

Client Alert

The SEC Adopts Amendments to Modernize and Enhance MD&A and Other Financial Disclosures

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The SEC Adopts Amendments to Modernize and Enhance MD&A and Other Financial Disclosures

On November 19, 2020, the Securities and Exchange Commission (“**SEC**”) announced that it has adopted certain amendments to certain financial disclosure requirements in Regulation S-K relating to the management’s discussion and analysis (the “**MD&A**”), as well as in related rules and forms. The amendments “modernize, simplify and enhance certain financial disclosures called for by Regulation S-K, and related rules and forms, in a manner that reduces the costs and burdens on registrants while continuing to provide material information to investors.” Reflecting the SEC’s long-standing commitment to principles-based disclosure, they eliminate some prescriptive requirements and allow registrants to exercise judgment based on materiality. They also include conforming changes to the disclosure requirements for foreign private issuers, such as in Form 20-F.

In addition to filings with the SEC, the amendments will likely affect the MD&A and other financial disclosures in unregistered offerings, such as those made pursuant to Rule 144A, where the market practice is to closely align the disclosure to that which is required in an SEC-registered offering.

Below is a high-level summary of the amendments. See [Appendix A](#) to this Client Alert for a more in-depth summary, including a summary of the principal objectives and key rationale of the amendments.

1. High-Level Summary of the Amendments

Objectives of the MD&A

The SEC has added an item stating the objective of the MD&A: to provide material information relevant to an assessment of the financial condition and results of operations, including an evaluation

of the amounts and certainty of cash flows from operations and from outside sources. The MD&A should focus on (i) material events and uncertainties known to management that are “reasonably likely” to cause reported financial information not to be indicative of future operating results or of future financial condition and (ii) material financial and statistical data that the registrant believes will enhance a reader’s understanding of financial condition, cash flows, and other changes in financial condition and results of operations.

The SEC expects the clear statement of the objective will better enable investors to view the registrant from the management’s perspective as it has encouraged the MD&A to do in its past guidance¹. To encourage the disclosure of forward-looking information, the SEC has confirmed that the safe harbor rules for projections apply to information supplied in the MD&A.

Enhanced Disclosure Requirement for Liquidity and Capital Resources and Elimination of the Contractual Obligations Table

The SEC will require the disclosure of “material cash requirements” from known contractual and other obligations, including commitments for capital expenditures, as of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirements. Partly in light of this new requirement, the SEC has eliminated the existing requirement for a tabular disclosure of contractual obligations. This requirement was burdensome for some registrants that do not track such information and had to gather information across various subsidiaries and departments across their organization specifically for this purpose.

Streamlined and Clarified Disclosure Requirements for Results of Operations

The SEC has streamlined the disclosure requirements for results of operations, for example, by incorporating the discussion of off-balance sheet arrangements in the discussion of results of operations. The SEC will also require discussion of the underlying reasons for the material changes in line items, focusing on each relevant reportable segment and/or other subdivision (e.g., geographic areas, product lines) and on the registrant as a whole.

Alternative Interim Period Disclosure

As an alternative to the existing requirement to compare the most recently completed quarter to the corresponding quarter of the prior year, the SEC will permit a comparison to the immediately preceding quarter. The SEC has recognized that not all businesses are seasonal and that, for some registrants, the alternative may provide a more meaningful, tailored disclosure.

Critical Accounting Estimates

The SEC has codified previous SEC guidance and adopted an explicit requirement to disclose critical accounting estimates. The SEC will require the disclosure of qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had or is reasonably likely to have on financial condition or results of operations, but the requirement applies to the extent the information is material and reasonably available.

Elimination of Selected Financial Data and Supplementary Financial Information Requirements

The SEC has eliminated the requirement to provide five years of selected financial data and the requirement to provide quarterly tabular disclosure for the past two years, partly in light of the accessibility of historical information.

¹ <https://www.sec.gov/rules/interp/33-8350.htm>

In lieu of the quarterly tabular disclosure requirement, the SEC will require a disclosure of summary financial information and earnings per share affected by any material retrospective changes to the statements of comprehensive income for any of the quarters within the two most recent fiscal years.

2. A Footnote on ESG

In a footnote in the adopting release, the SEC stated that it has declined to add any requirements relating to environmental, social, or governance issues (“ESG”) and sustainability matters, citing its principles-based approach to the MD&A. This approach is in line with the SEC’s past guidance set forth in the Commission Guidance Regarding Disclosure Related to Climate Change² and that taken in the modernization of certain items under Regulation S-K earlier this year³.

3. Other Amendments

The SEC’s adopting release contains several other rule changes affecting, among other requirements, smaller reporting companies, Canadian foreign private issuers, roll-up transactions, asset-based securities issuers, summary prospectuses, and various technical and clarificatory amendments (including various reporting forms) not detailed in this Client Alert.

