SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 210, 229, 239, 240 and 249

Release No. 33-10526; 34-83701; File No. S7-19-18

RIN 3235-AM12

FINANCIAL DISCLOSURES ABOUT GUARANTORS AND ISSUERS OF GUARANTEED SECURITIES AND AFFILIATES WHOSE SECURITIES COLLATERALIZE A REGISTRANT'S SECURITIES

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing amendments to the financial disclosure requirements for guarantors and issuers of guaranteed securities registered or being registered, and issuers' affiliates whose securities collateralize securities registered or being registered in Regulation S-X to improve those requirements for both investors and registrants. The proposed changes are intended to provide investors with material information given the specific facts and circumstances, make the disclosures easier to understand, and reduce the costs and burdens to registrants. In addition, by reducing the costs and burdens of compliance, issuers may be encouraged to offer guaranteed or collateralized securities on a registered basis, thereby affording investors protection they may not be provided in offerings conducted on an unregistered basis. Finally, by making it less burdensome and less costly for issuers to include guarantees or pledges of affiliate securities as collateral when they structure debt offerings, the proposed revisions may increase the number of registered offerings that include these credit enhancements, which could result in a lower cost of capital and an increased level of investor protection.

DATES: Comments should be received on or before [Insert date 60 days after publication in

the Federal Register].

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

Electronic comments:

- Use our Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an email to rule-comments@sec.gov. Please include File Number S7-19-18 on the subject line.

Paper comments:

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

All submissions should refer to File Number S7-19-18. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method of submission. We will post all comments on our website (http://www.sec.gov/rules/other.shtml). Comments also are available for website viewing and printing in our Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.

We or the staff may add studies, memoranda, or other substantive items to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on our website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Jarrett Torno, Assistant Chief Accountant, at (202) 551-3400, or John Fieldsend, Special Counsel, at (202) 551-3430, in the Division of Corporation Finance, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is proposing to amend 17 CFR 210.3-10 ("Rule 3-10"), 17 CFR 210.3-16 ("Rule 3-16"), 17 CFR 210.8-01 ("Rule 8-01"), 17 CFR 210.8-03 ("Rule 8-03"), and 17 CFR 210.10-01 ("Rule 10-01") of Regulation S-X[1] under the Securities Act of 1933 ("Securities Act")[2] and the Securities Exchange Act of 1934 ("Exchange Act");[3] 17 CFR 229.504 ("Item 504"), 17 CFR 229.1100 ("Item 1100"), 17 CFR 229.1112 ("Item 1112"), 17 CFR 229.1114 ("Item 1114"), and 17 CFR 229.1115 ("Item 1115") of Regulation S-K[4] under the Securities Act and Exchange Act; Forms F-1,[5] F-3,[6] 1-A,[7] 1-K,[8] and 1-SA[9] under the Securities Act; and 17 CFR 240.12h-5 ("Rule 12h-5") and Form 20-F[10] under the Exchange Act. In addition, the Commission is proposing to add new Article 13 to Regulation S-X that would include new 17 CFR 210.13-01 ("Rule 13-01") and 17 CFR 210.13-02 ("Rule 13-02").

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1 17 CFR 210.1-01 *et seq.*

2 15 U.S.C. 77a *et seq.*

3 15 U.S.C. 78a *et seq.*

4 17 CFR 229.10 *et seq.*

5 17 CFR 239.31.

6 17 CFR 239.33.

7 17 CFR 239.90.

8 17 CFR 239.91.

9 17 CFR 239.92.

10 17 CFR 249.220f.

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I. Introduction

A. Background

We are proposing changes to the disclosure requirements in Rules 3-10 and 3-16 of Regulation S-X to better align those requirements with the needs of investors and to simplify and streamline the disclosure obligations of registrants. Rule 3-10 requires financial statements to be filed for all issuers and guarantors of securities that are registered or being registered, but also provides several exceptions to that requirement. These exceptions are typically available for individual subsidiaries of a parent company[11] when certain conditions are met and the consolidated financial statements of that parent company are filed. Rule 3-16 requires a registrant to provide separate financial statements for each affiliate whose securities constitute a substantial portion of the collateral for any class of registered securities as if the affiliate were a separate registrant. The changes we are proposing include amending both rules and relocating part of Rule 3-10 and all of Rule 3-16 to new Article 13 in Regulation S-X, which would comprise proposed Rules 13-01 and 13-02.[12] These changes are intended to provide investors with the information that is material given the specific facts and circumstances, make the disclosures easier to understand, and reduce the costs and burdens to registrants.

