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SEC/CORPORATE

SEC-Proposed Amendments to Modernize, Simplify and Increase the Accessibility of Required Disclosure

As previously reported in the October 13, 2017 edition of *Corporate & Financial Weekly Digest*, on October 11, the Securities and Exchange Commission proposed amendments (the Proposal) to modernize and simplify disclosure requirements in Regulation S-K, and related rules and forms. The Proposal is intended to reduce registrants' burden and costs to comply with the SEC's disclosure requirements, while making public filings easier for investors to read, navigate and understand, including by discouraging repetitive disclosure and the disclosure of immaterial information.

The following are some key elements of the Proposal:

- **Management's Discussion and Analysis (MD&A) Disclosure.** Item 303(a) of Regulation S-K would be amended to allow registrants making a filing that includes financial statements covering three years to exclude Management Discussion and Analysis (MD&A) disclosure about the earliest year reflected in those financial statements so long as (1) the MD&A disclosure relating to the earliest year "is not material to an understanding of the registrant's financial condition, changes in financial condition or results of operations;" and (2) "the registrant previously filed its prior year Form 10-K on EDGAR" including such earliest year. The staff of the SEC (the Staff) noted that this proposed amendment is intended to discourage repetition of disclosure that is no longer material. This proposed amendment would not change the requirement for smaller reporting companies and emerging growth companies that include in their filings financial statements covering only two years, in which case, the MD&A disclosure would continue to require disclosure regarding the two-year period covered by the financial statements. The proposed amendment also would clarify that registrants may use any form of MD&A presentation that would "enhance a reader's understanding," noting, for example, that a registrant may decide that narrative disclosure for one or more of the years in the three-year period is more appropriate than a year-to-year comparison.

- **Confidential Treatment Requests and Exhibits.**

    - The SEC proposed to add Items 601(a)(5), 601(a)(6) and 601(b)(10)(iv) to Regulation S-K, which would permit registrants, without submitting a confidential treatment request, to omit from exhibit filings (1) schedules and similar attachments from *all* exhibits unless any schedule or similar attachment contains material information or information not otherwise reflected in the exhibit or disclosure document (effectively expanding the existing accommodation under Item 601(b)(2) of Regulation S-K that permits registrants to omit such schedules and attachments from plans of acquisition, reorganization, arrangement, liquidation or succession) provided that the registrant provides with each exhibit a list identifying the contents of omitted schedules and attachments and agrees to provide, on a supplemental basis, a copy of any omitted schedules or attachments to the Staff upon request; (2) personally identifiable information; and (3) confidential information contained in material contracts filed as exhibits if such information both (a) would be competitively harmful if disclosed to the public, and (b) is not material, even where the registrant has not submitted a confidential treatment request to the SEC. The Staff noted that it will continue its selective review of registrant filings and will selectively assess whether the exhibit redactions appear to be limited to "information that is not material and that would subject the registrant to competitive harm if publicly disclosed." The Staff may request that registrants promptly provide supplemental materials, consistent with the current confidential treatment process, including an unredacted paper copy of the exhibit and the registrant's analysis to support its redaction. Similar to the current confidential treatment process, if the supplemental materials do not support the redactions, the Staff may request that the registrant amend its filing to include some or all of the previously redacted information.

  - Currently, Item 202 of Regulation S-K requires registrants to provide disclosure in their registration statements regarding the terms and conditions of the securities it is registering. The SEC proposed an amendment that would require a registrant to provide similar disclosure for each registered class of the registrant's securities as exhibits to Form 10-K.

  - Registrants are currently required to file every material contract not made in the ordinary course of business, so long as either (1) some or all of the contract must be performed at or following the filing of the relevant registration statement or report; or (2) the contract was not entered into more than two years before the relevant filing (the Two Year Look Back). The Proposal contains a proposed amendment to Item 601(b)(10)(i) of Regulation S-K that would restrict the application of the Two Year Look Back to "newly reporting registrants" (which the proposal defines as any registrant that either (a) is not subject to the reporting requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) at the time it files a registration statement; or (b) has not filed an annual report since becoming subject to SEC reporting obligations again following a previously suspended reporting obligation).

- **Description of Property.** Item 102 of Regulation S-K would be amended to "emphasize materiality" by providing that the description of property is only required if one or more physical properties are material to the registrant. However, the proposed amendment would not apply to companies involved in the mining, real estate or oil and gas industries, given the significance of this disclosure for registrants in those industries.