4. Compliance Dates

Registrants are required to comply with the amendments beginning with the first fiscal year ending on or after the date that is 210 days after publication in the Federal Register. Registrants may comply with the amendments 30 days after they are published in the Federal Register, so long as they provide disclosure responsive to an amended item in its entirety – for example, a registrant that voluntarily provides disclosure pursuant to the amended Item 303 prior to the mandatory compliance date must provide disclosure pursuant to each provision of amended Item 303 in its entirety.

² <http://www.sec.gov/rules/interp/2010/33-9106.pdf>

³ <https://www.sec.gov/rules/final/2020/33-10825.pdf>

Appendix A

Summary of the Amendments

ITEM (PRE-AMENDMENT)	SUMMARY DESCRIPTION OF AMENDED RULES	PRINCIPAL OBJECTIVES	KEY RATIONALE (IN ADDITION TO THE EXPRESSED PRINCIPAL OBJECTIVES)
Item 301, Selected financial data	<ul style="list-style-type: none"> - Registrants will <i>no longer be required</i> to provide five years of selected financial data. - The SEC encourages registrants to continue to consider a tabular presentation of financial or other information (including for periods earlier than those presented in the financial statements) to demonstrate material trends. 	<p>Modernize disclosure requirement in light of technological developments and simplify disclosure requirements.</p>	<ul style="list-style-type: none"> - Easy access to past information through EDGAR. - Material trends that would be illustrated by the disclosure of the earlier two years would be required to be disclosed by the MD&A anyway.
Item 302(a), Supplementary financial information	<ul style="list-style-type: none"> - Registrants will <i>no longer be required</i> to provide two years of tabular selected quarterly financial data. - The item will be replaced with a requirement to (i) provide an explanation for <i>material retrospective changes</i> to the statements of comprehensive income for any of the quarters within the two most recent fiscal years or for any subsequent interim period and (ii) disclose, <i>for each affected quarterly period and the fourth quarter in the affected year</i>, summarized financial information related to the statements of comprehensive income and earnings per share reflecting such changes. <p>As non-exhaustive examples of a retrospective change that may trigger disclosure, the SEC mentions:</p> <ul style="list-style-type: none"> - Correction of an error; - Disposition of a business that is accounted for as discontinued operations; - Reorganization of entities under common control; and - Change in accounting principle. 	<ul style="list-style-type: none"> - Reduce repetition and focus disclosure on material information. - Modernize disclosure requirement in light of technological developments. 	<ul style="list-style-type: none"> - Easy access to past information through EDGAR. - Fourth-quarter results (which would otherwise not be disclosed) can be readily derived from annual results. - The SEC recognizes that timely disclosure of the effects of material retrospective changes may be important to investors, and the lack of such disclosure could impact the ability to derive fourth-quarter changes when there have been such changes.
Item 303(a), MD&A	<ul style="list-style-type: none"> - Clarify the objective of MD&A and streamline the 14 instructions. - States that the objective of the MD&A is to provide <i>material information</i> relevant to an assessment of the financial condition and results of operations, including an evaluation of the amounts and certainty of cash flows from operations and from outside sources. - The MD&A must focus on: 	<p>Simplify and enhance the purpose of MD&A.</p>	<p>Better allow investors to view the registrant from management's perspective.</p>

ITEM (PRE-AMENDMENT)	SUMMARY DESCRIPTION OF AMENDED RULES	PRINCIPAL OBJECTIVES	KEY RATIONALE (IN ADDITION TO THE EXPRESSED PRINCIPAL OBJECTIVES)
	<ul style="list-style-type: none"> - Material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be indicative of future operating results or of future financial condition; and - Material financial and statistical data that the registrant believes will enhance a reader's understanding of financial condition, cash flows and other changes in financial condition and results of operations. 		
Item 303(a)(2), Capital resources	<ul style="list-style-type: none"> - Registrants will need to provide material cash requirements from known contractual and other obligations, including commitments for capital expenditures, as of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirements. - Any known material trends in liquidity and capital resources must also be disclosed, as well as any known demands, commitments, events of uncertainties that will result in or that are reasonably likely to result in liquidity increasing or decreasing in any material way. 	Modernize and enhance disclosure requirements to account for capital expenditures that are not necessarily capital investments.	While capital expenditures remain important in many industries, certain expenditures and cash commitments other than capital expenditures may be increasingly important (e.g., companies for which human capital or intellectual property are key resources).
Item 303(a)(3)(ii), Results of operations	<ul style="list-style-type: none"> - Registrants will need to disclose known events that are reasonably likely to cause a material change in the relationship between costs and revenues, such as known or reasonably likely future increases in costs of labor or materials or price increases or inventory adjustments. - When applying the "reasonably likely" threshold, registrants should consider whether a known trend, demand, commitment, event or uncertainty is likely to come to fruition. If such known trend, demand, commitment, event or uncertainty would reasonably be likely to have a material effect on the registrant's future results or financial condition, disclosure is required. 	Clarify item requirement by using a disclosure threshold of "reasonably likely," which is consistent with the SEC's interpretative guidance on forward-looking statements.	Require management to make a thoughtful and objective evaluation based on materiality, including where the fruition of future events is unknown.
Item 303(a)(3)(iii), Results of operations	Clarify that a discussion of material changes in net sales or revenue is required (rather than only material increases).	Clarify MD&A disclosure requirements by codifying existing SEC guidance.	Require an analysis that should consist of material substantive information and present a balanced view of the underlying dynamics of the business.