This proposal results from an ongoing, comprehensive evaluation of our disclosure requirements.[13] As part of that evaluation, in September 2015, the Commission issued a *Request*

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[11] The identity of the parent company depends on the particular corporate structure. *See* additional discussion in Section II.C, "Parent Company Financial Statements Condition."

[12] Proposed Article 13 would contain financial and non-financial disclosure requirements for certain types of securities registered or being registered that, while material to investors, need not be included in the audited and unaudited financial statements.

[13] The staff, under its Disclosure Effectiveness Initiative, is reviewing the disclosure requirements in Regulations S-K and Regulation S-X and is considering ways to improve the disclosure regime for the benefit of both companies and investors. The goal is to comprehensively review the requirements and make recommendations

for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant ("Request for Comment").[14] The Request for Comment sought feedback on, among other things, the financial disclosure requirements in Regulation S-X for certain entities other than the registrant, including the requirements in Rules 3-10 and 3-16. More specifically, the Commission solicited comment on how investors use the disclosures required by these rules to make investment decisions; the challenges that registrants face in providing the required disclosures; and potential changes to these requirements that could enhance the information provided to investors and promote efficiency, competition, and capital formation.

In response, we received approximately 50 comment letters.[15] About half of these comment letters addressed Rule 3-10,[16] and nearly as many addressed Rule 3-16.[17] Additionally, prior to issuing the Request for Comment, one comment letter was submitted, in response to the

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on how to update them to facilitate timely, material disclosure by companies and shareholders' access to that information.

[14] Release No. 33-9929 (Sept. 25, 2015) [80 Fed. Reg. 59083 (Oct. 1, 2015)].

[15] Comments that we received in response to the Request for Comment are available at https://www.sec.gov/comments/s7-20-15/s72015.shtml. References to comment letters in this release refer to the comments on the Request for Comment unless otherwise specified.

[16] *See, e.g.*, letters from Association of the Bar of the City of New York (Nov. 30, 2015) ("AB-NYC"); Anuradha RK (Nov. 23, 2015) ("Anuradha"); BDO USA, LLP (Dec. 7, 2015) ("BDO"); Cahill Gordon & Reindel LLP (Nov. 30, 2015) ("Cahill"); California Public Employees' Retirement System (Nov. 30, 2015) ("CalPERS"); Center for Audit Quality (Nov. 25, 2015) ("CAQ"); CFA Institute (Mar. 2, 2016) ("CFA"); Comcast Corporation (Dec. 11, 2015) ("Comcast"); Covenant Review, LLC (Nov. 30, 2015) ("Covenant"); Davis Polk & Wardwell LLP (Nov. 30, 2015) ("Davis Polk"); Deloitte & Touche LLP (Nov. 23, 2015) ("DT"); Ernst & Young LLP (Nov. 20, 2015) ("EY"); FedEx Corporation ("Nov. 30, 2015) ("FedEx"); General Motors Company (Nov. 30, 2015) ("GM"); Grant Thornton LLP (Dec. 1, 2015) ("Grant"); Headwaters Incorporated (Nov. 30, 2015) ("Headwaters"); KPMG LLP (Nov. 30, 2015) ("KPMG"); Medtronic plc (Nov. 30, 2015) ("Medtronic"); Noble Corporation plc (Dec. 1, 2015) ("Noble-UK"); PricewaterhouseCoopers LLP (Nov. 30, 2015) ("PwC"); RSM US LLP (Nov. 30, 2015) ("RSM"); Securities Industry and Financial Markets Association (Nov. 30, 2015) ("SIFMA"); Simpson Thacher & Bartlett LLP (Nov. 30, 2015) ("Simpson"); U.S. Chamber of Commerce, Center for Capital Markets Competitiveness (Nov. 30, 2015) ("Chamber"); and WhiteWave Foods Company (Nov. 30, 2015) ("WhiteWave").

[17] *See, e.g.*, letters from Anuradha, BDO, Cahill, CalPERS, CAQ, CFA, Covenant, Davis Polk, DT, EY, KPMG, PwC, SIFMA, and Chamber.

staff's Disclosure Effectiveness Initiative, that addressed Rules 3-10 and 3-16.[18] These comments were considered carefully in developing these proposals.

