 is focused on disclosure relating to the offering of interests in oil and gas programs, such as the terms of the offering, the participation in costs and revenues, application of proceeds and risk factors.

[629] Securities Act Industry Guide 5—Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships. Industry Guide 5 was originally published in 1976 as Guide 60 and redesignated as Securities Act Industry Guide 5 in 1982. *See* Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships, Release No. 33–5692 (March 17, 1976) [41 FR 17403 (Apr. 26, 1976)]; Industry Guide Release. In 1991 the Commission expanded the application of Industry Guide 5 to include the preparation of registration statements for real estate investment trusts and all other limited partnership offerings, as applicable. *See* Limited Partnership Reorganizations and Public Offerings of Limited Partnership Interests, Release No. 33–6900 (June 17, 1991) [56 FR 28979 (June 25, 1991)].

[630] Securities Act Industry Guide 6 and Exchange Act Industry Guide 4—Disclosures Concerning Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Insurance Underwriters. These Industry Guides were first published in 1984 and there have been no significant revisions since their adoption. *See* Rules and Guide for Disclosure Concerning Reserves for Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Underwriters, Release No. 33–6559 (Nov. 27, 1984) [49 FR 47594 (Dec. 6, 1984)].

[631] Securities Act and Exchange Act Industry Guide 7—Description of Property by Issuers Engaged or To Be Engaged in Significant Mining Operations (''Industry Guide 7''). Industry-specific disclosure requirements for mining companies were previously included in various Securities Act Forms. In 1992, in connection with the Commission's small business initiatives that rescinded Form S–18, Item 17A of Form S–18 was redesignated as Industry Guide 7, so that the industry specific guidance would be applicable to all issuers engaged in mining operations, not only to small business issuers. *See* Small Business Initiatives, Release No. 33–6949 (July 30, 1992) [57 FR 36442 (Aug. 13, 1992)] (''Small Business Initiatives Adopting Release''). A rulemaking petition to amend Industry Guide 7 was submitted to the Commission in October 2012. *See* letter from the Society for Mining, Metallurgy and Exploration, Oct. 1, 2012, *available at http://www.sec.gov/rules/petitions/2012/petn4-654.pdf.*

[632] Guidance contained in Exchange Act Industry Guides 3 and 4 applies to the description of business portion of registration statements filed on Form 10; in proxy and information statements relating to mergers, consolidations, acquisitions, and similar matters (Item 14 of Schedule 14A and Item 1 of Schedule 14C); and in reports filed on Forms 10–K. *See* Item 802 of Regulation S–K [17 CFR 229.802]. Exchange Act Industry Guide 7 does not specify the Exchange Act filings to which the guidance applies.

In proposing to re-designate the Industry Guides, the Commission noted that industry guidelines ''maximize'' the quality of disclosure in certain industries. Accordingly, though not specifically applicable to Exchange Act filings, Industry Guide 5 may be useful in determining the type of information that might be important in an Exchange Act filing for a real estate program. *See* Proposed Revision of Regulation S–K and Guides for the Preparation and Filing of Registration Statements and Reports, Release No. 33–6276 (Dec. 23, 1980) [46 FR 78 (Jan. 2, 1981)] (''1980 Proposed Revision of Regulation S–K'').

whether the Industry Guides provide useful guidance for registrants that improves disclosure to investors. Additionally, we are seeking input on whether the Industry Guides or portions of the Industry Guides should be codified in Regulation S–K.[633]

1. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. A few commenters recommended general updates to all Industry Guides.[634] One commenter recommended that we consider additional industry-specific disclosure requirements and consider whether changes in the economy require additional industry-specific disclosure in either or both Regulations S–X and S–K.[635] This commenter also stated that the Industry Guides should be updated to reflect changes in disclosure requirements within Regulations S–X and S–K and stated that the Industry Guides, relative to U.S. GAAP and Regulation S–X, could use improvement. One commenter suggested that improved Industry Guides could be helpful in highly-regulated or specialized industries, such as financial institutions and banks, mining, oil and gas exploration, and the pharmaceutical industry.[636] This commenter also suggested moving industry-specific disclosure requirements currently in Regulation S–K to the relevant Industry Guide.[637] One commenter recommended requiring additional disclosure from oil and gas companies about the carbon asset risk to such companies.[638]

2. Discussion

Between 1962 and 1992, the Commission published various Guides and Industry Guides to assist registrants in preparing and filing registration statements and periodic reports and to shorten the comment process.[639] The Guides represented policies and practices followed by the Division and were published in response to an increase in the number of filings reviewed by the Division and an associated increase in the amount of time between the filing and effective dates of a registration statement.[640] The Guides were intended to provide uniformity and enhance comparability of disclosure while reducing the necessity for staff comment on matters addressed in the Guides.[641] The Guides were modified and expanded over time, in part, to address anticipated disclosure issues.[642]

In connection with the adoption of the integrated disclosure system in 1982, the Guides relating to specific industries were re-designated as Industry Guides and the titles of the Securities Act Industry Guides and Exchange Act Industry Guides were listed in Items 801 and 802 of Regulation S–K, respectively.[643] Although the Industry Guide titles are listed in Items 801 and 802 of Regulation S–K, these guides are not part of Regulation S–K and are not rules, regulations or statements of the Commission.[644]

In 1996, the Task Force on Disclosure Simplification recommended incorporating the Industry Guides into Regulation S–K, based on the Task Force's understanding that registrants find the role of the Industry Guides within our disclosure regime confusing.[645] The Task Force also recommended eliminating Industry Guide 1 (Disclosure of Principal Sources of Electric and Gas Revenues) because the Task Force believed that the information required by the Industry Guide was provided in response to other disclosure requirements.[646]

Although it did not incorporate the Industry Guides into Regulation S–K,[647] the Commission did follow the Task Force's recommendation [648] to eliminate Industry Guide 1 (Disclosure of Principal Sources of Electric and Gas Revenues) because the information requested by the Industry Guide is covered by other Commission rules, including Items 101 and 303 of Regulation S–K.[649] In 2008, the Commission modernized the reporting requirements applicable to oil and gas reserves and codified the disclosure items formerly in Industry Guide 2 by relocating them into Regulation S–K.[650]

The S–K Study recommended reviewing the Industry Guides to evaluate whether they continue to elicit useful information that would not otherwise be disclosed. The S–K Study also recommended considering whether any Industry Guide provisions should

[633] We focus only on the Industry Guides in this section of the release. We do not address items of Regulation S–K that contain industry-specific disclosure requirements, such as Item 104, which requires disclosure about mine safety that is applicable only to registrants that operate coal or other mines. Additionally, this section focuses on the Industry Guides generally and does not pose questions specific to any of the Industry Guides, although we welcome comments on specific revisions to any of the Industry Guides. As part of the Disclosure Effectiveness Initiative, the staff is currently considering recommendations for Industry Guides 3 and 7. Comment letters received specific to Industry Guides 3 and 7 are being considered as part of these staff recommendations.

[634] *See, e.g.,* letters from Rep. Shelley Moore Capito, et al. (July 7, 2014); Senators Dean Heller, Mike Crapo and Jon Tester (Aug. 13, 2014); Shearman.

[635] *See* CFA Institute (listing the technology and social media sectors as examples of industries where industry-specific disclosure may be useful).

[636] *See* Shearman (suggesting that new industry guides could address issues such as the regulatory environments in which industries operate).

[637] *Id.* (citing Item 104—Mine Safety Disclosure as an industry-specific disclosure requirement in Regulation S–K that could be moved to an Industry Guide).

[638] *See* letter from Ceres (Apr. 17, 2015) (''Ceres'').

[639] The first Guides were published in 1962. By 1979, there were 63 Guides for the preparation and filing of registration statements and five Guides for the preparation and filing of periodic reports. *See* 1980 Proposed Revision of Regulation S–K (discussing the history of the guides) 1964 Guides; S–K Study at 7, footnote 16, and 10, footnote 28.

[640] *See id.* The backlog of filings and inordinate length of the pre-effective period was attributed in part to the low-quality of first-time filings and inexperience of counsel and accountants. *See* Acceleration of Registration Statements, Release No. 33–4475 (Apr. 13, 1962) [27 FR 3990 (Apr. 26, 1962)]; 1980 Proposed Revision of Regulation S–K.

[641] *See* 1964 Guides (''It is expected that the publication of these policies and practices will not only be of assistance to registrants, their counsel and accountants in the preparation of registration statements, but also that it will relieve the staff of the Commission of the necessity for commenting on these matters in respect of such statements.'' Id. at 2490); Proposed Guides Concerning Prospectuses Relating to a Public Offering of Interests in Oil and Gas Programs, Release No. 33–5001 (Aug. 27, 1969) [34 FR 14125 (Sept. 6, 1969)] (''The guide is designed to accomplish, to the extent feasible, uniformity in both the sequence of disclosures and their general content. The guide should thus serve to assist issuers in preparing registration statements involving oil and gas drilling programs and to facilitate the understanding and analysis of the program by the investor, enabling him also to compare more readily one offering with another.'' Id. at 14125).

[642] *See* 1980 Proposed Revision of Regulation S–K (also citing the Commission's investigation of the hot issues securities markets, recommendations of the Industrial Issuers Advisory Committee and recommendations in the Sommer Report as factors to which the expansion and modification of the Guides can be attributed).

[643] *See* Industry Guide Release (rescinding all guides other than those which contain industry-specific disclosure); Items 801 and 802 of Regulation S–K [17 CFR 229.801; 17 CFR 229.802].

[644] *See* Industry Guide Release.

[645] *See* Task Force Report (recommending that the Industry Guides be placed intact at the end of Regulation S–K, in the manner that industry-specific disclosure requirements are currently placed in Regulation S–X). The Task Force also recommended that the Commission consider adopting rules applicable to additional industries and recommended general modernization of the Industry Guides. *Id.*

[646] *See* Task Force Report. The Task Force stated that the disclosure provided by Guide 1 appears to be adequately covered by the requirements of Regulation S–K, primarily Items 101 and 303 of Regulation S–K.

[647] In addressing other Task Force recommendations, the Commission stated that its action for certain Task Force recommendations was not intended to indicate either approval or disapproval of any of the remaining recommendations or suggestions in the Task Force Report. *See* Phase One Recommendations of Task Force on Disclosure Simplification Release.

[648] *See* Task Force Report.

[649] *See* Phase One Recommendations of Task Force on Disclosure Simplification Release.

[650] *See* Oil and Gas Release.

be codified in Regulation S–K, whether any information is duplicative of U.S. GAAP requirements and whether industry-specific disclosure requirements should be scaled or transition periods be provided for certain classes of registrants.[651]

In proposing the re-designation of the Industry Guides, the Commission cited industry guidelines as an example of the limited instances where the use of guidelines is appropriate, stating that guidelines should pertain only to areas such as industry-specific information, where more specific guidance is appropriate yet flexibility is necessary to tailor disclosures to particular facts and circumstances.[652] The Commission cited findings of the Sommer Report in concluding that the use of industry guidelines minimizes the extent to which registrants must comply with inapplicable disclosure requirements, maximizes the quality of the disclosure made for particular industries, and provides Commission staff with a reference for examining filings by particular industries.[653]

We are seeking input on whether the Industry Guides continue to achieve the benefits cited by the Commission when it re-designated the guides in 1980. Today, the Division publicly releases its comment letters.[654] These letters are often analyzed by third parties that publish reports about comment trends in an industry.[655] We believe that registrants look to filings in their industry and recently-issued staff comment letters to anticipate and proactively address industry-specific issues.

We also are seeking public input on the advantages and disadvantages of codifying industry-specific disclosure requirements in Regulation S–K. Codifying the Industry Guides in Regulation S–K would be consistent with the approach taken by the Commission in 2008 when former Industry Guide 2 was codified as Subpart 1200 of Regulation S–K.[656] This approach could help provide consistency in the disclosure provided by registrants in certain industries by making such disclosure a regulatory requirement. A potential disadvantage of this approach, however, is that over time registrants may be required to provide industry-specific disclosure that has become obsolete due to changes in industry practices or technology. Codifying the Industry Guides may afford registrants less flexibility in determining the industry-specific disclosures that are most applicable to them.

Another possible approach is to update but not codify the Industry Guides in Regulation S–K. While this approach may allow registrants the flexibility to omit obsolete disclosures, the fact that the guidance is not a regulatory requirement may result in less uniformity in compliance and therefore less comparability across an industry.

3. Request for Comment

205. Do the Industry Guides result in disclosure that is important to investors that registrants might not otherwise disclose under Regulation S–K or Regulation S–X? If so, what are examples of this type of disclosure?

206. Do registrants find the Industry Guides useful in preparing disclosure for periodic reports?

207. To the extent that the Industry Guides call for information that registrants would not otherwise disclose but for the Industry Guides, what are the challenges of providing this disclosure?

208. Should we include additional industry-specific disclosure requirements in Regulation S–K by codifying all or portions of the Industry Guides? What are the advantages and disadvantages of including industry-specific disclosure requirements in Regulation S–K versus retaining the Industry Guides?

209. Should some or all of the Industry Guides be updated? If so, which ones? Should additional Industry Guides or industry-specific rules for other industries be developed? If so, which industries would benefit from such guidance? Should industry-specific disclosure in Regulation S–K or staff guidance be limited to certain industries? If so, what criteria should be used to identify those industries?

210. What additional costs or costs savings, including the administrative and compliance costs of preparing and disseminating disclosure, do registrants experience because of the Industry Guides? Would registrants' disclosure costs be higher, lower or the same if the disclosures currently detailed in Industry Guides were incorporated into Regulation S–K or Regulation S–X? Please provide quantitative estimates if possible.

211. The Industry Guides originally were intended to assist registrants, their counsel and accountants in the preparation of disclosure by publishing staff policies and practices related to staff review of registrant filings.[657] Does the public release of the staff's comment letters and increased availability of tools that aggregate information about disclosure included in Commission filings and comment letters reduce the need for the Industry Guides as guidance for registrants?

212. Does the status of the Industry Guides as staff policy rather than Commission rules have any impact on the extent to which registrants provide disclosure consistent with the Industry Guides?

213. Regulations S–K and S–X include some industry specific disclosures. For example, Form S–11[658] and Schedules III and IV prescribed by Articles 12–28 and 12–29 of Regulation S–X, respectively, include industry specific disclosure requirements for certain real estate companies. If we update and codify the Industry Guides in Regulation S–K, should we also move and consolidate other industry-specific disclosure requirements currently located elsewhere to Regulation S–K at the same time? If so, how should we identify those disclosure requirements? Are any of these other industry-specific disclosure requirements already substantially addressed by non-industry-specific required disclosures either in Regulation S–K or by U.S. GAAP?

214. Should industry-specific disclosure requirements apply to every registrant in a particular industry or should they be limited to certain categories of registrants? If they should be limited, to which registrants should they apply?

215. What types of investors or audiences are most likely to value the information that registrants would not disclose but for the Industry Guides?

F. Disclosure of Information Relating to Public Policy and Sustainability Matters

In recent years, Congress has mandated new disclosure requirements that address specific public policy concerns. For example, Section 1502 of the Dodd-Frank Act mandated that the Commission adopt rules regarding registrants' use of ''conflict minerals'' originating in specified countries, and Section 1504 of the Dodd-Frank Act

[651] *See* S–K Study at 103.

[652] *See* 1980 Proposed Revision of Regulation S–K (stating waiver procedures would be necessary if Industry Guides were codified as formal regulations to address scenarios in which the rule technically applies but where disclosure was neither necessary nor appropriate).

[653] *See id.*

[654] *See* Commission Staff to Begin Publicly Releasing Comment Letters and Responses, May 9, 2005, *available at http://www.sec.gov/news/press/2005-72.htm.*

[655] *See, e.g.,* PricewaterhouseCoopers LLP, *SEC Comment Letter Trends, available at http://www.pwc.com/us/en/cfodirect/publications/sec-comment-letter-trends.html.*

[656] *See* Oil and Gas Release.

[657] *See* 1964 Guides.

[658] 17 CFR 239.18.

directed the Commission to adopt rules regarding the disclosure of payments made by resource extraction issuers to foreign governments or the federal government for the purpose of the commercial development of oil, natural gas, or minerals.[659] In addition, Section 1503 of the Dodd-Frank Act requires certain registrants to disclose information about health and safety violations at mining-related facilities.[660]

Some investors and interest groups also have expressed a desire for greater disclosure of a variety of public policy and sustainability matters, stating that these matters are of increasing significance to voting and investment decisions.[661] For example, some have urged the Commission to adopt disclosure requirements on political spending.[662] The Commission, however, has determined in the past that disclosure relating to environmental and other matters of social concern should not be required of all registrants unless appropriate to further a specific congressional mandate or unless, under the particular facts and circumstances, such matters are material.[663]

We are interested in receiving feedback on the importance of sustainability and public policy matters to informed investment and voting decisions. In particular, we seek feedback on which, if any, sustainability and public policy disclosures are important to an understanding of a registrant's business and financial condition and whether there are other considerations that make these disclosures important to investment and voting decisions. We also seek feedback on the potential challenges and costs associated with compiling and disclosing this information.

1. Comments Received

S–K Study. None.

Disclosure Effectiveness. We received a number of comment letters on a variety of sustainability and public policy matters, including climate change.[664] Sustainability disclosure encompasses a range of topics, including climate change, resource scarcity, corporate social responsibility, and good corporate citizenship.[665] These topics often are characterized broadly as environmental, social, or governance (''ESG'') concerns.[666] Many commenters noted a growing interest in ESG disclosure among investors[667] and many recommended increased sustainability disclosure requirements.[668] Some commenters criticized the primarily voluntary nature of current corporate sustainability reporting and stated their belief that information made available to investors is inconsistent and incomplete.[669] Many commenters also sought disclosure of sustainability related risks, and some of these commenters sought related MD&A and trend disclosure.[670]

One commenter opposed mandatory disclosure of sustainability risks,[671] while another opposed disclosure requirements that it described as

[659] 15 U.S.C. 78m(p) and 15 U.S.C. 78m(q)(2)(A). The Commission adopted Exchange Act Rule 13p–1 and Form SD to implement Section 1502 and proposed Rule 13q–1 and an amendment to Form SD to implement Section 1504. Rule 13q–1 was initially adopted by the Commission on August 22, 2012, but it was subsequently vacated by the U.S. District Court for the District of Columbia. *See* Conflict Minerals, Release No. 34–67716 (Aug. 22, 2012) [77 FR 56274 (Sept. 12, 2012)] and Disclosure of Payments by Resource Extraction Issuers, Release No. 34–76620 (Dec. 11, 2015) [80 FR 80057 (Dec. 23, 2015)]. *See* Section III.A.1 for a discussion of the Commission's statutory mandates.

[660] 15 U.S.C. 78m–2. Pursuant to authority granted in Section 1503(d) of the Dodd-Frank Act, the Commission adopted Item 104 of Regulation S–K to implement the statute. *See* Item 104 of Regulation S–K [17 CFR 229.104]. *See also* Mine Safety Disclosure Release.

[661] *See, e.g.,* Ernst & Young LLP, *Tomorrow's Investment Rules 2.0,* 2015 (''Tomorrow's Investment Rules 2015''), at 19, *available at http://www.ey.com/Publication/vwLUAssets/EY-tomorrows-investment-rules-2/$FILE/EY-tomorrows-investment-rules-2.0.pdf* (stating that, in a survey of more than 200 institutional investors around the world, ''. . . almost two-thirds of respondents say companies do not adequately disclose information about ESG risks, and nearly 40% call for companies to do so more fully in the future.''); Mark Carney, Breaking the Tragedy of the Horizon—Climate Change and Financial Stability, Speech given at Lloyd's of London, Sept. 29, 2015, *available at http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx* (stating that a new disclosure ''framework for firms to publish information about their climate change footprint, and how they manage their risks and prepare (or not) for a 2 degree world, could encourage a virtuous circle of analyst demand and greater use by investors in their decision making''); Gibson Dunn, *Shareholder Proposal Developments During the 2015 Proxy Season,* July 15, 2015 (stating that the most common 2015 shareholder proposal topics, along with the approximate number of proposals submitted were: Political and lobbying activities (110 proposals); proxy access (108 proposals); and independent chair (76 proposals)).

[662] *See Petition for Rulemaking from the Committee on Disclosure of Corporate Political Spending,* Aug. 3, 2011, *available at http://www.sec.gov/rules/petitions/2011/petn4-637.pdf.* The Consolidated Appropriations Act of 2016 prohibits the Commission from using appropriated funds to ''finalize, issue, or implement any rule, regulation, or order regarding the disclosure of political contributions, contributions to tax exempt organizations, or dues paid to trade associations.'' Public Law 114–113, Sec. 707, 129 Stat. 2242 (2015) (requirement in Division O, Title VII). This appropriations limitation applies with respect to the Commission's current fiscal year.

[663] *See* Environmental and Social Disclosure, Release No. 33–5627 (Oct. 14, 1975) [40 FR 51656 (Nov. 6, 1975)] (''1975 Environmental Disclosure Release''). In this release, the Commission concluded that, although it is generally not authorized to consider the promotion of social goals unrelated to the objectives of the federal securities laws, it is authorized and required by NEPA to consider promotion of environmental protection as a factor in exercising its rulemaking authority. *See also infra* note 687 and accompanying text.

[664] *See, e.g.,* letters from Union of Concerned Scientists (May 5, 2015) (''UCS''); Ceres; Business Roundtable; Global Reporting Initiative (Apr. 14, 2015) (''GRI''); Carbon Tracker Initiative (Feb. 13, 2015) (''CTI''); Investor Environmental Health Network (Feb. 11, 2015) (''IEHN''); Wallace Global Fund (Dec. 1, 2014) (''Wallace Global Fund''); CFA Institute; SASB; Harrington Investments (Oct. 15, 2014) (''Harrington Investments''); Interfaith Center on Corporate Responsibility (Sept. 24, 2014) (''ICCR''); SCSGP; Sustainability Group (Aug. 12, 2014) (''Sustainability Group''); Corporate Reform Coalition (July 2, 2014) (''Corporate Reform Coalition''); First Affirmative Financial Network (June 26, 2014) (''First Affirmative Financial Network''); US SIF 1; Allianz.

[665] *See,* PricewaterhouseCoopers LLP, *Sustainability goes mainstream: Insights into investor views,* May 2014, *available at https://www.pwc.com/us/en/governance-insights-center/publications/sustainability-goes-mainstream-investor-views.html. See also, e.g.,* World Federation of Exchanges, *Exchange Guidance and Recommendation—October 2015,* Oct. 2015, (''WFE Guidance'') *available at http://www.world-exchanges.org/home/index.php/news/world-exchange-news/world-exchanges-agree-enhanced-sustainability-guidance.*

[666] *See, e.g.,* WFE Guidance.

[667] *See, e.g.,* US SIF 1 (citing an increase in assets under management by signatories to the Principles for Responsible Investment and the number of institutional investors urging companies to disclose greenhouse gas goals and plans to reduce emissions); Ceres (noting that a ''growing number of investors are working to integrate climate risk into their investment strategies . . . .''); CFA Institute (noting ''[a] small, albeit growing, constituency of investors has advocated for the inclusion of sustainability information/disclosures'').

[668] *See, e.g.,* UCS; Ceres; GRI; CTI; IEHN; Wallace Global Fund; Harrington Investments; ICCR; Sustainability Group (concerned with underreporting of material information related to environmental liabilities); US SIF 1; First Affirmative Financial Network Group; Allianz.

[669] *See, e.g.,* US SIF 1; Corporate Reform Coalition; letter from Warren G. Lavey, (Nov. 4, 2015).

[670] *See, e.g.,* UCS; Ceres (requesting staff scrutiny of and comment on filings made by oil and gas companies on carbon asset risks, stating such risks constitute ''known trends''); CTI (noting that ''the relevant 'trend' is how the increasing threat of unmanageable warming will exert pressure to curb emissions from fossil fuel consumption,'' with potential disclosure impacts throughout MD&A, including capital expenditure plans and reserve valuations, and seeking quantitative disclosures when reasonably available); IEHN (recommending enhanced trend disclosure of emerging scientific literature that is both relevant to a company's products and activities and indicative of potential for substantial health or environmental risks, in addition to disclosure of: (i) Potential long-term impact, (ii) the scope of potential exposure, (iii) measures the company is taking to reduce or mitigate these risks, and (iv) relevant benchmarks of liability); ICCR (supportive of risk related requirements relating to climate change); US SIF 1 (affirming its 2009 recommendation to require annual disclosure on a comprehensive set of sustainability indicators (both universal and industry-specific) and seeking interpretive guidance to clarify that short and long-term sustainability risk disclosure is appropriate in MD&A).

[671] *See* SCSGP (stating that sustainability disclosure can be effectively communicated outside of SEC filings).

addressing ''societal issues unrelated to investor protection'' in periodic filings.[672] One of these commenters acknowledged the importance of sustainability information to a variety of stakeholders but opined that these issues ''are not typically material to an understanding of the company's financial performance'' and therefore are not appropriate for inclusion in Exchange Act reports.[673] The other commenter raised similar materiality concerns, stating that ''some groups are seeking to use the federal securities laws to address various societal concerns, without giving effect to the bedrock materiality principle.'' [674]

We received several comment letters that specifically mentioned climate change disclosure.[675] Many of these commenters expressed concern that disclosures made in response to the Commission's current rules do not adequately address the risks associated with climate change.[676] Some commenters cited specific risks that they believe are not adequately disclosed, such as stranded assets and regulatory risk.[677] Other commenters referenced the Commission's 2010 Interpretive Guidance on Climate Change and stated that registrants are not following that guidance.[678]

A few commenters suggested that we adopt new line-item disclosure requirements for climate change matters.[679] One suggested that we adopt a requirement to disclose anticipated full-cycle costs of future capital expenditures and a requirement to disclose the carbon content of a registrant's reserves and resources.[680] Another suggested that we require oil and gas companies to disclose carbon costs alongside the company's disclosure of proved reserves.[681] A third commenter suggested a rule that requires an annual reporting of the risks to the registrant of the effects of climate change, if any.[682] We also received many letters recommending the Commission adopt a rule requiring disclosure of political spending.[683]

2. Discussion

In 1975, the Commission considered a variety of ''environmental and social'' disclosure matters, as well as its own authority and responsibilities to require disclosure under the federal securities laws.[684] Following extensive proceedings on these topics, the Commission concluded that it generally is not authorized to consider the promotion of goals unrelated to the objectives of the federal securities laws when promulgating disclosure requirements, although such considerations would be appropriate to further a specific congressional mandate.[685] The Commission also noted that disclosure to serve the needs of limited segments of the investing public, even if otherwise desirable, may be inappropriate, because the cost to registrants, which must ultimately be borne by their shareholders, would likely outweigh the resulting benefits to most investors.[686]

In 1975, the Commission also concluded that it would require disclosure relating to social and environmental performance ''only if such information . . . is important to the reasonable investor—material information.'' [687] While the Commission concluded that its proceedings did not support a specific requirement for all registrants to disclose information describing ''corporate social practices,'' the Commission noted that in specific cases, some information of this type might be necessary in order to make the statements in a filing not misleading or otherwise complete.[688]

The current statutory framework for adopting disclosure requirements remains generally consistent with the framework that the Commission considered in 1975.[689] However, the Commission has recognized that the task of identifying what information is material to an investment and voting decision is a continuing one in the field of securities regulation.[690] The role of sustainability and public policy information in investors' voting and

[672] *See* Business Roundtable (suggesting that Commission guidance about when disclosure might be warranted in this area would be more appropriate than expanding the disclosure requirements).

[673] *See* SCSGP (also noting that when these issues are material to a registrant's financial performance, registrants generally provide disclosure under existing Commission requirements).

[674] *See* Business Roundtable.

[675] *See, e.g.,* First Affirmative Financial Network; US SIF 1; ICCR; SASB; Wallace Global Fund; letter from US SIF and US SIF Foundation (Dec. 19, 2014) (''US SIF 2''); CTI; GRI; Ceres; UCS; Allianz.

[676] *See, e.g.,* First Affirmative Financial Network; Wallace Global Fund; Ceres; UCS.

[677] *See, e.g.,* Wallace Global Fund (stating that failure to disclose ''stranded assets,'' which are fossil fuel assets that must stay in the ground because of caps imposed by treaty, law or regulation, may result in a material misrepresentation of a corporation's balance sheet); Ceres (noting an absence of disclosure regarding material risks to the oil and gas industry due to increased capital expenditures on high-cost projects, regulatory risk, and carbon asset risk); UCS.

[678] *See, e.g.,* First Affirmative Financial Network; SASB; US SIF 1.

[679] *See, e.g.,* US SIF 1; CTI; Allianz; UCS.

[680] *See* CTI.

[681] *See* Allianz.

[682] *See* UCS.

[683] *See, e.g.,* Form Letter Type A; UCS; Ceres; Daniel A. Simon, et al. (Apr. 21, 2015); Business Roundtable; GRI; CTI; IEHN; Wallace Global Fund; CFA Institute; SASB; Harrington Investments; ICCR; SCSGP; Sustainability Group; Agenda Project Action Fund; Corporate Reform Coalition; First Affirmative Financial Network; US SIF 1; Allianz.

[684] *See* 1975 Environmental Disclosure Release, *supra,* note 663. The Commission instituted public proceedings in response to a court order that required the Commission to ''undertake further rulemaking action to bring the Commission's corporate disclosure regulations into full compliance with the letter and spirit of NEPA'' and to ''provide a statement of reasons for the denial of the equal employment portion of Plaintiff's Rulemaking Petition.'' *Id.* at 51657. The order relates to plaintiffs' 1971 rulemaking petition in which the plaintiffs made specific proposals for new disclosure requirements pertaining to the environment and disclosure about the employment of minorities and women. Regarding the equal employment portion of the petition, the plaintiffs sought to require that the Commission require registrants to provide disclosure of statistics on equal employment practices. The court found that the Commission's denial of this portion of the plaintiffs' rulemaking petition failed to comply with the Administrative Procedures Act. *See Natural Resources Defense Council.*

[685] *See id. See also, supra,* note 61. The Commission was ordered to resolve two overriding factual issues as part of the proceeding, ''the extent of 'ethical investor' interest in the type of information which Plaintiffs have requested'' and ''what avenues of action are available which ethical investors may pursue and which will tend to eliminate corporate practices that are inimical to the environment and equal employment opportunity.'' *See Natural Resources Defense Council* at 701.

[686] *See* 1975 Environmental Disclosure Release at 51666. *See also id.* at note 26 (''If the Commission were required to promulgate rules by plebiscite at the behest of any member of the public, its functions would be purely ministerial, a result clearly not intended by Congress . . . '').

[687] *See id.* at 51660. The Commission's conclusions in the 1975 proceedings were endorsed by the Sommer Report. The Sommer Report recommended that the Commission ''should require disclosure of matters of social and environmental significance only when the information in question is material to informed investment or corporate suffrage decision-making or required by laws other than the securities laws.'' *Id.* at 395. The Sommer Report further expressed the view that the Commission should classify social and environmental information as material ''only when it reflects significantly on the economic and financial performance of the Company.'' *Id. at 326–327.* However, the Sommer Report noted that a minority of the Advisory Committee on Corporate Disclosure believed that disclosure of social and environmental information is material to an investment decision regardless of its economic impact on the financial performance of the company. The minority argued that this kind of information reflects on the quality and character of management, which ''clearly plays an important role in both investment and corporate suffrage decision-making,'' and urged the Commission to require increased disclosure in the social and environmental area. *Id.* at 397.

[688] *See id.* at 51656; Exchange Act Rule 12b–20 [17 CFR 240.12b–20].

[689] Since 1996, the Commission also has been statutorily required to consider, in addition to the protection of investors, whether an action will promote efficiency, competition, and capital formation. *See* Section 2(b) of the Securities Act [15 U.S.C. 77b(b)]; Section 3(f) of the Exchange Act [15 U.S.C. 78c(f)]. *See also* Section 23(a)(2) of the Exchange Act [15 U.S.C. 78w(a)(2)].

[690] *See* 1980 Proposed Revisions.

investment decisions may be evolving as some investors are increasingly engaging on certain ESG matters.[691] According to one study, investors are more likely to engage registrants on sustainability issues than on financial results or transactions and corporate strategy.[692] One observer expressed the view that ESG is not only a public policy issue but also a financial issue, noting a positive correlation between a ''strong ESG record'' and excellence in operations and management.[693] Moreover, this observer specifically noted that regulatory risks posed by climate change are investment issues.[694] Recent studies have also found that asset managers increasingly incorporate or have committed to incorporating ESG considerations into their financial analyses.[695]

In seeking public input on sustainability and public policy disclosures, we recognize that some registrants historically have not considered this information material. Some observers continue to share this view and have expressed concern that sustainability or policy-driven disclosure requirements do not always result in disclosure that a reasonable investor would consider material.[696] Some have expressed concerns that policy-driven disclosure requirements represent a shift away from the Commission's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation, and that such requirements could risk burdening both registrants and investors with costly disclosure that is not material to any investment or voting decision.[697] Similarly, concerns have been expressed that adopting sustainability or policy-driven disclosure requirements may have the goal of altering corporate behavior, rather than producing information that is important to voting and investment decisions.[698] Additionally, one observer has noted numerous attempts to use the Commission's regulatory apparatus to address societal issues.[699] As the costs of compiling and disclosing information about sustainability and public policy issues are borne by the registrant, and ultimately its shareholders, as is all disclosure, we are seeking input on whether these disclosures are important to investors' voting and investment decisions.