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<p>Item 303(a)(3)(iv), <i>Results of operations</i></p> <p>Instructions 8 and 9 (Inflation and price changes)</p>	<ul style="list-style-type: none"> - The item and instructions that generally require a discussion of the impact of inflation and price changes on net sales, revenue and income from continuing operations will be eliminated. - Registrants will still be required to discuss these matters if they are part of a known trend or uncertainty that has had, or the registrant reasonably expects to have, a material favorable or unfavorable impact on net sales, or revenue, or income from continuing operations. 	<p>Encourage registrants to focus on material information that is tailored to a registrant's businesses, facts and circumstances.</p>	<p>Eliminate a redundant requirement and move towards a principles-based approach.</p>
<p>Item 303(a)(4), <i>Off-balance sheet arrangements</i></p>	<ul style="list-style-type: none"> - The item that requires the disclosure of material off-balance sheet arrangements will be replaced by a new instruction to Item 303. - Under the new instruction, registrants will be required to discuss commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on such registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources even when the arrangement results in no obligation being reported in the registrant's consolidated balance sheets. 	<p>Prompt registrants to consider and integrate disclosure of off-balance sheet arrangements within the context of their MD&A.</p>	<p>Eliminate redundancy caused by additional requirements in U.S. GAAP that have caused it to overlap with the existing item.</p>
<p>Item 303(a)(5), <i>Contractual obligations</i></p>	<ul style="list-style-type: none"> - Registrants will no longer be required to provide a contractual obligations table. - A discussion of material contractual obligations will remain required through an enhanced principles-based liquidity and capital resources requirement focused on material short- and long-term cash requirements from known contractual and other obligations. - Known contractual obligations may include, for example, lease obligations, purchase obligations, or other liabilities reflected on the registrant's balance sheet. 	<p>Promote the principles-based nature of MD&A and simplify disclosures.</p>	<ul style="list-style-type: none"> - Eliminating the requirement would not result in a loss of material information to investors given the overlap with information required in the financial statements and the expansion of the capital resources requirement. - A prescriptive requirement to prepare a contractual obligations table was unnecessarily burdensome for some registrants.
<p>Instruction 4 to Item 303(a)</p>	<ul style="list-style-type: none"> - Clarify that where there are material changes in a line item, including where material changes within a line item offset one another, disclosure of the underlying reasons for these material changes in quantitative and qualitative terms is required. 	<p>Enhance analysis in MD&A. Clarify MD&A disclosure requirements by codifying existing SEC guidance on the importance of analysis in MD&A.</p>	<ul style="list-style-type: none"> - The SEC has previously observed that many registrants simply recite the amounts of changes from year to year that are readily computable from their financial statements.

ITEM (PRE-AMENDMENT)	SUMMARY DESCRIPTION OF AMENDED RULES	PRINCIPAL OBJECTIVES	KEY RATIONALE (IN ADDITION TO THE EXPRESSED PRINCIPAL OBJECTIVES)
(Material changes in line items)	<ul style="list-style-type: none"> - Where it is necessary to an understanding of the business, the discussion must focus on each relevant reportable segment and/or other subdivision (e.g., geographic areas, product lines) and on the registrant as a whole. 		
Item 303(b), Interim periods	<ul style="list-style-type: none"> - Registrants will be permitted to compare their most recently completed quarter to either the corresponding quarter of the prior year or to the immediately preceding quarter. - If there is a change in the form of presentation from period to period that forms the basis of comparison from previous periods provided pursuant to this paragraph, the registrant must discuss the reasons for changing the basis of comparison and provide both comparisons in the first filing in which the change is made. 	<p>Allow for flexibility in comparison of interim periods to help registrants provide a more tailored and meaningful analysis relevant to their business cycles.</p>	<p>Not all businesses are seasonal.</p>
Critical Accounting Estimates	<ul style="list-style-type: none"> - Registrants will be explicitly required to disclose critical accounting estimates⁴. Previously, the requirement was in SEC guidance. - Registrants must provide qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had or is reasonably likely to have on financial condition or results of operations to the extent the information is material and reasonably available. - This information should include why each critical accounting estimate is subject to uncertainty and, to the extent the information is material and reasonably available, how much each estimate and/or assumption has changed over a relevant period, and the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation. 	<p>Facilitate compliance and improve resulting disclosure. Eliminate disclosure that duplicates the financial statement discussion of significant policies. Promote meaningful analysis of measurement uncertainties.</p>	<ul style="list-style-type: none"> - Provide investors with a greater understanding of subjective accounting estimates and the variability that is reasonably likely to affect the financial condition or results of operations. - Provide investors with information beyond what is provided in the notes to the financial statements.

⁴ Estimates made in accordance with GAAP that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the financial condition or results of operations.

European Leveraged Finance and Capital Markets Group

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