B. Scope of Proposals

We are proposing changes to the disclosure requirements contained in Rules 3-10 and 3-16. These rules represent a discrete, but important, subset of the Regulation S-X disclosure requirements.[19] Both rules affect disclosures made in connection with registered debt offerings[20] and subsequent periodic reporting.[21] We believe that revising these rules would reduce the cost of compliance for registrants and encourage potential issuers to conduct registered debt offerings or private offerings with registration rights. The proposed amendments would benefit investors by simplifying and streamlining the disclosure provided to them about registered transactions and improve transparency in the market to the extent more offerings are registered.[22] In addition,

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[18] *See* letter from Disclosure Effectiveness Working Group of the Federal Regulation of Securities Committee and the Law and Accounting Committee of the Business Law Section of the American Bar Association (Nov. 14, 2014) ("ABA-Committees"), https://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness.shtml.

[19] Until 2000, the disclosure requirements for guarantors and issuers of guaranteed securities registered or being registered and those for affiliates whose securities collateralized securities registered or being registered were included in the same rule. The Commission separated those disclosure requirements in 2000 because of the significant change made to the structure and substance of the disclosure requirements for guarantors and issuers of guaranteed securities registered or being registered. *See Financial Statements and Periodic Reports for Related Issuers and Guarantors*, Release No. 33-7878 (Aug. 4, 2000) [65 Fed. Reg. 51691 (Aug. 24, 2000)] ("2000 Release"). The Commission kept these new disclosure requirements in Rule 3-10 and moved the disclosure requirements for affiliates whose securities collateralize securities registered or being registered to new Rule 3-16. The substance of the requirements moved to Rule 3-16 were unchanged. *See Separate Financial Statements Required by Regulation S-X*, Release No. 33-6359 (Nov. 6, 1981) [46 Fed. Reg. 56171 (Nov. 16, 1981)].

[20] In practice, pledges of affiliate securities as collateral are almost always for debt securities. However, the requirements of Rule 3-16 are applicable to any security registered or being registered, whether or not in the form of debt.

[21] The proposed amendments will not affect the presentation of registrants' consolidated financial statements prepared in accordance with U.S. GAAP or International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board in registration statements and Exchange Act periodic reports, such as Form 10-K. The proposed amendments are focused on the supplemental information about subsidiary issuers and guarantors as well as affiliates whose securities are pledged as collateral.

[22] In a recent report to Congress, the Commission's Division of Economic Risk Analysis determined that capital raising activity in the registered debt market was approximately $1.3 trillion in 2016. *See* U.S. Sec. & Exch.

if the proposed changes reduce the burden associated with providing guarantees or pledges of affiliate securities as collateral,[23] investors may benefit from access to more registered offerings that are structured to include such enhancements and, accordingly, the additional protections that come with Section 11 liability for disclosures made in those offerings.

II. Rule 3-10 of Regulation S-X

A. Background

A guarantee of a debt or debt-like security ("debt security")[24] is a separate security under the Securities Act[25] and, as a result, offers and sales of these guarantees[26] must be either registered or exempt from registration. If the offer and sale is registered, the issuer of the debt security and the guarantor[27] must each file its own audited annual and unaudited interim[28] financial statements required by Regulation S-X. Additionally, the offer and sale of the securities pursuant to a Securities Act registration statement causes the issuer and guarantor to

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Comm'n, Div. of Econ. & Risk Analysis, *Access to Capital and Market Liquidity* 96 (Aug. 2017) [hereinafter *Access to Capital and Market Liquidity Report*], https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-2017.pdf. In 2016, debt offerings under Securities Act Rule 144A raised approximately $562.8 billion, based on staff analysis of data from the SDC Platinum (Thomson Reuters) database.

[23] Currently, registrants often structure debt agreements to release affiliate securities pledged as collateral if the disclosure requirements of Rule 3-16 would be triggered, thereby depriving investors of that collateral protection. *See* additional discussion below. Registrants may cease structuring offerings to release such collateral if disclosure burdens are reduced by the proposed amendments, which would benefit investors.

[24] Rule 3-10 exceptions are available to issuers and guarantors of guaranteed securities that are "debt or debt-like." The 2000 Release stated, in part, "[t]he characteristics that identify a guaranteed security as debt or debt-like for this purpose are: the issuer has a contractual obligation to pay a fixed sum at a fixed time; and where the obligation to make such payments is cumulative, a set amount of interest must be paid." *See* Section III.A.4 of the 2000 Release and additional discussion in Section II.H, "Securities to which Rule 3-10 Applies."

[25] *See* Section 2(a)(1) of the Securities Act.

[26] These securities, while separately identified in the Securities Act, are typically purchased by investors together with the related debt security and are held together while outstanding.

[27] The issuer and guarantor structures contemplated by Rule 3-10 can comprise multiple issuers and multiple guarantors. For example, a parent can co-issue a security with one of its subsidiaries that several of its other subsidiaries guarantee.