3. Request for Comment

216. Are there specific sustainability or public policy issues are important to informed voting and investment decisions? If so, what are they? If we were to adopt specific disclosure requirements involving sustainability or public policy issues, how could our rules elicit meaningful disclosure on such issues? How could we create a disclosure framework that would be flexible enough to address such issues as they evolve over time? Alternatively, what additional Commission or staff guidance, if any, would be necessary to elicit meaningful disclosure on such issues?

217. Would line-item requirements for disclosure about sustainability or public policy issues cause registrants to disclose information that is not material to investors? Would these disclosures obscure information that is important to an understanding of a registrant's business and financial condition? Why or why not?

218. Some registrants already provide information about ESG matters in sustainability or corporate social responsibility reports or on their Web sites.[700] Corporate sustainability reports may also be available in databases aggregating such reports.[701] Why do some registrants choose to provide sustainability information outside of their Commission filings? Is the information provided on company Web sites sufficient to address investor needs? What are the advantages and disadvantages of registrants providing

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[691] *See* Bill Libit and Todd Freier, *The Corporate Social Responsibility Report and Effective Stakeholder Engagement,* Harvard Law School Forum on Corporate Governance and Financial Regulation, Dec. 28, 2013, *available at https://corpgov.law.harvard.edu/2013/12/28/the-corporate-social-responsibility-report-and-effective-stakeholder-engagement* (discussing increasing stakeholder engagement on ESG issues); Matteo Tonello, *Global Trends in Board-Shareholder Engagement,* Harvard Law School Forum on Corporate Governance and Financial Regulation, Oct. 25, 2013, *available at http://corpgov.law.harvard.edu/2013/10/25/global-trends-in-board-shareholder-engagement* (describing representative shareholder engagement examples that ''indicate that much engagement activity involves executive compensation practices, corporate governance structure, and environmental and social issues'').

[692] *See* Institutional Shareholder Services for the Investor Responsibility Research Center Institute, *Defining Engagement: An Update on the Evolving Relationship Between Shareholders, Directors and Executives,* Apr. 10, 2014, (stating this trend in engagement ''may reflect that investors are satisfied with existing levels of disclosure on financials and strategy, and do not feel a need to engage further; or it may reflect that some of the survey respondents were corporate governance and proxy voting specialists, who are more likely to engage on governance or environmental and social matters than on financial matters.''). *See also supra* note 691.

[693] *See* BlackRock Investment Institute, *The Price of Climate Change,* Oct. 2015, at 7, *available at https://www.blackrock.com/corporate/en-us/literature/whitepaper/bii-pricing-climate-risk-us.pdf* (indicating that ''ESG factors cannot be divorced from financial analysis. We view a strong ESG record as a mark of operational and management excellence. Companies that score high on ESG measures tend to quickly adapt to changing environmental and social trends, use resources efficiently, have engaged (and, therefore, productive) employees, and face lower risks of regulatory fines or reputational damage.'').

[694] *Id.* at 2 (indicating that ''[c]limate change risk has arrived as an investment issue. Governments are setting targets to curb greenhouse gas emissions. This may pave the way for policy shifts that we could see ripple across industries. The resulting regulatory risks are becoming key drivers of investment returns.'')

[695] *See* US SIF Foundation, *Unlocking ESG Integration,* Sept. 2015, at 7, *available at http://www.ussif.org/files/Publications/UnlockingESGIntegration.pdf*, (stating that inclusion of ESG criteria in the financial analysis of surveyed asset managers increased over three times in terms of U.S.-domiciled assets managed (from about $1.4 trillion to about $4.8 trillion) over a two-year period).

See also, UNEP Finance Initiative, *United Nations Principles for Responsible Investment Report on Progress 2015, available at http://2xjmlj8428u1a2k5o34l1m71.wpengine.netdna-cdn.com/wp-content/uploads/PRI_Report-on-Progress_2015.pdf* (stating that approximately 1,000 financial firms with aggregate assets under management of approximately $59 trillion had signed on to the U.N.'s six Principles for Responsible Investment (PRI) as of 2015. Among other things, the signatories to the PRI committed to incorporate ESG issues into their investment analyses and decision making processes, be active owners around these issues, seek appropriate disclosure on ESG issues by companies in which they invest, and collaborate to promulgate the PRI broadly and enhance implementation, while reporting on their own activities).

[696] *See* David M. Lynn, *The Dodd-Frank Act's Specialized Corporate Disclosure: Using the Securities Laws to Address Public Policy Issues,* 6 J. Bus. & Tech. L. 327 (Spring 2011) (''Lynn''); Business Roundtable; SCSGP.

[697] *See, e.g.,* Business Roundtable; Lynn.

[698] *See generally,* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency,* 112 Harv. L. Rev. 1197 at 1297 (Apr. 1999) (describing what the author refers to as the ''Corporate Management Constraint,'' which is an argument against requiring social disclosure, particularly social disclosure with the explicit or implicit purpose of changing the way registrants are managed, because the Commission has no authority to do so); Lynn; Business Roundtable.

[699] *See* Matt Levine, *Climate Change and Sovereign Debt,* Bloomberg View (Jan. 25, 2016).

[700] *See, e.g.,* Center for Political Accountability and Zicklin Center for Business Ethics at the Wharton School of the University of Pennsylvania, *The 2015 CPA-Zicklin Index of Corporate Political Disclosure and Accountability,* Oct. 8, 2015 at 8, *available at http://files.politicalaccountability.net/index/CPA-Zicklin_Index_Final_with_links.pdf*; KPMG LLP, *Currents of Change: The KPMG Survey of Corporate Responsibility Reporting 2015,* Nov. 24, 2015 (''2015 KPMG''), *available at https://assets.kpmg.com/content/dam/kpmg/pdf/2016/02/kpmg-international-survey-of-corporate-responsibility-reporting-2015.pdf*; Governance & Accountability Institute, *Sustainability—what matters?,* 2014, *available at http://www.ga-institute.com/fileadmin/user_upload/Reports/G_A_sustainability_-_what_matters_-FULL_REPORT.pdf.*

[701] *See, e.g.,* CorporateRegister.com for a database of corporate responsibility reports from over 900 companies in the United States and about 8,100 companies internationally, *available at http://www.corporateregister.com*; Sustainability Disclosure Database of the Global Reporting Initiative *available at http://database.globalreporting.org.*

such disclosure on their Web sites? How important to investors is integrated reporting,[702] as opposed to separate financial and sustainability reporting? If we permitted registrants to use information on their Web sites to satisfy any ESG disclosure requirement, how would this affect the comparability and consistency of the disclosure?

219. In an effort to coordinate ESG disclosures, several organizations have published or are working on sustainability reporting frameworks.[703] Currently, some registrants use these frameworks and provide voluntary ESG disclosures.[704] If we propose line-item disclosure requirements on sustainability or public policy issues, which, if any, of these frameworks should we consider in developing any additional disclosure requirements?

220. Are there sustainability or public policy issues for which line-item disclosure requirements would be consistent with the Commission's rulemaking authority and our mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation, as described in Section III.A.1 of this release? If so, how could we address the evolving nature of such issues and keep our disclosure requirements current?

221. What, if any, challenges would registrants face in preparing and providing this information? What would be the additional costs of complying with sustainability or public policy line-item disclosure requirements, including the administrative and compliance costs of preparing and disseminating disclosures, beyond the costs associated with current levels of disclosure? Please quantify costs and expected changes in costs where possible.

222. If we propose line-item disclosure requirements that require disclosure about sustainability or public policy issues, should we scale the disclosure requirements for SRCs or some other category of registrant? Similarly, should we exempt SRCs or some other category of issuer from any such requirements?

223. In 2010, the Commission published an interpretive release to assist registrants in applying existing disclosure requirements to climate change matters. As part of the Disclosure Effectiveness Initiative, we received a number of comment letters suggesting that current climate change-related disclosures are insufficient. Are existing disclosure requirements adequate to elicit the information that would permit investors to evaluate material climate change risk? Why or why not? If not, what additional disclosure requirements or guidance would be appropriate to elicit that information?

G. Exhibits

Exhibits to Commission filings provide detailed information about the registrant that generally is not available in the form itself. Item 601 of Regulation S–K specifies, by form type, the exhibits that registrants must file with Securities Act and Exchange Act forms. The exhibit requirements for Exchange Act forms overlap with many—but not all—of the exhibit requirements for Securities Act forms. Similarly, although there are some differences between the exhibit requirements for Forms 8–K, 10–Q and 10–K, many of the required exhibits are the same. Exhibits required in Exchange Act reports cover such categories as certain transactions,[705] corporate organization and governance,[706] rights of securities holders,[707] matters relating to the financial statements (including certifications),[708] and material contracts.[709]

The requirement to file exhibits originated in Schedule A of the Securities Act, which requires registrants to file copies of certain agreements, opinions and governing instruments.[710] Over time, the Commission has adopted additional requirements for exhibits as part of different forms under the Securities Act and the Exchange Act.[711] In 1980, the Commission standardized and centralized the exhibit requirements by moving them from individual forms to Item 601 in Regulation S–K.[712] The exhibit requirements adopted in 1980 remain substantially the same today.[713] In 2003, however, the Commission adopted additional exhibit requirements mandated by the Sarbanes-Oxley Act.[714]

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[702] *See* International Integrated Reporting Council, *The International IR Framework,* Dec. 2013, *available at http://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf*; Robert G. Eccles and George Serafeim, *Corporate and Integrated Reporting: A Functional Perspective* (Harvard Business School, Working Paper 14–094 May 5, 2014).

[703] *See* WFE Guidance at 8 (describing sustainability reporting frameworks established by CDP (formerly, the Carbon Disclosure Project), Global Reporting Initiative, the International Integrated Reporting Council, SASB, and the United Nations Global Compact).

[704] For example, according to an industry study, about seventy percent of corporate responsibility reporting in the Americas uses the Global Reporting Initiative reporting framework. *See* 2015 KPMG at 42.

[705] *E.g.,* Item 601(b)(2) of Regulation S–K (plan of acquisition, reorganization, arrangement, liquidation or succession) [17 CFR 229.601(b)(2)].

[706] *E.g.,* Items 601(b)(3)(i)–(ii) (articles of incorporation, bylaws); (b)(14) (code of ethics); (b)(20) (documents or statements to security holders); (b)(21) (subsidiaries of the registrant); (b)(22) (published report regarding matters submitted to vote of security holders); (b)(24) (power of attorney); (b)(31) (Exchange Act Rule 13a–14(a)/15d–14(a) certifications) and (b)(32) (Exchange Act Section 1350 certifications) of Regulation S–K [17 CFR 229.601(b)(3)(i)–(ii), (b)(14), (b)(20), (b)(21), (b)(22), (b)(24), (b)(31) and (b)(32)].

[707] *E.g.,* Items 601(b)(4) (instruments defining the rights of security holders) and (b)(9) (voting trust agreement) of Regulation S–K [17 CFR 229.601(b)(4) and (9)].

[708] *E.g.,* Items 601(b)(15) (letter re unaudited interim financial information); (b)(16) (change in certifying accountant); (b)(18) (change in accounting principles); (b)(31) (Exchange Act Rule 13a–14(a)/15d–14(a) certifications) and (b)(32) (Exchange Act Section 1350 certifications) of Regulation S–K [17 CFR 229.601(b)(15), (b)(16), (b)(18), (b)(31) and (b)(32)].

[709] Item 601(b)(10) (material contracts) of Regulation S–K [17 CFR 229.601(b)(10)].

[710] *See* Securities Act of 1933 Schedule A Paragraphs (28) through (32) [15 U.S.C. 77aa(28)–(32)], which require registrants to file underwriting agreements, opinions of counsel regarding the legality of the offering, material contracts, governing instruments (such as articles of incorporation, bylaws and partnership agreements) and agreements or indentures affecting the offered securities.

[711] For instance, in 1971, the Commission adopted a new exhibit requirement for a report on a material change in accounting principles or practices accompanied by a letter from the independent accountant approving or otherwise commenting on such changes. *See* Section IV.G.6. Similarly, in 1977, the Commission began requiring companies to file as exhibits copies of every contract specifically referred to in the company's discussion of its reportable industry segments. *See infra* note 754 and accompanying text.

[712] *See* Amendments Regarding Exhibit Requirements, Release No. 33–6230 (Aug. 27, 1980) [45 FR 58822 (Sept. 5, 1980)] (''1980 Exhibits Adopting Release''). Prior to 1980, exhibit requirements were included in each registration statement form or periodic report form and many requirements were inconsistent from form to form. The changes were intended to simplify and codify the exhibit requirements.

[713] With the adoption of the integrated disclosure system in 1982, the Commission made technical changes to the exhibit requirements and re-designated the requirements from Item 7 to Item 601. *See* 1982 Integrated Disclosure Adopting Release.

[714] *See, e.g.,* Management's Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reporting, Release No. 33–8238 (June 5, 2003) [68 FR 36636 (June 18, 2003)] (adopting Items 601(b)(31) and (b)(32) requiring companies to file the certifications mandated by Sections 302 and 906 respectively of the Sarbanes-Oxley Act as exhibits to certain periodic reports); Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Release No. 33–8177 (Jan. 23, 2003) [68 FR 5110

Continued

In 2009, the Commission adopted rules to require filing of interactive data-tagged financial statements as part of its 21st Century Disclosure Initiative.[715] More recently, the Commission adopted additional exhibit requirements mandated by the Dodd-Frank Act.[716]

To the extent that exhibits contain confidential and proprietary information, Commission rules permit registrants to omit this information from their public filings. For Exchange Act filings, registrants may obtain confidential treatment of information under Rule 24b–2. This rule requires registrants seeking confidential treatment to submit an application to the Commission objecting to disclosure of such information along with an analysis of the applicable exemption under FOIA.[717] Most applicants rely on the exemption that covers trade secrets and commercial or financial information obtained from a person and privileged or confidential.[718] If the Commission grants the application, the registrant may omit the information from its public filings for a limited period of time identified in the application.[719]

We are seeking input on Item 601 of Regulation S–K to determine whether its requirements continue to provide investors with information important to making informed investment and voting decisions. Consistent with the scope of this release, we are considering only those exhibits required in quarterly and annual reports filed under the Exchange Act, which are identified in the following table.[720] While we do not specifically address each exhibit in our discussion, we welcome comments on any of the items listed below.[721]

	Forms		
	8–K[722]	10–Q	10–K
(1) Underwriting agreement	X		
(2) Plan of acquisition, reorganization, arrangement, liquidation or succession	X	X	X
(3)(i) Articles of incorporation	X	X	X
(ii) Bylaws	X	X	X
(4) Instruments defining the rights of security holders, including indentures	X	X	X
(7) Correspondence from an independent accountant regarding non-reliance on a previously issued audit report or completed interim review	X		
(9) Voting trust agreement			X
(10) Material contracts		X	X
(11) Statement re computation of per share earnings		X	X
(12) Statements re computation of ratios			X
(13) Annual report to security holders, Form 10–Q or quarterly report to security holders			X
(14) Code of Ethics	X		X
(15) Letter re unaudited interim financial information		X	
(16) Letter re change in certifying accountant	X		X
(17) Correspondence on departure of director	X		
(18) Letter re change in accounting principles		X	X
(19) Report furnished to security holders		X	
(20) Other documents or statements to security holders	X		
(21) Subsidiaries of the registrant			X
(22) Published report regarding matters submitted to vote of security holders		X	X
(23) Consents of experts and counsel	X	X	X
(24) Power of attorney	X	X	X
(31)(i) Rule 13a–14(a)/15d–14(a) Certifications		X	X
(ii) Rule 13a–14/15d–14 Certifications			X
(32) Section 1350 Certifications		X	X
(33) Report on assessment of compliance with servicing criteria for asset-backed issuers			X
(34) Attestation report on assessment of compliance with servicing criteria for asset-backed securities			X
(35) Servicer compliance statement			X
(95) Mine Safety Disclosure Exhibit		X	X
(99) Additional exhibits	X	X	X
(100) XBRL-Related Documents	X	X	X
(101) Interactive Data File	X	X	X

(Mar. 31, 2003)] (''Audit Committee Financial Expert and Code of Ethics Adopting Release'') (adopting Item 601(b)(14), which requires companies to file a copy of any code of ethics that applies to the company's CEO, CFO and senior accounting personnel with their annual reports, as mandated by Section 406 of the Sarbanes-Oxley Act).

[715] *See supra* note 41.

[716] *See, e.g.,* Mine Safety Disclosure Release (adopting Item 601(b)(95) requiring companies that operate coal or other mines to provide information about mine safety required by Item 104 in an exhibit).

[717] Exchange Act Rule 24b–2 [17 CFR 240.24b–2]. The rule requires an application containing: An identification of the confidential portion; a statement of the grounds of objection referring to, and containing an analysis of, the applicable exemption(s) from disclosure under the Commission's rules and regulations adopted under FOIA, and a justification of the period of time for which confidential treatment is sought; a written consent to the furnishing of the confidential portion to other government agencies, offices or bodies and to the Congress; and the name of each exchange, if any, with which the material is filed. *Id.*

[718] *See* FOIA Section 552(b)(4) [5 U.S.C. 552(b)(4)] and Staff Legal Bulletin 1A.

[719] Exchange Act Rule 24b–2(b)(2)(ii) [240.24b–2(b)(2)(ii)]. In interpreting Rule 24b–2, the staff has indicated that the time period for confidential treatment generally will be limited to the duration of the contract, but no more than ten years. *See* Staff Legal Bulletin 1A.

[720] Many of the exhibits addressed in quarterly and annual reports are also required in current reports on Form 8–K. Though not within the scope of this release, the table includes exhibits required in current reports on Form 8–K to provide additional context.

[721] As part of its work to develop recommendations for the Commission for potential changes to update or simplify certain disclosure requirements, the staff is separately considering paragraphs (b)(11), (b)(12), (b)(19), (b)(22) and (b)(26) of Item 601. The staff is also separately considering recommendations to aspects of Item 601(b)(25)(ii) and 601(a)(2) as part of this effort. For a description of this project, *see* Section I.

[722] A Form 8–K exhibit is required only if it is relevant to the subject matter reported on the Form 8–K report. For example, if the Form 8–K pertains to the departure of a director, only the exhibit described in paragraph (b)(17) of Item 601 must be filed.

1. Request for Comment

224. Should we modify or eliminate any of the exhibit requirements in Item 601? If so, which ones and why? Should we add any new exhibit requirements to Item 601? If so, what requirements should we add and why?

225. Should we revise any of our exhibit requirements to change the presentation or format of the exhibits?

226. Should the Commission consider changes to improve the usefulness of the exhibits? For example, should the exhibits be provided in a tagged or searchable manner?

227. What types of investors or audiences are most likely to value the information that registrants disclose in the exhibits?

228. What is the cost of providing the disclosure required under Item 601, including administrative and compliance costs of preparing and disseminating this disclosure? How would these costs change if we made any of the changes contemplated here? Please provide quantified estimates if possible and include only those costs associated with Item 601.

2. Schedules and Attachments to Exhibits

In response to Item 601, registrants generally must file exhibits as complete documents, including any schedules or attachments. These schedules and attachments can be lengthy and sometimes contain proprietary information. The only exception to the requirement to file schedules and attachments applies to a plan of acquisition, reorganization, arrangement, liquidation or succession filed under Item 601(b)(2).[723] The rule provides that schedules or similar attachments to these exhibits shall not be filed unless they contain information which is material to an investment decision and has not been disclosed otherwise.[724]

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter suggested adding a new instruction to Item 601 permitting the omission of schedules to all exhibits required to be filed, unless such schedules contain material information that is not otherwise disclosed in the exhibit or in the filing, as is the case with current Item 601(b)(2).[725] Alternatively, this commenter suggested that we revise Item 601 to permit companies to omit personally identifiable and similar information, such as bank account numbers and home addresses, without having to apply for confidential treatment to protect the information.[726]

b. Discussion

The Commission first permitted registrants to omit schedules and attachments for Item 601(b)(2) exhibits in 1980.[727] In revising the exhibit requirement, the Commission stated that many of the schedules received by the staff pursuant to the exhibit requirement were not material for investor information or protection and were unnecessary for Commission review purposes.[728]

Material contracts filed under Item 601(b)(10) often include schedules that contain information that is not material to investors or that has been disclosed or sufficiently described elsewhere in the exhibit or in the disclosure. Examples of schedules and attachments providing information that may be immaterial include detailed product specifications attached to royalty agreements; implementation plans attached to service agreements; premises descriptions and plots as schedules to real estate leases; and licensing agreements with schedules listing immaterial patents. To the extent these schedules contain confidential and proprietary information, registrants may be permitted to omit such information from the public filing.[729]

c. Request for Comment

229. Should we continue to allow registrants to omit schedules and attachments for exhibits filed under Item 601(b)(2)? Why? If so, what qualitative or quantitative factors should be considered when determining if omission is appropriate?

230. Should we allow registrants to omit immaterial schedules and attachments from their filed exhibits? If so, should we expand this approach to all exhibits, or should we limit it to material contracts filed under Item 601(b)(10)? Should we provide examples or other guidance on how registrants could evaluate materiality for purposes of including schedules and attachments? If so, what type of guidance would be most useful for assessing the importance of the information (*e.g.,* quantitative thresholds, qualitative factors)? What would be the potential benefits and challenges associated with such an approach? If registrants omit schedules and attachments based on immateriality, should we require registrants to disclose how they assessed materiality for these purposes?

231. If we allow the omission of immaterial schedules and attachments from all or certain filed exhibits, should we require registrants to include with such exhibits a list briefly identifying the contents of all omitted schedules, together with an agreement to provide a supplemental copy of any omitted schedule to the Commission upon request, similar to the requirement in Item 601(b)(2)?

232. Schedules and attachments to exhibits sometimes contain personally identifiable information (''PII''), and registrants may request confidential treatment of that information. Division staff generally does not object to the omission of PII from exhibits without a formal confidential treatment request, provided the registrant does not omit any other information from its exhibits. If we retain the requirement for registrants to file schedules and attachments to exhibits, should we codify current staff practice and permit registrants to omit PII without making a formal request under Rule 24b–2 of the Exchange Act? Should we limit such an accommodation to information contained in schedules and attachments to exhibits, or should we expand it to all exhibit filings?

3. Amendments to Exhibits

Any amendment or modification to a previously filed exhibit to a Form 10–K or Form 10–Q must be filed as an exhibit to a Form 10–K or Form 10–Q.[730] Registrants generally must file such amendments or modifications regardless of the significance of the change.[731] As a result, registrants may be required to file a significant number of amendments that are not necessarily material to investors. However, registrants are not required to file amendments or modifications when the previously filed exhibit would not currently be required.[732]

[723] *See* Item 601(b)(2) of Regulation S–K [17 CFR 229.601(b)(2)].

[724] *Id.* The exhibit filed must include a list briefly identifying the contents of all omitted schedules along with an agreement to provide a supplemental copy of any omitted schedules to the Commission upon request. *Id.*

[725] *See* ABA 2.

[726] *Id.*

[727] *See* 1980 Exhibits Adopting Release.

[728] *See id.*

[729] *See supra* notes 717, 718 and 719 and accompanying text.

[730] Item 601(a)(4) of Regulation S–K [17 CFR 229.601(a)(4)].

[731] For a discussion of changes to exhibits and Instruction 1 to Item 601, *see* Section IV.G.4.

[732] For example, a previously filed exhibit may no longer be material to a registrant as a result of the registrant's growth or change in business focus. The Commission revised Item 601 in 1982 to clarify that amendments and modifications must be filed only

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For amendments to articles of incorporation or bylaws, Item 601 requires registrants to file a complete copy of the document as amended.[733] Item 601 does not include a similar requirement for other exhibits, and registrants typically file amendments to these exhibits without filing a complete, amended and restated version of the agreement.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter suggested revising Item 601(a)(4) to exclude amendments to material contracts that do not affect the economics of such contracts (*e.g.,* technical amendments) from the requirement to file any amendment or modification to a previously filed exhibit.[734]

b. Discussion

With adoption of the integrated disclosure system, the Commission consolidated several requirements in Forms 10–Q and 10–K for amendments and modifications to previously filed exhibits.[735] The new item required registrants to file as exhibits all amendments or modifications to exhibits that were previously filed with those forms.[736] The requirement was moved to paragraph (a)(4) of Item 601 in 1993 and has remained unchanged since.[737]

Registrants frequently amend agreements, such as credit facilities, licensing agreements, manufacturing agreements and supply agreements, to extend their duration. Registrants also amend credit facilities to increase the amount available for borrowing. Other than amended articles of incorporation or bylaws, multiple amendments to the same agreement may be dispersed among different periodic reports.

c. Request for Comment

233. Should we continue to require registrants to file all amendments or modifications to previously filed exhibits as required under Item 601(a)(4)? Should we instead amend Item 601(a)(4) to exclude immaterial amendments? If so, should we provide guidance to registrants about how to determine whether an amendment is immaterial? Instead of materiality, should we permit registrants to exclude amendments based on a different standard? If so, what standard would be appropriate?

234. Does an amendment-only exhibit provide investors with the information they need to evaluate the impact of the amendment on the registrant? Should we instead require registrants to file a complete, amended and restated agreement each time an exhibit is modified, consistent with the requirement for amendments to articles of incorporation and bylaws? If so, should we require registrants to identify changes in the amended and restated contracts such as by underlining or highlighting the changes? Would complying with such a requirement be more burdensome for agreements than for articles of incorporation or bylaws? If so, why?

4. Changes to Exhibits (Instruction 1 to Item 601)

If an exhibit to a registration statement is filed in preliminary form, Instruction 1 to Item 601 provides that registrants are not required to file an amendment to the exhibit if it has been changed only (1) to insert certain information that appears elsewhere in an amendment to the registration statement or a prospectus filed pursuant to Securities Act Rule 424(b), or (2) to correct typographical errors, insert signatures or make other similar immaterial changes.[738] No similar provision exists for exhibits to Exchange Act reports. Instruction 1 also provides that any such incomplete exhibit may not be incorporated by reference in any subsequent filing under any Act administered by the Commission.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter recommended eliminating the last sentence of Instruction 1 to Item 601, which states that incomplete exhibits already on file that do not reflect the modifications described in the instruction may not be incorporated by reference in any subsequent filing.[739]

b. Discussion

The Commission adopted the predecessor to Instruction 1 of Item 601 in 1954 in connection with new rules designed to simplify the registration procedure for offers involving competitive bidding.[740] Those rules provided that, if certain conditions were met, post-effective amendments reflecting the results of the bidding would become effective without the need for a Commission order.[741] This provision was intended to avoid the delay and attendant uncertainty that occurred between the filing and effectiveness of post-effective amendments.[742] Consistent with this goal, the Commission eliminated a requirement for registrants to refile exhibits solely to insert interest rate, redemption prices and certain other offering-related information.[743] The Commission retained this provision as Instruction 1 to Item 601.[744]

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for currently required exhibits as opposed to previously filed exhibits that are no longer material and required to be filed. *See* 1982 Integrated Disclosure Adopting Release.

[733] Item 601(b)(3) of Regulation S–K [17 CFR 229.601(b)(3)]. If such amendment is being reported on Form 8–K, however, the registrant is required to file only the text of the amendment as a Form 8–K exhibit. In such case, a complete copy of the articles of incorporation or bylaws as amended must be filed as an exhibit to the next Securities Act registration statement or periodic report filed by the registrant to which this exhibit requirement applies. *Id.*

[734] *See* ABA 2.

[735] *See* 1980 Exhibits Adopting Release. For example, prior to 1980, Form 10–K required registrants to file copies of all amendments or modifications, not previously filed, to all exhibits previously filed, or copies of such exhibits as amended or modified. *See, e.g.,* 1965 Amendments to Form 10–K Adopting Release.

[736] *Id.*

[737] *See* Rulemaking for EDGAR System, Release No. 33–6977 (Feb. 23, 1993) [58 FR 14628 (Mar. 18, 1993)] at note 388.

[738] Instruction 1 to Item 601 of Regulation S–K [17 CFR 229.601]. The instruction states that if an exhibit to a registration statement (other than an opinion or consent), filed in preliminary form, has been changed only (A) to insert information as to interest, dividend or conversion rates, redemption or conversion prices, purchase or offering prices, underwriters' or dealers' commissions, names, addresses or participation of underwriters or similar matters, which information appears elsewhere in an amendment to the registration statement or a prospectus filed pursuant to Rule 424(b) under the Securities Act (230.424(b) of this chapter), or (B) to correct typographical errors, insert signatures or make other similar immaterial changes, then, notwithstanding any contrary requirement of any rule or form, the registrant need not refile such exhibit as so amended. Any such incomplete exhibit may not, however, be incorporated by reference in any subsequent filing under any Act administered by the Commission. *Id.*

[739] *See* ABA 2.

[740] *See* Adoption of Rule 415 Relating to Competitive Bidding Registration Statements, Amendment of Rules 424, 427, 455, 471 and 472 and Rescission of Rule 460, Release No. 33–3494 (Jan. 13, 1954) [*not published in the* ***Federal Register***] (''1954 Adopting Release'').

[741] *See id.* At the time, registrants engaged in offerings involving competitive bidding were required to file post-effective amendments to registration statements at the time the bids were opened to reflect the results of the bidding. These post-effective amendments were only effective pursuant to an order from the Commission.

[742] *See* Notice of Proposal to Adopt Rule 415 Relating to Competitive Bidding Registration Statements, To Amend Rules 424, 427, 455, 471 and 472 and to Rescind Rule 460, Release No. 33–3491–Z (Nov. 10, 1953) [*not published in the* ***Federal Register***].

[743] *See* 1954 Adopting Release.

[744] *See* 1982 Integrated Disclosure Adopting Release. *See also* Proposed Rescission of Guides for the Preparation and Filing of Registration Statements and Reports, Release No. 33–6332 (Aug. 6, 1981) [46 FR 41925 (Aug. 18, 1981)] (''Proposed Revision of Regulation S–K (1981)'') (proposing to incorporate the predecessor to Instruction 1 into the

While Instruction 1 is intended to address timing concerns in certain registered offerings, it also affects registrants' ability to incorporate exhibits by reference to other filings. To the extent a registrant modifies an incomplete exhibit that was filed in preliminary form, as permitted under Instruction 1, the incomplete exhibit already on file may not be incorporated by reference into its Exchange Act reports. Instead, the registrant would be required to file the complete exhibit with an Exchange Act report for the relevant reporting period.

c. Request for Comment

235. Should we eliminate Instruction 1?

236. Should we expand the applicability of Instruction 1 to all filings? Should we expand the type of information in clauses (A) and (B) of Instruction 1 to cover additional types of information that, if changed, do not need to be refiled as an amendment to the exhibit?

237. Instruction 1 states that any incomplete exhibit may not be incorporated by reference in any subsequent filing.[745] Should we eliminate this limitation?

5. Material Contracts (Item 601(b)(10))

Item 601(b)(10) of Regulation S–K requires registrants to file material contracts that fall into one of three broad categories:

- All contracts not made in the ordinary course of business that are material to the registrant (Item 601(b)(10)(i));
- Contracts made in the ordinary course of business of a type that are specified in the rule (Item 601(b)(10)(ii)); and
- Management contracts and compensatory plans in which any director, named executive officer, or other executive officer of the registrant participates (Item 601(b)(10)(iii)).[746]

Any material contract that is executed or becomes effective during a reporting period must be filed as an exhibit to the Forms 10–Q or 10–K for the corresponding period.[747]

a. Contracts Not Made in the Ordinary Course—Item 601(b)(10)(i)

Item 601(b)(10)(i) requires registrants to file every contract not made in the ordinary course of business that is material to the registrant and is to be performed in whole or in part at or after the filing of the report, or was entered into not more than two years before such filing.[748] Registrants are required to file only those contracts to which the registrant or subsidiary of the registrant is a party or has succeeded to a party by assumption or assignment or in which the registrant or such subsidiary has a beneficial interest.

i. Comments Received

S–K Study. Two commenters stated that the agreements required to be filed pursuant to Item 601(b)(10)(i) often contain confidential information.[749] These commenters also stated that the process of filing the agreements and obtaining confidential treatment is burdensome on registrants and provides information of limited value to investors.[750]

Disclosure Effectiveness Initiative. None.

ii. Discussion

In 1964, Congress expanded the information requirements for registration statements filed under Section 12 of the Exchange Act by adding a requirement to include material contracts not made in the ordinary course of business.[751] Following these Exchange Act amendments, the Commission revised Form 10–K to make the form available for annual reports of all Exchange Act registrants and expanded the form's disclosure requirements.[752] Among other changes, these amendments included a requirement in Form 10–K to file material contracts not made in the ordinary course of business, not previously filed and performed or to be performed at or after the beginning of the fiscal year covered by the report.[753] This requirement was similar to the new requirement to file such exhibits with Exchange Act registration statements which, however, required this information for two years prior to filing of the registration statement.

In 1977, with the adoption of Regulation S–K, the Commission expanded the exhibit requirements for contracts not made in the ordinary course of business to include those that were material to an understanding of the registrant's overall business or specifically referred to in the registrant's discussion of its reportable industry segments.[754] In 1980, the Commission eliminated the latter requirement,[755] noting that many contracts referred to in the disclosure may not be material to the registrant.[756] With this revision, the Commission sought to reduce the number of contracts required to be filed without impairing investor information or protection.[757] In 1982, the Commission adopted the current requirements described in Items 601(b)(10)(i) and (ii) with the adoption of the integrated disclosure system.[758]

instructions to Item 601) and 1981 Proposed Revisions (proposing to delete Rule 472(d), which addressed immaterial changes in exhibits, because its substance was proposed to be included in Item 601). In connection with the adoption of Rule 430A, the Commission amended Instruction 1 to include a reference to prospectus supplements under Rule 424. *See* Elimination of Certain Pricing Amendments and Revision of Prospectus Filing Procedures, Release No. 33–6714 (May 27, 1987) [52 FR 21252 (June 5, 1987)].