- **Section 16 Compliance.** Section 16(a) of the Exchange Act requires that certain insiders report their beneficial ownership of a registrant's equity securities in a format prescribed by the SEC, and Item 405 of Regulation S-K (Item 405) requires registrants to disclose certain information regarding Section 16 reporting persons. The Proposal would:

  - eliminate the requirement that reporting persons furnish Section 16 reports to the registrant;

  - clarify that, in order for registrants to make the disclosure required by Item 405, registrants may rely on Section 16 reports filed on EDGAR (rather than Section 16 reports furnished to the registrant by its reporting persons), but are not required to limit their inquiry to those Section 16 filings; and

  - include an instruction that registrants should not include the "Section 16(a) Beneficial Ownership Reporting Compliance" heading in their filings if they do not have any Section 16(a) delinquencies to report. In addition, the SEC proposes to change the heading to "Delinquent Section 16(a) Reports" to more precisely describe the required disclosure.

- **Offerings and Prospectuses.**

  - The proposed amendments would explicitly permit a registrant, when it is impracticable to state on a prospectus cover page the public offering price of the securities (as is currently required by Item 501(b)(3) of Regulation S-K), to state that the offering price will be determined by a particular method or formula that is more fully explained in the prospectus (including a cross-reference to the method or formula).

  - Currently, Item 501(b)(4) of Regulation S-K requires a registrant to disclose each national securities exchange that lists, and the corresponding trading symbols for, the securities being offered. The Proposal would require each registrant to disclose each principal U.S. market (not just each national securities exchange) for, and the corresponding trading symbols of, the securities being offered.

- **Risk Factors.** The SEC has proposed to eliminate the risk factor examples currently listed in Item 503(c) of Regulation S-K in order to both (1) avoid the implication that a registrant must address each of the example risk factors (regardless of the relevance of those risk factors to the registrant's business); and (2) "encourage registrants to focus on their own risk identification processes."

- **Elimination of Certain Undertakings.** The Proposal contains proposed amendments to Item 512 of Regulation S-K that would eliminate the requirement that registrants include certain undertakings that are duplicative of other rules or that have become unnecessary due to developments since their adoption.

- **Accessibility (XBRL, Hyperlinking, Incorporation by Reference and Flexibility in Items/Numbering).**

  - The SEC has proposed to require registrants to tag *all* "data points" on the cover pages of Form 10-K, Form 10-Q, Form 8-K, Form 20-F and Form 40-F (as applicable) using Inline XBRL (or traditional XBRL if the SEC's Inline XBRL proposal is not adopted) (whereas the current rules require that operating company registrants tag some, but not all, data points on cover pages). The SEC also proposed an amendment to revise the cover page of those forms to require that registrants include the trading symbol for each class of its securities that are registered under the Exchange Act, as an additional data point to be formatted in XBRL.

  - The Proposal would:

    - subject to certain exceptions, eliminate the prohibition on registrants incorporating a document by reference if the document has been on file with the SEC for more than five years;

    - eliminate the requirement that copies of information incorporated by reference be filed as exhibits to periodic reports or registration statements; and

    - unless otherwise specifically allowed or required by applicable SEC rules, prohibit registrants from incorporating by reference or cross-referencing information from disclosure outside of the financial statements into the financial statements.

  - The Proposal also would permit registrants filing a Form 10, Form 10-K or Form 20-F to exclude certain item numbers and captions or create their own captions tailored to their disclosure, other than those captions that are expressly required by those forms or otherwise by Regulation S-K. The Staff noted that the purpose of this proposed amendment is to "reduce the use of unnecessary cross-references when information may be responsive to more than one disclosure item."

The SEC is soliciting comments on the Proposal for a period of 60 days after publication in the *Federal Register*.

The full text of the Proposal is available here.

