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SEC / CORPORATE

SEC Division of Corporation Finance Issues New and Updated C&DIs on Omission of Financial Information from Draft Registration Statements

Since the adoption of the Fixing America's Surface Transportation Act (FAST Act) on December 4, 2015, the Division of Corporation Finance (the Division) of the Securities and Exchange Commission has issued six Compliance and Disclosure Interpretations (C&DIs) relating to the FAST Act, the first two of which were summarized in the *Corporate and Financial Weekly Digest* edition of December 18, 2015 and the remainder of which were summarized in the *Corporate and Financial Weekly Digest* edition of January 8, 2016. On August 17, the Division updated FAST Act C&DI #1 and issued new Securities Act Forms C&DI 101.05, which modified and supplemented the original guidance. The FAST Act provides that an emerging growth company (EGC) conducting an initial public offering (IPO) or a follow-on offering within one year of its IPO, or filing an initial registration under the Securities Exchange Act of 1934 (the Exchange Act) may file registration statements that omit historical financial information for a period the EGC reasonably believes would not be required in the filing at the time of the contemplated offering. The Division's original guidance specified that an EGC *would be* required to include in its filings or confidential submissions interim financial statements for a period that will be part of a longer interim or annual period covered by financial statements required to be included in a subsequent public filing at the time of the offering.

On August 17, the Division updated FAST Act C&DI #1 and changed its position with regard to the presentation of interim financial statements in confidential submissions by an EGC, advising that an EGC *may* omit from such confidential submissions interim financial information that the EGC reasonably believes will not be required to be presented *separately* at the time the EGC launches its offering. Also on August 17, following the expansion of the non-public review process to non-EGCs in certain circumstances (which was previously discussed in the *Corporate and Financial Weekly Digest* editions of July 7, 2017 and August 25, 2017), the Division adopted Securities Act Forms C&DI 101.05, extending to non-EGCs accommodations similar to those provided to EGCs with regard to the omission of financial information from confidential draft registration statements (but not from publicly filed registration statements). Under the Division's new guidance with respect to non-EGCs, a non-EGC may omit from its confidential draft registration statement both annual and interim financial information that the issuer reasonably believes will not be required to be presented separately at the time the non-EGC files its registration statement publicly.

By way of illustration based on examples provided by the Division, in a November 2017 confidential draft registration statement for an offering by an EGC or a filing by a non-EGC that is expected to occur in April 2018, the issuer may not only omit financial information for the earliest year that would not be required for an April offering or filing, as applicable (meaning that, for purposes of the confidential draft registration statement, the EGC may omit financial information for 2015—as an EGC is only required to present annual financial information for two fiscal years; and the non-EGC may not only omit financial information for 2014—as a non-EGC is required to present annual financial information for three fiscal years), but may also omit *interim* financial information for 2016 and 2017 (as such interim financial information would not separately be required at the time of the offering, in the case of an EGC, or at the time of public filing, in the case of a non-EGC). The staff of the SEC has not changed its guidance, however, that, regardless of whether the issuer is an EGC or a non-EGC, a *publicly filed registration statement* must contain interim period financial information that is otherwise required at the time of such public filing, if such interim financial information will be part of a longer interim or annual period that will be required to be included in the registration statement at the time of the offering or public filing, as applicable.

The complete text of the updated FAST Act C&DI is available here, and the complete text of Securities Act Forms C&DI 101.05 is available here.

Speech From the Office of the Investor Advocate Addresses FASB's Proposals Regarding the Definition of Materiality

On August 22, the Investor Engagement Advisor in the Office of the Investor Advocate, Stephen Deane, gave a speech to the Tulsa chapter of the Institute of Management Accountants in which, among other things, he addressed two proposals by the Financial Accounting Standards Board (FASB) to revise the definition of materiality under generally accepted accounting standards.

In 2015, FASB proposed two updates that would remove its definition of materiality established in Concepts Statement No. 8 in favor of relying on the US federal courts' definition of materiality, under which "information is material if there is a substantial likelihood that the omitted or misstated item would have been viewed by a reasonable resource provider as having significantly altered the total mix of information." In doing so, FASB emphasized that materiality is a "legal concept" and that removal of its definition would align FASB's understanding of materiality with the legal concept of materiality.

Mr. Deane noted, however, that investors and investor groups raised several concerns with regards to the FASB's proposals, including that the proposals would reduce the flow of information to investors and shift decision-making on materiality from accountants to lawyers. He further acknowledged the lack of an existing framework for the evaluation of whether a disclosure is "material," including who should make that determination for the purposes of the accounting standards, and as a result, the "inconsistent application of the materiality standard."

In response to the FASB proposals, Mr. Deane noted the Office of the Investor Advocate's proposal to adopt a hybrid approach rooted in both a prior FASB definition of materiality that more closely aligns with the definition adopted by the US Supreme Court (in Concepts Statement No. 2), as well as the Securities and Exchange Commission Staff Accounting Bulletin 99, which provides a "helpful framework for evaluating materiality decisions" and takes into account "quantitative factors and qualitative factors"

The full text of Mr. Deane's speech is available here.