[745] For a discussion of incorporation by reference, *see* Section V.B.

[746] As this release is focused on our business and financial disclosure requirements, we are not addressing Item 601(b)(10)(iii) of Regulation S–K [17 CFR 229.601(b)(10)(iii)].

[747] Item 601(a)(4) of Regulation S–K [17 CFR 229.601(a)(4) and Instruction 2 to Item 601(b)(10) of Regulation S–K [17 CFR 229.601(b)(10)].

[748] Item 601(b)(10)(i) of Regulation S–K [17 CFR 229.601(b)(10)(i)]. This requirement is virtually identical to paragraph 24 of Schedule A of the Securities Act. [15 U.S.C. 77aa(24)].

[749] *See* Silicon Valley; M. Liles.

[750] *Id.*

[751] *See* Summary and Interpretation of Amendments to Securities Act of 1933 and Securities Exchange Act of 1934 Contained in the Securities Acts Amendments of 1964, Release No. 34–7425 (Sept. 15, 1964) [29 FR 13455 (Sept. 30, 1964)].

As amended, Section 12(b) required registrants to file material contracts, not made in the ordinary course of business, which are to be executed in whole or in part at or after the filing of the Exchange Act registration statement or which were made not more than two years before such filing. Schedule A includes a similar requirement for Securities Act registration statements. [15 U.S.C. 77aa(24)]. As noted at the time, the amendment to Section 12(b) followed the Commission's recommendation that registration under both the Exchange Act and the Securities Act be made as similar as possible. *See* Lee J. Sclar, *The Securities Acts Amendments of 1964: Selected Provisions and Legislative Deficiencies,* 53 Cal. L. Rev. 1494, 1515 (1965).

The two-year requirement was intended as a ''cutoff period'' so registrants would not have to file all material contracts executed as early as 1932, even though they may have been fully performed years ago. *See* H.R Rep. No. 88–1418, 83rd Cong., 2nd Sess., 1964. *See also* Richard M. Phillips and Morgan Shipman, An Analysis of the Securities Acts Amendments of 1964, 1964 Duke L.J. 706, 788–789 (1964).

[752] *See* 1965 Amendments to Form 10–K Adopting Release.

[753] *Id.* Similar to the language in amended Section 12(b) of the Exchange Act, the new requirement called for ''[c]opies of every material contract not made in the ordinary course of business and not previously filed which was performed or to be performed in whole or in part at or after the beginning of the fiscal year covered by the report on this form.'' *Id.* at 3433. The Commission adopted additional exhibit requirements with these amendments, which we discuss below in Section IV.G.5.b.

[754] *See* 1977 Regulation S–K Adopting Release.

[755] *See* 1980 Exhibits Adopting Release.

[756] *See* Proposed Amendments Regarding Exhibit Requirements, Release No. 33–6149 (Nov. 16, 1979) [44 FR 67143 (Nov. 23, 1979)] (''Proposed Amendments Regarding Exhibit Requirements Release'').

[757] *See* 1980 Exhibits Adopting Release. *See also* Proposed Amendments Regarding Exhibit Requirements Release.

[758] *See* 1982 Integrated Disclosure Adopting Release. *See also* Proposed Revision of Regulation

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In 2004, the Commission adopted Items 1.01 and 1.02 of Form 8–K, which require disclosure when a registrant enters into, amends or terminates an agreement that is material to the registrant and is not made in the ordinary course of business.[759] In the proposing release, the Commission sought comment on whether it should use a disclosure threshold that is tied to a financial measure, rather than materiality.[760] The Commission ultimately adopted the reporting requirements with a materiality threshold because the standard was ''already familiar to reporting companies,'' noting that the materiality threshold parallels the materiality threshold for filing this type of agreement under Item 601(b)(10) of Regulation S–K.[761]

iii. Request for Comment

238. Item 601(b)(10)(i) does not include any guidance for determining whether a contract not made in the ordinary course of business is material to a registrant. Should we consider revising the requirement to provide quantitative or other thresholds for determining when a contract is material to the registrant? If so, how should we define these thresholds? Would such a change facilitate registrants' compliance with this item requirement? Would such a change result in disclosure that is useful to investors?

239. Does ''not made in the ordinary course of business'' provide a clear standard for agreements covered by the rule? Should a different standard to apply? Should we revise Item 601(b)(10)(i) to define the types of contracts not made in the ordinary course of business that companies are required to file as exhibits? If so, how should we define such contracts?

240. Item 601(b)(10)(i) requires registrants to file material contracts that either (i) are to be performed in whole or in part at or after the filing of the periodic report, or (ii) were entered into not more than two years before such filing. This requirement was enacted in the context of requiring material contracts for newly reporting registrants that were entered into within the last two years but may have been fully performed before the period covered by the report. Do such contracts continue to be important to investors? Should we limit subparagraph (ii) to newly reporting registrants? For registrants that are already subject to reporting requirements, should we eliminate subparagraph (ii) and require registrants to file only material contracts that are to be performed in whole or in part at or after the filing of the report? Should we revise Item 601(b)(10)(i) to require all material agreements to be filed regardless of when they were entered into, as long as such agreements remain material to the registrant? Under what circumstances could a contract remain material to a registrant if it has been fully performed in a prior period?

b. Certain Contracts Made in the Ordinary Course—Item 601(b)(10)(ii)

Contracts made in the ordinary course of business conducted by a registrant and its subsidiaries generally do not need to be filed. Item 601(b)(10)(ii), however, establishes specific exceptions to the general rule and requires certain contracts to be filed even when they ordinarily accompany the kind of business conducted by the registrant and its subsidiaries. The following types of contracts must be filed, except where immaterial in amount or significance:

- Any contract to which directors, officers, voting trustees, security holders named in the registration statement or report, or underwriters are parties, other than contracts involving only the purchase or sale of current assets that have a determinable market price, at such market price;[762]
- Any contract upon which the registrant's business is substantially dependent, such as continuing contracts to sell the major part of the registrant's products or services or to purchase the major part of the registrant's requirements of goods, services or raw materials or any franchise or license or other agreement to use a patent, formula, trade secret, process or trade name upon which the registrant's business depends to a material extent;[763]
- Any contract calling for the acquisition or sale of any property, plant or equipment for a consideration exceeding fifteen percent of such fixed assets of the registrant on a consolidated basis;[764] or
- Any material lease under which a part of the property described in the filing is held by the registrant.[765]

i. Comments Received

S–K Study. We received letters from two commenters addressing the requirement in Item 601(b)(10)(ii)(B) to file any contract upon which the registrant's business is substantially dependent, as in the case of a continuing contract to sell the major part of a registrant's products or services or to purchase the major part of a registrant's requirements for goods, services or raw materials. Both commenters requested guidance interpreting the phrase ''the major part'' to mean agreements involving a majority of the products or services sold or purchased.[766] Both commenters also noted that the filing threshold for agreements that are ''immaterial in amount or significance'' as it relates to Item 601(b)(10)(ii)(A) leads to a disproportionate burden on EGCs, which frequently enter into agreements with parties that have a five percent or greater ownership of the registrant.[767] These commenters suggested that other disclosure provisions require the filing or disclosure of ''relevant information'' regarding these related party agreements.[768]

Disclosure Effectiveness Initiative. One commenter noted that the reference in Item 601(b)(10)(ii)(B) to contracts to sell the major part of a registrant's products or services is tied neither to a specific quantitative threshold nor to materiality.[769] This commenter recommended that the Commission undertake a study to harmonize various qualitative disclosure thresholds in Regulation S–K, such as ''major part'' in Item 601(b)(10)(ii)(B) and ''major significance'' in Item 102, to reduce the ambiguity in their application. This commenter also suggested revising Item 601(b)(10)(ii) so that contracts with certain insiders or other parties identified in the item need not be filed if they contain terms no less favorable to the registrant than terms that could have been obtained from unrelated third parties. Another commenter

S–K (1981). In connection with these amendments, the Commission revised Item 601(b)(10)(ii)(D) to require that only material leases be filed as exhibits and revised Item 601(b)(10)(iii) regarding management contracts and compensatory plans.

[759] *See* 2004 Form 8–K Adopting Release. *See also* Items 1.01 and 1.02 of Form 8–K.

[760] *See* 2002 Form 8–K Proposing Release at 42917 (''Because we believe that agreements can be material for reasons other than the monetary amount involved, we propose to require disclosure under this item based on a 'materiality' standard and do not propose to tie the disclosure to a financial measure.'').

[761] *See* 2004 Form 8–K Adopting Release at 15596. *See also* Instruction 1 to Item 1.01 of Form 8–K.

[762] Item 601(b)(10)(ii)(A) of Regulation S–K [17 CFR 229.601(b)(10)(ii)(A)].

[763] Item 601(b)(10)(ii)(B) of Regulation S–K [17 CFR 229.601(b)(10)(ii)(B)].

[764] Item 601(b)(10)(ii)(C) of Regulation S–K [17 CFR 229.601(b)(10)(ii)(C)].

[765] Item 601(b)(10)(ii)(D) of Regulation S–K [17 CFR 229.601(b)(10)(ii)(D)].

[766] *See* Silicon Valley; M. Liles.

[767] *Id.*

[768] *Id.* (referring to Item 404(a) for disclosure of related party agreements, Item 601(b)(4) for agreements establishing the terms of the registrant's securities, and financial statement footnotes for disclosure about joint venture agreements).

[769] *See* ABA 2.

recommended eliminating the requirement in Item 601(b)(10)(ii)(D) to file material leases and suggested that disclosure about physical properties usually does not provide investors with meaningful information.[770]

ii. Discussion—Background and Scope of Item 601(b)(10)(ii)

The Commission's 1965 amendments to Form 10–K included a requirement for registrants to file as exhibits certain specified contracts made in the ordinary course of business.[771] The contracts specified in Form 10–K at that time were similar to those identified today in Item 601(b)(10)(ii).[772] In addition, Form 10–K included a catch-all requirement to file an exhibit when the ''amount of the contract, or its importance to the business of the registrant and its subsidiaries, [is] material, and the terms and conditions are of a nature of which investors reasonably should be informed.'' [773]

In 1980, the Commission codified in Regulation S–K the exhibit filing requirements, including the filing requirements for material contracts.[774] The requirements adopted in 1980 modified the existing requirements and were substantially similar to the current requirements in Item 601(b)(10)(ii)(A)–(D). The Commission modified the requirement to file agreements for the acquisition or sale of ''fixed assets,'' adopting instead a requirement to file contracts for the acquisition or sale of any ''property, plant or equipment.''

iii. Request for Comment

241. Should we expand Item 601(b)(10)(ii) to include other types of contracts that, although made in the ordinary course of business, should be filed?

242. Should we revise our overall approach to Item 601(b)(10)(ii) and if so, how? Rather than specifying categories of contracts, is there an alternative approach that would appropriately capture those ordinary course contracts that are important to investors? For example, should we replace the current requirements in Item 601(b)(10)(ii)(A)–(D) with a requirement for registrants to file all ordinary course contracts entered into (i) since the beginning of the last fiscal year, (ii) that exceed a percent of some measure, such as revenue or net income and (iii) where the registrant has a direct or indirect material interest? If we took this approach, how should we establish the relevant time frame and percentage threshold and what measures should we use? What would be the benefits and challenges of such an approach?

243. Do contracts that are required to be filed pursuant to Item 601(b)(10)(ii) contain information that is important to an understanding of the registrant or its business? Are the types of contracts identified in Item 601(b)(10)(ii) sufficiently significant that they should be filed, notwithstanding that they were made in the ordinary course of business?

244. Is ''immaterial in amount or significance'' a helpful standard by which to determine when a contract need not be filed? How do registrants currently apply this standard? Should we revise the item to provide guidance on the meaning of that phrase? Is it possible for contracts to be material in amount but not in significance? Should we revise the item to exclude only contracts that are immaterial in amount *and* significance? Would it facilitate compliance if we revised Item 601(b)(10)(ii) to state in the affirmative that registrants must file all material contracts made in the ordinary course of business that fall within one or more of the categories listed?

245. Item 404(a) of Regulation S–K requires disclosure of any related party transaction since the beginning of the registrant's last fiscal year if the amount involved exceeds $120,000.[775] Unlike this bright-line disclosure threshold in Item 404(a), Item 601(b)(10)(ii)(A) generally requires registrants to file related party contracts as exhibits unless immaterial in amount or significance. Do the two different disclosure thresholds provide investors with the information they need to evaluate related party contracts? Should we revise Item 601(b)(10)(ii) to require registrants to file as exhibits all contracts involving related party transactions disclosed pursuant to Item 404(a)? What would be the benefits and challenges associated with such a revision?

246. Taken together, Items 601(b)(10)(i) and (ii) require registrants to file material contracts not made in the ordinary course of business as well as certain contracts made in the ordinary course of business that are material to the registrant. Should we revise Item 601(b)(10)(ii) to require registrants simply to file all contracts that are material to an understanding of the registrant or its business, whether or not entered in the ordinary course of business? Are there any contracts currently required to be filed as exhibits under Item 601(b)(10)(ii) that would not be captured by such a principles-based approach? Conversely, would this approach require registrants to file material ordinary course contracts that they are not currently required to file? Would this change enhance the information available to investors? What would be the benefits and challenges of this approach?

iv. Discussion—Disclosure Thresholds under Item 601(b)(10)(ii)

Qualitative Thresholds. Item 601(b)(10)(ii)(B) requires registrants to file any contract upon which the registrant's business is substantially dependent. The item provides examples of contracts upon which a registrant may be substantially dependent, such as continuing contracts to sell the major part of a registrant's products or services or to purchase the major part of a registrant's requirements of goods, services or raw materials.[776] A registrant's business also may be substantially dependent on any franchise or license or other agreement to use a patent, formula, trade secret, process or trade name upon which the registrant's business depends to a material extent.[777] Since the item's adoption in 1965, the Commission has not provided registrants with additional guidance about how to determine

[770] *See* Shearman.

[771] *See* 1965 Amendments to Form 10–K Adopting Release.

[772] *See id.* The 1965 amendments consisted of the following six categories: ''(1) Directors, officers, promoters, voting trustees, or security holders named in answer to Item 5 [Principal Holders of Voting Securities] are parties thereto except where the contract merely involves purchase or sale of current assets having a determinable market price, at such price; (2) It is of such materiality as to call for specific reference to it in answer to Item 4 [Changes in the Business] or 9 [Interest of Management and Others in Certain Transactions]; (3) The registrant's business is substantially dependent upon it, as in the case of continuing contracts to sell the major part of registrant's production in the case of a manufacturing enterprise or to purchase the major part of registrant's requirements of goods in the case of a distribution enterprise, or licenses to use a patent or formula upon which registrant's business depends to a material extent; (4) It calls for the acquisition or sale of fixed assets for a consideration exceeding 10 percent of all fixed assets of the registrant and its subsidiaries; (5) It is a lease under which a material amount of property is held by the registrant; or (6) The amount of the contract, or its importance to the business of the registrant and its subsidiaries, are material, and the terms and conditions are of a nature of which investors reasonably should be informed.'' *Id.* at 3433.

[773] *Id.* at 3433.

[774] *See* 1980 Exhibits Adopting Release.

[775] Item 404(a) of Regulation S–K [17 CFR 229.404(a)]. Registrants must describe any transaction, since the beginning of the registrant's last fiscal year, or any currently proposed transaction, in which the registrant was or is to be a participant and the amount involved exceeds $120,000, and in which any related person had or will have a direct or indirect material interest. *Id.*

[776] Item 601(b)(10)(ii)(B) of Regulation S–K [17 CFR 229.601(b)(10)(ii)(B)].

[777] *Id.*

''substantial dependence'' or ''major part,'' as those terms are used in the exhibits requirements.

To enhance consistency and clarity, we are considering whether to quantify ''substantial dependence'' as used in the item. Possible alternatives include establishing a dollar amount or percentage threshold, similar to the thresholds used in Item 601(b)(10)(ii)(C), as described below. While an objective requirement may provide clarity for registrants in their efforts to comply with the exhibit requirements, this approach could inadvertently exclude material contracts or result in a large number of contracts being filed that contain information that is neither material nor useful for investors.

Quantitative Thresholds. Unlike subparagraph (B), which relies on a qualitative threshold, subparagraph (C) provides a quantitative threshold for filing exhibits. Specifically, Item 601(b)(10)(ii)(C) requires registrants to file any contract calling for the acquisition or sale of any property, plant or equipment for a consideration exceeding fifteen percent of such fixed assets of the registrant on a consolidated basis.[778]

As originally adopted in 1965, this requirement used a threshold of ten percent of all fixed assets of a registrant and its subsidiaries. In 1980, the Commission raised the threshold to fifteen percent,[779] consistent with similar requirements on Form S–1 at the time. In doing so, the Commission increased the threshold triggering the filing of such an agreement from consideration exceeding ''10 percent of all fixed assets of the registrant and its subsidiaries'' to consideration exceeding ''15 percent of such fixed assets of the registrant on a consolidated basis.'' [780] In the adopting release, the Commission stated that the higher threshold was consistent with the purpose of reducing the burden that exhibit filing requirements impose on registrants ''without materially impairing investor information or protection.'' [781]

In contrast to Item 601(b)(10)(ii)(C), Item 2.01 of 8–K requires a registrant to report the acquisition or disposition of a ''significant amount of assets.'' [782] Instruction 4 to Item 2.01 provides that an acquisition or disposition shall be deemed to involve a significant amount of assets (i) if the registrant's and its other subsidiaries' equity in the net book value of such assets or the amount paid or received for the assets upon such acquisition or disposition exceeded ten percent of the total assets of the registrant and its consolidated subsidiaries; or (ii) if it involved a business that is significant.[783] In addition, Form 8–K encompasses any acquisition or disposition, while Item 601(b)(10)(ii)(C) is limited to the acquisition of property, plant or equipment. Accordingly, an acquisition could trigger a disclosure requirement under Item 2.01 of Form 8–K without triggering a requirement to file the related contract under Item 601(b)(10)(ii)(C).

When proposing amendments to Form 8–K in 2002, the Commission sought comment on whether to remove the ten percent test from Item 2.01 and replace it with the more general ''materiality'' test used in Item 1.01 of Form 8–K.[784] Although several commenters supported harmonization between the reporting thresholds in Items 1.01 and 2.01, the Commission retained the ten percent test for Item 2.01, stating its intention that Item 1.01 address a different scope of agreements than those that trigger disclosure under Item 2.01. The Commission also indicated it did not believe that the use of two different thresholds will cause undue confusion.[785]

We are seeking public input on whether the fifteen percent threshold in Item 601(b)(10)(ii)(C) continues to provide investors with information that is important for an understanding of a registrant's business. We are interested in receiving input on whether a quantitative threshold is useful and, if so, whether fifteen percent of fixed assets is the appropriate measure. We also seek comment on the scope of contracts covered by subparagraph (C) and whether we should broaden the scope to better harmonize the exhibit filing requirements with the Form 8–K disclosure requirements. In addition, we are seeking public input on whether quantitative thresholds would be appropriate for other types of agreements required to be filed under Item 601(b)(10)(ii).

v. Request for Comment

247. Should we adopt additional or different qualitative or quantitative thresholds for determining when contracts identified in Item 601(b)(10)(ii) must be filed as exhibits? If so, what should these qualitative or quantitative thresholds be? Why?

248. Should we revise Item 601(b)(10)(ii)(B) to provide qualitative or quantitative standards for what constitutes ''substantial dependence''? Should we define the term ''major part'' in addition to or in lieu of defining ''substantial dependence''? What factors should we consider in developing definitions or quantitative thresholds? What other alternatives should we consider to clarify which contracts must be filed under Item 601(b)(10)(ii)?

249. How could we design a quantitative threshold that would accommodate the diversity of registrants and business models? What would be the disadvantages of a quantitative threshold? If we used quantitative measures based on registrants' financial statements, what would be the appropriate measures to use? Alternatively, should we tie the threshold to a registrant's market capitalization?

250. Should we provide guidance on the phrase ''depends to a material extent'' in Item 601(b)(10)(ii)(B)? If so, should we adopt a similar approach to the one discussed in the preceding request for comment? Alternatively, should our requirements distinguish franchise or license agreements to use a patent, formula, trade secret, process or trade name from contracts to sell the major part of a registrant's products or services or to purchase the major part of a registrant's requirements of goods, services or raw materials?

251. Should we revise Item 601(b)(10)(ii)(C) to either increase or decrease the fifteen percent threshold for exhibits relating to acquisitions of property, plant or equipment? Should the threshold continue to be based on fixed assets? Alternatively, should we eliminate the threshold in favor of a principles-based requirement, such as ''material'' or ''significant'' acquisitions of property, plant or equipment?

252. Should Item 601(b)(10)(ii)(C) continue to focus on property, plant and equipment? Should we expand the scope to require registrants to file contracts for the acquisition or

[778] Item 601(b)(10)(ii)(C) of Regulation S–K [17 CFR 229.601(b)(10)(ii)(C)].

[779] *See* 1980 Exhibits Adopting Release.

[780] *See* Technical Amendments to Rules, Forms and Schedules; Delegation of Authority to the Director of the Division of Corporation Finance, Release No. 33–6260 (Nov. 13, 1980) [45 FR 76974 (Nov. 21, 1980)]. This release corrected the regulatory text adopted in the 1980 Exhibits Adopting Release, which ''inadvertently chang[ed] the materiality test from a percentage of fixed assets to a percentage of all assets.'' *Id.* at 76976.

[781] 1980 Exhibits Adopting Release at 58823.

[782] A registrant must file a Form 8–K report if it has completed the acquisition or disposition of a significant amount of assets otherwise than in the ordinary course of business.

[783] Form 8–K [17 CFR 249.308]. For the definitions of ''business'' and ''significant,'' Instruction 4 refers to Rule 11–01(d) and (b), respectively, of Regulation S–X [17 CFR 210.11–01].

[784] *See* 2002 Form 8–K Proposing Release. The Commission proposed retaining the ten percent threshold in Instruction 4 of Item 2.01 due to ''companies' familiarity with th[e] test.'' *Id.* at 42919.

[785] *See* 2004 Form 8–K Adopting Release.

disposition of other assets, including intangible assets such as patents, licenses and other intellectual property? If so, should we consider a disclosure threshold consistent with Item 2.01 of Form 8–K? Would a different threshold be more appropriate?

6. Preferability Letter (Item 601(b)(18))

Registrants will, at times, make a voluntary change in accounting principles or practices when two or more generally accepted accounting principles apply. For example, a registrant may choose to switch its inventory valuation from last-in, first-out to first-in, first-out. When such a change occurs, Item 601(b)(18) requires a registrant to file a letter from its independent accountant indicating whether, in the independent accountant's judgment, the change is preferable under the circumstances.[786] No letter is required for changes made in response to a standard adopted by the FASB that creates a new accounting principle, expresses a preference for an accounting principle, or rejects a specific accounting principle.[787]

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. None.

b. Discussion

The precursor to Item 601(b)(18), adopted in 1971, required registrants to describe and state the reasons for any change in accounting principles or practices that would materially affect the financial statements filed or to be filed for the current year.[788] Registrants also were required to file as an exhibit to Form 10–K or Form 10–Q a letter from the independent accountant approving or otherwise commenting on such changes.[789]

In 1975, the Commission amended Form 10–Q to require the accountant's letter to state whether the change, in the accountant's judgment, is preferable.[790] Several commenters objected to the requirement, stating that no standards existed for judging preferability among generally accepted accounting principles and that authoritative accounting principles only required management to justify that a change was preferable. The Commission concluded, however, that management's justification for a change in accounting principle must convince an independent accountant that, in the accountant's judgment, the new accounting principle is an improvement over alternative principles.[791] The requirement for a preferability letter was included in Form 10–K in 1980 when the Commission centralized all exhibit requirements within Regulation S–K.[792]

While Item 601(b)(18) requires an auditor to articulate the preferability of a change in accounting principle or policy, the nature of the auditors' statements varies.[793] In addition, there is no standard methodology for determining preferability. Since 2000, the number of preferability letters filed in a given year has fluctuated from a high of 108 in 2000 to a low of 57 in 2007.[794]

In addition to the exhibit requirement of Item 601(b)(18), disclosure about a voluntary change in accounting principles is required under Rule 10–01(b)(6) of Regulation S–X and under U.S. GAAP. In certain instances, Public Company Accounting Oversight Board (''PCAOB'') Auditing Standards require auditors to address such changes in their opinions. While U.S. GAAP and PCAOB Auditing Standards require consideration of a registrant's change in accounting principle or practice, they differ from the Commission's requirements in terms of nature, timing and extent of reporting by the auditor. We are interested in commenters' views on whether existing disclosure requirements provide investors with sufficient information about a change in accounting principle without the need for registrants to file a preferability letter.

Commission Requirements. Rule 10–01(b)(6) of Regulation S–X requires registrants to (1) state in the notes to the financial statements the date and reasons for any material accounting change and (2) file, in accordance with Item 601(b)(18), a letter from the registrant's independent accountant as an exhibit to Form 10–Q.[795]

U.S. GAAP. U.S. GAAP requires disclosure in the notes to the financial statements about the nature of and reason for a change in accounting principle, including an explanation of why the newly adopted principle is preferable.[796] Registrants must report the change in accounting principle in the financial statements of both the interim and annual period of the change.[797]

PCAOB Auditing Standards. PCAOB Auditing Standard No. 6 (''AS No. 6'') requires auditors to evaluate a change in accounting principle to determine whether, among other things, the registrant ''has justified that the alternative accounting principle is preferable.'' [798] AU Section 722

[786] Item 601(b)(18) of Regulation S–K [17 CFR 229.601(b)(18)]. Item 601(b)(18) refers to ''independent accountant.'' We also refer to ''independent accountant,'' as ''independent auditor'' in this release.

[787] *Id.*

[788] *See* Notice of Adoption of Amendments to Form 8–K, Form 7–Q, Form 10–Q, Form 10–K and Form N–1Q, Release No. 34–9344 (Sept. 27, 1971) [*not published in the* **Federal Register**].

[789] *See id.*

[790] *See* 1975 Interim Financial Reporting Release.

[791] *See id.* The Commission based its rationale on the Accounting Principles Board Opinion No. 20 (since replaced by Statement of Financial Accounting Standards No. 154 (ASC Topic 250)), which stated that (i) there is a presumption that an accounting principle once adopted should not be changed, (ii) that presumption may be overcome only if the company justifies the use of an alternative acceptable accounting principle on the basis that it is preferable, and (iii) the burden of justifying a change in accounting principle rests with the company proposing the change. *See* Proposals to Increase Disclosure of Interim Results by Registrants.

[792] *See* 1980 Exhibits Adopting Release. *See also supra* note 712 and accompanying text.

[793] As an example, one auditor's letter reads: ''There are no authoritative criteria for determining a 'preferable' presentation method based on the particular circumstances; however, we conclude that such change in the method of accounting is to an acceptable alternative method which, based on your business judgment to make this change and for the stated reasons, is preferable in your circumstances.'' Another states: ''Based on our review and discussion, with reliance on management's business judgment and planning, we concur that the newly adopted method of accounting is preferable in the Company's circumstances.'' Another auditor's letter provides: ''We believe, on the basis of the facts so set forth and other information furnished to us by appropriate officials of the Company, that the accounting change described in your Form 10–Q is to an alternative accounting principle that is preferable under the circumstances.'' One preferability letter briefly states: ''In our judgment, such change is an alternative accounting principle that is preferable under the circumstances.''

[794] *See* Audit Analytics, *Preferability Letters: A 15 Year Review,* Jan. 2, 2015, *available at http://www.auditanalytics.com/blog/preferability-letters-a-15-year-review.* Over the last fifteen years the most common reasons for filing preferability letters have been changes in accounting principles or practices related to: (1) Goodwill Impairment Measurement Date; (2) Inventory Valuation; (3) Expense Recognition; (4) Classification; and (5) Benefits Program.

[795] Rule 10–01(b)(6) of Regulation S–X [17 CFR 210.10–01(b)(6)]. Rule 8–03(b)(5) of Regulation S–X is the equivalent requirement for SRCs. As part of its work to develop recommendations for the Commission for potential changes to update or simplify certain disclosure requirements, the staff is separately considering Rules 8–03(b)(5) and 10–01(b)(6) of Regulation S–X which require registrants to disclose the date and reasons for any material accounting change. For a description of this project, *see* Section I.

[796] *See* ASC 250–10–50–1(a). ASC 250–10–45–12 also requires companies to justify the use of an alternative accounting principle on the basis that it is preferable.

[797] *See* ASC 250–10–50–2.

[798] AS No. 6, paragraph 7. *See also* Auditing Standard No. 6—Evaluating Consistency of Financial Statements and Conforming Amendments, PCAOB Release No. 2008–001, Jan. 29, 2008, at note 14, *available at http://pcaobus.org/Rules/Rulemaking/Docket023/PCAOB_Release_No._2008-001--Evaluating_Consistency.pdf* (noting that the language in AS No. 6 was updated ''to be

Continued

addresses the review of interim financial statements and requires the auditor to, among other things, make inquiries of management on changes in accounting principles or methods of application. AU 722 does not require the auditor to specifically express a view on the preferability of the change as part of an interim review.

The auditor's opinion on the annual financial statements must discuss the nature of the change in accounting principle if the change has a material effect on the financial statements, but may not necessarily address preferability.[799] Under AU 508, the auditor is not required to opine explicitly on the preferability of the change. Rather, if the auditor concludes a registrant has justified that the alternative accounting principle is preferable (as required by AS No. 6 and U.S. GAAP), then it must include an explanatory paragraph in its report identifying the nature of the change, if the change has a material effect on the financial statements.[800] If the auditor concludes that the registrant has not justified the preferability of the alternative accounting principle, the auditor should consider the matter a departure from U.S. GAAP and, if the effect of the change in accounting principle is material, issue either a qualified or adverse opinion.[801] Consequently, where the change in accounting principle is material, an auditor's report without a qualified or adverse opinion and identifying the nature of the change is akin to the preferability letter filed under Item 601(b)(18) as both documents convey the auditor's conclusion that the registrant has justified that the alternative accounting principle is preferable.

Unlike a preferability letter filed under Item 601(b)(18), the audit opinion will include an explicit statement as to preferability only when the registrant has not provided a reasonable justification that the alternative accounting principle is preferable.[802] Additionally, while Item 601(b)(18) requires registrants to file a preferability letter with the first Form 10–Q following the date of the accounting change, AU 508 requires a statement in the opinion about this change only in the annual financial statements on Form 10–K. U.S. GAAP requires disclosure about this change in the notes to the interim financial statements.[803]

We are seeking public input on whether to eliminate the exhibit requirement of Item 601(b)(18) in light of the significant overlap with the accounting requirements under U.S. GAAP and the PCAOB auditing standards. We are also interested in whether requirements in U.S. GAAP and PCAOB auditing standards are sufficient to alert investors to changes in a registrant's accounting policies or principles. We also seek input on the utility of Item 601(b)(18) given the small number of preferability letters filed and whether the small number of preferability letters reflects decreased utility and importance of this requirement or if, alternatively, these limited occurrences make this disclosure more valuable to investors.

c. Request for Comment

253. Given the development of auditing and accounting standards over the past 40 years, including the adoption of more prescriptive standards such as SFAS No. 154 [804] and AS No. 6, do preferability letters continue to provide incremental information to investors that is not otherwise available in either the auditor's opinion on the annual financial statements or in the notes to the interim financial statements? If so, is this incremental information important to investors and how could it be improved?

254. Should we revise Item 601(b)(18) to specify the language that must be included in a preferability letter? Is there any particular language that gives investors more insight into the determination that the change is preferable? In light of the lack of a standard for assessing preferability, do investors receive more information from a preferability letter than from an auditor's report? Does it depend on the nature of the change in accounting principle?

255. Should we eliminate Item 601(b)(18) in light of the current requirements under U.S. GAAP and the PCAOB's auditing standards? When a change in accounting principle is material, is an auditor's report without a qualified or adverse opinion sufficient to convey the independent accountant's conclusion that the registrant has justified the change to be preferable? Would eliminating the exhibit requirement affect the independent accountant's analysis of whether an accounting change is preferable?

256. Would it be more appropriate for the independent accountant to indicate in the auditor's report whether a change in accounting principle is to an alternative principle that in the auditor's judgment is preferable under the circumstances?

7. Subsidiaries and Legal Entity Identifiers

Item 601(b)(21) requires registrants to list all of their subsidiaries, the state or other jurisdiction of incorporation or organization of each, and the names under which such subsidiaries do business.[805] The names of particular subsidiaries may be omitted if the unnamed subsidiaries, considered in the aggregate as a single subsidiary, would not constitute a significant subsidiary as of the end of the year covered by the report.[806]

A legal entity identifier (''LEI'') is a 20-character, alpha-numeric code that connects to key reference information that allows for unique identification of entities engaged in financial transactions. Recently, the Commission has adopted rules requiring disclosure of LEIs in certain circumstances, if available, and in one instance the Commission has mandated use of

consistent with SFAS No. 154''). The PCAOB adopted AS No. 6, in part, in response to the FASB's issuance of Statement of Financial Accounting Standards No. 154 (ASC 250). *See supra* note 791. AS No. 6 requires the auditor to assess whether the company has met its burden of justifying the change in accounting principle as set forth in SFAS No. 154 (ASC 250).

[799] *See* AU 508, Paragraph 17A.

[800] *See id.*

[801] *See* AU 508, Paragraph 17E.

[802] *See* AU 508, Paragraph 52.

[803] *See supra* note 797 and accompanying text. Under U.S. GAAP, companies should, whenever possible, adopt any accounting changes during the first interim period of a fiscal year. *See* ASC Topic 250–10–45–16.