[28] A foreign private issuer need only provide interim period disclosure in certain registration statements.

become subject to reporting under Section 15(d) of the Exchange Act.[29] Reporting under Section 15(d) requires filing periodic reports that include audited annual and unaudited interim financial statements for at least the fiscal year in which the related Securities Act registration statement became effective.[30]

When the Commission amended Rule 3-10 in 2000, it recognized that "[t]here are circumstances, however, where full Securities Act and Exchange Act disclosure by both the issuer and the guarantors may not be useful to an investment decision and, therefore, may not be necessary."[31] Common examples are when: (1) a parent company offers its own securities that its subsidiary guarantees; and (2) a subsidiary offers securities that its parent company fully and unconditionally guarantees. In these and similar situations, in which a parent company and one or more of its subsidiaries serve as issuers and/or guarantors of guaranteed securities, we believe the disclosure requirements generally have been guided by an overarching principle: the consolidated financial statements of the parent company are the principal source of information for investors when evaluating the debt security and its guarantee together.[32] This principle is grounded in the idea that the investment is in the *consolidated* enterprise when: (1) the parent company is fully obligated as either issuer or full and unconditional guarantor of the security;[33]

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29 *See* 15 U.S.C. 78o(d).

30 The duty to file under Section 15(d) is automatically suspended as to any fiscal year, other than the fiscal year within which the registration statement became effective, if, at the beginning of such fiscal year, the securities of each class to which the registration statement relates are held of record by less than 300 persons. *See* Section 15(d)(1) of the Exchange Act.

31 *See* Section I of the 2000 Release.

32 Parent company consolidated financial statements must be filed in all instances where the omission of financial statements of subsidiary issuers and guarantors are permitted under existing Rule 3-10. *See* paragraph (4) in each of Rules 3-10(b)-(f).

33 Typically, all of a parent company's subsidiaries support the parent company's debt-paying ability. However, in the event of default, the holders of debt without the benefit of guarantees are comparatively disadvantaged. In the event of default, a holder of a debt security issued by a parent company can make claims for payment directly against the issuer and guarantors. The assets of non-issuer and non-guarantor subsidiaries typically

(2) the parent company controls each subsidiary issuer and guarantor, including having the ability to direct all debt-paying activities;[34] and (3) the financial information of each subsidiary issuer and guarantor is included as part of the consolidated financial statements of the parent company.[35] In these circumstances, we believe full Securities Act and Exchange Act disclosures for each subsidiary issuer and guarantor are generally not material for an investor to make an informed investment decision about a guaranteed security. Instead, we believe information included in the consolidated disclosures about the parent company, as supplemented with details about the issuers and guarantors, is sufficient. These disclosures help an investor understand how the consolidated entities within the enterprise support the obligation.

B. Overview of the Existing Requirements

Rule 3-10(a) states the general rule that every issuer of a registered security that is guaranteed and every guarantor of a registered security must file the financial statements required for a registrant by Regulation S-X. The rule also sets forth five exceptions to this general rule.[36] Each exception specifies conditions that must be met, including, in each case, that the parent company provide certain disclosures ("Alternative Disclosures"). If the conditions are met, separate financial statements of each qualifying subsidiary issuer and guarantor may be omitted. Only one of the five exceptions can apply to any particular offering and the subsequent

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would be accessible only by the holder indirectly through a bankruptcy proceeding. In such a proceeding, without a direct guarantee, the claims of the holder would be structurally subordinate to the claims of other creditors, including trade creditors of the non-issuer and non-guarantor subsidiaries.

[34] Debt-paying activities typically include, but are not limited to, the use of the subsidiary issuer's and guarantor's assets and the timing and amount of distributions.

[35] A parent company that prepares its financial statements in accordance with U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), would apply Accounting Standards Codification ("ASC") 810, *Consolidation*, in determining whether to consolidate a subsidiary issuer or guarantor. A parent company that qualifies as a foreign private issuer and prepares its financial statements in accordance with IFRS would apply IFRS 10, *Consolidated Financial Statements*.

[36] *See* Rules 3-10(b)-(f) of Regulation S-X. *See* Section II.F, "Exceptions," below.

Exchange Act reporting.

Two primary conditions, included in each of the exceptions, must be satisfied for a subsidiary issuer or guarantor to be eligible to omit its separate financial statements:

- each subsidiary issuer and guarantor must be "100% owned" by the parent company; and
- each guarantee must be "full and unconditional."