BROKER-DEALER

FINRA Publishes Regulatory Notice Regarding Sales Practice Obligations for Volatility-Linked Exchange-Traded Products

On October 16, the Financial Industry Regulatory Authority (FINRA) published Regulatory Notice 17-32 (Notice), which reminds FINRA member firms of their sale practice obligations related to the sale of volatility-linked exchange-traded products (ETPs), which are designed to track Chicago Board Options Exchange Volatility Index (VIX) futures. Based on the high likelihood that such instruments may lose value over time, FINRA notes that volatility-linked ETPs may not be suitable for certain retail investors, in particular those who use them as part of a buy-and-hold strategy; and that because of the complex nature of these instruments, it is possible that investors and registered representatives may not understand the risks of the product. Based on the risk profile of these investments, the Notice reminds member firms of the need to (among other things) (1) perform reasonable diligence to determine whether there is a reasonable basis to believe that each such ETP is suitable for at least some investors prior to recommending the ETP; (2) form a reasonable belief that a recommended volatility-linked ETP is suitable for particular investors to whom it is recommended; (3) provide investors with fair and accurate communications with respect to these products; and (4) consider implementation of heightened scrutiny and supervision to ensure that registered representatives and supervisors understand the risks of the instruments and comply with applicable suitability and communications obligations.

A copy of the Notice is available here.

DERIVATIVES

See "CFTC Clarifies That Variation Margin Constitutes Settlement" and "CFTC Conducts DCO Liquidity Stress Tests" in the CFTC section.

Three Developments Concerning EU-US Cross-Border Swaps

On October 13, the Commodity Futures Trading Commission and the European Commission (EC) made three announcements that are significant for cross-border swap activity between the United States and Europe.

1. CFTC Margin Rule Comparability Determination.

The CFTC has made a determination that the margin rules for uncleared swaps that apply in the European Union are comparable to the CFTC's margin rules. This determination activates the substituted compliance provisions found in Section 23.160(b)(2)(iii) of the CFTC margin rules that until now have not been available to EU entities registered as swap dealers. The CFTC's summary of the determination is as follows:

> "Accordingly, a CSE [Covered Swap Entity] that is subject to both the Final Margin Rule and the EU's margin rules with respect to an uncleared swap that is also a non-centrally cleared OTC derivative may rely on substituted compliance for all aspects of the Final Margin Rule and the Cross-Border Margin Rule. Any such CSE that, in accordance with this comparability determination, complies with the EU margin rules, would be deemed to be in compliance with the Final Margin Rule but would remain subject to the Commission's examination and enforcement authority."

This determination does not apply to bank swap dealers, which must wait until a similar comparability determination is made by the US prudential regulators before substituted compliance can be used under the prudential regulator margin rules.

In addition, the determination only applies to a transaction that is both a swap (as defined in the Commodity Exchange Act) and an over-the-counter (OTC) derivative (as defined by the EU), so it will not help when deliverable FX forwards and FX become subject to the EU margin rules on January 3, 2018 (since they are not swaps under US law).

The CFTC press release is available here.

The determination is available here.

2. European Commission Equivalence Decisions

The EC has taken similar action by adopting two equivalence decisions with respect to US swap regulations that allow both parties to a swap to comply with US swap rules instead of EU rules when one of the parties is a US person that is registered as a swap dealer and one is an EU person subject to EU swap rules.

One decision relates to swap margin:

> ". . . the legal, supervisory and enforcement arrangements of the USA for the exchange of collateral that are applied to transactions regulated as 'swaps' by the Commodity Futures Trading Commission (CFTC) . . . and that are not cleared by a CCP shall be considered as equivalent to the requirements of Article 11(3) of Regulation (EU) No 648/2012, where at least one of the counterparties to those transactions is established in the USA and registered with the CFTC as a swap dealer or major swap participant, and that counterparty is subject to the Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

> and the Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross Border Application of the Margin Requirements."

The equivalence decision has the same limitations as the US comparability determination—it only relates to the CFTC swap margin rules, not the prudential regulator margin rules, and only covers OTC derivatives that are subject to mandatory margining under both EU law and CFTC regulations.

The second decision relates to risk mitigation rules (meaning requirements concerning timely confirmation, portfolio compression, reconciliation, valuation and dispute resolution):

> ". . . the legal, supervisory and enforcement arrangements of the United States of America (USA) for operational risk-mitigation techniques that are applied to transactions regulated as 'swaps' by the Commodity Futures Trading Commission (CFTC) in accordance with section 721(a)(21) of the Dodd-Frank Act and that are not cleared by a CCP shall be considered as equivalent to the requirements set out in paragraphs 1 and 2 of Article 11 of Regulation (EU) No 648/2012, where at least one of the counterparties to those transactions is established in the USA and registered with the CFTC as a swap dealer or major swap participant."

The EC equivalence decisions are available here.