[804] *See supra* note 791.

[805] Item 601(b)(21)(i) of Regulation S–K [17 CFR 229.601(b)(21)(i)].

[806] Item 601(b)(21)(ii) of Regulation S–K [17 CFR 229.601(b)(21)(ii)]. This exception does not apply to banks, insurance companies, savings and loan associations or to any subsidiary subject to regulation by another Federal agency.

The term ''significant subsidiary'' is defined by reference to Rule 1–02(w) of Regulation S–X [17 CFR 210.1–02(w)]. Under that rule, a significant subsidiary means any subsidiary that meets any of the following conditions: (1) The registrant's and its other subsidiaries' investments in and advances to the subsidiary exceed ten percent of the total assets of the registrant and its subsidiaries consolidated as of the end of the most recently completed fiscal year (for a proposed combination between entities under common control, this condition is also met when the number of common shares exchanged or to be exchanged by the registrant exceeds ten percent of its total common shares outstanding at the date the combination is initiated); or (2) The registrant's and its other subsidiaries' proportionate share of the total assets (after intercompany eliminations) of the subsidiary exceeds ten percent of the total assets of the registrants and its subsidiaries consolidated as of the end of the most recently completed fiscal year; or (3) The registrant's and its other subsidiaries' equity in the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle of the subsidiary exclusive of amounts attributable to any noncontrolling interests exceeds ten percent of such income of the registrant and its subsidiaries consolidated for the most recently completed fiscal year. *Id.*

LEI.[807] LEI disclosure is not required in Exchange Act reports.

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter recommended that we require disclosure of all subsidiaries instead of only significant subsidiaries, asserting that registrants use the Commission's significance test to hide material information from investors.[808] This commenter also recommended requiring disclosure of additional information for each subsidiary, such as profits earned and number of employees, for investors to understand registrants' structures and their international strategies, on the grounds that this information is necessary to understand a registrant's corporate structure and tax strategy.

Another commenter recommended requiring registrants to disclose each country of operation and the name of each entity domiciled in each country of operation; the number of employees physically working in each country of operation; the total pre-tax gross revenue of each entity in each country of operation; and the total amount of payments made to governments by each entity in each country of operation.[809] This commenter stated that investors have an interest in understanding how much of a registrant's profits are generated from business operations and how much is a function of tax strategies. This commenter added that a registrant's filings should explain to investors the tax liabilities it incurred for the year, how much it paid, and where. While not addressing Item 601(b)(21) specifically, one commenter recommended revising the test for determining whether a subsidiary is a significant subsidiary by replacing the existing pre-tax income, investment and asset test with a revenue test and a fair value test.[810]

We received two comment letters addressing LEIs.[811] One of these commenters recommended the Commission consider ''a commitment to adopt'' the LEI endorsed by the G20 as an ''authoritative, unique, and common identifier for entities subject to financial regulators, throughout existing forms.'' [812] This commenter specified that a registrant's list of subsidiaries would be more useful to investors if the Commission required issuers to disclose each subsidiary's LEI. The other commenter recommended the Commission move away from ''proprietary identifiers such as the CUSIP and toward an open source identifier such as the Legal Entity Identifier'' stating this ''will make it easier for investors to connect other datasets with structured data from the Commission.'' [813]

b. Subsidiaries

i. Discussion

Before the adoption of Regulation S–K, Form 10–K required registrants to disclose a list or diagram of all parents and subsidiaries of the registrant in the text of the annual report.[814] In addition, for each entity identified, registrants were required to disclose the percentage of voting securities owned or other bases for control by the immediate parent.[815] Registrants were permitted to omit the names of particular subsidiaries if those subsidiaries, considered in the aggregate as a single subsidiary, would not constitute a significant subsidiary.[816] In 1970, the Commission revised Form 10–K to permit registrants to omit the names of certain consolidated wholly-owned multiple subsidiaries carrying on the same line of business.[817] This exclusion was similar to one recommended in the Wheat Report.[818]

With the adoption of the integrated disclosure system, the Commission replaced the Form 10–K subsidiary disclosure requirement with a less-detailed requirement to file as an exhibit a list of subsidiaries and each subsidiary's jurisdiction of incorporation or organization.[819] This change was based on the Sommer Report which recommended that Form 10–K contain only a ''list of all subsidiaries,'' as opposed to the additional disclosure requirements mentioned above, such as the bases for control of each subsidiary.[820] In the adopting release, the Commission also noted that, although a few commenters stated that no such exhibit relating to subsidiaries, in any form, should be required, most commenters did not object to the exhibit requirement if insignificant subsidiaries were not required to be disclosed.[821] The Commission agreed with the commenters that listing all subsidiaries would be too burdensome and adopted the exhibit requiring only the names of significant subsidiaries.[822] In 1982, the Commission amended the item to allow registrants to incorporate by reference their lists of subsidiaries if an accurate and complete list is contained in a document previously filed with the Commission.[823]

Disclosure provided under Item 601(b)(21) has decreased in the last several years. Specifically, the average number of subsidiaries reported by

[807] *See infra* notes 831 to 835 and accompanying text.

[808] *See* US SIF 1.

[809] *See* AFL–CIO.

[810] *See* ABA 1 (stating that, compared to existing tests, revenue and fair value-based tests are more reliable indicators of the significance of a tested entity to the registrant, easier to calculate and calculated using more consistently measured amounts that are not affected by different bases of accounting). *See also supra* note 806.

[811] *See* Data Transparency Coalition and letter from TagniFi, LLC (Jan. 27, 2016) (''TagniFi'').

[812] *See* Data Transparency Coalition (noting that the ''Commission has already proposed requiring the LEI to be included in security-based swap reports where available, but has not yet committed to use the LEI in its corporate disclosure system'' and that the ''Commission should incorporate commonly-used data fields wherever applicable, starting with the LEI . . .'').

[813] *See* TagniFi.

[814] *See, e.g.,* 1965 Amendments to Form 10–K Adopting Release.

Item 1(a) of former 10–K required disclosure of subsidiaries of ''material significance in relation to the total enterprise represented by the registrant and its subsidiaries, in respect of either (1) the investment in and advances to such subsidiary, or (2) the sales or operating revenues of such subsidiary, or (3) the essential nature of the function performed by such subsidiary in the total enterprise represented by the registrant and its subsidiaries.'' The item also required certain disclosures of omitted subsidiaries such as the number of subsidiaries omitted and the total investment of the registrant in such omitted subsidiaries. *Id.*

[815] This disclosure was required under Item 3 of prior Form 10–K. *See* 1965 Amendments to Form 10–K Adopting Release.

[816] *See, e.g.,* 1965 Amendments to Form 10–K Adopting Release. The item requirement did not define the term ''significant subsidiary.'' Registrants were also required to indicate (i) subsidiaries for which separate financial statements are filed; (ii) subsidiaries included in the respective consolidated financial statements; (iii) subsidiaries included in the respective group financial statements filed for unconsolidated subsidiaries; and (iv) other subsidiaries, indicating briefly why statements of such subsidiaries are not filed. *Id.*

[817] *See* 1970 Revised Form 10–K Adopting Release. Current Item 601(b)(21)(ii) contains substantially the same exception, permitting the omission of consolidated wholly-owned multiple subsidiaries carrying on the same line of business, such as chain stores or small loan companies, provided the name of the immediate parent, the line of business, the number of omitted subsidiaries operating in the United States and the number operating in foreign countries are given.

[818] *See* Wheat Report at Appendix X–3 (recommending that the names of consolidated totally-held subsidiaries may be omitted on a Form 10–K, provided that the number of such subsidiaries shall be given together with an explanation of the basis for omission of names).

[819] *See* 1980 Form 10–K Adopting Release.

[820] *See* 1980 Form 10–K Proposing Release. The Commission also stated that after consideration, it had determined that the value of parent and subsidiary data is not sufficient to warrant its inclusion in Form 10–K itself. In addition, it noted its belief that occasional references to such data may be useful. Accordingly, the Commission proposed a new exhibit requirement rather than including this disclosure in Form 10–K itself. *See id.*

[821] *See* 1980 Form 10–K Adopting Release.

[822] *See id.*

[823] *See* 1982 Integrated Disclosure Adopting Release.

registrants under Item 601(b)(21) is estimated to have decreased approximately twenty percent in the five years from 2009 to 2014. However, this decrease is roughly equivalent to the increase observed in the previous five years, from 2004 to 2009.[824] According to one press report, in recent years certain large registrants have reduced the number of subsidiaries listed pursuant to Item 601(b)(21) by omitting subsidiaries that are not significant.[825] While omission of insignificant subsidiaries from the exhibit is permitted under Item 601(b)(21), the report suggested such registrants may be seeking to avoid disclosing subsidiaries located in countries regarded as tax havens at a time when government officials and academics are scrutinizing the use of offshore tax havens.[826] We are interested in commenters' views on the impact of the rule's exclusion for insignificant subsidiaries.

ii. Request for Comment

257. Should we revise Item 601(b)(21) to eliminate the exclusions and require registrants to disclose all subsidiaries? What would be the benefits and challenges associated with this alternative?

258. Should we expand the exhibit requirement to include additional disclosure about the registrant's subsidiaries? What additional information would be important to investors and why?

259. Should we require registrants to include an organization or corporate structure chart or similar graphic depicting their subsidiaries and their basis of control? How could such a graphic facilitate investors' understanding of a registrant's corporate structure? Should we require this chart or graphic as an exhibit or in the text of the annual report? What would be the challenges associated with this approach?

260. For purposes of identifying which subsidiaries a registrant may omit from the exhibit, Item 601(b)(21) relies on the definition of ''significant subsidiary'' in Rule 1–02(w) of Regulation S–X. Does this definition appropriately exclude subsidiaries that are not important to investors? Does it exclude any subsidiaries that should be included? Should we consider a different definition or test for excluding certain subsidiaries from the exhibit? If so, what factors should we consider?

c. Legal Entity Identifiers

i. Discussion

While there are currently many ways to identify entities, there is no unified global identification system for legal entities across markets and jurisdictions. The LEI is a reference code to uniquely identify a legally distinct entity that engages in a financial transaction.[827] It is based on an international standard published by the International Organization for Standardization in June 2012.[828] Efforts to expand the use of a universal LEI have progressed significantly over the last few years.[829]

Obtaining an LEI entails both initial registration and annual maintenance fees and is done through local operating utilities such as the Global Market Entity Identifier utility in the United States.[830] Fees are not imposed to use or access LEIs, and all of the associated reference data needed to understand, process, and utilize the LEIs is widely and freely available.

In recent rulemakings, the Commission has prescribed disclosure of LEI, if available, for parties to certain financial transactions. For example, the Commission recently prescribed disclosure of an obligor's LEI, if available, with respect to a rating action involving a credit rating of an obligor as an entity.[831] In doing so, it stated that use of an LEI can promote accuracy and standardization of NRSRO data and therefore can further the purpose of allowing users of credit ratings to compare the performance of credit ratings by different NRSROs.[832] As another example, the Commission recently adopted an LEI disclosure requirement related to credit risk retention for open market collateralized loan obligations (''CLOs''), if an LEI has been obtained by the obligor, stating that this requirement would allow investors to better track the performance of assets originated by specific originators.[833] While these recent

[824] These estimates are based on DERA staff analysis of Item 601(b)(21) data collected using text analysis techniques by academic researchers. The estimates represent approximations and may be affected by, among other things, the limitations of text analysis and sample composition changes over this time frame. The data is *available at https://sites.google.com/site/scottdyreng/Home/data-and-code*. For more information about this dataset, *see* S. Dyreng and B. Lindsey, *Using Financial Accounting Data to Examine the Effect of Foreign Operations Located in Tax Havens and Other Countries on U.S. Multinational Firms' Tax Rates,* 47 J. Acct. Res. 1283, 1283–1316 (2009); and S. Dyreng, B. Lindsey and J. Thornock, *Exploring the Role Delaware Plays as a Domestic Tax Haven,* 108 J. Fin. Econ. 751, 751–772 (2013).

[825] *See* Jessica Holzer, *From Google to FedEx: The Incredible Vanishing Subsidiary,* The Wall Street Journal, May 22, 2013, *available at http://www.wsj.com/articles/SB10001424127887323463704578497290099032374* (noting the number of subsidiaries disclosed has declined from over 100 subsidiaries to single digits among certain large registrants).

[826] *Id. See also* U.S. PIRG Education Fund and Citizens for Tax Justice, *Offshore Shell Games 2015, The Use of Offshore Tax Havens by Fortune 500 Companies,* Oct. 2015, *available at http://ctj.org/pdf/offshoreshell2015.pdf* (stating that, based on information in Exhibit 21 to Form 10–K, 358 of Fortune 500 companies operated subsidiaries in tax haven jurisdictions at the end of 2014 and noting that ''it is possible that many of the remaining 142 companies simply do not disclose their offshore tax haven subsidiaries''); and United States Government Accountability Office, *International Taxation, Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions,* Report to Congressional Requestors, Dec. 2008, *available at http://www.gao.gov/assets/290/284522.pdf* (concluding that 83 of the 100 largest publicly traded U.S. corporations in terms of 2007 revenue reported having subsidiaries in jurisdictions listed as tax havens or financial privacy jurisdictions. Findings were based on information filed in Exhibit 21 to Form 10–K, and the report notes that the findings may be understated because ''the SEC only requires public companies to report significant subsidiaries . . .'').

[827] For further information about LEIs, *see Frequently Asked Questions: Global Legal Entity Identifier (LEI),* Aug. 2012 *available at http://www.treasury.gov/initiatives/wsr/ofr/Documents/LEI_FAQs_August2012_FINAL.pdf*.

[828] *See* International Organization for Standardization, *Financial Services—Legal Entity Identifier,* 2012, Reference No. ISO 17442–2012(E).

[829] *See, e.g., The Global LEI System and regulatory uses of the LEI,* Nov. 5, 2015, *available at http://www.leiroc.org/publications/gls/lou_20151105-1.pdf* (progress report by the Legal Identifier Regulatory Oversight Committee, including an annex listing regulatory actions in the United States, the EU countries, and eight other countries which require, request, or allow the use of LEIs). The global LEI system currently has over 419,000 registrations and is growing. *See* the Global LEI Foundation daily updated ''concatenated file,'' which includes all LEIs issued globally and related LEI reference data, *available at https://www.gleif.org/en/lei-data/gleif-concatenated-file/lei-download#* or *http://openleis.com*.

[830] As of December 7, 2015, the cost of obtaining an LEI from the Global Markets Entity Identifier (''GMEI'') Utility in the United States was $200, plus a $19 per record surcharge for the LEI Central Operating Unit. The annual cost of maintaining an LEI from the GMEI Utility was $100, plus a $19 surcharge for the LEI Central Operating Unit. *See https://www.gmeiutility.org/frequentlyAskedQuestions.jsp*.

[831] *See* Nationally Recognized Statistical Rating Organizations, Release No. 34–72936 (Aug. 27, 2014) [79 FR 55077 (Sept. 15, 2014)] (''2014 NRSRO Amendments Release''). The Commission revised Exchange Act Rule 17g–7 to require that NRSROs, taking rating action with respect to certain obligors or issuers, disclose the LEI issued by a utility endorsed or otherwise governed by the Global LEI Regulatory Oversight Committee or the Global LEI Foundation of the obligor or issuer, if available, or, if an LEI is not available, the Central Index Key (CIK) number of the obligor or issuer, if available. *Id. See also* Rule 17g–7(b)(2)(iii)(A) and (iv)(A) [17 CFR 240.17g–7].

[832] *See* 2014 NRSRO Amendments Release. The Commission also stated that coded identifiers like LEI and CIK will add a level of standardization to the credit rating history data, making for easier electronic querying and processing. *Id.*

[833] *See* Credit Risk Retention, Release No. 34–73407 (Oct. 22, 2014) [79 FR 77601 (Dec. 24, 2014)]. Under the final rule's lead arranger option for open

rulemakings have required LEI disclosure only if available, the Commission has mandated use of LEI in the context of security-based swap transactions [834] and has proposed mandatory use of LEI in investment company reporting.[835] To the extent that LEIs become more widely used by regulators and the financial industry, they could potentially facilitate investor and Commission use of registrant data by showing networks of control, ownership, liability and risks.

ii. Request for Comment

261. Should we require registrants to disclose their LEI and the LEIs of their subsidiaries (if available) in the list of subsidiaries filed under Item 601(b)(21)? How would this information benefit investors? Should the industry in which the company operates or the extent to which the company engages in financial market transactions affect whether disclosure of LEIs is required? What would be the costs of requiring disclosure of this information?

262. Should our rules encourage registrants to obtain an LEI? If so, how could we structure our rules, consistent with our authority under the Securities Act and the Exchange Act, to achieve this purpose? For example, should we make obtaining and maintaining an LEI a condition to any of our existing disclosure accommodations or alternatives? Why or why not? If so, should such a condition be limited to certain types of registrants, such as those operating in financial services? For registrants that have not obtained an LEI, will these registrants seek to obtain an LEI in the future absent any regulatory incentive to do so? In addition to the fees for obtaining and maintaining an LEI, would there be other costs associated with obtaining LEIs?

263. Some registrants may have hundreds or thousands of subsidiaries or affiliates operating globally while other registrants have simple corporate structures. If we required registrants to disclose LEIs (if available) in the list of significant subsidiaries, should we limit the requirement to larger registrants or larger subsidiaries, independent of the industry in which the registrant operates? For example, should we limit the requirement to large accelerated filers or well-known seasoned issuers (WKSIs)?

H. Scaled Requirements

1. Categories of Registrants Eligible for Scaled Disclosure

Over the years, the Commission has developed a disclosure system that provides regulatory relief in the form of reduced disclosure requirements for certain smaller registrants. Although initially developed to facilitate smaller companies' access to the capital markets,[836] these reduced or scaled disclosure requirements also apply to annual and quarterly reports. Currently, registrants are eligible for scaled disclosure if they qualify as an SRC or an EGC. SRCs are registrants having less than $75 million in public float (*i.e.,* the aggregate market value of the issuer's outstanding voting and non-voting common equity held by non-affiliates) or, if public float is zero, less than $50 million in annual revenue in the last fiscal year.[837]

In 2012, Title I of the JOBS Act created a new category of issuer called an ''emerging growth company.'' Like SRCs, EGCs are eligible for a variety of accommodations, including scaled disclosure requirements.[838] A company qualifies as an EGC if it did not complete its first registered sale of common equity securities on or before December 8, 2011 and has total annual gross revenues of less than $1 billion during its most recently completed fiscal year.[839] A company retains EGC status until the earliest of the following:

- The last day of its fiscal year during which its total annual gross revenues are $1 billion or more;
- the date it is deemed to be a large accelerated filer under the Commission's rules;
- the date on which it has issued more than $1 billion in non-convertible debt in the previous three years; or
- the last day of the fiscal year following the fifth anniversary of the first registered sale of common equity securities of the issuer.[840]

The Commission has specified other categories of registrants for different purposes. These include: Accelerated filers, with a public float of $75 million or more but less than $700 million; and large accelerated filers, with a public float of $700 million or more.[841] A filer with a public float of less than $75 million is a ''non-accelerated filer.'' [842]

These categories determine periodic reporting schedules.[843] They also determine the age requirements for financial statements under Regulation S–X [844] and certain requirements for audits of internal control over financial reporting (''ICFR'') under Item 308 of Regulation S–K.[845] In addition, accelerated and large accelerated filers are subject to other disclosure requirements, such as the requirements to disclose their Internet address,[846] information about how they make their periodic reports available,[847] and a description of any open unresolved staff

market CLOs, the sponsor is required to disclose a complete list of every asset held by an open market CLO (or before the CLO's closing, in a warehouse facility in anticipation of transfer into the CLO at closing). This list requires, among other things, the full legal name, Standard Industrial Classification category code and LEI (if an LEI has been obtained by the obligor) of the obligor of the loan or asset. [24 CFR 267.9].

[834] *See* Regulation SBSR-Reporting and Dissemination of Security-Based Swap Information, Release No. 34–74244 (Feb. 11, 2015) [80 FR 14563 (Mar. 19, 2015)] (''2015 Regulation SBSR Release'').

[835] In connection with our efforts to modernize reporting and disclosure by registered investment companies, the Commission proposed new Form N–PORT in May of 2015. Form N–PORT would require certain registered investment companies to report information about their monthly portfolio holdings in a structured data format. We proposed inclusion of LEIs in Part A of Form N–PORT and stated that inclusion of this information would facilitate the ability of investors and the Commission to link the data reported on Form N–PORT with data from other filings or sources that is or will be reported elsewhere as LEIs become more widely used by regulators and the financial industry. *See* Investment Company Reporting Modernization, Release No. 33–9776 (May 20, 2015) [80 FR 33589 (June 12, 2015)] (''2015 Investment Company Release'') at notes 40–43 and accompanying text.

[836] *See* Small Business Initiatives Adopting Release and Form S–18 Release.

[837] Item 10(f) of Regulation S–K [17 CFR 229.10(f)].

[838] Public Law 112–106, Secs. 102–104, 126 Stat. 306 (2012). For a discussion of the scaled disclosure accommodations available to SRCs and EGCs, *see* Section IV.H.2.

[839] Public Law 112–106, Sec. 101, 126 Stat. 306 (2012); 15 U.S.C. 77b(a)(19); 15 U.S.C. 78c(a)(80).

[840] *Id.* In addition, the FAST Act amended Securities Act Section 6(e)(1) [15 U.S.C. 77 f(e)(1)] to provide a grace period for EGCs at risk of losing their status as an EGC after the initial filing or confidential submission of their IPO registration statement but before the IPO is completed. Such companies shall continue to be treated as an EGC through the earlier of the consummation of the IPO or one year after they would otherwise cease to be an EGC. *See* Public Law 114–94, Sec. 71002, 129 Stat. 1312 (2015).

[841] Exchange Act Rule 12b–2 [17 CFR 240.12b–2]. Under Rule 12b–2, accelerated filers and large accelerated filers must also have been subject to the requirements of Exchange Act Section 13(a) or 15(d) for at least 12 months and must not be eligible to use the SRC requirements under Regulation S–K for its annual and quarterly reports. *Id. See also* Revisions to Accelerated Filer Definition and Accelerated Deadlines for Filing Periodic Reports, Release No. 33–8644 (Dec. 21, 2005) [70 FR 76626 (Dec. 27, 2005)] (''2005 Accelerated Filer Revisions Release'').

[842] *See* 2005 Accelerated Filer Revisions Release. While a ''non-accelerated filer'' is not defined in Exchange Act Rule 12b–2, it represents a category of filer that, among other things, has a different deadline for filing periodic reports.

[843] *See* 2005 Accelerated Filer Revisions Release.

[844] Rule 3–01 of Regulation S–X [17 CFR 210.3–01].

[845] Item 308 of Regulation S–K [17 CFR 229.308].

[846] Item 101(e)(3) of Regulation S–K [17 CFR 229.101(e)(3)].

[847] Item 101(e)(4) of Regulation S–K [17 CFR 229.101(e)(4)].

comments on their periodic or current reports.[848]

The following table summarizes the criteria for determining whether a company qualifies as an EGC, SRC, non-accelerated filer, accelerated filer or large accelerated filer.

Category of filer	Public float[849] to enter status	Revenues[850] to enter status	Criteria to exit status	Public float to re-enter status (after exceeding threshold(s))	Revenues to re-enter status (after exceeding threshold(s))
EGC	N/A	<$1 billion	• Revenues ≥$1 billion • 5th anniversary of IPO[851]. • Non-convertible debt >$1 billion[852]. • Float ≥$700 million[853].	N/A	N/A.
SRC	<$75 million	<$50 million[854]	Float ≥$75 million	<$50 million[855]	<$40 million.[856]
Non-Accelerated Filer	<$75 million	N/A	Float ≥$75 million	<$50 million[857]	N/A.
Accelerated Filer	≥$75 million but <$700 million.	N/A	Float <$75 million or ≥$700 million.	<$500 million but ≥$50 million[858].	N/A.
Large Accelerated Filer	≥$700 million	N/A	Float <$700 million	N/A	N/A.

a. Comments Received

S–K Study. One commenter noted that the $1 billion threshold for EGCs established in the JOBS Act appeared to be arbitrary and opposed any potential Commission guidance broadening the definition of EGCs, because it would unnecessarily increase the risks to investors.[859] Two commenters suggested that the Commission should modify Regulation S–K to apply to different classes of EGCs, such as those that reach specified revenue levels lower than $1 billion, or to phase in different requirements after a certain period of time following the IPO.[860]

Disclosure Effectiveness Initiative. One commenter suggested that overreliance on public float to define SRCs and non-accelerated filers creates a compliance burden for companies with high valuations that would be considered ''small'' by any ''reasonable observer.'' [861] This commenter recommended revising the definition of SRC and non-accelerated filer to include any issuer with public float below $250 million, or annual revenues below $100 million regardless of its public float, to avoid grouping highly valued small companies with little or no revenue with larger corporations.

b. Discussion

The Commission's practice of providing disclosure accommodations to smaller companies with less established trading markets dates back to 1979. In providing these accommodations and determining what categories of registrants are eligible for scaled disclosure requirements, the Commission has sought to promote capital formation and reduce compliance costs while maintaining investor protections.[862]

Our current system of reporting and registration for SRCs is based on Form S–18, which allowed an entity that was not previously a reporting company to raise a limited amount of capital without immediately incurring the full range of disclosure and reporting obligations required of other issuers.[863] As part of a larger effort to facilitate capital raising by small businesses and reduce the compliance burdens placed on these companies by the federal securities laws, the Commission created Regulation S–B in 1992 and rescinded

[848] Item 1B of Part I of Form 10–K.

[849] Public float is computed as of the last business day of company's most recently completed second fiscal quarter. Item 10(f) of Regulation S–K [17 CFR 229.10(f)].

[850] Revenues are as reported in a company's most recently completed fiscal year. [15 U.S.C. 78c(a)(80)]; Exchange Act Rule 12b–2 [17 CFR 240.12b–2]; Item 10(f) of Regulation S–K [17 CFR 229.10(f)].

[851] Ineligibility begins on the last day of the fiscal year in which the fifth anniversary occurs. [15 U.S.C. 78c(a)(80)]. The Division has interpreted the phrase ''first sale of common equity securities'' under the JOBS Act (''IPO'' in the table above) not to be limited to a company's initial primary offering of common equity securities for cash. It could also include offering common equity pursuant to an employee benefit plan on a Form S–8 as well as a selling shareholder's secondary offering on a resale registration statement. *See* Jumpstart Our Business Startups Act Frequently Asked Questions, Generally Applicable Questions on Title I of the JOBS Act, Question 2 (Apr. 28, 2012), *available at https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm.*

[852] Ineligibility begins on the date on which the company has issued more than $1 billion in non-convertible debt during the previous three year period. [15 U.S.C. 78c(a)(80)].

[853] *See supra* note 840.

[854] Revenue test applies only if public float is zero. Item 10(f)(1)(iii) of Regulation S–K [17 CFR 229.10(f)(1)(iii)].

[855] Once a registrant fails to qualify as an SRC, it will remain unqualified unless its public float falls below $50 million as of the last business day of its second fiscal quarter, or if public float is zero, if revenues fall below $40 million during its previous fiscal year. Item 10(f)(2)(iii) of Regulation S–K [17 CFR 229.10(f)(2)(iii)].

[856] *Id.*

[857] Once a registrant becomes an accelerated filer, it will remain an accelerated filer unless it determines at the end of a fiscal year that its public float was less than $50 million as of the last business day of it most recently completed second fiscal quarter. The registrant will not become an accelerated filer again unless it subsequently meets the conditions for initial qualification as an accelerated filer. Rule 12b–2 of the Exchange Act [17 CFR 240.12b–2].

[858] Once a registrant becomes a large accelerated filer, it will remain a large accelerated filer unless it determines at the end of a fiscal year that its public float was less than $500 million as of the last business day of it most recently completed second fiscal quarter. The registrant will not become a large accelerated filer again unless it subsequently meets the conditions for initial qualification as a large accelerated filer. *Id.*

[859] *See* letter from Council of Institutional Investors (Aug. 9, 2012) (''CII'').

[860] *See* Silicon Valley and M. Liles.

[861] *See* Biotech Industry Organization.

[862] *See, e.g.,* Form S–18 Release; and Small Business Initiatives, Release No. 33–6924 (Mar. 11, 1992) [57 FR 9768 (Mar. 20, 1992)] (''Small Business Initiatives Proposing Release'').

[863] *See* Small Business Initiatives Adopting Release and Form S–18 Release. Form S–18 was ''in the nature of an experiment'' for use by certain non-reporting issuers seeking to register certain offerings of less than $5 million. Registrants using Form S–18 were permitted to provide narrative disclosure somewhat less extensive than Form S–1 and audited financial statements for two fiscal years instead of the three fiscal years required in Form S–1. In addition, and to help reduce the expenses resulting from registration and reporting under the Securities Act and the Exchange Act, the Commission allowed Form S–18 registrants to include this scaled narrative and financial disclosure in their initial Form 10–K. *See* Form S–18 Release. *See also* Section III.A.2.b for a discussion of Form S–18.

Notably, while Form S–18 was intended to facilitate a small business's access to public capital markets, eligibility to use the form was not determined by the size of the issuer. After observing the form's use, the Commission later expanded the availability of Form S–18. *See supra* note 78. The offering threshold was raised to $7.5 million in 1983. *See* Revisions to Optional Form S–18, Release No. 33–6489 (Sept. 23, 1983) [48 FR 45386 (Oct. 5, 1983)].

Form S–18.[864] Regulation S–B was a new integrated disclosure system modeled after Form S–18 and specifically tailored to ''small business issuers,'' which it defined as registrants with annual revenues of less than $25 million whose voting stock had a public float of less than $25 million.

In 2007, the Commission replaced the ''small business issuer'' definition with the current definition for ''smaller reporting companies,'' which expanded the universe of registrants eligible for scaled disclosure.[865] Unlike the dual eligibility test under Regulation S–B, which required separate calculations using both public float and annual revenues, the 2007 definition, which remains in effect today, eliminated the revenue test for most companies.[866] The Commission stated its belief that this would simplify and streamline the definition while expanding the number of companies eligible to qualify. The majority of commenters also supported a revenue test only if a company is unable to calculate public float.

Recently, we have received recommendations to revisit some of our registrant categories eligible for scaled disclosure, with particular focus on expanding the SRC definition to include a greater number of registrants.[867] In the S–K Study, the staff recommended consideration of the criteria used to determine eligibility for potential further scaling of disclosure requirements and, in particular, whether it would be appropriate to scale for companies other than EGCs. The staff also noted that any determination of which companies should be allowed to scale their disclosures, how companies should migrate to a standard disclosure regime as they mature, and the extent to which disclosure of previously undisclosed information should later be required should reflect the overarching economic principles recommended in the S–K Study. The staff further recommended consideration of the eligibility criteria for SRCs, as well as the criteria for accelerated filers and large accelerated filers.[868]

We are interested in receiving input on how we should approach the eligibility criteria for using scaled disclosure. The FAST Act requires the Commission to revise Regulation S–K to further scale or eliminate disclosure requirements to reduce the burden on a variety of smaller issuers, including SRCs.[869] In response to this mandate, the staff is currently evaluating, among other things, the criteria to qualify as an SRC, and expects to make recommendations to the Commission. Consequently, we are not addressing the existing criteria in this release.

c. Request for Comment

264. In the context of registered offerings, the Commission has determined that certain types of issuers are unsuited for short-form registration or disclosure-related relief.[870] These issuers include reporting companies that are not current in their Exchange Act reports, issuers that may raise greater potential for abuse (such as blank check and shell companies) [871] and issuers that have violated the anti-fraud provisions of the federal securities laws. Are there types of registrants that would meet the current criteria for scaled disclosure but are unsuited for providing such disclosure? If so, which issuers and why? Should we exclude certain types of registrants from the use of scaled disclosure and if so, what should be the criteria (*e.g.,* failure to timely file, subject to enforcement actions for disclosure violations or fraud, being an ''ineligible issuer'' as defined under Rule 405 of the Securities Act or disqualified under Regulation A or Regulation D) and the time period of exclusion?

265. Should we tie eligibility for scaled disclosure to a certain proportion of companies, such as companies in the lowest one percent of total U.S. market capitalization or the lowest six percent of total U.S. market capitalization, as previously recommended by the ACSPC? [872]

266. Should we allow one or more categories of larger companies, such as companies with a longer reporting history or more readily available public information to benefit from scaled disclosure requirements as a means of reducing compliance costs?

267. The benefits of disclosure may be greater for smaller registrants because information asymmetries between investors and managers of smaller companies are typically higher than for larger, more seasoned companies with a large following.[873] However, disclosure

[864] *See* Small Business Initiatives Adopting Release. In addition to the small business integrated disclosure system and forms, the Commission revised Regulation A to, among other things, raise the dollar limit to $5 million in a 12-month period and revised Rule 504 to, among other things, allow for receipt of freely transferable securities and remove the proscription on general solicitation. *Id.*

[865] *See* SRC Adopting Release. Several of the amendments the Commission adopted in the SRC Adopting Release originated in recommendations made by the Advisory Committee on Smaller Public Companies (ACSPC), which the Commission chartered in 2005 to assess the regulatory system for smaller companies. The ACSPC's recommendations included establishing a system of scaled securities regulation for ''smaller public companies,'' which referred to registrants in the lowest six percent of total U.S. equity market capitalizations, and included: ''microcap companies'' which referred to registrants in the lowest one percent of total U.S. equity market capitalization and would have included registrants with capitalizations below approximately $128 million; and ''smallcap companies,'' which referred to registrants in the next lowest five percent of total U.S. equity market capitalization and would have included registrants with capitalizations between approximately $128 million and $787 million. *See* Final Report of the Advisory Committee on Smaller Public Companies to the U.S. Securities and Exchange Commission, Apr. 23, 2006, *available at http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf.*

[866] *See* SRC Adopting Release.