The form and content of the Alternative Disclosures are determined based on the facts and circumstances and can range from a brief narrative to highly-detailed condensed consolidating financial information ("Consolidating Information"). Subsidiary issuers and guarantors that are permitted to omit their separate financial statements under Rule 3-10 are also automatically exempt from Exchange Act reporting under Exchange Act Rule 12h-5. The parent company, however, must continue to provide the Alternative Disclosures for as long as the guaranteed securities are outstanding.[37]

Recently acquired subsidiary issuers and guarantors are addressed separately within Rule 3-10. Rule 3-10(g)[38] requires the Securities Act registration statement of a parent company filed in connection with issuing guaranteed debt securities to include one year of audited, and, if applicable, unaudited interim pre-acquisition financial statements for recently-acquired subsidiary issuers and guarantors that are significant and have not been reflected in the parent company's audited results for at least nine months of the most recent fiscal year.

C. Parent Company Financial Statements

Each of the exceptions in Rule 3-10 requires the parent company to file its financial

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[37] *See* Section III.C.1 of the 2000 Release and additional discussion in Section II.J, "Exchange Act Reporting Requirements."

[38] Rule 3-10(g) of Regulation S-X.

statements, but Rule 3-10 does not address when an issuer or guarantor is, in fact, the "parent company" because, as noted in the 2000 Release, the identity of the parent company will vary based on the particular corporate structure.[39] The 2000 Release identified three conditions that must be met before an entity can be considered the "parent company" for purposes of Rule 3-10, including that the entity owns 100% of each subsidiary issuer or guarantor directly or indirectly.[40]

D. 100% Owned

Rule 3-10(h)(1) defines a subsidiary as "100% owned" if all of its outstanding voting shares are owned, either directly or indirectly, by its parent company. A subsidiary not in corporate form is "100% owned" if the sum of all interests are owned, either directly or indirectly, by its parent company, except that the following are not included in the sum of all interests owned: 1) securities that are guaranteed by its parent, and, if applicable, other 100%-owned subsidiaries of its parent; and 2) securities that guarantee securities issued by its parent and, if applicable, other 100%-owned subsidiaries of its parent.[41] This condition was adopted so the risks associated with an investment in the parent company and its subsidiary would be "identical."[42] A subsidiary issuer or guarantor with any third party ownership interest would fail to meet this condition and not be eligible for an exception in Rule 3-10. This condition would

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[39] *See* Section III.A.6. of the 2000 Release.

[40] The three conditions for an entity to be considered the "parent company" are that the entity: (1) is an issuer or guarantor of the subject securities; (2) is an Exchange Act reporting company, or will become one as a result of the subject Securities Act registration statement; and (3) owns 100% of each subsidiary issuer or guarantor directly or indirectly. *See id.* A number of examples illustrating when an entity is or is not the parent company were included in an appendix to the 2000 Release. *See id.* at Appendix C.

[41] The 2000 Release states that "[u]nincorporated entities operate differently than corporations. For example, in a limited liability corporation, the ability to vote can be separated from the ability to manage the financial affairs of the entity." *See* Section III.A.1.a.ii of the 2000 Release. In recognition of such differences, separate definitions of 100% owned were included in existing Rule 3-10(h)(1) for corporate and non-corporate entities.

[42] *See* Section III.A.1.a.i.(A) of the 2000 Release.

also not be met if a subsidiary issued securities convertible into its voting securities to someone other than the parent company.[43]

E. Full and Unconditional Guarantees

Rule 3-10(h)(2) defines a guarantee as "full and unconditional" if, when an issuer of a guaranteed security has failed to make a scheduled payment, the guarantor is obligated to make the scheduled payment immediately and, if the guarantor does not, any holder of the guaranteed security may immediately bring suit directly against the guarantor for payment of all amounts due and payable. There can be no conditions, beyond the issuer's failure to pay, to the guarantor's payment obligation.[44] The condition that all guarantees be "full and unconditional" was adopted to limit the availability of Alternative Disclosures to situations where the payment obligations of the issuer and guarantor are essentially identical.[45]

F. Exceptions

Each of the five exceptions in the existing rule contains conditions that, if satisfied, permit registrants to omit separate financial statements of the subject subsidiary issuers and guarantors. These five exceptions are:

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[43] *See id.*

[44] For example, a guarantee is not full and unconditional if it is not operative until some time after default or if the amount the guarantor is obligated to pay differs from the amount the issuer must pay. As the payment obligation does not fall uniformly across the issuer and related guarantors before enforceability of the guarantee, each party in that structure must provide separate financial statements. *See* Section III.A.1.b.i. of the 2000 Release. However, a guarantee can meet the full and unconditional condition if it has a fraudulent conveyance "savings clause," such as the guarantee being limited to the maximum amount that can be guaranteed without constituting a fraudulent conveyance or fraudulent transfer under applicable insolvency laws, or if the guarantee is enforceable to the fullest extent of the law. *See* Section III.A.1.b.ii. of the 2000 Release. Additionally, a guarantee can be full and unconditional even if it has different subordination terms than the guaranteed securities. For example, a parent company's guarantee can be full and unconditional if the subsidiary's debt obligation ranks senior to all of its other debt and the parent company's guarantee ranks junior to other debt obligations of the parent company. While different subordination terms may mean the guaranteed security holders have different rights in the priority of payment with respect to the issuer and guarantor, both the issuer and guarantor remain fully liable to holders for all amounts due under the guaranteed security. *See* Section III.A.1.b.iii. of the 2000 Release.

[45] *See* Section III.A.1.b of the 2000 Release.

1) a finance subsidiary[46] issues securities that its parent company guarantees;[47]

2) an operating subsidiary issues securities that its parent company guarantees;[48]

3) a subsidiary issues securities that its parent company and one or more other subsidiaries of its parent company guarantee;[49]

4) a parent company issues securities that one of its subsidiaries guarantees;[50] or

5) a parent company issues securities that more than one of its subsidiaries guarantees.[51]

In addition to the two primary conditions discussed above, depending on which exception is applicable, additional conditions must be satisfied, including providing Alternative Disclosures in the footnotes to the parent company's consolidated financial statements. In most cases, the Alternative Disclosures consist of Consolidating Information. However, there are three situations in which the Alternative Disclosures consist of a brief narrative.[52] These three situations are:

- the subsidiary is a finance subsidiary, and the parent company is the only guarantor of the securities;

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[46] Rule 3-10(h)(7) of Regulation S-X ("A subsidiary is a finance subsidiary if it has no assets, operations, revenues or cash flows other than those related to the issuance, administration and repayment of the security being registered and any other securities guaranteed by its parent company.").

[47] *See* Rule 3-10(b) of Regulation S-X.

[48] *See* Rule 3-10(c) of Regulation S-X.

[49] *See* Rule 3-10(d) of Regulation S-X.

[50] *See* Rule 3-10(e) of Regulation S-X.

[51] *See* Rule 3-10(f) of Regulation S-X.

[52] The content of the brief narrative is specified within each of the exceptions based on the applicable facts and circumstances. For example, if the conditions are met, Rule 3-10(b)(4) of Regulation S-X specifies that the narrative disclosure to be included in a footnote to the parent company's consolidated financial statements must state, if true, "that the issuer is a 100%-owned finance subsidiary of the parent company and the parent company has fully and unconditionally guaranteed the securities." It also requires the footnote to include "the narrative disclosures specified in paragraphs (i)(9) and (i)(10) of this section."

- the parent company of the subsidiary issuer has no independent assets or operations,[53] the parent company guarantees the securities, no subsidiary of the parent company guarantees the securities, and any subsidiaries of the parent company other than the issuer are minor;[54] and
- the parent company issuer has no independent assets or operations and all of the parent company's subsidiaries, other than minor subsidiaries, guarantee the securities.

G. Consolidating Information

When the brief narrative disclosure is not permitted, Rule 3-10 requires the inclusion of Consolidating Information in the financial statements. Consolidating Information is detailed financial information consisting of a columnar footnote presentation of each category of parent and subsidiaries as issuer, co-issuers, guarantor(s), or non-guarantor(s) that sums to the consolidated amounts. The presentation must include all major captions of the balance sheet, income statement, and cash flow statement that are required to be shown separately in interim financial statements prepared under Article 10 of Regulation S-X.[55] In order to distinguish the assets, liabilities, operations, and cash flows of the entities that are legally obligated to make payments under the guarantee from those that are not, the columnar presentation must show: 1) a parent company's investments in all consolidated subsidiaries based upon its proportionate share of their net assets;[56] and 2) subsidiary issuer and guarantor investments in certain consolidated

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53 Rule 3-10(h)(5) of Regulation S-X ("A parent company has no independent assets or operations if each of its total assets, revenues, income from continuing operations before income taxes, and cash flows from operating activities (excluding amounts related to its investment in its consolidated subsidiaries) is less than 3% of the corresponding consolidated amount.").

54 Rule 3-10(h)(6) of Regulation S-X ("A subsidiary is minor if each of its total assets, stockholders' equity, revenues, income from continuing operations before income taxes, and cash flows from operating activities is less than 3% of the parent company's corresponding consolidated amount.").