SEC and Staff Issue Interpretative Guidance on Revenue Recognition

On August 18, the Securities and Exchange Commission issued a press release announcing its issuance of two releases and the SEC staff's release of a Staff Accounting Bulletin to provide updates to interpretative guidance on revenue recognition.

The SEC updated its guidance on bill-and-hold arrangements, providing that registrants should no longer refer to criteria in Accounting and Auditing Enforcement Release No. 108, *In the Matter of Stewart Parness*, to recognize revenue for such arrangements upon the registrant's adoption of Accounting Standards Codification (ASC) Topic 606 (Revenue from Contracts with Customers).

The SEC updated its 2005 guidance on *Commission Guidance Regarding Accounting for Sales of Vaccines and Bioterror Countermeasures to the Federal Government for Placement into the Pediatric Vaccine Stockpile or the Strategic National Stockpile*, providing that manufacturers should recognize revenue for vaccines that are placed in the Vaccines for Children Program and the Strategic National, consistent with ASC Topic 606.

The SEC's Office of the Chief Accountant and Division of Corporation Finance released Staff Accounting Bulletin No. 116 (SAB 116), which conforms SEC staff guidance on revenue recognition to the Financial Accounting Standards Board's adoption of, and amendments to, ASC Topic 606.

The SEC and SEC staff noted that, until a registrant adopts ASC Topic 606, it should continue to rely on prior guidance.

The press release is available here.

PRIVATE INVESTMENT FUNDS

See "DOL Proposes 18-Month Extension of Transition Period for Compliance With ERISA Fiduciary Investment Advice Rule" in the Executive Compensation and ERISA section.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

See "DOL Proposes 18-Month Extension of Transition Period for Compliance With ERISA Fiduciary Investment Advice Rule" in the Executive Compensation and ERISA section.

EXECUTIVE COMPENSATION AND ERISA

DOL Proposes 18-Month Extension of Transition Period for Compliance With ERISA Fiduciary Investment Advice Rule

On August 31, the US Department of Labor proposed an 18-month extension of the full implementation of the Best Interest Contract Exemption and other related exemptions issued under the ERISA fiduciary rule. Under existing guidance, a fiduciary may comply with the exemptions by adhering to an abbreviated set of requirements referred to as the "impartial conduct standards." If the extension is finalized, a fiduciary may continue to satisfy the requirements of the exemptions by adhering to the impartial conduct standards through July 1, 2019.

Please see our August 11 advisory for additional information.

UK DEVELOPMENTS

New FCA Web Page on Position Limits for Commodity Derivative Contracts Under MiFID II

On August 30, the UK Financial Conduct Authority (FCA) published a new web page on position limits for commodity derivative contracts under the revised Markets in Financial Instruments Directive (MiFID II).

Under MIFID II, position limits are required on the size of a net position a person can hold at all times in commodity derivatives traded on trading venues and economically equivalent over-the-counter contracts. The web page lists the commodity derivative contracts that the FCA has currently identified as trading on a UK trading venue, which, beginning January 3, 2018, will have a bespoke position limit set against them. The list will be subject to change, and firms are encouraged to check it regularly.

Any other commodity derivatives not listed in the table and traded on a UK trading venue (but not traded in significant volumes on a venue in another EU member state) will, starting January 3, 2018, be subject to a limit of 2,500 lots.

The web page is available here.

EU DEVELOPMENTS

European Commission Adopts Delegated Regulation Mending MiFID II Systematic Internalizer Definition

On August 28, the European Commission (EC) published the text of an EC Delegated Regulation (SI Delegated Regulation), amending Delegated Regulation (EU) 2017/565 with respect to the specification of the definition of systematic internalizers (SI) for the purposes of the revised Markets in Financial Instruments Directive (MiFID II).

Delegated Regulation (EU) 2017/565 supplements MiFID II with respect to organizational requirements and operating conditions for investment firms and defined terms. Articles 12 to 16 expand on the definition of an SI as set out in Article 4(1)(20) of MiFID II.

The EC consulted on the SI Delegated Regulation in June 2017 because of perceived ambiguities about the meaning of "trading on own account when executing client orders" (for further information please see the June 23, 2017 *Corporate Financial Weekly Digest*). The EC stated in the SI Delegated Regulation that, during the consultation, concerns were also raised about prudential risk management achieved by means of intragroup transactions. The EC goes on to state that these concerns have been addressed by introducing a new recital and amendment to clarify the scope of matching arrangements that are considered dealing on own account.

The EC adopted the SI Delegated Regulation on August 28. If neither the Council of the European Union nor the European Parliament object to the SI Delegated Regulation, it will be published in the *Official Journal of the European Union* (*OJ*). It will become effective on the day after its publication in the *OJ* and will apply beginning January 3, 2018.

The SI Delegated Regulation 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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