[867] The Annual SEC Government-Business Forum on Small Business Capital Formation (''Small Business Forum'') has recommended revising the SRC definition to include a company with a public float of less than $250 million or a company with a public float of less than $700 million with annual revenues of less than $100 million. *See e.g., Final Report of the 2014 SEC Government-Business Forum on Small Business Capital Formation,* May 2015 (''2014 Forum Report''), *available at http://www.sec.gov/info/smallbus/gbfor33.pdf.*

Similarly, the Commission's Advisory Committee on Small and Emerging Companies (''ACSEC'') recommended the Commission revise the SRC definition to include companies with a public float of up to $250 million to extend regulatory relief to a broader range of smaller public companies, including, among other things, the exemption from the requirement to provide an auditor attestation of the registrant's ICFR. Item 308(b) of Regulation S–K [17 CFR 229.308(b)]. Item 308(b) applies to accelerated filers and large accelerated filers, both of which definitions exclude issuers that that are eligible to use the SRC requirements in Regulation S–K. Exchange Act Rule 12b–2 [17 CFR 240.12b–2]. Because the definitions of accelerated filer and larger accelerated filer specify that they do not include registrants that are eligible to use the requirements for SRCs for their annual and quarterly reports, a change to the threshold for SRCs would extend this exemption even without a corresponding change to the threshold for accelerated filers.

The ACSEC also has recommended the Commission revise the definition of ''accelerated filer'' to include companies with a public float of $250 million or more, but less than $700 million, thereby exempting companies with public float between $75 million and $250 million from the requirement to provide an auditor attestation of the registrant's ICFR. *See e.g., Advisory Committee on Small and Emerging Companies Recommendations about Expanding Simplified Disclosure for Smaller Issuers,* Sept. 23, 2015 (''2015 ACSEC Recommendations''), *available at http://www.sec.gov/info/smallbus/acsec/acsec-recommendations-expanding-simplified-disclosure-for-smaller-issuers.pdf.*

[868] *See* S–K Study at 98 and 102–103. For a discussion of the overarching economic principles of the S–K Study, *see* Section II.C.

[869] Public Law 114–94, Sec. 72002(1), 129 Stat. 1312 (2015).

[870] *See* Securities Offering Reform Release.

[871] *See id.,* citing Penny Stock Definition for Purposes of Blank Check Rule, Release No. 33–7024 (Oct. 25, 1993) [58 FR 58099] (the Commission stated that Congress found blank check companies to be common vehicles for fraud and manipulation in the penny stock market, and concluded that the Commission's disclosure-based regulation and review of such offerings protects investors).

[872] *See supra* note 865.

[873] *See, e.g.,* R. Frankel and X. Li, *Characteristics of a firm's information environment and the information asymmetry between insiders and outsiders,* 37 J. Acct. Econ. 229, 229–259 (June

Continued

requirements may impose disproportionate costs on smaller registrants, especially if these requirements impose fixed rather than variable costs.[874] To what extent are the costs imposed by our disclosure requirements fixed costs that do not scale with the size of a registrant?

2. Scaled Disclosure Requirements for Eligible Registrants

Registrants that qualify as an SRC or EGC are allowed to provide less detailed disclosure about their business operations and financial condition and to limit the number of periods for which disclosure is required.[875] An SRC may limit the description of the development of its business under Item 101(h) of Regulation S–K to the last three years rather than the five years required of other registrants. The business description should include the registrant's form and year of organization, any bankruptcy proceedings, any material reclassification, merger, sale or purchase of assets outside the ordinary course of business and a description of the business. The disclosure required in the description of business for SRCs is less detailed than that required for other reporting companies and does not require information about seasonality, working capital practices, backlog information and certain material government contracts.[876] The scaled requirements do, however, call for information not specifically required for other reporting companies, such as the need for government approval of principal products and services.[877]

SRCs also are required to provide only two years of audited financial statements [878] rather than the three years required of other companies.[879] To the extent a SRC presents only two years of financial statement information, they also are permitted under Item 303 of Regulation S–K to provide MD&A for only these two years.[880]

Not all EGCs qualify as SRCs. EGCs are only required to provide two years of audited financial statements in an initial public offering of common equity securities and may limit their MD&A to only those audited periods presented in the financial statements.[881] In interpretive guidance, the Division has stated that in any other offering or in an Exchange Act annual report or registration statement, an EGC that is not an SRC is required to provide three years of audited financial statements, except the registrant is not required to include financial statements for any periods prior to the earliest period presented in its initial public offering of common equity securities.[882] In addition, EGCs may take advantage of an extended transition period for complying with new or revised financial accounting standards.[883]

SRCs are not required to provide certain line-item requirements in Regulation S–K, including Item 201(e) (Market price of and dividends on the registrant's common equity and related stockholder matters—Performance Graph),[884] Item 301 (Selected Financial Data),[885] Item 302 (Supplementary Financial Data),[886] Item 303(a)(5) (contractual obligations table),[887] Item 305 (Quantitative and Qualitative Disclosures about Market Risk),[888] Item 308(b) (Internal Control over Financial Reporting—auditor's attestation report) [889] and Item 503(c) (Risk Factors).[890] Scaled disclosure requirements under these items differ slightly for EGCs. For example, an EGC is permitted to limit the selected financial data it includes in a registration statement under Item 301 to those periods for which audited financial statements are included in the registration statement. For periodic reports, an EGC is not required to

2004). *See also,* L. Cheng, S. Liao, and H. Zhang, *The Commitment Effect versus Information Effect of Disclosure—Evidence from Smaller Reporting Companies,* 88 Acct. Rev. 1239, 1239–1263 (2013).

[874] Empirical evidence suggests the imposition of additional disclosure requirements in the past has imposed disproportionate costs on smaller registrants relative to larger registrants. *See supra* note 169.

[875] SRCs and EGCs may take advantage of additional scaled disclosure requirements and other accommodations, such as reduced executive compensation disclosure under Item 402(n) through (r) of Regulation S–K [17 CFR 229.402(n) through (r)] that we do not discuss in detail here, as they are beyond the scope of this release.

[876] Item 101(c)(1)(v), (vi), (viii) and (ix) of Regulation S–K [17 CFR 229.101(c)(1)].

[877] *See, e.g.,* Item 101(h)(4)(viii) of Regulation S–K [17 CFR 229.101(h)].

[878] Rule 8–02 of Regulation S–X. [17 CFR 210.8–02].

[879] Article 3 of Regulation S–X requires: Audited balance sheets as of the end of each of the two most recent fiscal years; audited statements of income and cash flows for each of the three fiscal years preceding the date of the most recent audited balance sheet; and an analysis of changes in stockholders' equity for each period for which an income statement is required. Rules 3–01, 3–02, and 3–04 of Regulation S–X [17 CFR 210.3–01; 17 CFR 210.3–02; 17 CFR 210.3.04].

[880] Instruction 1 to Item 303(a) of Regulation S–K [17 CFR 229.303(a)].

[881] Public Law 112–106, Sec. 102(b)–(c), 126 Stat. 306 (2012). One study, however, indicated that only fifty-nine percent of EGCs provided the minimum financial statement disclosures required by the JOBS Act and voluntarily provided more disclosure. *See* Ernst & Young LLP, *The JOBS Act: 2015 Mid-Year Update,* (Sept. 2015), *available at http://www.ey.com/Publication/vwLUAssets/JOBSAct_2015MidYear_CC0419_16September2015/$FILE/JOBSAct_2015MidYear_CC0419_16September2015.pdf.* While the JOBS Act permits EGCs to limit their MD&A to only those audited periods presented in its financial statements, Division staff has provided interpretive guidance that Section 102(c) does not permit an EGC to comply with the SRC provisions of Item 303. An EGC that is not an SRC is therefore required to include the contractual obligations table required by Item 303(a)(5). *See* Question 41, Jumpstart Our Business Startups Act Frequently Asked Questions, Generally Applicable Questions on Title I of the JOBS Act, (May 3, 2012), *available at https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm.* Additionally, a non-SRC EGC must provide three years of audited financial statements in an Exchange Act registration statement or annual report, and therefore its MD&A in such filing must cover the same three-year period. *See* Division of Corporation Finance Financial Reporting Manual, Section 10220.1.

[882] *See* Questions 30 and 48, Jumpstart Our Business Startups Act Frequently Asked Questions, Generally Applicable Questions on Title I of the JOBS Act, (May 3, 2012), *available at https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm.*

Section 71003 of the FAST Act amended Section 102 of the JOBS Act to allow an EGC that is filing a registration statement (or submitting a draft registration statement for confidential review) under Section 6 of the Securities Act on Form S–1 or Form F–1 to omit financial information for historical periods otherwise required by Regulation S–X if it reasonably believes the omitted information will not be required in the filing at the time of the contemplated offering, so long as the issuer amends the registration statement prior to distributing a preliminary prospectus to include all financial information required by Regulation S–X at the time of the amendment. This provision took effect 30 days after the date of enactment of the FAST Act. Section 71003 also directs the Commission to revise the general instructions to Form S–1 and Form F–1 to reflect this self-executing change. In addition, Section 84001 of the FAST Act requires the Commission to revise Form S–1 to permit an SRC to incorporate by reference into its registration statement any documents filed by the issuer subsequent to the effective date of the registration statement. Public Law 114–94, Sec. 71003, 129 Stat. 1312 (2015).

We recently adopted interim final rules to implement Sections 71003 and 84001 of the FAST Act. *See* Simplification of Disclosure Requirements for Emerging Growth Companies and Forward Incorporation by Reference on Form S–1 For Smaller Reporting Companies, Release No. 33–10003 (Jan. 13, 2016) [81 FR 2743 (Jan. 19, 2016)] (''FAST Act Interim Rules Release'').

[883] 15 U.S.C. 77g(a)(2)(B).

[884] Instruction 6 to Item 201(e) of Regulation S–K [17 CFR 229.201(e)].

[885] Item 301(c) of Regulation S–K [17 CFR 229.301(c)].

[886] Item 302(c) [17 CFR 229.302(c)].

[887] Item 303(d) of Regulation S–K [17 CFR 229.303(d)].

[888] Item 305(e) of Regulation S–K [17 CFR 229.305(e)]. Although SRCs are not required to provide the information required by this item, the adopting release notes that ''if market risk represents a material known risk or uncertainty, [SRCs], like other registrants, will continue to be required to discuss those risks and uncertainties to the extent required by Management's Discussion and Analysis.'' *See* Disclosure of Market Risk Sensitive Instruments Release.

[889] Non-accelerated filers, a category that includes SRCs, are not subject to the requirements of Item 308(b) (attestation report of the registered public accounting firm). Item 308(b) of Regulation S–K [17 CFR 229.308(b)].

[890] Item 1A, Part I of Form 10–K and Item 1A, Part II of Form 10–Q.

provide the selected financial data for any periods earlier than those for which financial statements were presented in the IPO.[891] EGCs are also not required to provide auditor attestations of ICFR and, accordingly, are not subject to Item 308(b).[892]

The following table summarizes the scaled disclosure accommodations available to EGCs and SRCs for periodic reports as well as certain other filings.[893]

Scaled disclosure requirement	Emerging growth company	Smaller reporting company
Audited Financial Statements Required	• 2 years in a Securities Act registration statement for an IPO of common equity. • 3 years in an IPO of debt securities. • 3 years in an annual report or Exchange Act registration statement, unless the company is also an SRC.	• 2 years.
Description of Business (Item 101)	Standard disclosure requirements apply	• Development of its business during the most recent three years, including: ○ form and year of organization; ○ bankruptcy proceedings; ○ material reclassification, merger, sale or purchase of assets; and ○ description of the business. • Not required: ○ seasonality; ○ working capital practices; ○ backlog; or ○ government contracts. • Names of principal suppliers. • Royalty agreements or labor contracts. • Need for government approval of principal products and services. • Effect of existing or probable governmental regulations.
Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters (Item 201).	Standard disclosure requirements apply	Not required to provide the stock performance graph.
Selected Financial Data (Item 301)	Not required to present selected financial data for any period prior to the earliest audited period presented in initial registration statement.	Not required.
Supplementary Financial Data (Item 302)	Not required until after IPO	Not required.
MD&A (Item 303)	May limit discussion to those years for which audited financial statements are included.	• May limit discussion to those years for which audited financial statements are included. • Not required to comply with contractual obligations table requirements in 303(a)(5).
Quantitative and Qualitative Disclosures about Market Risk (Item 305).	Standard disclosure requirements apply	Not required, but related disclosure may be required in MD&A.
Extended Transition for Complying with New or Revised Accounting Standards.	• May elect to defer compliance with new or revised financial accounting standards until a company that is not an "issuer"[894] is required to comply with such standards. • Any decision to forego the extended transition period is irrevocable.	Standard disclosure requirements apply.
Internal Control over Financial Reporting (Item 308).	• Not required to provide attestation report of the registered public accounting firm. • Not exempt from Item 308(a), but newly public company is not required to comply until it either has filed or has been required to file an annual report for the prior fiscal year.	Non-accelerated filers, a category that includes SRCs, are not required to provide an attestation report of the registered public accounting firm.
Executive Compensation Disclosure (Item 402)	• Permitted to follow requirements for SRCs[895]. • Exempt from principal executive officer pay ratio disclosure.	• 2 years of summary compensation table information, rather than 3. • Limited to principal executive officer, two most highly compensated executive officers and up to two additional individuals no longer serving as executive officers at year end.[896] • Not required: ○ compensation discussion and analysis;

[891] Public Law 112–106, Sec. 102(b), 126 Stat. 306 (2012). Title I of the JOBS Act provided EGCs with a variety of scaled disclosure and other accommodations. These provisions were effective upon enactment of the JOBS Act without rulemaking by the Commission.

[892] *Id.* at Sec. 103 (amending Section 404(b) of the Sarbanes-Oxley Act [Pub. L. 107–204, Sec. 404(b) 116 Stat. 745 (2002)]).

[893] Many of the scaled disclosure accommodations apply to filings other than periodic reports. Some of these filings are identified in the table. Though not within the scope of this release, this information is included here to provide additional context.

Scaled disclosure requirement	Emerging growth company	Smaller reporting company
		○ grants of plan-based awards table; ○ option exercises and stock vested table; ○ change in present value of pension benefits; ○ CEO pay ratio; ○ compensation policies as related to risk management; or ○ pension benefits table. • Description of retirement benefit plans.
Certain Relationships and Related Party Transactions (Item 404).	Standard disclosure requirements apply	• Lower threshold to disclose related party transactions. • Not required to disclose procedures for review, approval or ratification of related party transactions. • Additional requirement to disclose certain controlling entities. • Required to disclose related party transactions not only since the beginning of last fiscal year but also for the preceding fiscal year.[897]
Corporate Governance (Item 407)	Standard disclosure requirements apply	• Not required to disclose whether it has an audit committee financial expert until its second annual report following IPO.[898] • Exempt from requirements to disclose compensation committee interlocks and insider participation and to provide a compensation committee report.[899]
Risk Factors (Item 503(c))	Standard disclosure requirements apply	Not required in periodic reports.[900]
Ratio of Earnings to Fixed Charges (Item 503(d))[901].	Required for same number of years for which it provides selected financial data disclosures[902].	Not required.[903]

a. Comments Received

[894] An ''issuer'' is defined in Section 2(a) of the Sarbanes-Oxley Act to mean an issuer whose securities are registered under Exchange Act Section 12, that is required to file reports under Securities Act Section 15(d), or that has filed a registration statement that has not yet become effective and that it has not withdrawn. Public Law 107–204, Sec. 2(a), 116 Stat. 747 (2002).

[895] Public Law 112–106, Sec. 102(c), 126 Stat. 306 (2012).

[896] Item 402(m)(2) of Regulation S–K [17 CFR 229.402(m)(2)]. Companies that are not SRCs must provide disclosure for the principal executive officer, principal financial officer, three most highly paid executive officers and up to two additional individuals no longer serving as executive officers. Item 402(a)(3) of Regulation S–K [17 CFR 229.402(a)(3)].

[897] Item 404(d) of Regulation S–K [17 CFR 229.404(d)].

[898] Item 407(g)(1) of Regulation S–K [17 CFR 229.407(g)(1)].

[899] Item 407(g)(2) of Regulation S–K [17 CFR 229.407(g)(2)].

[900] Item 1A of Form 10–K [17 CFR 249.310]; Item 1A of Form 10–Q [17 CFR 249.308a]. SRCs also are not required to provide the information required by Item 503(c) of Regulation S–K in Exchange Act registration statements on Form 10 [17 CFR 249.210].

[901] The staff is separately considering Item 503(d) of Regulation S–K in developing recommendations for the Commission for potential changes to update or simplify certain disclosure requirements. For a description of this project, *see* Section I.

[902] *See* Jumpstart Our Business Startups Act Frequently Asked Questions, Generally Applicable Questions on Title I of the JOBS Act, Question 27 (May 3, 2012), *available at https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm.*

S–K Study. One commenter encouraged the Commission not to issue guidance or rules to increase the scope of companies eligible for EGC status or to defer further the application of internal control requirements, such as the requirement to provide an auditor attestation report, for EGCs that outgrow their EGC status.[904]

Two commenters suggested that EGCs should be exempt from Item 305 disclosure.[905] These commenters specified that companies that have not yet reached the revenue or market capitalization thresholds that would disqualify them from EGC status are unlikely to face meaningful market risks. These commenters also recommended eliminating the requirement in Item 101(c) to disclose the amount of backlog orders believed to be firm for EGCs, stating the concept of backlog is not a ''meaningful metric'' for most of these companies. In addition, these commenters noted that the threshold for agreements that are ''immaterial in amount or significance'' in Item 601(b)(10)(ii)(A) is too low for EGCs, because they often enter into agreements with parties that have a five percent or greater ownership of the company.[906]

Disclosure Effectiveness Initiative. One commenter generally supported the concept of scaled disclosure requirements noting that smaller companies face challenges when preparing annual reports.[907] Another commenter expressed concerns with a differential disclosure regime for different sized entities, stating that investors will factor the differences into their price determinations (*i.e.,* they will price the lack of transparency, clarity and comparability in what may be perceived to be lower-quality requirements).[908] One commenter recommended that requirements related exclusively to SRCs should be grouped together under separate headings in Regulation S–K.[909]

b. Discussion

In simplifying disclosure requirements for small businesses, we seek to facilitate capital formation without compromising investor protection. Previous Commission efforts in this area have focused on reducing requirements that impede the formation and growth of small businesses and,

[903] Item 503(e) of Regulation S–K [17 CFR 229.503(e)].

[904] *See* CII.

[905] *See* Silicon Valley; M. Liles.

[906] *Id.*

[907] *See* UK Financial Report Council.

[908] *See* CFA Institute.

[909] *See* Shearman.

given the nature of these smaller companies, the Commission determined are not necessary for the protection of investors.[910]

The disclosure items formerly required by Form S–18 generally were consistent with the corresponding items in Form S–1. However, Form S–18 required less extensive narrative disclosure and simplified financial statements, consistent with Regulation A. Based on input from public hearings and written comments, the Commission sought to require in Form S–18 only the information that normally would be applicable to those small businesses expected to use the form. Accordingly, the Commission reduced or eliminated requirements that it determined were particularly burdensome to small businesses and tended to elicit information that, in the small business context, was less relevant or less beneficial to investors.[911]

For example, Form S–18 did not use the description of business requirement from Regulation S–K. Instead, Form S–18 provided smaller issuers the flexibility to discuss other business-related disclosure, such as their dependence on a limited number of customers or suppliers (including suppliers of raw materials or financing) and cyclicality of their industry, only if it would have ''a material impact upon the registrant's future financial performance.'' [912] In addition, Form S–18 required two years of audited financial statements prepared in accordance with U.S. GAAP,[913] similar in content to those required by Regulation A at the time,[914] as opposed to the more detailed requirements in Form S–1. In adopting Form S–18, the Commission stated its belief that the simplified financial statements and schedules would result in costs savings to registrants while providing investors adequate information about these smaller offerings.[915]

Under Regulation S–B, the narrative disclosure requirements generally paralleled those in Regulation S–K at the time, except that Regulation S–B incorporated the simplified requirements of Form S–18. The financial information required by Regulation S–B was substantially similar to that required by Form S–18, except that Regulation S–B also addressed interim financial statement requirements.[916]

In 2007, the Commission eliminated the separate Regulation S–B disclosure requirements and instead provided scaled disclosure requirements in Regulation S–K and Regulation S–X.[917] For example, new paragraph (h) to Item 101 of Regulation S–K set forth the alternative disclosure standards for smaller companies that had appeared in Item 101 of Regulation S–B.[918] The Commission included an index in Item 10 to identify the Items of Regulation S–K containing scaled disclosure requirements for SRCs.[919]

In response to comment letters and the recommendation of the ACSPC, the Commission revised the requirements in Regulation S–X to require two years of comparative audited balance sheet data for SRCs, rather than the one year previously required by Regulation S–B.[920] The Commission noted that the additional balance sheet data would provide a more meaningful presentation for investors without a significant additional burden on SRCs, because the earlier year data would be readily available for purposes of preparing the otherwise required statements of income, cash flows and changes in stockholders' equity.[921]

Unlike Regulation S–B, which required small business issuers to comply with the entire Regulation S–B disclosure regime, the amendments to Regulation S–K adopted in 2007 permitted SRCs to comply selectively with the scaled disclosure requirements on an item-by-item basis.[922] The Commission intended the amendments to eliminate redundancies and provide a more streamlined disclosure system for SRCs.[923]

In recent years, the Small Business Forum has recommended that the Commission:

- Eliminate or significantly reduce the extent of XBRL tagging requirements for SRCs; and
- permit SRCs to exclude line item-responsive disclosures from their periodic reports if such disclosures are not material.[924]

Similarly, in the last few years, the ACSEC has recommended that the Commission:

- exempt SRCs from XBRL tagging requirements; [925]
- exempt SRCs from filing immaterial attachments to material contracts; [926] and
- when adopting new disclosure rules, consider whether such rules place a disproportionate burden on SRCs in terms of the cost of, and time spent on, compliance with such requirements, and if so, provide for exemptions from or phase-in periods for such new rules for SRCs.[927]

In 2015, the FAST Act directed the Commission to revise Regulation S–K to further scale or eliminate requirements in order to reduce the burden on EGCs, accelerated filers, SRCs, and other smaller issuers, while still providing all material information to investors.[928] Given these recommendations and the recent legislative directive, we are seeking public input on whether we should expand or eliminate any of our scaled disclosure requirements to further ease the compliance burden for smaller registrants and, if so, how we could do so without sacrificing investor protection.

c. Request for Comment

268. Are there any disclosure requirements for which scaling is not appropriate?

269. How should we assess whether scaled disclosures are effective at

[910] *See, e.g.,* Form S–18 Release and Small Business Initiatives Proposing Release.

[911] *See* Form S–18 Release.

[912] Form S–18 Release at 21570; *See also* 1977 Regulation S–K Adopting Release.

[913] Specifically, Form S–18 required: (1) A consolidated balance sheet as of a date within ninety days prior to the date of filing; and (2) consolidated statements of income, source and application of funds, and other stockholders' equity for the two fiscal years prior to the date of filing. *See* Form S–18 Release.

[914] Until 2015, Regulation A required financial statements to be prepared in accordance with U.S. GAAP. In 2015, the Commission revised Regulation A to allow Canadian issuers to prepare their financial statements in accordance with either U.S. GAAP or International Financial Reporting Standards. *See* 2015 Regulation A Release.

[915] *See* Form S–18 Release.

[916] *See* Small Business Initiatives Adopting Release. *See also supra* note 913.

[917] *See* SRC Adopting Release.

[918] Item 101(h) of Regulation S–K [17 CFR 229.101(h)].

[919] Item 10(f) of Regulation S–K [17 CFR 229.10(f)].

[920] *See* SRC Adopting Release.

[921] *See id.*

[922] *Id.* Where a disclosure requirement applicable to SRCs was more stringent than the corresponding requirement for other registrants, SRCs were required to comply with the more stringent standard. The SRC Adopting Release identified Item 404 of Regulation S–K as the only instance where the requirements applicable to SRCs could be more stringent than the larger company standard.

[923] *Id.*

[924] *See, e.g.,* 2014 Forum Report; *Final Report of the 2013 SEC Government-Business Forum on Small Business Capital Formation,* June 2014, *available at http://www.sec.gov/info/smallbus/gbfor32.pdf*; *31st Annual SEC Government-Business Forum on Small Business Capital Formation Final Report,* Nov. 15, 2012, *available at http://www.sec.gov/info/smallbus/gbfor31.pdf.*

[925] *See* 2015 ACSEC Recommendations; *Advisory Committee on Small and Emerging Companies Recommendations Regarding Disclosure and Other Requirements for Smaller Public Companies,* Feb. 1, 2013, (''2013 ACSEC Recommendations''), *available at http://www.sec.gov/info/smallbus/acsec/acsec-recommendation-032113-smaller-public-co-ltr.pdf.*

[926] *See* 2015 ACSEC Recommendations; 2013 ACSEC Recommendations.

[927] *See* 2013 ACSEC Recommendations.

[928] Public Law 114–94, Sec. 72002(1), 129 Stat. 1312 (2015).

achieving the Commission's mission of protecting investors, maintaining fair and orderly markets and facilitating capital formation?

270. Are there disclosure requirements that are particularly beneficial for investors in smaller registrants? For example, are there disclosure requirements that elicit information that is not as readily available outside of smaller registrants' filings although this information might be readily available outside of a filing for larger or more seasoned companies? If so, which requirements and why? Does the information elicited from smaller registrants by these disclosure requirements appropriately consider the costs of these requirements to these smaller registrants?

271. Are there additional item requirements that we should consider scaling for SRCs? Are there any current scaled disclosure requirements that we should scale further or eliminate entirely?

272. Should we allow EGCs to take advantage of the scaled disclosure requirements currently available only to SRCs, such as the less extensive requirements for the description of business set forth in Item 101(h) of Regulation S–K or the elimination of the contractual obligations table available under Item 303(d) of Regulation S–K?

273. Should we reorganize Regulation S–K, as recommended by one commenter,[929] to group the requirements related exclusively to SRCs together under separate headings? Why or why not?

274. Should we eliminate or reduce the XBRL tagging requirements for SRCs? What, if any, XBRL tagging should we require of SRCs?

275. Should we permit SRCs to exclude disclosure that would be responsive to specific items in Regulation S–K from their periodic reports if such disclosures are not material? Should we permit SRCs to omit all such disclosure or should we limit this accommodation to specific items in Regulation S–K?

276. What types of investors or audiences would be affected by further scaling? How?

277. Do our scaled disclosure requirements appropriately consider the costs and benefits of these requirements to smaller registrants and investors in these registrants? What savings (or costs avoided) for registrants, including the administrative and compliance costs of preparing and disseminating disclosure, would likely arise from scaling additional item requirements? Please provide quantifications of savings and costs avoided where possible.

3. Frequency of Interim Reporting

The federal securities laws have required registrants to provide annual reports since 1934.[930] In 1955, the Commission adopted rules requiring registrants to file semi-annual reports on Form 9–K.[931] In the proposing release for Form 9–K, the Commission stated that ''consideration should be given to requiring reports of certain significant information more frequently than annually.'' [932] Investors and the securities industry supported the semi-annual reporting proposal, while registrants opposed it.[933]

The Commission has required quarterly reporting since 1970, when it adopted Form 10–Q to replace the semi-annual report on Form 9–K.[934] However, prior to adopting Form 10–Q, more than seventy percent of public companies produced quarterly reports, partially in response to exchange listing standards.[935] As adopted in 1970, Form 10–Q required summarized financial information and profit and loss information in more detail than was required by Form 9–K, including data on earnings per common share. In addition, information on a registrant's capitalization and stockholders' equity was also required.[936]

In 1981, in connection with its integrated disclosure initiatives, the Commission revised Form 10–Q to ''build upon the annual reporting system to ensure meaningful disclosure on a continuous basis by making quarterly reporting a mechanism to update the annual report.'' [937] The amendments were intended to complement the previously adopted revisions relating to annual reporting, and included the addition of management's discussion and analysis of interim financial information.[938] Other significant additions to Form 10–Q over time have included quantitative and qualitative disclosures about market risk,[939] disclosure controls and procedures,[940] and risk factors.[941]

a. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. One commenter suggested that semiannual financial reporting may be sufficient for SRCs that are not listed on a national exchange, noting that scaling the requirement in this way would align the treatment of SRCs with that of comparable companies that are now

[929] *See* Shearman.

[930] As enacted, Section 13 of the Exchange Act required listed companies to furnish annual reports, and if the Commission required, quarterly reports. John Hanna, *The Securities Exchange Act as Supplementary of the Securities Act,* 4 Law & Contemp. Probs. 256, 256–268 (1937). Exchange Act reporting requirements were extended to non-listed registrants with the enactment of Section 12 of the Exchange Act in 1964. *See supra* note 14.

[931] *See* Semi-Annual Reports, Release No. 34–5189 (June 23, 1955) [20 FR 4816 (July 7, 1955)]. The Form 9–K was filed once a year, 45 days after the end of the first half the registrant's fiscal year. The semi-annual report required disclosure with respect to sales and gross revenues, net income before and after taxes, extraordinary and special items, and charges and credits to earned surplus. Form 9–K did not require formal statements of profit and loss or earned surplus and was not required to be certified.

[932] Notice of Proposed Rule Making, Semi-Annual Reports, Release No. 34–5129 (Jan. 27, 1955) [20 FR 771 (Feb. 4, 1955)] at 772.

[933] *See* Philip Augar, *For Markets There is Such a Thing as Too Much Information,* Financial Times, Feb. 1, 2015 (''Augar'').

[934] *See* Quarterly Reporting Form, Release No. 34–9004 (Oct. 28, 1970) [35 FR 17537 (Nov. 14, 1970)] (''Form 10–Q Adopting Release''). Form 10–Q was adopted in response to the Wheat Report. *See* Wheat Report at 357–58 (''More and more publicly-held corporations are releasing condensed quarterly financial information. Both the New York and American Stock Exchanges require publication of such information by all listed companies, although the standards which they set for such information are minimal . . . The Study carefully examined a significant sample of quarterly financial reports and releases provided by the two exchanges. It was readily apparent . . . that they varied from extremely useful to extremely poor and uninformative . . . It was concluded that a useful advance in disclosure policy could be achieved by developing standards for quarterly financial reporting.'').

[935] *See* Arthur Kraft et al., *Real Effects of Frequent Financial Reporting* (Cass Business School, City University London, Working Paper Series No. 26, Aug. 2014) at 2 (''Kraft et al.''). *See also* Marty Butler et al., *The effect of reporting frequency on the timeliness of earnings: The cases of voluntary and mandatory interim reports,* 43 J. Acct. Econ. 181, 185 (2007).

The New York Stock Exchange began requiring annual reports in 1914, and by 1923, over twenty-five percent of NYSE-listed companies were publishing quarterly reports with another eight percent publishing semi-annual reports. By 1933, over sixty percent of NYSE-listed companies were publishing quarterly reports and twelve percent published semi-annual reports. *See* James E. Davis, *Corporate Disclosure through the Stock Exchanges,* Apr. 24, 1999 (unpublished paper) (on file with Harvard Law School and *available at http://cyber.law.harvard.edu/rfi/papers/disclose.pdf).*

The Form 10–Q proposing release also noted that ''[m]any publicly held companies are releasing condensed quarterly financial information, and the major stock exchange[s] require publication of such information by listed companies.'' Form 10–Q For Disclosure of Financial Information, Release No. 34–8683 (Sept. 1969) [34 FR 14239 (Sept. 10, 1969)].

[936] *See* Form 10–Q Adopting Release.

[937] *See* New Interim Financial Information Provisions and Revision of Form 10–Q for Quarterly Reporting, Release No. 33–6288 (Feb. 9, 1981) [46 FR 12480 (Feb. 17, 1981)] (''New Interim Financial Information Release'') at 12481.

[938] *Id.*

[939] *See* Disclosure of Market Risk Sensitive Instruments Release.

[940] *See* Certification of Disclosure in Companies' Quarterly and Annual Reports, Release No. 33–8124 (Aug. 29, 2002) [67 FR 57276 (Sept. 9, 2002)].

[941] *See* Securities Offering Reform Release.

able to rely on the exemption under Regulation A.[942]

b. Discussion

The Commission adopted quarterly reporting with the purpose of ensuring meaningful disclosure to investors on a continuous basis.[943] The Wheat Report concluded that one of the principal omissions in the Exchange Act reporting system was the absence of a quarterly summary of basic financial information prepared using reasonably specific standards.[944] The Wheat Report also concluded that ''a regular, quarterly report would be more useful than the current reports on Form 8–K, which were filed irregularly.'' [945] Accordingly, quarterly reports were intended to provide a mechanism to update the information in an annual report on Form 10–K in a more consistent manner and on a regular basis.