3. Joint CFTC-EC Announcement Concerning Derivatives Trading Venues

The CFTC and the EC jointly issued a paper entitled "A Common Approach on Certain Derivatives Trading Venues," which describes the intention of each party to allow swap market participants to use any regulated swap trading platform in the US or the EU to satisfy mandatory trade execution requirements. Implementation of this intention will require the EC to adopt an equivalence decision with respect to CFTC-authorized swap execution facilities (SEF) and designated contract markets (DCMs) and the CFTC to exempt trading venues authorized in accordance with the Markets in Financial Instruments Directive (MiFID II)/Markets in Financial Instruments Regulation (MiFIR) requirements from possible SEF registration.

The announcement says that "[t]he CFTC staff and the EC services will work as expeditiously as practicable to ensure that this arrangement is put into place and operating in a coordinated manner. . . ."

The announcement is available here.

CFTC

CFTC Clarifies That Variation Margin Constitutes Settlement

The Division of Clearing and Risk (DCR) of the Commodity Futures Trading Commission has issued an interpretive letter clarifying that payments of variation margin, price alignment amounts and other payments in satisfaction of outstanding exposures on a counterparty's cleared swap positions constitute "settlement" under the Commodity Exchange Act (CEA) and CFTC Regulation 39.14. The CEA and CFTC Regulation 39.14 provide that a derivatives clearing organization (DCO) must effect a settlement at least once each business day and ensure that settlements are final when effected.

Although not mentioned by DCR, the letter is clearly intended to complement earlier guidance issued jointly by the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (Guidance) regarding the *Regulatory Capital Treatment of Certain Centrally Cleared Derivatives Contracts Under Regulatory Capital Rules*. As the Guidance explains in greater detail, for purposes of the risk-based capital calculation and the supplementary leverage ratio calculation, the regulatory capital rules require financial institutions to calculate their trade exposure amount with respect to derivatives contracts. The trade exposure amount, in turn, is determined, in part, by taking into account the remaining maturity of such contracts. The Guidance goes on to explain that for a derivatives contract that is structured such that on specific dates any outstanding exposure is settled and the terms are reset so that the fair value of the contract is zero, the remaining maturity equals the time until the next reset.

> "Accordingly, for the purpose of the regulatory capital rules, if, after accounting and legal analysis, the institution determines that (i) the variation margin payment on a centrally cleared Settled-to-Market Contract settles any outstanding exposure on the contract, and (ii) the terms are reset so that fair value of the contract is zero, the remaining maturity on such contract would equal the time until the next exchange of variation margin on the contract."

CFTC Letter No. 17-51 provides the legal analysis to confirm that, as a condition of registration with the CFTC as a DCO, each DCO must provide for daily settlement of all obligations, including the payment and receipt of all variation margin obligations, which payments are irrevocable and unconditional when effected. As a result, a clearing member's obligations to each DCO are satisfied daily and the fair value of the open cleared derivatives held at the DCO is effectively reset to zero daily.

CFTC Letter No. 17-51 is available here.

The Guidance is available here.

CFTC Conducts DCO Liquidity Stress Tests

The Division of Clearing and Risk (DCR) of the Commodity Futures Trading Commission has issued a report summarizing stress tests conducted by three derivatives clearing organizations (DCOs): the Chicago Mercantile Exchange (CME), ICE Clear US (ICUS) and LCH Ltd (LCH). During the stress tests, DCR evaluated whether each DCO could obtain, in a timely manner, the funds necessary to meet the settlement obligations resulting from the simultaneous default of two large clearing members. DCR also evaluated whether the need for liquidity at multiple DCOs under such circumstances might have systemic implications.

DCR determined that all the DCOs demonstrated the ability to generate sufficient liquidity to fulfill settlement obligations on time. Similarly, DCR concluded that the cumulative size of liquidity requirements in the test scenario would not impair the ability of each DCO to meet its settlement obligations.

The tests included futures and options on futures cleared at CME and ICUS, and interest rate swaps cleared at LCH and CME.

DCR's report is available here.

CFTC Issues Primer on Cryptocurrencies

The Commodity Futures Trading Commission's LabCFTC has issued a primer on cryptocurrencies and distributed ledger technology. The primer is the first in a series that is intended to provide the public with educational information on financial technology innovation.

In the primer, LabCFTC highlights various risks inherent in cryptocurrencies, including operational risks, cybersecurity risks, speculative risks and fraud and manipulation risks.

LabCFTC's primer is available here.