55 Rule 10-01(a) of Regulation S-X.

56 Rule 3-10(i)(3) of Regulation S-X.

subsidiaries using the equity method of accounting.[57]

Consolidating Information must be provided as of, and for, the same periods as the parent company's consolidated financial statements and must be audited for the same periods that the parent company financial statements are required to be audited.[58] In addition to requiring disclosures about restricted net assets,[59] as well as certain types of restrictions on the ability of the parent company or any guarantor to obtain funds from their subsidiaries,[60] the instructions specify that the disclosure may not omit information about each guarantor that would be material for investors to evaluate the sufficiency of the guarantee, and that the disclosure must include sufficient information so as to make the financial information presented not misleading.

H. Securities to which Rule 3-10 Applies

The exceptions to the general rule in existing Rules 3-10(b) through (f) are available only to issuers and guarantors of debt securities.[61] In the 2000 Release, the Commission explained the circumstances under which a guaranteed security should be considered "debt or debt-like" and described certain characteristics of such a security. Generally, the substance of the security's obligation will dictate eligibility for Rule 3-10 rather than the form or title of the security. The

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[57] *See* Rule 3-10(i)(5) of Regulation S-X. Investments in the following subsidiaries are required to be presented under the equity method within Consolidating Information: non-guarantor subsidiaries; subsidiary issuers or subsidiary guarantors that are not 100% owned and/or whose guarantee is not full and unconditional; subsidiary guarantors whose guarantee is not joint and several with the guarantees of other subsidiaries; and subsidiary guarantors with differences in domestic or foreign laws that affect the enforceability of the guarantees. The equity method is used primarily to ensure that a subsidiary guarantor does not consolidate, within this presentation, its own non-guarantor subsidiary. The equity method of accounting is described in ASC 323, *Investments – Equity Method and Joint Ventures*, for registrants that apply U.S. GAAP and in International Accounting Standards ("IAS") 28, *Investments in Associates and Joint Ventures*, for foreign private issuers that apply IFRS.

[58] Rule 3-10(i)(2) of Regulation S-X.

[59] Rule 3-10(i)(10) of Regulation S-X.

[60] Rule 3-10(i)(9) of Regulation S-X.

[61] The 2000 Release states that "modified financial information permitted by paragraphs (b)-(f) will be available only for guaranteed debt and debt-like instruments." *See* Section III.4.b.i. of the 2000 Release. As discussed below, we are proposing to state this requirement in the rule for clarity.

characteristics that identify a guaranteed security as debt or debt-like are: 1) the issuer has a contractual obligation to pay a fixed sum at a fixed time; and 2) where the obligation to make such payments is cumulative, a set amount of interest must be paid.[62]

I. Recently-Acquired Subsidiary Issuers and Guarantors

If a parent company acquires a new subsidiary issuer or guarantor that otherwise qualifies for one of the exceptions in Rules 3-10(c) through (f), the parent company may be required to provide one year of audited pre-acquisition financial statements of the newly-acquired issuer or guarantor and, if applicable, unaudited interim financial statements. This requirement is triggered when: 1) a parent company acquires the new subsidiary during or subsequent to one of the periods for which financial statements are presented in a Securities Act registration statement filed in connection with the offer and sale of the debt securities; 2) the subsidiary is deemed significant; and 3) the subsidiary is not reflected in the audited consolidated results of the parent company for at least nine months of the most recent fiscal year.[63] A subsidiary is significant if its net book value or purchase price, whichever is greater, is 20 percent or more of the principal amount of the securities being registered.[64] The financial statements of the recently-acquired subsidiary must conform to the requirements of Regulation S-X because, as an issuer of a security or provider of a guaranty, it is an issuer. These include the requirement that an audit be performed in accordance with the standards of the Public Company Accounting Oversight Board

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[62] The Commission provided implementation guidance for certain types of securities such as preferred securities, trust preferred securities, and convertible debt or debt-like securities. *See* Section III.4.b.i and ii of the 2000 Release.

[63] Rule 3-10(g)(1) of Regulation S-X.

[64] Rule 3-10(g)(1)(ii) of Regulation S-X.

("PCAOB") by an auditor registered with the PCAOB.[65]

J. Exchange Act Reporting Requirements

Issuers and guarantors availing themselves of an exception that allows for the Alternative Disclosures in lieu of separate financial statements are exempt from Exchange Act reporting by Exchange Act Rule 12h-5. The parent company, however, must continue to provide the Alternative Disclosures for as long as the guaranteed securities are outstanding.[66] This obligation continues even if the subsidiary issuers and guarantors could have suspended their reporting obligations under 17 CFR 240.12h-3 ("Rule 12h-3") or Section 15(d) of the Exchange Act,[67] had they chosen not to avail themselves of a Rule 3-10 exception and reported separately from the parent company.