The value of quarterly financial reporting has been the subject of debate.[946] Opponents of quarterly reporting argue that frequent financial reporting may lead management to focus on short-term results to meet or beat earnings targets rather than on long-term strategies.[947] Consequently, some have argued that quarterly reports should be discontinued [948] or made voluntary [949] in the United States.[950]

On the other hand, some advocates of frequent reporting, typically on a quarterly basis, point out that greater frequency improves the timeliness of earnings and reduces information asymmetry between managers and investors.[951] Others are skeptical of the benefits of eliminating quarterly reporting requirements.[952] According to one survey of institutional investors, fifty-eight percent of investors preferred to receive information on a quarterly basis to confirm or reframe expectations.[953] Some advocates have expressed concern that eliminating quarterly reporting requirements would result in inconsistent reporting intervals across registrants and potentially, from period to period.[954] Meanwhile, others argue that delaying a report by a few months would not fix the problems of short-termism.[955]

The value of quarterly reporting may vary by industry or by the size of the registrant. For example, investors in smaller, capital-intensive technology companies may focus more on significant business or technology developments than on quarterly financial reports.[956] Similarly, the costs of more frequent reporting may impose a disproportionate burden on smaller or less capitalized registrants.[957] At the same time, smaller registrants may be more volatile and quarterly reporting may provide more timely disclosure of performance issues.[958] Additionally, because smaller, capital-intensive companies may need greater or more frequent access to capital markets, more frequent reporting may provide greater investor confidence and a lower cost of capital for these companies.[959]

c. Request for Comment

278. Do investors, registrants and the markets benefit from quarterly reporting? What are the benefits and costs to investors, registrants and the markets from the current system of quarterly reporting? Should we revise or eliminate our rules requiring quarterly reporting? Why or why not?

279. Should the reporting requirements be different for different types of registrants? Should we consider permitting SRCs to file periodic reports on a less frequent basis, such as semi-annually? If so, what disclosures should we require in those reports?

280. Should we allow other categories of registrants to file periodic reports on a less frequent basis, such as semi-annually? If so, which categories of registrants should be permitted to file less frequently, and what disclosure should be required?

281. Should we require certain registrants to file periodic reports on a more frequent basis such as monthly?

282. Should we consider reducing the level of disclosure required in the quarterly reports for the first and third quarters? If so, what disclosure should we require in these abbreviated quarterly reports? Should the disclosure requirements for SRCs be the same as those that apply to other categories of registrants?

283. Do quarterly reporting obligations influence the strategic goals and timelines of registrants' management? Do quarterly reporting

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[942] *See* Ernst & Young 2.

[943] *See* New Interim Financial Information Release.

[944] *See* Wheat Report at 332–334.

[945] *See id.* at 332.

[946] The debate over quarterly reporting sometimes includes concerns of ''short-termism.'' The discussion here is not intended to capture all aspects of, or issues raised in, the short-termism debate.

For a list of recent publications on short-termism, *see* Therese Strand, *Re-Thinking Short-Termism and the Role of Patient Capital in Europe: Perspectives on the New Shareholder Rights Directive,* 22 Colum. J. Eur. L. 1, footnote 26 (2015) at footnote 26.

[947] *See* Kraft et al.

[948] *See* Martin Lipton, *Legal & General Calls for End to Quarterly Reporting,* Aug. 19, 2015, *available at http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.24734.15.pdf.* The author suggests that the Commission should consider the UK's move toward discontinuing quarterly reporting in pursuing disclosure reform initiatives. He notes that Legal & General Investment Management, a global investment firm with more than £700 billion in assets under its management, contacted the boards of London Stock Exchange's 350 largest companies to support the discontinuation of quarterly reporting. According to the author, Legal & General emphasized that short-term reporting ''is not necessarily conducive to building a sustainable business'' and ''adds little value for companies that are operating in long-term business cycles.'' *See also* David Benoit, *Time to End Quarterly Reports, Law Firm Says,* The Wall Street Journal, Aug. 19, 2015, *available at; http://www.wsj.com/articles/time-to-end-quarterly-reports-law-firm-says-1440025715.*

[949] *See* Augar.

[950] Other jurisdictions have eliminated quarterly reporting. For example, in the European Union, the requirement for issuers traded on a regulated market to publish financial information more frequently than annual financial reports and semi-annual reports was abolished in 2013. *See* Directive 2013/50/EU of the European Parliament and of the Council, Oct. 22, 2013, *available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013L0050.* Following implementation, E.U. member states generally will require only annual and semi-annual reports. However, an E.U. member state may require issuers to publish additional periodic financial information if the requirement does not constitute a significant financial burden and if the required information is proportionate to the factors that contribute to investment decisions. *Id.*

[951] *See* Kraft et al.

[952] *See* Ronald Barusch, *Dealpolitik: Attention CFOs—Don't Get Your Hopes Up for an End to Quarterly Reporting,* The Wall Street Journal Blog, Aug. 20, 2015 (''Barusch''), *available at http://blogs.wsj.com/moneybeat/2015/08/20/dealpolitik-attention-cfos-dont-get-your-hopes-up-for-an-end-to-quarterly-reporting* (''Eliminating quarterly reporting won't make investors any less interested in quarterly results. Analysts and professional investors will do their best to figure out what the quarterly would have shown even if companies don't disclose it themselves.'').

[953] *See* Ernst & Young, *Right team, right story, right price,* (2013), *available at http://www.ey.com/Publication/vwLUAssets/Investment_appetite_up_for_IPOs_among_institutional_investors/$FILE/Institutional_Investor_Survey.pdf.*

[954] *See, e.g.,* Barusch (expressing concerns that eliminating the quarterly report requirement could allow public companies to ''provide just what they want the public to know in whatever intervals they choose,'' whereas the ''current rules require quarterly GAAP-compliant financial information in a standard format'').

[955] *See* Barry Ritholtz, *Wrong Fix for Short-Term Corporate Thinking,* Bloomberg, Aug. 20, 2015, *available at http://www.bloombergview.com/articles/2015–08–20/wrong-fix-for-short-term-corporate-thinking*; and Mark J. Roe, *The Imaginary Problem of Corporate Short-Termism,* The Wall Street Journal, Aug. 17, 2015, *available at www.wsj.com/articles/the-imaginary-problem-of-corporate-short-termism-1439853276.*

[956] *See* Transcript, Meeting of SEC Advisory Committee on Small and Emerging Companies (Sept. 23, 2015) at 64–65 (noting that some biotechnology companies may not trade on their financial quarterly reporting but rather, may trade on their fundamental clinical development and regulatory events). The ACSEC discussed issues raised by quarterly reporting for small and emerging companies at its September 2015 meeting but did not issue formal recommendations. *See id.*

[957] *See id.* at 60–61.

[958] *See id.* at 74.

[959] *See id.* at 87–90.

obligations help or hinder long-term decision making by registrants?

284. What types of investors or audiences are most likely to value the information that registrants disclose in quarterly reports?

285. What are the savings (or costs avoided) for registrants, including the administrative and compliance costs of preparing and disseminating disclosure, that would likely arise from revising or eliminating our rules requiring quarterly reporting? Please provide quantifications of savings and costs avoided where possible.

V. Presentation and Delivery of Important Information

Given the volume, complexity and sophistication of corporate disclosures, the presentation and delivery of information may play a significant role in investors' ability to access and use important disclosure. The Commission's own disclosure system creates some fragmentation of information, in both location and time. Registrants provide disclosure on Forms 10–K, 10–Q, and 8–K, which are filed on EDGAR. Registrants also can provide broad, non-exclusionary distribution of information under Regulation FD either on Form 8–K or through press releases, conference calls, or Web sites.[960] In addition, registrants may use tools such as cross-referencing and incorporation by reference to reduce repetitive disclosure and present more streamlined information in each filing. As different investors and third parties likely use disclosures in different ways, the benefits of different presentation and delivery approaches may vary.

The S–K Study recommended that the staff consider ways to present information that would improve the readability and navigability of disclosure. It also recommended that the staff explore methods to discourage repetition and disclosure of immaterial information.[961] Additionally, the FAST Act requires the Commission to issue regulations permitting registrants to submit a summary page in their Form 10–K only if each item on the summary page includes a cross-reference (by electronic link or otherwise) from each item in the summary to the related material in the Form 10–K.[962]

In light of the S–K Study's recommendations and the recent FAST Act mandate, we are seeking public input on how our rules can facilitate the readability and navigability of disclosure documents. We are seeking public input on the use of tools such as cross-referencing, incorporation by reference, hyperlinks and registrant Web sites as well as other ways we could change our disclosure requirements to improve the readability and navigability of registrant filings.[963] Given the various types of filings and other delivery methods available to registrants, we also are seeking input on where information should be provided directly and in full, and where references to the location of the information may suffice. Additionally, we are interested in whether any required disclosures would be more effective if we required registrants to present them in a specified format, such as a tabular or graphic presentation, to layer the disclosures by means of a summary or overview, or to provide certain information as structured data.

A. Cross-Referencing

In lieu of presenting duplicative disclosure, our rules generally permit registrants to cross-reference to information in one section of a document to satisfy a disclosure requirement in another section of the document. Several items in Regulation S–K specify that a company may include in its financial statements or related notes a cross-reference to certain information in the non-financial statement disclosure or, conversely, a company may cross-reference from the disclosure to the financial statements or notes thereto.[964] In addition to allowing for cross-referencing, Item 303(a)(4) of Regulation S–K requires that the substance of the cross-referenced information be integrated into the discussion to help inform readers of the significance of the information that is omitted from MD&A.[965]

1. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. Many commenters provided recommendations supporting the use of cross-referencing.[966] A few of these commenters recommended clear and precise cross-references to help investors locate important information in the current volume of disclosure.[967] Several supported greater use of cross-referencing to eliminate redundancies.[968] One of these commenters supported the use of cross-referencing where appropriate to eliminate duplicative information but suggested that any referenced document should be considered ''filed with the SEC'' for legal and liability purposes.[969] One of these commenters supported cross-referencing so long as the level of auditor assurance was not diminished.[970] This same commenter noted that many sections within Commission filings are meant to touch on the same topic but from a different perspective and encouraged the Commission to consider not whether those sections should be eliminated, but whether they should be tailored to meet the original disclosure objective.

Some commenters suggested that the Commission require or encourage the use of cross-references within filings.[971] One of these commenters recommended a new Commission policy on the avoidance of duplication and the use of cross-references.[972] This commenter recommended adding instructions to specific Regulation S–K items to encourage the use of cross-references to avoid duplicative disclosure.[973] This commenter also recommended that the inclusion of responsive disclosure anywhere in a document should be sufficient to satisfy the disclosure requirement without the need to include

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[960] *See* Selective Disclosure and Insider Trading, Release No. 33–7881 (Aug. 15, 2000) [65 FR 51716 (Aug. 24, 2000)] (''Regulation FD Release'').

[961] *See* S–K Study at 98–99.

[962] Public Law 114–94, Sec. 72001, 129 Stat. 1312 (2015).

[963] Some of the concepts raised in this section, such as incorporation by reference to Securities Act filings, may include filings outside of the scope of this release.

[964] *See, e.g.,* Items 101(b) and (d)(2), 202(a)(5), and Instruction 5 to Item 303(a)(4) of Regulation S–K [17 CFR 229.101(b) and (d)(2), 17 CFR 229.202(a)(5), and 17 CFR 229.303(a)(4)]. For a discussion of circumstances where cross-referencing would not be permissible or appropriate, *see* Section V.A.2.c.

[965] Instruction 5 to Item 303(a)(4) of Regulation S–K [17 CFR229.303(a)(4)].

[966] *See, e.g.,* letter from Thomas Amy (June 5, 2014) (''T. Amy''); CCMC; SCSGP; CFA Institute; Shearman; ABA 2; letter from William J. Klein and Thomas J. Amy (Dec. 12, 2014) (''Klein and Amy 1''); letter from William J. Klein and Thomas J. Amy (Aug. 31, 2015) (''Klein and Amy 4''); AFL–CIO.

[967] *See, e.g.,* T. Amy; Klein and Amy 1; Klein and Amy 4.

[968] *See, e.g.,* ABA 2; CCMC; CFA Institute; Shearman.

[969] *See* AFL–CIO.

[970] *See* CFA Institute.

[971] *See, e.g.,* Klein and Amy 1 (recommending that the Commission consider requiring that filers: (1) Make specific cross-references between the line items on their financial statements and the related notes, including the page where the note may be found; and (2) include a detailed table of contents or index for the notes, which would increase the transparency of financial information and make it easier to read and understand); Klein and Amy 4 (reiterating their previous recommendations and recommending that the Commission consider requiring that filers provide specific cross-references between all discussions of Legal Proceedings that appear in different sections of the report and in the notes to the financial statements); ABA 2; Shearman.

[972] *See* ABA 2.

[973] *See id.* (recommending amendments to Items 101(c)(ix) and 303(a)(1), (4) and (5) to state that ''cross-references should be used to avoid duplicative disclosure'').

a cross-reference in each item calling for the information.[974]

2. Discussion

We recognize that an investor may find it easier to access all relevant information in a single location, even if a portion of the information is repeated elsewhere in the document. However, repetitive disclosure may obscure relevant information or render it difficult to evaluate the importance of the information. Below, we consider ways in which cross-references could potentially be used to reduce redundant disclosure and improve the navigability of lengthy documents.

a. Cross-References to Reduce Repetitive Disclosure

Where different disclosure requirements call for the same information in separate parts of the same document, as discussed above, our rules generally allow the registrant to cross-reference to the applicable discussion in another part of the document rather than duplicating the disclosure.[975] In some instances, Regulation S–K and U.S. GAAP requirements call for similar but not identical disclosures.[976] A registrant, subject to certain conditions, may present all the information required by both requirements in one location, with the second location simply containing a cross-reference back to the first location.[977] In this way, the related disclosures may be logically presented together and both requirements met in their separate locations within the filing while avoiding duplicative or partially duplicative disclosure.

In seeking input on how registrants can most effectively present and deliver important information, we recognize that information may be relevant to more than one filing or more than one section of a given filing. Registrants often repeat information in response to different item requirements in Form 10–K. For example, disclosure about the registrant's business appears in the Business section, and parts of that disclosure may be repeated in MD&A, risk factors, and the footnotes to the financial statements. Repetition of this information may be beneficial in certain contexts, such as a registrant with a complex organizational structure or business model. Repetition also may provide users of disclosure with direct access to the information they need in a consistent location, particularly to the extent that different audiences for disclosure focus on different filings or sections of filings. In other instances, such repetition can be distracting.

i. Request for Comment

286. Do investors find that cross-referencing within a filing in lieu of repeating the disclosure helps them locate important information? Why or why not?

287. Are there specific items in Regulation S–K that would benefit from greater use of cross-referencing to reduce duplicative disclosure? If so, which items? For these specific items, should we amend the item to specifically encourage use of cross-references? Alternatively, and as suggested by a commenter,[978] should we amend these items to meet the original disclosure objective more effectively?

288. Does cross-referencing negatively affect investors' ability to use disclosure by creating inconsistency in the location of information across different registrants and different filings? To what extent does cross-referencing introduce challenges with respect to comparative analyses or large-scale automated processing of disclosure?

289. Should we require registrants to provide certain disclosures in the same location (*e.g.,* under a specific item of the form) in every filing, rather than permitting cross-referencing? If so, which information should be located consistently and where should that information be located?

290. To what extent does the flexibility to use cross-references reduce compliance and administrative costs to registrants of preparing and disseminating disclosures? Please provide quantifications if possible.

b. Cross-References To Navigate Disclosure

Cross-references can also assist readers in navigating disclosure where disclosures are not necessarily duplicative but relate to the same topic and may be required in multiple locations throughout a filing.[979] For example, a discussion in the business section about how a registrant generates revenue may benefit from a cross-reference to the registrant's revenue recognition policy. Similarly, a risk factor that the registrant may not be able to meet payments on its outstanding debt may benefit from a reference to the debt footnote in the financial statements. Including these cross-references may help readers obtain a more complete picture by directing them to other similar information that the reader may not have otherwise reviewed. In addition, where registrants include a summary or overview of their filing or part of their filing, as contemplated by the FAST Act,[980] cross-references can assist the reader in locating the more detailed disclosure included elsewhere in the filing.[981]

i. Request for Comment

291. Are there certain items or topics that would benefit from a cross-reference to related or more comprehensive disclosure in different parts of the filing? If so, what are those items or topics?

292. Do cross-references that identify related information make the disclosure more or less readable?

c. Limitations on Cross-Referencing

Registrants' ability to use cross-references is not unlimited, as the

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[974] *See id.* The one exception recommended was for the financial statements and notes to the financial statements, where cross-references should not be used to satisfy U.S. GAAP requirements. However, where the financial statements and notes to the financial statements include disclosure that is responsive to Regulation S–K items, the commenter recommended that the rules allow an appropriate cross-reference to the relevant financial statement disclosure to satisfy the requirement.

[975] *See* Section V.A.

In the Securities Act context, Commission staff has discouraged registrants from repeating disclosure in multiple places in a prospectus, instead encouraging the inclusion of a brief overview to provide context in one section along with a cross-reference to more detailed discussion elsewhere. *See also* Updated Staff Legal Bulletin No. 7. In addition, Securities Act Rule 421(b), amended at the same time as our Plain English Rules, discourages repeating disclosure in more than one location that lengthens the filing without enhancing the quality of the information. *See* Note 4 to Rule 421(b) [17 CFR 230.421(b)]; Plain English Disclosure Adopting Release.

[976] *See, e.g.,* Item 103 of Regulation S–K (Legal proceedings) [17 CFR 229.103] and ASC Topic 450 (Contingencies); Item 404 of Regulation S–K (Transactions with related persons, promoters and certain control persons) [17 CFR 229.404] and ASC Topic 850 (Related Party Disclosures). The staff is separately considering Item 103 in developing recommendations for potential changes to update or simplify the requirements. For a description of these recommendations, *see* Section I.

[977] In some instances, a cross-reference is effectively prohibited because it would be inconsistent with the disclosure requirement. For example, the table of contractual obligations calls for aggregated information in a single location. A registrant could not satisfy the requirement to provide the data required in the table of contractual obligations with a cross-reference in MD&A to multiple financial statement footnotes. *See* Item 303(a)(5) of Regulation S–K [17 CFR 229.303(a)(5)]; and Off-Balance Sheet and Contractual Obligations Adopting Release.

[978] *See* CFA Institute.

[979] For a discussion of hyperlinks, *see* Section V.C.

[980] Public Law 114–94, Sec. 72001, 129 Stat. 1312 (2015).

[981] *See, e.g.,* H.R. Rep. 114–279, 114th Cong., 1st Sess. 4 (2015) (stating ''[b]ecause the typical 10–K . . . is hundreds of pages long, investors find it difficult to locate important information'' and that ''a summary page would enable companies to concisely disclose pertinent information . . . [and] would also enable investors to more easily access the most relevant information about a company''). For a discussion of layered disclosure, *see* Section V.F.

Commission has discouraged cross-references that render disclosure unclear or incomplete. It also has acknowledged that vague or excessive cross-references can hinder the reader's ability to locate and understand information.[982] Moreover, even specific cross-references may draw the reader away from key information.[983]

While none of our rules prohibit the use of cross-references, there may be instances where cross-references would not satisfy the requirements or would detract from the readability or completeness of the disclosure. For example, the Commission has stated that its MD&A rules are intended to provide, in one section of a filing, a discussion of all the material impacts on the registrant's financial condition or results of operations, including those arising from circumstances discussed elsewhere in the filing.[984]

Cross-referencing is contemplated under auditing standards.[985] However, some auditors have expressed concern that cross-referencing from the financial statements to MD&A may confuse users on the auditor's responsibilities and what information the auditor's report covers.[986] Others have stated that the financial statements and the related notes should stand on their own so they can be audited or reviewed, as applicable.[987]

In addition, the financial statements are not covered by the PSLRA safe harbor from liability for forward-looking statements. The PSLRA does, however, cover MD&A disclosures.[988] While nothing prohibits cross-referencing between the financial statements and, for example, MD&A, forward-looking statements pulled from MD&A into the financial statements could ''lose'' their PSLRA safe harbor. Accordingly, preparers concerned about forward-looking information may have a disincentive to include a cross-reference in the financial statements to forward-looking information elsewhere in the document out of concern that doing so would effectively pull the statements into the financial statements and expose the registrant to liability without the protection of the PSLRA for such statements.[989]

i. Request for Comment

293. Are there items or topics where cross-references detract from the readability of a filing? Are there items or topics where we should prohibit cross-references and require all related information be presented in a single location? What are these items or topics?

294. Some of the Commission's guidance limiting the use of cross-referencing pre-date the expanded use of technology that allows registrants to hyperlink to referenced disclosure.[990] In light of technological changes that allow hyperlinks, which we discuss below, should we reconsider those rules that seek to provide investors with information in a single location?

295. Should we introduce requirements or guidance for the use of cross-references in order to increase the consistency in location of information across periods and registrants? If so, what requirements or guidance should we consider?

B. Incorporation by Reference

Rule 12b–23 of the Exchange Act generally allows a registrant to incorporate by reference information in any part of a registration statement or report in answer, or partial answer, to any other item of a registration statement or report.[991] In Form 10–K, registrants may incorporate by reference the information called for by Parts I and II [992] of Form 10–K from the company's annual report to security holders. Registrants also may incorporate by reference the information required by Part III of Form 10–K from the registrant's definitive proxy statement or information statement, as applicable.[993] The staff has provided interpretive guidance on Rule 12b–23, stating that within the guidelines specified by the rule, a registrant may incorporate by reference into its own Exchange Act documents any information contained in the filed documents of another issuer.[994]

Rule 12b–23 provides that where material is incorporated by reference:

- The material must be clearly identified by page, paragraph, and caption or otherwise;
- the filing must state that the specified matter is incorporated by

[982] *See* Plain English Disclosure, Release No. 33–7380 (Jan. 14, 1997) [62 FR 3152 (Jan. 21, 1997)].

[983] *See* U.S. Securities and Exchange Commission, Office of Investor Education and Assistance. *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (1998), *available at https://www.sec.gov/pdf/handbook.pdf.*

[984] *See* 1989 MD&A Interpretive Release. This guidance predated the use of hyperlinking technology. For a discussion of the limitations on hyperlinks to related materials, *see* Section V.C.

[985] AU 508, Paragraph 41 provides: Inadequate disclosure. Information essential for a fair presentation in conformity with generally accepted accounting principles should be set forth in the financial statements (which include the related notes). *When such information is set forth elsewhere in a report to shareholders, or in a prospectus, proxy statement, or other similar report, it should be referred to in the financial statements.* [Emphasis added]

[986] *See, e.g.,* letter from PricewaterhouseCoopers LLP to FASB, Nov. 29, 2012, *available at http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175825243422&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=621509&blobheadervalue1=filename%3DDISFR.DP.0029.PRICEWATERHOUSECOOPERS_LLP.pdf&blobcol=urldata&blobtable=MungoBlobs* (recommending that notes not cross-reference to MD&A as it will not be clear what the audit report covers).

[987] *See, e.g.,* Financial Accounting Standards Board and Center for Audit Quality, *Financial Statement Disclosure Effectiveness: Forum Observations Summary,* Oct. 2012, *available at http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176160567809* (''FASB/CAQ Forum'') (noting that some participants opposed cross-referencing as a tool to address disclosure overlap between MD&A and notes to financial statements due to concerns related to audit responsibility or because they felt that MD&A and the notes should each stand on their own); letter from PricewaterhouseCoopers LLP to FASB, July 10, 2014, *available at http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=2014-200* (expressing concern that disclosures presented outside the audited financial statements prepared in accordance with U.S. GAAP may not be subject to the same degree of scrutiny and assurance). *See also* ABA 2 (recommending a policy encouraging cross-referencing, except in the financial statements and notes to the financial statements, which should be considered a standalone section).

[988] 15 U.S.C. 78u–5. *See also* Off-Balance Sheet and Contractual Obligations Adopting Release.

[989] *See e.g.,* FASB/CAQ Forum.

[990] *See supra* note 984.

[991] Exchange Act Rule 12b–23 [17 CFR 240.12b–23]. In addition, Item 10(d) of Regulation S–K provides that where rules, regulations, or instructions to forms permit incorporation by reference, information may be incorporated by reference to the specific document and to the prior filing or submission containing the information. 17 CFR 229.10(d).

[992] Subject to some scaled disclosure requirements discussed in Section IV.H above, Parts I and II of Form 10–K generally require the following information:

Part I: Business, Risk Factors, Unresolved Staff Comments, Properties, Legal Proceedings, and Mine Safety Disclosures.

Part II: Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, Selected Financial Data, MD&A, Quantitative and Qualitative Disclosures about Market Risk, Financial Statements and Supplementary Data, Changes in and Disagreements with Accountants on Accounting and Financial Disclosure, Controls and Procedures, and Other Information.

[993] Subject to some scaled disclosure requirements discussed in Section IV.H, Part III of Form 10–K generally requires the following information: Directors, Executive Officers and Corporate Governance; Executive Compensation; Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters; Certain Relationships and Related Transactions and Director Independence; and Principal Accounting Fees and Services.

To incorporate Part III information into the Form 10–K, the proxy statement or information statement must be filed not later than 120 days after the end of the fiscal year covered by the Form 10–K *See* General Instruction G(3) to Form 10–K.

[994] *See* Exchange Act Rules Compliance and Disclosure Interpretations Question 134.01, *available at http://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.htm.*

reference at the particular place in the report where the information is required; and

• except in certain circumstances, a copy of any information incorporated by reference or the pertinent pages of the document containing such information must be filed as an exhibit to the report where it is incorporated by reference.[995]

For exhibits, Rule 12b–32 allows any document or part thereof filed with the Commission to be incorporated by reference as an exhibit to any report filed with the Commission by the registrant or any other person.[996] Registrants regularly satisfy exhibit filing requirements by relying on Rule 12b–32 to incorporate exhibits by reference to previously filed reports or registration statements.[997] Rule 12b–32 also allows a registrant to meet the exhibit filing requirement of Rule 12b–23(a)(3) by incorporating by reference as an exhibit the document or portion of the document containing the information incorporated by reference under that rule.[998]

1. Comments Received

S–K Study. None.

Disclosure Effectiveness. One commenter suggested that the Commission encourage the use of incorporation by reference by revising Rule 12b–23(a)(3) to eliminate the requirement that copies of the pertinent pages containing incorporated disclosure be filed as an exhibit and ease the navigability of filings by requiring incorporated disclosure to be made accessible via hyperlink in the filed document.[999] Another commenter stated that many registrants fail to provide the page, paragraph, citation or other information required by Rule 12b–23(b), rendering the references less helpful.[1000]

2. Discussion

The Commission has a long history of permitting incorporation by reference.[1001] Incorporation by reference was a key component of Form S–3, introduced as part of the integrated disclosure system, based on the efficient market theory.[1002] The Commission envisioned that its integrated disclosure system would eliminate duplicative disclosure by allowing registrants to incorporate by reference information filed in Exchange Act reports into Securities Act registration statements.[1003] The Commission also acknowledged that incorporation by reference has limitations, as there is no assurance that the mere reference to incorporated information will be meaningful to an investor or potential investor.[1004]

The Commission initially limited eligibility to incorporate by reference in registration statements to seasoned, exchange-traded companies based on the likelihood that the information in the incorporated filings has been thoroughly analyzed and reflected in the price or rating of the securities offered. For these types of registrants, the Commission concluded that the cost savings to registrants of not having to repeat or refile information disclosed elsewhere outweighed the risk to investors that the stock price does not reflect the omitted information.[1005]

The integrated disclosure system also gave rise to the current structure of Form 10–K that allows registrants to incorporate Parts I and II from the annual report to shareholders and Part III from the definitive proxy statement.[1006] For periodic reports, registrants regularly incorporate by reference the information required by Part III of Form 10–K from their definitive proxy statements. Fewer registrants incorporate Parts I and II of Form 10–K from their annual reports to shareholders.[1007] This likely is because many companies have eliminated their separate annual report to shareholders and instead use Form 10–K to satisfy their Rule 14a–3 requirements.[1008] For exhibits, registrants often incorporate by reference exhibits from prior filings into their periodic reports.

Advancements in technology support greater use of incorporation by reference. In Securities Offering Reform, the Commission expanded the use of incorporation by reference conditioned on the registrant making its incorporated Exchange Act reports and other materials readily accessible on a Web site maintained by or for the

[995] Exchange Act Rule 12b–23 [17 CFR 240.12b–23]. Rule 12b–23(a)(3) provides that the following need not be filed as an exhibit: A proxy or information statement incorporated by reference in response to Part III of Form 10–K; a form of prospectus filed pursuant to 17 CFR 230.424(b) incorporated by reference in response to Item 1 of Form 8–A; and information filed on Form 8–K.

[996] Rule 12b–32 [17 CFR 240.12b–32].

[997] Item 601(a) of Regulation S–K [17 CFR 229.601(a)].

[998] Rule 12b–23 [17 CFR 240.12b–23(a)(3)].

[999] *See* ABA 2.

[1000] *See* Klein and Amy 1; Klein and Amy 4.

[1001] *See* Release No. 34–51 (Nov. 27, 1934) [*not published in the* **Federal Register**] (adopting the first Exchange Act rule, JB4, allowing registrants to incorporate by reference as an exhibit any document previously or concurrently filed with the Commission under the Exchange Act); *see also* Registration and Reporting Rules and Rules of General Application [13 FR 9321 (Dec. 31, 1948)] and 1948 Adoption of Amendments to General Rules and Regulations Release (adopting early versions of Rules 12b–23 and 12b–32).

[1002] *See* 1982 Integrated Disclosure Adopting Release at 11382 (stating that ''Form S–3, in reliance on the efficient market theory, allows maximum use of incorporation by reference of Exchange Act reports and requires the least disclosure to be presented in the prospectus and delivered to investors'' and that ''[g]enerally, the Form S–3 prospectus will present the same transaction-specific information as will be presented in a Form S–1 . . . The prospectus will not be required to present any information concerning the registrant unless there has been a material change . . . which has not been reported in an Exchange Act filing or the Exchange Act reports incorporated by reference do not reflect certain restated financial statements or other financial information.''). For a description of the efficient market theory, *see supra* note 163.

[1003] *See* 1980 Form 10–K Proposing Release.

Certain Commission forms allow historical incorporation by reference, meaning a registrant or issuer may incorporate information by reference to previous filings. Examples include Exchange Act Form 8–A, which allows for incorporation by reference of the description of a registrant's securities if a comparable description is contained in a prior filing. *See* Instruction to Item 1 of Form 8–A [17 CFR 249.208a]. Certain Securities Act registration statements also permit historical incorporation by reference, such as Form S–3, Form S–4, and Form S–11, which allow incorporation by reference of previous Exchange Act filings into the prospectus. *See* Item 12(a) of Form S–3 [17 CFR 239.13]; Item 11(a) of Form S–4 [17 CFR 239.25]; Item 29(a) of Form S–11 [17 CFR 239.18].

Certain Securities Act forms allow for forward incorporation by reference by certain issuers, where an issuer is permitted to forward incorporate by reference to Exchange Act reports filed in the future. Examples include Form S–3 and Form S–4. *See* Item 12(b) of Form S–3 [17 CFR 239.13]; Item 11(b) of Form S–4 [17 CFR 239.25]. In addition, the FAST Act recently directed the Commission to revise Form S–1 to permit SRCs to incorporate by reference to future filings. Public Law 114–94, Sec. 84001, 129 Stat. 1312 (2015); *See also* FAST Act Interim Rules Release.

Given the scope of this release and its focus on Exchange Act periodic reports, the discussion here generally is limited to historical incorporation by reference.

[1004] *See* 1980 Form 10–K Proposing Release.

[1005] *See id.*

[1006] *See* 1980 Form 10–K Adopting Release. Although Form 10–K was amended in 1980 to reflect the current structure, the Commission has allowed some form of incorporation by reference from the annual report to shareholders to satisfy requirements of Form 10–K since 1942. *See* Amendment to Forms for Registration and Filing Annual Reports [7 FR 10653 (Dec. 22, 1942)] and Release No. 34–3347 [*not published in the* **Federal Register**] (Dec. 18, 1942).

[1007] Based on data compiled by DERA, in calendar year 2014 approximately two percent of registrants incorporated some portion of the information required in either Part I or Part II of their Form 10–K from their annual report to shareholders, with more registrants incorporating Part II information than Part I information.

[1008] Exchange Act Rule 14a-3 [17 CFR 240.14a-3]; *see* Randi Morrison and Broc Romanek, *Annual Report & 10–K Wrap Handbook: Practice Guide & Toolkit,* Jul. 2014 (noting that more than fifty percent of companies use a ''10–K wrap''); Neil Stewart, *Designers discuss trends in the latest crop of annual reports,* IR Magazine, Jun. 14, 2011, *available at http://www.irmagazine.com/articles/earnings-calls-financial-reporting/18271/directions-annual-reports/* (noting that investors are ''far more likely to [receive] a plain 10K filing or perhaps a 10K-wrap'' and that ''[t]he traditional annual report may have been all but killed off by the austere 10K-wrap'').

registrant.[1009] By conditioning the ability to incorporate by reference on the ready availability of a registrant's incorporated Exchange Act reports and other materials on its Web site, the Commission sought to provide investors with the ability to obtain the information from those reports and materials at the same time that they would have been able to obtain the information if it were set forth directly in the registration statement.[1010]

3. Request for Comment

296. To what extent does including previously disclosed information along with recent developments in a single self-contained filing facilitate an investor's understanding of a registrant's disclosure? Does repeating information that previously has been disclosed hinder an investor's ability to identify information that has changed since the registrant's last report? Does providing previously disclosed information along with information that is new or has changed better enable investors to consider the changes in context? If so, should we structure our requirements to elicit disclosure that highlights changes from a registrant's last report and provides a comprehensive discussion in a single location?

297. Should we expand or limit registrants' ability to incorporate by reference? Why or why not? Does incorporation by reference make the disclosure more or less readable?