BREXIT/UK DEVELOPMENTS

FCA Launches Asset Management Authorization Hub

On October 16, the UK Financial Conduct Authority (FCA) launched the asset management authorization hub (Hub), a new section of its website. The Hub is designed to support new entrants to the UK asset management industry from start-up, through authorization and into the early stages of supervision.

The FCA states that the Hub aims to clarify regulator expectations and offer better guidance, easier access to information, as well as create more positive and personalized contact with the regulator to improve the application process. The Hub offers pre-application meetings, dedicated case officers and a centralized website for information relevant to asset managers. The FCA plans to develop the Hub in the future by offering further support such as surgeries and online booking for pre-application meetings.

Ultimately, the FCA wants to reduce unnecessary barriers to entry and to encourage competition in the asset management sector, one of the key themes of its final report on its asset management market study (for more information on the final report, please see the June 30, 2017 edition of *Corporate & Financial Weekly Digest*). The FCA also may seek to make the United Kingdom a more attractive proposition for asset managers in light of Brexit. However, the FCA wants to stress that the Hub is not intended to lower entry standards to the market and it expects all firms to meet the same rigorous standards as current firms.

The Hub is available here.

FCA Issues MiFID Passporting Reminder

On October 16, the UK Financial Conduct Authority (FCA) reminded firms via email of changes to the process for the submission of passporting notifications under the Markets in Financial Instruments Directive (MiFID I) and the revised Markets in Financial Instruments Directive (MiFID II).

Firms wishing to passport activities under MiFID I (in relation to existing business to be passported prior to January 3, 2018, when MiFID II goes into effect), can continue to submit passport notifications as normal via Connect until December 3, 2017.

From December 4, firms can continue to submit MiFID passport notifications on Connect, but the system will reflect the MiFID II framework. This will mean, for example, that firms must submit one passport notification for each country in which they intend to provide cross-border services. However, it will not be possible to select MiFID II specific passport activities on Connect until January 3.

More information is available here.

FCA Opens Commodity Derivatives Position Limit Exemption Applications

On October 18, the UK Financial Conduct Authority (FCA) published the necessary forms for firms to apply for position limits exemptions under the revised Markets in Financial Instruments Directive (MiFID II).

A position limit is the maximum size of a position held by a person in any commodity derivative traded on a European Economic Area (EEA) trading venue and economically equivalent over-the-counter (EEOTC) contracts. MiFID II requires competent authorities, such as the FCA, to establish and apply such position limits.

Non-financial entities (NFEs) can apply to the FCA for a position-limit exemption for one or more contracts. Applicants will need to show that its position in a particular commodity derivative is directly risk-reducing in relation to its commercial activity.

The FCA states that any approved exemption will be an uncapped exemption for risk-reducing positions in the specific contract. However, the FCA will still monitor the reported positions against the basis of the information provided in the application form. If there is a significant change in the nature or value of the NFE's commercial or trading activities, the NFE is required to submit a new application.

Further information and the relevant application forms can be found here.

EU DEVELOPMENTS

See "Three Developments Concerning EU-US Cross-Border Swaps," sections 2 and 3, in the Derivatives section.

EU Begins Infringement Proceedings Against 19 Member States Failing to Implement MiFID II

The European Commission has launched infringement proceedings against 19 member states of the European Union whom it states are failing in transposing the revised Markets in Financial Instruments Directive (MiFID II) into local law. MiFID II is due to go into effect on January 3, 2018, and the deadline for transposition into local law was July 3, 2017.

The member states involved are Belgium, Bulgaria, Croatia, Estonia, Finland, France, Greece, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden.

Such proceedings are launched against a backdrop of industry calls for further delay to the start date of MiFID II to allow affected firms more time to prepare for the significant changes that the directive mandates. The UK Financial Conduct Authority (FCA) recently stated that firms would not be punished for not complying with MiFID II if they have taken sufficient steps to meet the new requirements (for more information, please see the September 22, 2017 edition of Corporate & Financial Weekly Digest). Steven Maijoor, European Securities and Markets Authority (ESMA) Chairman, re-iterated in September, however, that there would be no further delay to MiFID II, which was originally due to go into effect in January (for more information, please see the October 6, 2017 edition of *Corporate & Financial Weekly Digest*).

More information on the EU's current infringement proceedings is available here.

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

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BREXIT/UK/EU DEVELOPMENTS

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