

SEC Seeks to Encourage Registered Debt Offerings by Amending Financial Statement Requirements

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by Jason Brenkert

On March 2, the Securities and Exchange Commission adopted amendments to the financial disclosure requirements applicable to registered debt offerings that include credit enhancements, such as subsidiary guarantees. The final amendments amend Rule 3-10 of Regulation S-X and partially relocate its provisions to new Rule 13-01 and completely relocate Rule 3-16 into new Rule 13-02 (Rule 3-16 will continue to exist during the transition period). The Commission stated that the amendments are intended to:

- Improve existing Rules 3-10 and 3-16 by requiring disclosures that focus investors on the information that is material given the specific facts and circumstances and by making the disclosures easier to understand;
- Reduce the cost of compliance for registrants and encourage potential issuers to offer guaranteed or collateralized securities on a registered basis, thereby affording investors protections they may not be provided in offerings conducted on an unregistered basis; and
- Facilitate, through lower costs and burdens of compliance, issuers' flexibility to include guarantees or pledges of affiliate securities as collateral when they structure debt offerings, which may increase the number of registered offerings that include these credit enhancements and could result in a lower cost of capital and an increased level of investor protection.

The amendments as adopted are substantially similar to the amendments proposed by the Commission on July 24, 2018. The amendments will be effective on January 4, 2021, but voluntary compliance will be permitted in advance of the effective date.

Amendments to Rule 3-10 and New Rule 13-01

Prior to the amendments, Rule 3-10 required financial statements to be filed for all issuers and guarantors of securities that are registered or being registered, subject to several exceptions.

Under the amendments, Rule 3-10 will continue to permit the omission of separate

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financial statements of subsidiary issuers and guarantors when certain conditions are met and the parent company provides supplemental financial and non-financial disclosure about the subsidiary issuers and/or guarantors and the guarantees. Similar to the existing rule, the amended rule will provide the conditions that must be met in order to omit separate subsidiary issuer or guarantor financial statements. New Rule 13-01 sets forth the accompanying amended disclosure requirements, as follows:

- The condition that a subsidiary issuer or guarantor be 100%-owned by the parent company is replaced with a condition that it be consolidated in the parent company's consolidated financial statements;
- The condensed consolidating financial information, as specified in existing Rule 3-10, is replaced with certain new financial and non-financial disclosures. The amended financial disclosures will consist of summarized financial information of the issuers and guarantors, which may be presented on a combined basis, and reduce the number of periods presented. The amended non-financial disclosures, among other matters, will expand the qualitative disclosures about the guarantees and the issuers and guarantors. Consistent with the existing rule, disclosure of additional information about each guarantor will be required if it would be material for investors to evaluate the sufficiency of the guarantee;
- The amended disclosures may be provided outside the footnotes to the parent company's audited annual and unaudited interim consolidated financial statements in all filings; and
- The amended financial and non-financial disclosures are required for as long as an issuer or guarantor has an Exchange Act reporting obligation with respect to the guaranteed securities rather than for as long as the guaranteed securities are outstanding.

Amendments to Rule 3-16 and New Rule 13-02

Rule 3-16 requires a registrant to provide separate financial statements for each affiliate whose securities constitute a substantial portion of the collateral, based on a numerical threshold, for any class of registered securities as if the affiliate were a separate registrant. Under the amendments, the requirements in Rule 3-16 will be replaced with the disclosure requirements in new Rule 13-02 (although existing Rule 3-16 will remain in place for transitional purposes). Among other things, the amendments will:

- Replace the existing requirement to provide separate financial statements for each affiliate whose securities are pledged as collateral with amended financial and non-financial disclosures about the affiliate(s) and the collateral arrangement as a supplement to the consolidated financial statements of the registrant that issues the collateralized security. The registrant will be permitted to provide the amended financial and non-financial disclosures outside the footnotes to its audited annual and unaudited interim consolidated financial statements in all filings; and
- Replace the requirement to provide disclosure only when the pledged securities meet or exceed a numerical threshold relative to the registered securities with a requirement to provide the proposed financial and non-financial disclosures in all cases, unless they are immaterial.