298. Are there particular filings or sections of filings that should remain direct sources of disclosure information, rather than permitting incorporation by reference? If so, what information should be located consistently and in which filings? Which sections of those filings should contain the information? For example, is it more important for an investor to have information included directly and in full in a Securities Act registration statement than it is in an Exchange Act filing?

299. Should our requirements to provide historical and recent information within a single self-contained filing differ for registrants of different sizes, development stages, reporting histories or other factors?

300. Should registrants be permitted to incorporate by reference historical information from prior filings in lieu of presenting prior years' information in the Form 10–K? If so, when or how frequently should we require registrants to present or refresh their complete core disclosure? Should we limit this approach to certain categories of registrants and, if so, how should we determine which categories would be eligible?

301. Should we expand or limit registrants' ability to incorporate by reference to exhibits? Why or why not? Does incorporation by reference make it more difficult to locate exhibits?

302. To what extent does the flexibility to use incorporation by reference reduce compliance and administrative costs to registrants of preparing and disseminating disclosures? Please provide quantifications if possible.

C. Hyperlinks

Under Rule 105 of Regulation S–T, a registrant may include hyperlinks within a filing, such as a table of contents that hyperlinks to specific sections in a filing or a cross-reference that hyperlinks to another part of a filing.[1011] Rule 105 also allows registrants to include hyperlinks to exhibits within the same filing or hyperlinks to other Commission filings.[1012] However, registrants may not include hyperlinks to information outside the EDGAR system, such as external Web sites.[1013]

Of the two formats that are generally accepted by the EDGAR system, the text-based American Standard Code for Information Interchange (''ASCII'') and hypertext markup language (''HTML''),[1014] only the HTML format accommodates hyperlinks. Currently, the vast majority of registrants file in HTML format.[1015] Many of these registrants include hyperlinks within their filings.

If a registrant includes a hyperlink in its filing, whether or not the link is permitted by Commission rules, the information in the linked material is not considered part of the filing for determining compliance with disclosure obligations. However, inclusion of the link will cause the registrant to be subject to the civil liability and antifraud provisions of the federal securities laws for the information contained in the linked material.[1016] Similarly, if a registrant hyperlinks to another hyperlink, the registrant will be treated as making all the hyperlinked material its own for liability purposes.[1017]

1. Comments Received

S–K Study. None.

Disclosure Effectiveness. Two commenters recommended amending Regulation S–K to specifically encourage use of hyperlinks within a filing.[1018] One of these commenters recommended requiring registrants to include a hyperlink to any material that is cross-referenced or incorporated by reference.[1019] The other commenter suggested allowing a hyperlink to information posted on a registrant's Web site to satisfy disclosure requirements.[1020]

2. Discussion

In 2000, the Commission stated that it is appropriate for registrants to assume liability for hyperlinked material as if it were part of the filing, because the use of hyperlinks in filings is voluntary and filers need not hyperlink to material that they do not wish to be understood as having adopted as their own. The Commission cautioned registrants not to use hyperlinks if they are not prepared to accept responsibility for the hyperlinked material.[1021]

The EDGAR system initially permitted hyperlinks only to different sections within a single document. In 2000, when the Commission expanded the permissibility of hyperlinks to allow hyperlinks to other documents and exhibits filed on EDGAR, the Commission stated that hyperlinks

[1009] *See* General Instruction VII.F. to Form S–1; General Instruction VI.F to Form F–1.

[1010] *See* Securities Offering Reform Release. Issuers may satisfy this condition by including hyperlinks directly to the reports or other materials filed on EDGAR or on another third-party Web site where the reports or other materials are available and access to the reports or other materials is free of charge to the user. *See* General Instruction VII.F. to Form S–1; General Instruction VI.F to Form F–1. The Commission noted that this manner of access was similar to those for disclosure of Web site access to an accelerated filer's Exchange Act reports. *See* Securities Offering Reform Release. In adopting the requirements for accelerated filers, the Commission noted that, while these reports were already available through the Commission Web site, access through company Web sites was still desirable to encourage the availability of information in a variety of locations and to foster best practices for making that information broadly accessible. *See* Acceleration of Periodic Report Filing Dates and Disclosure Concerning Web site Access to Reports, Release No. 33–8128 (Sept. 5, 2002) [67 FR 58480 (Sept. 16, 2002)].

[1011] Rule 105(b) of Regulation S–T [17 CFR 232.105(b)].

[1012] *Id.*

[1013] Rule 105 of Regulation S–T [17 CFR 232.105].

[1014] The EDGAR system also accepts PDF documents, but will not accept PDF documents containing hyperlinks. *See, e.g.,* EDGAR Filer Manual, Vol. I, v. 24 (Dec. 2015) at 3–27. Most PDF documents are considered unofficial copies, and PDF documents are permitted as official filings only in limited circumstances. *See* Rules 101 and 104 of Regulation S–T [17 CFR 232.101 and 17 CFR 232.104].

[1015] Based on data compiled by DERA, during calendar year 2015, ASCII represented less than one percent of all Form 10–K filings.

[1016] Rule 105(c) of Regulation S–T [17 CFR 232.105(c)].

[1017] *See* Rulemaking for EDGAR System, Release No. 33–7855 (Apr. 24, 2000) [65 FR 24788 (Apr. 27, 2000)] (''2000 EDGAR Release'').

[1018] *See* Shearman; ABA 2.

[1019] *See* ABA 2.

[1020] *See* Shearman.

[1021] *See* 2000 EDGAR Release.

alone should not satisfy the disclosure requirements.[1022] The Commission noted that it would not be appropriate for a registrant to use hyperlinks effectively to use incorporation by reference when it is not permitted.[1023] In addition, when the form or rule does permit incorporation by reference, the registrant must comply with all of the form or rule requirements for such incorporation by reference.[1024]

The Commission's rationale for limiting the use of hyperlinks was that readers might be unable to understand the content of the filing without accessing numerous hyperlinks and that readers would be unable to print the filing as an integrated whole.[1025] In 2008, in its guidance on the use of company Web sites, the Commission stated that the inability to print disclosure designed for interactive viewing and not for reading outside the electronic context, is not inherently detrimental to its readability.[1026] However, it also noted that certain disclosure would continue to be required in a format convenient for both reading online and printing.[1027]

Since this 2008 guidance, there has been a significant increase in the use of the Internet as a tool for disseminating information. As of 2014, eighty-seven percent of the U.S. population uses the Internet, up from seventy-four percent in 2008.[1028] In addition, recent data shows that most investors, even those who rely on financial advisors, use the Internet to conduct transactions and gather financial information.[1029] There have also been advancements in the types of technologies that can be used to report and analyze information.[1030] In light of these developments, we are interested in learning whether the Commission's prior concerns about disaggregated disclosure remain relevant. We are seeking public input on whether and how to revise our rules to take advantage of the Internet as a source of information about registrants.

3. Request for Comment

303. Should we consider revising our rules to permit registrants to include external hyperlinks in their filings? Should we consider permitting registrants to include external hyperlinks in their filings to satisfy disclosure obligations? Why or why not? What would be the benefits and challenges of such a requirement? [1031]

304. Would increased use of hyperlinks and further disaggregation of company disclosure into multiple filings hinder the quality or readability of disclosure? If so, how? What information, if any, should we require in a single filing or location?

305. Should we require registrants to include hyperlinks with any cross-reference to specific information or a specific section within a filing? Why or why not? What would be the benefits and challenges of such a requirement? In particular, what would be the costs or savings in compliance and administrative costs to registrants of required hyperlinks?

306. As suggested by one commenter,[1032] should we eliminate the requirement under Rule 12b–23 to attach, as an exhibit, information incorporated by reference from another filing, so long as the registrant includes in the text a hyperlink to the other filing?

D. Company Web sites

In certain circumstances, our rules and forms either permit or require the use of company Web sites as a means to provide information to investors. Depending on the circumstances, company Web sites may serve as a supplement to material filed or furnished via EDGAR, as an alternative to such materials, or as a stand-alone method of providing information to investors independent of EDGAR.[1033] Our rules do not permit a registrant to satisfy disclosure requirements by incorporating by reference to information on registrant Web sites.[1034]

When a company Web site supplements Commission filings, company information is available both on EDGAR and on the company's Web site. We have encouraged or required supplemental use of Web sites to make information more broadly accessible. For example, registrants are required to:

- Disclose their Web site addresses, if available, in annual reports on Form 10–K and state whether their Exchange Act reports are available on their Web sites; [1035]
- make their Exchange Act reports and documents incorporated by reference available on their Web site as a condition to incorporation by reference of previously filed reports into prospectuses filed as part of registration statements on Form S–1 or Form S–11; [1036]

[1022] *See* id.

[1023] *See* id. (stating that a filer would be permitted to use hyperlinks to optional information for the convenience of the reader, but could not omit information required within the filing by providing it through a hyperlink).

[1024] For example, the filing must contain a statement that the document is incorporated by reference, whether or not there is a hyperlink. As another example, Form 10–K may incorporate information from a registrant's annual report to security holders, so long as the information is filed as an exhibit to the Form 10–K. This exhibit is needed even if the information also is provided by hyperlink. *See* Section V.B for a discussion of incorporation by reference.

[1025] *See id.*

[1026] *See* 2008 Web site Guidance.

[1027] *See id.* (stating that the Commission did not think it was necessary that information appearing on company Web sites satisfy a printer-friendly standard unless our rules specifically require it, such as the notice and access model, which requires electronically posted proxy materials to be presented in a format convenient for both reading online and printing on paper). For a discussion of disclosure on company Web sites, *see* Section V.D.

[1028] *See* United Nations, International Telecommunications Union, *Percentage of Individuals using the Internet* (2015), *available at http://www.itu.int/en/ITU-D/Statistics/Documents/statistics/2015/Individuals_Internet_2000-2014.xls.*

[1029] *See Most Investors Use the Internet for Financial Research, Tools and Transactions; However, Two-Thirds Prefer to Interact with Advisors in Person,* Dec. 17, 2014, *available at http://www.johnhancock.com/about/news_details.php?fn=dec1714-text&yr=2014* (citing John Hancock's Investor Sentiment Survey and stating that eighty percent of investors have conducted transactions online and fifty-nine percent of investors prefer to use the Internet to research financial products).

[1030] *See* 2015 Investment Company Release; World Economic Forum, *Global Agenda Outlook 2013, available at http://www3.weforum.org/docs/WEF_GAC_GlobalAgendaOutlook_2013.pdf* (noting that technologies have evolved and continue to do so, while vast amounts of data are sent and received by billions of interconnected devices).

[1031] For a discussion of the use of company Web sites and our requests for comment on permitting registrants to incorporate information from their Web sites by reference in their flings, *see* Section V.D.

[1032] *See* ABA 2.

[1033] *See* 2008 Web site Guidance. More recently, in April 2013, in connection with an investigation of the use of social media to announce operational metrics, the Commission provided guidance to issuers on how the 2008 Web site Guidance and Regulation FD apply to disclosure made through social media channels. *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act: Netflix, Inc. and Reed Hastings, Release No. 34–69279 (Apr. 2, 2013), *available at https://www.sec.gov/litigation/investreport/34-69279.htm.*

[1034] *See* Item 10(d) of Regulation S–K [17 CFR 229.10(d)] (providing that where rules, regulations or instructions to forms permit, a document may be incorporated by reference to the specific document and to the prior filing or submission in which such document was physically filed or submitted).

[1035] Accelerated filers and large accelerated filers are required to disclose this information. Non-accelerated filers are encouraged to do so. *See* Item 101(e) of Regulation S–K [17 CFR 229.101(e)].

[1036] *See* Form S–1, General Instruction VII.F [17 CFR 239.11]; Form S–11, General Instruction H.6 [17 CFR 239.18]. In the adopting release for the Form S–11 amendments, the Commission noted that companies could satisfy the requirement to make filings available on their Web sites by ''including hyperlinks directly to the reports or other materials filed on EDGAR or on another third-party Web site where the reports or other materials are made available in the appropriate timeframe and access to the reports or other materials is free of charge to the user.'' *See* Revisions to Form S–11 to Permit Historical Incorporation by Reference, Release No. 33–8909, (Apr. 10, 2008) [73 FR 20512 (Apr. 15, 2008)].

• make their Exchange Act reports and other materials incorporated by reference available on their Web site as a condition for SRCs to forward incorporate by reference into a Form S–1;[1037]

• provide their financial statements to the Commission and post them on their corporate Web site, if any, in interactive data format using XBRL;[1038]

• post on their Web sites, if they maintain one, notice of their intent to delist or deregister their securities as a condition to withdrawing from registration under Section 12(b) of the Exchange Act;[1039] and

• post on their Web sites, if they maintain one, beneficial ownership reports filed by officers, directors and principal security holders under Section 16(a) of the Exchange Act.[1040]

In some situations, registrants may satisfy a disclosure requirement either by filing the disclosure on EDGAR or by making it available on the registrant's Web site, thereby using company Web sites as an alternative to EDGAR.[1041] For example, Regulation G requires a registrant that publicly discloses or releases a material non-GAAP financial measure to provide reconciliation to the most directly comparable U.S. GAAP measure. A registrant that releases non-GAAP financial measures orally, telephonically, by webcast, by broadcast, or by similar means may satisfy Regulation G by posting the required reconciliation on its Web site and disclosing the location and availability during the presentation.[1042]

In addition, Item 406(c) of Regulation S–K, which requires disclosure of a registrant's code of ethics, requires the registrant to: File a copy of its code of ethics as an exhibit to its annual report; post the text of its code of ethics on its Web site and disclose in its annual report its Web site address and the fact that it has posted its code of ethics on its Web site; or undertake in its annual report to provide any person a copy of its code of ethics upon request.[1043] The Commission originally proposed to require a registrant to file a copy of its code of ethics as an exhibit to its annual report.[1044] At adoption, the Commission opted for greater flexibility, citing commenters' concerns that some codes are extremely lengthy and therefore would be difficult to file electronically on EDGAR and noting that many registrants already post their codes on their Web sites. In addition, our rules require disclosure on either Form 8–K or the registrant's Web site of any change to or waiver of its code of ethics for its senior financial officers.[1045]

Only in very limited circumstances do our rules allow a company's Web site to serve as a standalone method of providing information to investors wholly independent of EDGAR. Rules 12h–6 and 12g3–2(b) permit certain formerly reporting foreign private issuers to use their Web sites to provide information about the company in lieu of Exchange Act registration and reporting requirements. Unlike the examples above, where registrants' alternative to posting the information on their Web sites is to include it in a Commission filing, these companies are required to include the relevant disclosure on their Web sites. Otherwise, these companies would lose their exemption from registration under Section 12(g) of the Exchange Act.

1. Comments Received

S–K Study. None.

Disclosure Effectiveness. One commenter recommended that particular focus should be given to adapting disclosure practices to a more technologically-driven marketplace.[1046] Two commenters suggested that registrants be permitted to use their Web sites to satisfy certain disclosure requirements such as those relating to their business, management team, and board.[1047] One of these commenters recommended that registrants use their Web site as a repository for basic corporate documents, such as a company's certificate of incorporation or bylaws.[1048] Another commenter opposed the delivery of information using a registrant's Web site because it would ''raise issues, including liability matters, certifications, preservation of past disclosure, comparability and accessibility that would need to be addressed.'' [1049] Another commenter stated that ''having some information on a company Web site and other information on EDGAR can cause confusion for investors because they are often unsure where, if anywhere, information will be, and information provided on company Web sites is often difficult to find.'' [1050]

Another commenter acknowledged the potential efficiency to be gained through use of the Internet and electronic delivery, but suggested that, to protect the interests of investors who rely on paper delivery, the Commission should take steps to protect the interests or access of investors who depend on non-electronic access to information.[1051]

2. Discussion

As noted by several commenters, today's technology provides virtually instant access to information through a variety of sources outside of EDGAR, including company Web sites.[1052] The Internet has become a primary source of information for investors. We are seeking public input on whether and the extent to which investors benefit from requiring disclosure in a filing when the information is readily available on the registrant's Web site. We are also interested in what additional investor protections we should consider in the event we allow registrants to exclude required information from filings when the information is otherwise provided on their Web sites, such as requirements

[1037] *See* FAST Act Interim Rules Release.

[1038] *See* Rule 405 of Regulation S–T [17 CFR 232.405] and Item 601(b)(101) of Regulation S–K [17 CFR 229.601(b)(101)]. In adopting the interactive data requirements, the Commission stated that requiring the submission and posting of interactive data has the potential to provide advantages for the investing public by making the data more accessible, timely, inexpensive and easier to analyze. *See* Interactive Data Release.

[1039] Exchange Act Rule 12d2–2(c)(2)(iii) [17 CFR 240.12d2–2(c)(2)(ii)].

[1040] *See* Exchange Act Section 16(a)(4)(C) [15 U.S.C. 78p] and Rule 16a–3(k) [17 CFR 240.16a–3(k)]. Section 403 of the Sarbanes-Oxley Act [Pub. L. 107–204, Sec. 403 116 Stat. 745 (2002)] amended Section 16(a) of the Exchange Act [15 U.S.C. 78p] to require issuers to file statements of beneficial ownership on Forms 3, 4 and 5 electronically with the Commission and issuers with company Web sites to post change in beneficial ownership reports on their Web sites. The Commission adopted Rule 16a–3(k) to require registrants that maintain a corporate Web site to post on its Web site all Forms 3, 4 and 5 filed with respect to its equity securities by the end of the business day after filing. The Commission noted that ''One objective of the amendments is to encourage availability of this information in a variety of locations, so that it is broadly accessible.'' *See* Mandated Electronic Filing and Web site Posting for Forms 3, 4 and 5, Release No. 33–8230 (May 7, 2003) [68 FR 25787 (May 13, 2003)].

[1041] *See* 2008 Web site Guidance.

[1042] *See* Non-GAAP Measures Release.

[1043] Item 406(c) of Regulation S–K [17 CFR 229.406(c)].

[1044] *See* Proposed Rule: Disclosure Required by Sections 404, 406 and 407 of the Sarbanes-Oxley Act of 2002, Release No. 33–8138 (Oct. 22, 2002) [67 FR 66208 (Oct. 30, 2002)].

[1045] *See* Sarbanes-Oxley Act, Section 406(b) [Pub. L. 107–204, Sec. 406(b) 116 Stat. 745 (2002)]. *See also* Audit Committee Financial Expert and Code of Ethics Adopting Release. A registrant may only use its Web site to disseminate this disclosure if it previously has disclosed in its most recently filed annual report its intention to disclose these events via its Web site and the address of its Web site.

[1046] *See* Lin.

[1047] *See* CCMC (suggesting companies cross-reference their Web sites to satisfy certain disclosure obligations); Shearman (suggesting companies file certain core corporate information both on EDGAR and the company's Web site).

[1048] *See* Shearman.

[1049] *See* SCSGP.

[1050] *See* letter from the Federal Regulation of Securities Committee, Business Law Section, American Bar Association (Feb. 15, 2016) (''ABA 3'').

[1051] *See* AFL–CIO.

[1052] *See, e.g.,* CCMC; SCSGP; CFA Institute; Shearman; ABA 2.

for registrants to preserve disclosure provided on their Web site.

Currently, investors typically can access registrants' public filings since 1996 through EDGAR.[1053] Investors may request other public filings or records from the Commission.[1054] However, information posted on company Web sites may change frequently and may not remain available to investors. Certain of our rules that allow registrants to disseminate information through their Web sites in lieu of including that information in a filing also require the registrant to maintain that information for a designated period of time. For example, registrants posting their code of ethics on their Web site under Item 406(c) are required to make the information accessible for as long as the registrant remains subject to Item 406.[1055] Similarly, registrants required to post Exchange Act Section 16(a) filings on their Web sites are required to keep those filings accessible on their Web sites for at least a 12-month period.[1056] As another example, while Regulation G does not specify how long a registrant must keep disclosure available on its Web site, the Commission encourages companies to provide ongoing Web site access to this information for at least a 12-month period.[1057]

For historical information available on company Web sites, the Commission has stated generally that ''the fact that investors can access previously posted materials or statements on a company's Web site does not in itself mean that such previously posted materials or statements have been reissued or republished for purposes of the antifraud provisions of the federal securities laws, that the company has made a new statement, or that the company has created a duty to update the materials or statements.'' [1058] To help assure that investors understand that the posted materials or statements speak as of a date or period earlier than when the investor may be accessing the posted materials or statements, the Commission has stated that historical or previously posted materials or statements should be:

- Separately identified as historical or previously posted materials or statements, including, for example, by dating the posted materials or statements; and
- located in a separate section of the Web site containing previously posted materials or statements.[1059]

In other contexts, the Commission has expressed concerns about whether information disclosed on company Web sites would be adequately preserved for purposes of the reporting and liability provisions under the federal securities laws.[1060]

Information on company Web sites currently is subject to some but not all Exchange Act liability provisions. Anti-fraud provisions of the federal securities laws, including Exchange Act Section 10(b) and Rule 10b–5, apply to statements made on a company Web site. If a registrant were to make a false or misleading statement of a material fact on its Web site in connection with the purchase or sale of a security, the registrant could face liability under Section 10(b) and Rule 10b–5. These anti-fraud provisions also apply in certain circumstances to third-party information available via hyperlink on a company Web site that could be attributable to the company, in the same way they would apply to any other statement made by, or attributable to, a company.[1061]

The reporting provisions of Exchange Act Section 13(a) and Exchange Act Rules 13a–1 and 12b–20 generally do not apply to disclosures on company Web sites. However, if a company fails to satisfy a Web site disclosure option that relieves it of its obligation to file or furnish an Exchange Act report, an action could be brought under the Exchange Act reporting provisions based on the company's failure to file the report.[1062] For example, in the event a company fails to make public disclosure of information as required by Regulation FD,[1063] that issuer would violate Regulation FD as well as Section 13(a) or Section 15(d) of the Exchange Act.[1064]

Material incorporated by reference into a filed document is subject to liability under Section 18 of the Exchange Act, which provides a private cause of action for a false or misleading statement of material fact in a filed document.[1065] Material appearing solely outside Commission filings, such as on a registrant's Web site, cannot be incorporated by reference into a registrant's filings [1066] and would not be subject to Section 18 liability.

Liability under Sections 11 and 12(a)(2) of the Securities Act applies to information in Exchange Act filings when it is incorporated by reference in a registration statement or prospectus. Section 11 imposes liability on an issuer for any untrue statement or omission of a material fact in a registration statement. Section 12(a)(2) of the Securities Act imposes similar liability for material misstatements or omissions in a prospectus or oral communication that constitutes an offer. This liability also applies to information incorporated by reference, where permitted, from Exchange Act filings filed after the registration statement. Under our current rules, disclosure provided on a registrant's Web site rather than in an Exchange Act filing cannot be incorporated by reference into a registration statement or prospectus. Accordingly, it would not be subject to Section 11 liability and would only be subject to Section 12(a)(2) liability to the extent it constitutes an offer.

3. Request for Comment

307. Should we continue to limit the permitted sources of information incorporated by reference to Commission filings, or should we allow registrants to incorporate information from their Web sites?

[1053] Registrants were phased into EDGAR over a three-year period ending May 6, 1996. As of that date, all domestic registrants were required to make their filings on EDGAR, except for filings made in paper because of a hardship exemption. *See* Rulemaking for EDGAR System, Release No. 33–7122 (Dec. 19, 1994) [59 FR 67752 (Dec. 30, 1994)]; U.S. Securities and Exchange Commission, Office of Information Technology, *Important Information About EDGAR, available at, https://www.sec.gov/edgar/aboutedgar.htm.*

[1054] *See* U.S. Securities and Exchange Commission, Office of Investor Education and Advocacy, *Records and Information, available at, http://www.sec.gov/answers/publicdocs.htm.*

[1055] Instruction 2 to Item 406(c) of Regulation S–K [17 CFR 229.406(c)].

[1056] Exchange Act Rule 16a–3(k) [17 CFR 240.16a-3(k)]. In addition, the Commission has stated that the availability of historical issuer information provides investors with more readily accessible information about the issuer and that issuers should be able to maintain historical information on their Web site so that information will remain accessible to the public but will not be considered to be reissued or republished for purposes of the Securities Act. *See* Securities Offering Reform Release.

[1057] *See* Non-GAAP Measures Release.

[1058] *See* 2008 Web site Guidance.

[1059] *See id.* These requirements are consistent with Securities Act Rule 433(e)(2) [17 CFR 230.433(e)(2)] (setting forth conditions under which Web site disclosure will not constitute an offer or a free writing prospectus).

[1060] *See, e.g.,* 2014 NRSRO Amendments Release; 2015 Investment Company Release.

[1061] 15 U.S.C. 78j; 17 CFR 240.10b–5. *See* 2008 Web site Guidance (citing Use of Electronic Media for Delivery Purposes, Release No. 33–7233 (Oct. 6, 1995) [60 FR 53458 (Oct. 13, 1995)]); Use of Electronic Media, Release No. 33–7856 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)]).

[1062] *See* 2008 Web site Guidance (citing Exchange Act Section 13(a) [15 U.S.C. 78m] (requiring companies with a class of securities registered under the Exchange Act to file reports prescribed by the Commission) and Exchange Act Rule 13a–1 [17 CFR 240.13a–1] (requiring such companies to file an annual report with the Commission)).

[1063] 17 CFR 243.100 *et seq.*

[1064] *See* Regulation FD Release; Rule 101 of Regulation FD [17 CFR 243.101]; 15 U.S.C. 78m; 15 U.S.C. 78o(d).

[1065] 15 U.S.C. 78r.

[1066] Exchange Act Rule 12b–23 [17 CFR 240.12b–23].

308. Are there challenges investors may face in using sources outside registrant filings to obtain information about a registrant? If so, what are these challenges? Would investors seeking information on a registrant's Web site rather than in its filings require specialized equipment, knowledge or expertise that some investors may not have? What would be the impact on investors who want to receive materials in paper? [1067] What would be the impact on investors or third parties who engage in automated processing or large-scale analysis of disclosure on EDGAR?

309. Would investors seeking information from third-party sources require specialized equipment, knowledge or expertise that some investors may not have? What would be the impact on investors who want to receive materials in paper? What other challenges would this approach pose for investors or for registrants?

310. Do the benefits or challenges of incorporating information by reference differ based on whether the information is incorporated from a company's Web site or from its filings?

311. If we allow registrants to provide required disclosure by incorporating information by reference to their Web sites, how could registrants limit or delineate the information on their Web sites that is ''filed'' for liability purposes? What obligation should the registrants have to preserve the material as incorporated or to update the incorporated information? How should it be preserved in the event the registrant exits the reporting system or goes out of business? What would be the impact on the reporting and liability provisions of the federal securities laws if this information is not preserved as required?

312. Are there categories of business or financial information that we should permit registrants to disclose by posting on their Web sites in lieu of including in their periodic reports?

313. Should we permit registrants to meet the requirements of Item 601 of Regulation S–K by incorporating exhibits by reference to documents posted on their Web sites? What would be the benefits and challenges of such an approach?

314. As an alternative to incorporation by reference, should we allow registrants to omit required information from filings when the information is otherwise provided on a registrant's Web site? If so, what information would be appropriate and what additional investor protections should we consider?

315. To the extent that information about a registrant is readily available on its Web site, what are the benefits of continuing to require disclosure of the same information in the registrant's filings? What would be the impact on registrant liability, accuracy of reported information or investor protection generally if we eliminated disclosure requirements for information that investors routinely access from Web sites?

316. Should we consider permitting incorporation by reference from sources other than a registrant's filings or its Web site? If we allow registrants to provide required disclosure by incorporating information by reference to third-party sources, should we require them to include a hyperlink to that information? Would registrants use such an option?

317. What types of investors or third parties are most likely to value disclosure made available on registrant Web sites?

318. To what extent would permitting registrants to incorporate information from their Web sites enable them to realize cost savings, including savings in the administrative and compliance costs of preparing and disseminating disclosure? Please provide quantifications of expected changes in costs if possible.

E. Specific Formatting Requirements

The business and financial disclosure requirements in Regulation S–K generally do not specify the precise layout or format for disclosure.[1068] In adopting the earliest Exchange Act report forms, the Commission's emphasis was ''on substance rather than on form,'' giving companies ''wide latitude in the manner of presenting the required data.'' [1069] Current Forms 10–K and 10–Q specify that they are not a blank form to be filled in but a guide to be used in preparing the report.[1070]

While our general approach allows registrants to use discretion in the overall layout of their disclosure, a few items prescribe the format for disclosure. In some cases, basic formatting requirements may be standardized, such as the prescribed location, order or title of required disclosure. For example, the structure of our periodic reports and related rules require registrants to include the numbers and captions of all items in the relevant form.[1071] Some of our more specific requirements seek to elicit standardized information, such as prescribed tables with standardized rows and columns, such as the tabular disclosure of contractual obligations in Item 303(a)(5).[1072]

1. Comments Received

S–K Study. None.

Disclosure Effectiveness Initiative. Many commenters provided recommendations on the placement or presentation of registrant disclosure to facilitate identification of current, material information.[1073] Two commenters suggested that prior to creating and implementing any new system, the Commission should encourage registrants to experiment with different formats in periodic reports, rather than strictly following the prescribed format of disclosure items in the applicable form.[1074] One of these commenters stated that this would support reaching (and effectively communicating with) the broadest possible set of investors.[1075] This commenter also suggested that our rules should incorporate the ''growing body of scholarship around user experience'' to improve the utility of corporate reporting. This commenter specified that some information lends itself well

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[1067] *See, e.g.,* Part I, Item 12(c) of Form S–3 (requiring issuers to state that it will provide a copy of any or all of the information, including Exchange Act reports, that has been incorporated by reference in the prospectus upon request at no cost to the requester).

[1068] This section discusses formatting requirements that call for a standardized visual presentation or layout of disclosure within a registrant's ASCII or HTML filing. For a discussion of structured disclosures and our requirements for specific data formats to facilitate the extraction of information into standardized formats, *see* Section V.G.

[1069] Release No. 34–66 (Dec. 21, 1934) [*not published in the* ***Federal Register***].

[1070] *See* General Instruction C.1 to Form 10–K [17 CFR 249.310]; General Instruction C.1 to Form 10–Q [17 CFR 249.308a]. In addition, Form 10–K cites Exchange Act Rule 12b–20, which requires a company to include, in addition to any information specifically required to be included in a statement or report, any further material information necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. *See* General Instruction C.3 to Form 10–K [17 CFR 249.310]; Exchange Act Rule 12b–20 [17 CFR 240.12b–20].

[1071] *See, e.g.,* Form 10–K [17 CFR 249.310]; Exchange Act Rule 12b–13 [17 CFR 240.12b–13].

[1072] Item 303(a)(5) of Regulation S–K [17 CFR 229.303(a)(5)]. While outside the scope of this release, Item 402 of Regulation S–K provides another example of prescribed format requirement calling for standardized tables with specified titles, rows, and columns for the disclosure of certain executive compensation information. [17 CFR 229.402].

[1073] *See, e.g.,* AFL–CIO; T. Amy; letter from Robert H. Chambers (June 13, 2014) (''R. Chambers''); CCMC; SCSGP; SIFMA; CFA Institute; Shearman.; ABA 2; UK Financial Reporting Council; Business Roundtable; Ernst & Young 2; Klein and Amy 3. Several of these commenters proposed various changes to EDGAR technology and related functionality to improve the readability, navigability, and usability of information.

[1074] *See* AFL–CIO; SCSGP.

[1075] *See* AFL–CIO.

to graphic presentation and that, where possible, reporting companies should use graphics to communicate key trends and practices to investors quickly and clearly. Another commenter suggested that we encourage registrants to base the order, prominence and extent of disclosures presented on the materiality of the matter covered by such disclosures.[1076] One commenter recommended a more complete and descriptive table of contents to help investors navigate the current volume of disclosure.[1077] One commenter stated that disclosure in ''[p]lain language, clear formatting, no footnotes, no jargon, complete information without having to jump to another site are critical and doable.'' [1078] Some commenters supported the concept of a ''company profile'' or ''company tab'' discussed in the S–K Study.[1079]

One commenter recommended disclosure in Q&A form for certain common risk factors, with standardized questions for all registrants allowing only for potential responses of ''yes,'' ''no,'' or ''NA.'' [1080] Another commenter provided results of a survey that it conducted showing that a ''substantial majority of respondents (65 percent) indicated that the increased use of tables and charts would be very important to improving financial reporting.'' [1081] This commenter stated that investors want quantitative tables with entity-specific information appropriately disaggregated and suggested that this information should be supported by ''qualitative explanations that are not littered with boilerplate or generic language.'' [1082] This commenter further stated that standardization of quantitative disclosures would enhance comparability over time and among firms.[1083] Similarly, another commenter recommended that companies consider the use of ''pie charts'' and ''bar charts'' to enhance certain disclosure.[1084]

2. Discussion

A standard layout, format, or style requirement may enhance the comparability of disclosures across periods and across issuers and registrants. Such comparability and consistency may reduce the costs of acquiring information, increase valuation accuracy, and enhance investment efficiency.[1085] A standardized presentation may also reduce the ability of registrants to choose presentation formats that could highlight more favorable disclosures and obscure less favorable ones.

However, flexibility in the presentation of disclosure may enhance the ability of registrants to tailor disclosure to their individual circumstances and investor bases. Flexibility in presenting disclosure could allow registrants to more effectively communicate the information most critical to understanding their particular company as prescriptive presentation requirements may increase the risk of important information being obscured by less important information. In addition, repetitive disclosure may be due in part to the structure of our Exchange Act forms and related rules, which require registrants to include in their periodic reports the numbers and captions of all items in the relevant form.[1086]

3. Request for Comment

319. Do current disclosure requirements appropriately consider the need for both standardization and flexibility in presentation? If not, how could we change our requirements?

320. How could we facilitate or encourage better presentation of disclosure by registrants?

321. Would further prescribing the order and format for presenting information in annual or quarterly reports improve readability or increase comparability across registrants? Would such standardized requirements enhance the ability of investors and third parties to use disclosures, including for large-scale processing and analyses, in a more timely and efficient way?

322. Is there particular information that investors would prefer we require registrants to present in a specific order or in a particular section of the document? If so, which information should be so presented? What would be the advantages or disadvantages of such an approach?

323. Do item numbers and captions improve the clarity, navigability or overall effectiveness of disclosure? Should we revise our rules to reduce or eliminate the requirement to include the item numbers and captions from any of our forms? Why or why not?

324. Should we revise any of our current disclosure rules to require a standardized tabular or graphic presentation rather than, or in addition to, the narrative disclosure we currently require? Which disclosures could be improved by a requirement for tabular or graphic presentation? Would such a presentation improve comparability of disclosure across registrants? Does increased comparability improve transparency or is it otherwise beneficial to investors? What would be the advantages or disadvantages of such an approach?

325. Should we require registrants to present certain disclosures in question-and-answer format? If so, what information would be appropriate for this format? Should we require or permit it for certain types of registrants?

326. Should we permit or require registrants to present certain disclosures in a ''check-the-box'' presentation, where registrants select the appropriate disclosure from a finite list of options? For example, should we require or permit registrants to indicate by checkbox rather than narrative disclosure portions of the information regarding changes in and disagreements with accountants under Item 304 or management's conclusions regarding the effectiveness of the registrant's disclosure controls and procedures under Item 307? What would be the advantages or disadvantages of such an approach?

327. What disclosure requirements, if any, would generate more meaningful disclosure if we modified or eliminated the specific formatting or presentation requirements and permitted greater flexibility in the manner of presentation?

328. How would disclosure costs or other challenges to registrants be affected by any increase in the use of specific formatting or presentation requirements?

F. Layered Disclosure

In first implementing our integrated disclosure system, the Commission

[1076] *See* Ernst & Young 2.

[1077] *See* T. Amy.

[1078] *See* letter from Barbara Amsden (Oct. 25, 2015).

[1079] *See, e.g.,* CCMC; SCSGP; CFA Institute; Shearman. *See also* S–K Study at 98 (recommending consideration of a framework based on the nature and frequency of disclosure that would include ''core'' disclosure or a ''company profile'' for information that changes infrequently and would be supplemented by periodic filings for information that changes more frequently).

[1080] *See* R. Chambers.

[1081] *See* CFA Institute. *See also* CFA Report.

[1082] *Id.*

[1083] *See id.*

[1084] *See* Klein and Amy 3 (discussing disclosure of share buyback programs).

[1085] *See, e.g.,* G. DeFranco, S.P. Kothari, and R. Verdi, *The Benefits of Financial Statement Comparability,* 49 J. Acct. Res. 895, 895–931 (2011); S. Young and Y. Zeng, *Accounting Comparability and the Accuracy of Peer-Based Valuations Models,* 90 Acct. Rev. 2571, 2571–2602 (2015); C. Chen, D. Collins, T. Kravet, and R. Mergenthaler, *Financial Statement Comparability and the Efficiency of Acquisition Decisions* (working paper) (Dec. 15, 2015) *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2169082.*

[1086] *See, e.g.,* Form 10–K; Exchange Act Rule 12b–13 [17 CFR 240.12b–13].

considered various approaches that might differentiate between institutional investors, professional security analysts and sophisticated individual investors.[1087] These approaches included providing investors the option of receiving a simplified annual report containing summary information in lieu of the full, or portions of the, traditional annual report.[1088] While the Commission did not adopt such an approach, it has encouraged layered disclosure in several instances.

The Wheat Report noted that special efforts should be made to call any unusually speculative elements or risk factors of an offering to the attention of the ordinary investor using an introductory statement.[1089] For MD&A, the Commission has suggested registrants use an overview, introduction or other statement of the principal factors, trends or other matters that are covered in more detail elsewhere in the section.[1090] The Commission cautioned that an introduction or overview should not be a duplicative layer of disclosure that repeats the more detailed discussion and analysis that follows. Instead, it should present information in a manner that emphasizes the information and analysis that is most important.

In offering prospectuses, our rules require summary presentations where the length or complexity of the prospectus makes a summary useful.[1091] Similarly, our rules require open-end management investment companies to include key information at the front of their statutory prospectuses in a standardized order to provide investors disclosure that is easier to use and more readily accessible, while retaining the comprehensive quality of the information available elsewhere.[1092]

1. Comments Received

S–K Study. One commenter suggested that the Commission analyze each required disclosure, segregating them by nature and frequency of change to determine the method of filing and delivery.[1093] This commenter proposed that basic information (such as the description of the business, risk factors, officers and directors, Web site address) that typically does not significantly change from quarter to quarter, absent a specific transaction or event, should only require updating when something changes. Additionally, the commenter recommended that the information presented in periodic reports be limited to new information specific to the most recent fiscal period (such as MD&A, selected quarterly financial data and executive compensation).

Disclosure Effectiveness Initiative. A few commenters addressed layering disclosure and the use of summaries to improve disclosure.[1094] One of these commenters stated that an integrated presentation of related information, such as layering information, with summary information presented first and details presented later or long-standing explanatory information that may still be relevant placed separately, perhaps as a schedule to the financial statements, enhances understanding of the relationship between items across financial statements.[1095] Another commenter proposed a rule requiring companies to provide an overview describing what happened at the company over the past year and the company's expectation and concerns about the year to come.[1096] This commenter noted that such a rule would not replace the more detailed financial and other business information that allows analysts to populate their models and otherwise scrutinize performance, but would permit management to identify up front what it determines to be the most important information in a way that is both understandable and provides context.

One commenter proposed the use of ''tabs'' to organize information topically (*e.g.,* business, officers and directors, material risks), with information under various tabs to be updated appropriately and supplemented with periodic MD&A disclosure.[1097] This commenter suggested that more effective, navigable documents should eliminate the need for summary disclosure for retail investors without eliminating material information. This commenter further noted that all investors, retail or institutional, should have access to full and fair disclosure.[1098]

2. Discussion

As discussed in Section III.B.2., the informational needs, financial resources, and capacity to analyze disclosure may vary significantly among investors. Highly sophisticated investors may seek a different level or presentation of information than those with fewer financial or analytical resources. For example, some investors may prefer a summary presentation while others may seek detailed data that they can analyze and compare across companies or industries.[1099] In addition, a ''layered'' approach to disclosure that highlights what management believes is the most important information, while still providing detailed data and analysis,[1100] may make filings more navigable for all investors. On the other hand, a ''layered'' approach could introduce challenges for investors or third parties seeking all available disclosure on a particular topic, as they many need to search summary disclosures as well as more detailed disclosures for all data and commentary relevant for their purposes. The FAST Act requires the Commission to issue regulations permitting registrants to submit a summary page in their Form 10–K.[1101] We do not address this aspect of layered disclosure here.

3. Request for Comment

329. Other than a summary page, are there other approaches to layering or layered disclosure that we should consider for business and financial information in periodic reports? If so, what are the benefits and challenges of these approaches?

G. Structured Disclosures

Investors, their financial advisors, and professional analysts use increasingly

[1087] *See* 1980 Form 10–K Adopting Release (''The Commission recognizes that the information content in Form 10–K not only was originally formulated for a specialized use, but that within those groups which have utilized the Form there are different constituencies. Those constituencies which have been the most frequent users of Form 10–K information are institutional investors, professional security analysts and sophisticated individual investors.'').

[1088] *See id.* The release noted that the potential approach would be based on an ''as yet unproven hypothesis that some users, particularly certain individual investors, either rely on financial advisers and therefore do not use detailed disclosure, or are overwhelmed by the technical nature or volume of presently required disclosure.'' However, the release also cited studies such as that conducted by Professors Lucia S. Chang and Kenneth S. Most at Florida International University indicating that the typical ''unsophisticated small investor'' often is quite sophisticated. *See* Lucia S. Chang and Kenneth S. Most, *Financial Statements and Investment Decisions* (1979).

[1089] *See* Wheat Report at 32.

[1090] *See* 2003 MD&A Interpretive Release. For a discussion of executive level overviews in MD&A, see Section IV.B.3.b.

[1091] *See, e.g.,* Item 503(a) of Regulation S–K [17 CFR 229.503(a)].

[1092] Form N–1A [17 CFR 239.15A].

[1093] *See* Ernst & Young 1.

[1094] *See, e.g.,* CFA Institute; NYC Bar; SGSCP.

[1095] *See* CFA Institute. *See also* CFA Report.

[1096] *See* NYC Bar.

[1097] *See* SCSGP.

[1098] *Id.*

[1099] *See, e.g., Study Regarding Financial Literacy Among Investors,* (Aug. 2012) *available at http://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf* (finding that investors favor ''layered'' disclosure and, wherever possible, the use of a summary document containing key information about an investment product or service).

[1100] *See, e.g.,* 2003 MD&A Interpretive Release.

[1101] Public Law 114–94, Sec. 72001, 129 Stat. 1312 (2015).

complex information and find that structured disclosures facilitate analysis of this information.[1102] Some investors seek structured data as it enhances their ability to use technology to process and synthesize information,[1103] allowing for more timely and granular analysis of financial information, including comparative [1104] and trend analysis.[1105]

Structured disclosures include both numeric and narrative-based disclosures that are made machine-readable by having reported disclosure items labeled (tagged) using a markup language, such as eXtensible Markup Language (''XML'') [1106] or XBRL.[1107] Tagging disclosure enables information to be structured, stored, shared, and presented in different systems or platforms.[1108]

Standardized markup languages, such as XBRL, use standard sets of data element tags for each required reporting element, referred to as taxonomies. Taxonomies provide common definitions that represent agreed-upon information or reporting standards, such as U.S. GAAP for accounting-based disclosures.[1109] The resulting standardization of financial reporting allows for aggregation, comparison, and large-scale statistical analysis of reported financial and other material information through significantly more automated means than is possible with unstructured formats, such as unstructured HTML or ASCII.

Commission rules currently require several categories of registrants to provide certain information in XBRL, including, the following:

Category of registrant	Information required to be tagged	Language required	Method of submission
Reporting companies [1110]	Financial statements, including footnotes and schedules.	XBRL	Filed as exhibit.
Security-based swap data repositories [1111]	Financial statements, including footnotes and schedules.	XBRL	Filed as exhibit.
Open-end management investment companies, or mutual funds [1112].	Risk/return summaries	XBRL	Filed as exhibit.
Nationally recognized statistical rating organization (NRSRO) [1113].	Credit rating history	XBRL	Posted on its Web site, with a link to such location included in an exhibit to its annual Form NRSRO.

The Commission requires certain registrants and other filers to provide certain information in XML or other machine-readable format. Asset-backed issuers are required to provide asset-level disclosures in XML in their registration statements.[1114] Forms D, filings required under Regulation A and Regulation Crowdfunding, and Section 16 ownership reports also require all or a part of the information to be filed using XML technology.[1115] In addition, beginning in 2016, Regulation SBSR will require security-based swap data repositories to report and publicly disseminate in machine-readable electronic format certain security-based swap transaction information, although

[1102] *See, e.g.,* CFA Report (stating that investors do not seek a reduction in data or volume of disclosures, as they can use technology to evaluate the data, but instead seek to identify more effective ways to capture, manage, analyze, present, and deliver financial data); Interactive Data Release (stating that many commenters generally supported the required submission of interactive data).

[1103] *See Recommendations of the Investor Advisory Committee Regarding the SEC and the Need for the Cost Effective Retrieval of Information by Investors* (July 25, 2013) (''IAC Data Tagging Recommendations''), *available at http://www.sec.gov/spotlight/investor-advisory-committee-2012/data-tagging-resolution-72513.pdf* (recommending that the Commission (i) promote the collection, standardization and retrieval of data filed with the Commission using machine-readable data tagging formats, (ii) take steps to reduce the costs of providing tagged data, especially for smaller issuers and investors and (iii) prioritize revising existing forms to provide for the tagging of data in order to increase transparency with respect to corporate governance).

[1104] *See* Hu 2014 at 620 (noting that greater standardization of information allows for cross-company comparisons of performance).

[1105] *See* Institute for Corporate Responsibility at George Washington University and the Center for Audit Quality, *Initiative on Rethinking Financial Disclosure,* Nov. 2014, *available at http://business.gwu.edu/about-us/research/institute-for-corporate-responsibility/research-projects/rethinking-financial-disclosure* (advocating a disclosure platform that allows comparison of information and analysis of a company's performance trends).

[1106] XML is an open source markup language to tag elements of a document. It does not have a defined set of tags, but instead provides a mechanism to define tags and structural relationships between tagged elements. *See* Norman Walsh, *A Technical Introduction to XML* (Oct. 1998), *available at http://www.xml.com/pub/a/98/10/guide0.html?page=2#AEN58.*

[1107] XBRL is an open source standardized language derived from XML for purposes of tagging business reporting information. Many commercial vendors and open source projects support the XBRL standards with tools and software. *See* Stephanie Farewell, *XBRL International, Inc., XBRL or Customized XML?* (Oct. 2010), *available at http://www.xbrl.org/bpboarddocs/xbrlorcustomizedxml.pdf.*

[1108] *See id.*

[1109] *See, e.g., The Standard for Reporting, available at https://www.xbrl.org/the-standard/what/the-standard-for-reporting*; *Financial Statements in XBRL: XBRL designed for Accounts and Financial Statements as well as fixed templates, available at https://www.xbrl.org/the-standard/what/financial-statement-data.*

[1110] Item 601(b)(101) of Regulation S–K [17 CFR 229.601(b)(101)]; Interactive Data Release.

[1111] Exchange Act Rule 13n–11(f)(5) [17 CFR 240.13n–11(f)(5)]. *See also* 2015 Regulation SBSR Release.

[1112] Form N–1A [17 CFR 239.15A]; Rule 405 of Regulation S–T [17 CFR 232.405]. *See also* Interactive Data for Mutual Fund Risk/Return Summary, Release No. 33–9006 (Feb. 11, 2009) [74 FR 7748 (Feb. 19, 2009)] (''Interactive Data for Mutual Funds Release'').

[1113] Exchange Act Rule 17g–2(d) [17 CFR 240.17g–2(d)]; Form NRSRO [17 CFR 249b.300]. *See also* Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34–59342 (Feb. 2, 2009) [74 FR 6456 (Feb. 9, 2009)] (adopting a public disclosure provision requiring NRSROs to make publicly available on their Web site in XBRL format a random sample of ten percent of the ratings histories of issuer-paid credit ratings and to disclose in Exhibit 1 to Form NRSRO the web address where the XBRL data may be accessed); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34–61050 (Nov. 23, 2009) [74 FR 63831 (Dec. 4, 2009)] (requiring NRSROs to make publicly available on their Web site in XBRL format ratings history information for one hundred percent of their credit ratings initially determined on or after June 26, 2007).

[1114] Item 1111(h) of Regulation AB [17 CFR 229.1111(h)]; Rule 11 of Regulation S–T [17 CFR 232.11]. Registrants will be required to comply with the asset-level disclosure requirements beginning in November 2016. *See* Asset-Backed Securities Disclosure and Registration, Release No. 33–9638 (Sept. 4, 2014) [79 FR 57184 (Sept. 24, 2014)] (''2014 ABS Release'').

[1115] Form D [17 CFR 239.500]; Forms 1–A *et seq.* [17 CFR 239.90 *et seq*]; Form C [17 CFR 239.900]; Forms 3, 4, & 5 [17 CFR 249.103–105].

See also Electronic Filing and Revision of Form D, Release No. 33–8891 (Feb. 6, 2008) [73 FR 10592 (Feb. 27, 2008)] (noting that because Form D information consists of relatively simple facts, XML is a sufficient technological solution, and . . . the information tagged in XML [is expected to] be compatible with systems designed for more sophisticated XBRL reporting); 2015 Regulation A Release; Crowdfunding Adopting Release (stating that XML data will enable issuers to provide information in a convenient medium without requiring new technology and will provide the Commission and the public with readily available data about offerings made in reliance on Section 4(a)(6)).

the regulation does not specify a required format.[1116] We are seeking public input on the use of structured data and other available standards and technologies that could enhance the quality of disclosure to investors while reducing burdens on registrants.

1. Comments Received

S–K Study. One commenter recommended that the Commission assess the value of XBRL for new registrants and their industries and consider allowing voluntary, rather than mandatory, structuring of data by EGCs.[1117] This commenter suggested that this would reduce initial compliance costs for EGCs and allow more time for the market to develop cost-effective XBRL tools, technologies and services.

Disclosure Effectiveness Initiative. One commenter encouraged regulators, in light of advances in technology and connectivity and the ever-increasing demand for data, to look to technology to facilitate the capture, management, analysis, presentation, and delivery of information to investors. This commenter also noted that ''technology holds the promise of better (improved quantity and quality of), faster (improved timeliness of), and cheaper (improved access to) information for investors.'' [1118] Another commenter stated that the ability to download financial tables and other data to better compare companies' disclosures across industries would appear to be particularly useful.[1119] This commenter also noted, however, that the time it takes to prepare the XBRL filing may cause registrants to forego updates to its disclosure in the days prior to filing to allow time for data tagging, and suggested that the Commission explore technological solutions that avoid unnecessary duplication, such as modifying XBRL or using another data tagging system that is more cost and time-efficient.[1120]

One commenter supported the continued improvement of tagging and coding of financial reporting, noting that investors and regulators alike would benefit greatly from real time access to comparable, searchable and sortable data.[1121] By contrast, another commenter indicated that XBRL data was not useful.[1122] One commenter stated that XBRL data should not require with registration statements if it has been previously filed with a Form 10–K or Form 10–Q.[1123]

Several commenters, in a jointly submitted letter, provided a number of specific recommendations to enhance and modernize EDGAR, including enhanced functionality associated with structured data.[1124] The recommendations included enhancements that would allow the user to save XBRL output more easily in Excel and identify tag extensions used by the registrant. Another commenter provided similar recommendations to modernize EDGAR and improve the Commission's data tagging framework and concurred with the jointly submitted letter.[1125] In addition to longer term improvements, this commenter recommended that the Commission extend XBRL or other data tagging requirements to MD&A and other parts of filings.

One commenter recommended that the Commission require complete ''non-dimensional'' financial statements to improve XBRL quality and usage.[1126] This commenter also recommended that the Commission consider taking steps to improve the comparability of XBRL data by addressing inconsistencies in XBRL extensions. In addition, this commenter recommended expanding XBRL requirements, such as to earnings releases, MD&A, and proxy statements, and requiring filers to make all ownership-related filings available in an XML structured data format.

One commenter encouraged the Commission to transform the current documents-based disclosure system to a system that collects, manages, and disseminates disclosure information as structured data with standardized tags and electronic formats.[1127] This commenter argued that such a system would improve accountability to investors, allow public companies eventually to reduce compliance costs by automating reporting tasks, and improve the Commission's ability to use data analytics to review and evaluate registrants' submissions. As an initial step, this commenter recommended that the Commission adopt Inline XBRL to eliminate the duplication associated with providing the XBRL exhibit in addition to the text-based financial statements, and to ''enforce'' the quality of XBRL filings.[1128] The commenter further recommended that the Commission work with industry groups to set clearer data standards. This commenter also suggested that the higher cost to market participants of absorbing unstructured disclosure results in higher cost of capital to registrants, particularly smaller registrants.

2. Discussion

The Commission requires registrants and other filers to provide certain information as structured data to facilitate the analysis and improve the accuracy of that information.[1129] When the Commission first adopted rules requiring reporting company registrants to provide financial statement information in XBRL, it cited the potential of structured data to reduce the time required for registrants to prepare their disclosures, to increase the usability of disclosures for investors, and eventually to reduce costs for both registrants and investors, as structured data can help automate regulatory filings and business information processing.[1130]

By requiring structured data, the Commission has sought to make disclosure easier for investors to access, analyze and compare across reporting periods, registrants, and industries.[1131]

[1116] Rule 900(cc) of Regulation SBSR [17 CFR 242.900(cc)].

[1117] *See* Ernst & Young 1.

[1118] *See* CFA Institute. *See also* CFA Report.

[1119] *See* ABA 3.

[1120] *See id.* (citing Emily Chasan, *Costly Data Go Untapped,* The Wall Street Journal, Jan. 22, 2013 (''Chasan''), *available at http://blogs.wsj.com/cfo/2013/01/22/costly-data-go-untapped* (noting that companies have invested in internal systems that they believe are superior to XBRL)).

[1121] *See* AFL–CIO.

[1122] *See* A. Radin (citing Chasan).

[1123] *See* letter from Fran Sesti (Feb. 1, 2016).

[1124] *See* letter from Center for Audit Quality, et al. (May 29, 2015).

[1125] *See* ABA 3.

[1126] *See* TagniFi.

[1127] *See* Data Transparency Coalition.

[1128] We are considering whether to amend the current XBRL tagging requirements with respect to the financial statements of registrants to require the use of ''Inline XBRL.'' Inline XBRL would allow registrants to file the required information and data tags in one document rather than requiring a separate exhibit for the interactive data. Commission rules and the EDGAR system do not currently allow for the use of Inline XBRL. Any such proposal would be subject to public notice and comment as part of a separate rulemaking initiative. In this concept release, we seek comment on the benefits and costs of structured data generally and whether it would be appropriate to extend data tagging requirements to other Commission disclosures.

[1129] *See, e.g.,* Rules 401–405 of Regulation S–T [17 CFR 232.401 *et seq.*]; *See also* Interactive Data Release; *What is Interactive Data and Who's Using It?, available at http://www.sec.gov/spotlight/xbrl/what-is-idata.shtml.*

[1130] *See* Interactive Data Release (noting that interactive data, unlike static, text-based information, (1) can be dynamically searched and analyzed, facilitating the comparison of financial and business performance across companies, reporting periods, and industries, and (2) allows for the automation of regulatory filings and business information processing, with the potential to increase the speed, accuracy, and usability of financial disclosure and eventually to reduce costs); Interactive Data for Mutual Funds Release (stating the Commission's intent not only to make risk/return summary information easier for investors to analyze but also to assist in automating regulatory filings and business information processing).

[1131] *See* Interactive Data Release; Interactive Data for Mutual Funds Release.

When registrants provide disclosure items in a standardized data format, investors can more easily search and obtain specific information about registrants, compare common disclosures across registrants, and observe how registrant-specific information changes across reporting periods as the same registrant continues to file in a structured data format.[1132] Additionally, data that investors can download, for example, from EDGAR, directly into a spreadsheet or statistical analysis software eliminates the need to enter the information manually, which minimizes the time burden and risk of errors associated with data entry.

In adopting Regulation AB requiring asset-level disclosures in XML, the Commission noted that requiring this information in a standardized machine-readable format makes the data transparent and comparable.[1133] The Commission stated that it expected that this would lower the cost for investors of accessing, collecting and analyzing information, which would lead to better allocation of capital. In requiring the information in XML rather than XBRL, the Commission noted that the relatively simpler data to be presented in these disclosures, in contrast to the rich complexity of corporate financial disclosures, was well-suited for XML.[1134]

Our rules requiring registrants to file financial and other information in a structured format require that data to be filed as an exhibit to the filing rather than embedded in the filing itself.[1135] In this way, the structured data supplements but does not replace the traditional HTML electronic filing format. Having XBRL and other structured data submitted as a separate exhibit, however, has raised a number of issues regarding the accuracy and usability of the data.

First, structured data filed as a separate exhibit does not look like the disclosure in the related HTML document submitted by the registrant unless specially rendered to do so with specialized software.[1136] In an effort to make the XBRL data look more like the HTML document, some registrants create custom elements or dimensions or otherwise alter their XBRL documents. While our rules permit custom or company-specific element extensions for disclosures for which the standard U.S. GAAP taxonomy does not provide an appropriate element, the Commission and its staff have cautioned against custom elements for minor differences[1137] or solely for formatting,[1138] which can inhibit automated parsing processes and potentially create confusion between U.S. GAAP and company specific extension elements. The staff also has found that many registrants create custom axis extensions despite the availability of appropriate standard axis elements in the standard U.S. GAAP taxonomy, further diminishing data quality and impairing comparability across registrants and filings.[1139] These and other potentially inappropriate uses of custom elements identified by Commission staff can affect the quality of the data and its potential use.[1140]

Second, the redundant process of preparing financial statements and periodic reports in HTML or ASCII and then preparing exhibits in XBRL creates a greater chance of data entry and other errors. Staff identified a number of errors, such as characterization of a number as negative when it is positive, missing amounts and calculations, and other inaccuracies,[1141] which may occur more frequently, partially as a result of these redundant processes. Registrants often outsource the structuring of their XBRL reports, thereby adding incremental manual processes and controls to their efforts, which in turn can adversely affect the quality of XBRL-formatted disclosures.[1142] Observers also have noted that XBRL data is not required to be audited, resulting in diminished investor confidence in the quality of the data.[1143]

We continue to explore ways to incorporate structured data. We also continue to explore changes to the Commission's Web site and the EDGAR system that could enhance the usefulness of structured disclosures. For example, in December 2014, the Commission announced a pilot program under which data that registrants provide in structured formats would be combined and organized into structured data sets and posted for bulk downloads on the Commission's Web site for use by investors and academics.[1144]

Concerns have been raised about the costs and time burden associated with structured data requirements. For example, the ACSEC has focused on the costs of structuring disclosures and

[1132] *See* Concept Release on the U.S. Proxy System, Release No. 34–62495 (July 14, 2010) [75 FR 42982 (July 21, 2010)].

[1133] *See* 2014 ABS Release.

[1134] *Id.*

[1135] *See, e.g.,* Item 601(b)(100) of Regulation S–K [17 CFR 229.601(b)(100)]; Rule 401 of Regulation S–T [17 CFR 232.401].

[1136] *See* Staff Observations from the Review of Interactive Data Financial Statements (Dec. 13, 2011) (''December 2011 Staff Observations''), *available at http://www.sec.gov/spotlight/xbrl/staff-review-observations-121311.shtml.*

[1137] EDGAR Filer Manual, Vol. II, v. 35 (Dec. 2015) at 6–28.

[1138] *See* Regulation S–T Compliance and Disclosure Interpretations, Question 130.08 *available at https://www.sec.gov/divisions/corpfin/guidance/regs-tinterp.htm. See also* December 2011 Staff Observations (encouraging registrants to concentrate on the quality of the tagging rather than trying to match the rendering of the XBRL exactly to the HTML filing and advising registrants not to create custom elements or use incorrect dates to achieve specific rendering results).

[1139] *See* Staff Observations of Custom Axis Tags (Mar. 29, 2016) (''2016 Staff Observations''), *available at: https://www.sec.gov/structureddata/reportspubs/osd_assessment_custom-axis-tags.html.*

[1140] *See id. See also,* Staff Observations of Custom Tag Rates (July 7, 2014) (''2014 Staff Observations''), *available at http://www.sec.gov/dera/reportspubs/assessment-custom-tag-rates-xbrl.html* (in which, for a random sample of filings that staff reviewed, staff observed instances of filers creating custom axis tags unnecessarily when an appropriate standard axis tag existed in the U.S. GAAP taxonomy).

An axis tag allows a filer to divide reported elements into different dimensions (*e.g.,* revenue by geographical area, fair value measurement levels, components of total equity (*e.g.,* common, preferred)). In a recent assessment of custom axis extensions use in XBRL exhibits, DERA staff reported that despite the overall decline in the use of custom tags generally, approximately 50% of filers continue to create custom axis tags, with large accelerated filers using custom axis tags more than twice as often as SRCs. DERA staff suggested that a contributing factor may be that SRCs likely have less complex financial disclosures that can be structured primarily using axis options provided by the U.S. GAAP taxonomy. *See* 2016 Staff Observations.

In a previous review of the use of custom tags in general in XBRL exhibits, the staff found a steady decline in custom element use by larger registrants, indicating improvements in the U.S. GAAP taxonomy and registrants' selections of tags. However, in contrast to the recent findings on axis extensions, the staff found that smaller filers were associated with an average custom tag rate almost 50% greater than that of larger filers. Staff analysis also revealed that some of the perceived quality issues associated with XBRL data are correlated with particular third-party providers of XBRL software and services, which may be, at least in part, due to continued innovation and growth in the market for filer software and services, resulting in offerings of varying functionality and ease of use. *See id;* 2014 Staff Observations.

[1141] *See, e.g.,* December 2011 Staff Observations; Staff Observations From Review of Interactive Data Financial Statements (Jun. 15, 2011), *available at http://www.sec.gov/spotlight/xbrl/staff-review-observations-061511.shtml.*

[1142] *See Disclosure management: Streamlining the Last Mile,* PricewaterhouseCoopers (Mar. 2012), *available at https://www.pwc.com/gx/en/xbrl/pdf/pwc-streamlining-last-mile-report.pdf.*

[1143] *See* Trevor S. Harris and Suzanne Morsfield, *An Evaluation of the Current State and Future of XBRL and Interactive Data for Investors and Analysts—White Paper Number Three,* Columbia Business School Center for Excellence in Accounting and Security Analysis, Dec. 2012, *available at http://www8.gsb.columbia.edu/ceasa/sites/ceasa/files/An%20Evaluation%20of%20the%20Current%20State%20and%20Future%20of%20XBRL%20and%20Interactive%20Data%20for%20Investors%20and%20Analysts.pdf.*

[1144] *See SEC Announces Program to Facilitate Analysis of Corporate Financial Data* (Dec. 30, 2014), *available at http://www.sec.gov/news/pressrelease/2014-295.html*; Financial Statement Data Sets, *available at http://www.sec.gov/dera/data/financial-statement-data-sets.html.*

asserted that the requirements impose a disproportionate burden on smaller registrants in terms of cost and time.[1145] As discussed above, both ACSEC and the Small Business Forum have recommended that the Commission exempt SRCs from the requirement to provide financial information in XBRL.[1146] In its own structured data recommendation, the Investor Advisory Committee generally supported structured data but acknowledged the costs of data tagging and recommended that the Commission take steps to reduce these costs, particularly for smaller registrants and investors.[1147] According to a 2015 AICPA study, however, XBRL filing costs for smaller registrants were lower than initially expected and have been decreasing since the 2009 inception of the Commission's Structured Data Program.[1148]

We acknowledge that registrants may incur costs to provide disclosure in structured data format, particularly initial set-up costs. We seek public 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.

3. Request for Comment

330. How can the quality of structured disclosures be enhanced?

331. Are there changes to the EDGAR system that the Commission should make to render the structured disclosure filed by registrants more useful?

332. Are company-specific custom extensions, such as element or axis extensions, useful to investors or other users of structured disclosures? If so, how might these custom extensions be made more useful for enhancing automated analysis? If not, are there better ways to express disclosures that are unique to a company (*e.g.,* business segment, product line)?

333. Should we require registrants to provide additional disclosures in a structured format? If so, which disclosures? For example, are there categories of information in Parts I and II of Form 10–K or in Form 10–Q that investors would want to receive as structured data?

334. To the extent that we consider additional structured data requirements for disclosure in periodic reports, what level of structured data requirements would be appropriate? For example, should we require registrants to identify sections, sub-sections or topics with ''block text'' labels, or should we require registrants to structure numeric elements and tables individually? What would be the challenges and costs of such an approach? What would be the benefit?

335. How does the availability of structured data in registrants' periodic reports affect the timeliness, efficiency, or depth of investors' review of disclosures? How do the effects of structured disclosure requirements vary across investor types? Are there other methods of structuring disclosures that would make disclosures more accessible or useful?

336. To what extent is the information currently provided in structured disclosures readily available through other sources, such as third-party data aggregators? What are the costs and benefits to investors of obtaining this data from such third parties rather than through the use of structured disclosures filed by registrants?

337. To what extent do investors, analysts, third-party data aggregators, or other market participants rely on structured data provided by registrants in their periodic reports? What specific content in structured disclosures is useful to each of these groups?

338. Are there other ways in which our requirements can improve the accuracy of tagged data? What would be the challenges to registrants posed by such alternatives?

339. Are there certain categories of registrant for which we should provide an exemption from some or all structured disclosure requirements, require more limited information to be tagged, or require a different presentation of this information? Why or why not? If so, to which registrants or structured disclosure requirements should such exemptions apply?

340. In requiring structured data, the Commission has sought to make disclosure easier for investors to access, analyze and compare across reporting periods, registrants, and industries.[1149] Are there other technologies that could make disclosure easier for investors to access, analyze and compare? If so, how should we incorporate these technologies into our disclosure requirements?

VI. Conclusion

We are interested in the public's views on any of the matters discussed in this concept release or on the staff's Disclosure Effectiveness Initiative. We encourage all interested parties to submit comment on these topics. If possible, please reference the specific question numbers or sections of the release when submitting comments. In addition to investors and registrants, the Commission welcomes comment from other market participants and particularly welcomes statistical, empirical, and other data from commenters that may support their views and/or support or refute the views or issues raised. We also solicit comment on any other aspect of our disclosure requirements in Regulation S–K that commenters believe may be improved upon. Please be as specific as possible in your discussion and analysis of any additional issues.

By the Commission.

Dated: April 13, 2016.

Brent J. Fields,

Secretary.

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[1145] *See* 2015 ACSEC Recommendations; 2013 ACSEC Recommendations.

[1146] *See* Section IV.H.2.b.

[1147] *See* IAC Data Tagging Recommendations.

[1148] *See* American Institute of CPAs, *Research Shows XBRL Filing Costs Lower than Expected* (Jan. 2015), *available at https://www.aicpa.org/interestareas/frc/accountingfinancialreporting/xbrl/pages/xbrlcostsstudy.aspx.*

[1149] *See* supra notes 1130 to 1131.