A subsidiary issuer or guarantor that initially meets the requirements but subsequently ceases to satisfy Rule 12h-5 must begin separately reporting under the Exchange Act. It must present the financial statements required by Regulation S-X in a separate periodic report at the time the next report is due and may no longer rely on its parent company's provision of Alternative Disclosures in the parent company's periodic reports.

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[65] In certain circumstances, pre-acquisition financial statements of a recently-acquired subsidiary that were previously provided by a parent company may not meet the requirements of Rule 3-10(g). For example, a parent company may provide on Form 8-K pre-acquisition financial statements of a subsidiary required by Rule 3-05 of Regulation S-X that may be audited in accordance with U.S. generally accepted auditing standards or audited by an auditor not registered with the PCAOB. If the parent company later files a registration statement for the offer and sale of its securities that are guaranteed by that same recently acquired subsidiary, those previously filed pre-acquisition financial statements would not meet the requirements of Rule 3-10(g). The parent company would then be required to file pre-acquisition financial statements of that recently acquired subsidiary guarantor audited in accordance with the standards of the PCAOB by an auditor registered with the PCAOB, or request pre-filing relief from the staff.

[66] *See* Section III.C.1 of the 2000 Release and Rule 3-10(a).

[67] *See* 15 U.S.C. 78o(d).

III. Proposed Amendments to Rule 3-10 and Partial Relocation to Rule 13-01

A. Overarching Principle

We believe that investors in guaranteed securities would be best served by continuing to adhere to the overarching principle upon which existing Rule 3-10 is based, namely that investors in guaranteed debt securities rely primarily on the consolidated financial statements of the parent company and supplemental details about the subsidiary issuers and guarantors when making investment decisions.[68] Although the existing rules provide investors with information about issuers of guaranteed debt and guarantors of those securities, our experience since the adoption of these rules in 2000 suggests the requirements could be improved for the benefit of both investors and registrants while adhering to the overarching principle. In this regard, the existing rules impose certain eligibility restrictions and disclosure requirements that may require unnecessary detail, thereby shifting investor focus away from the consolidated enterprise towards individual entities or groups of entities and may pose undue compliance burdens for registrants. For example, a parent company is not eligible, under the existing rule, to provide the Alternative Disclosures if a subsidiary issuer or guarantor is 99% instead of 100% owned by its parent company. As another example, the use of a brief narrative instead of Consolidating Information is not available if the total assets of either the parent company or non-issuer and non-guarantor subsidiaries of the parent company exceed 3% of the parent company's consolidated total assets. In both cases, slight variations from the conditions set forth in the rule lead to substantially different disclosure outcomes despite the investments being substantially the same. More broadly, the volume of the Consolidating Information and level of detail required can undermine the overarching principle. Consolidating Information typically occupies multiple pages of a

[68] *See* discussion in Section II.A, "Background."

parent company's financial statements, is composed of detailed information that may not be material for investors in making an investment decision, and could distract from the financial information of the obligated entities that is most likely to be material. In addition, according to one commenter, debt agreements are often structured to either meet or avoid the requirements of Rule 3-10, which may result in a guarantor structure that is less beneficial to investors.[69] Another commenter stated that the "burdensome requirements" of the existing rule "[lead] to issuers electing to do more unregistered as opposed to registered deals."[70] We are proposing amendments to address the challenges posed by the current rules in an effort to improve the disclosures to investors, encourage more registered offerings, and facilitate debt structures where the provision of guarantees is less burdensome.

B. Overview of the Proposed Amendments

Under the proposed amendments, the rules would continue to permit the omission of separate 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 ("Proposed Alternative Disclosures"). Similar to the existing rule, proposed Rule 3-10 would provide the conditions that must be met in order to omit separate subsidiary issuer or guarantor financial statements. Proposed Rule 13-01, contained in new Article 13 of Regulation S-X, would specify the disclosure requirements for the accompanying Proposed Alternative Disclosures. The proposed amendments would:

- replace the condition that a subsidiary issuer or guarantor be 100% owned by the parent company with a condition that it be consolidated in the parent company's

69 *See* letter from DT.

70 *See* letter from Davis Polk.

consolidated financial statements;

- replace Consolidating Information with summarized financial information, as defined in Rule 1-02(bb)(1) of Regulation S-X,[71] ("Summarized Financial Information") of the issuers and guarantors (together, "Obligor Group"), which may be presented on a combined basis, and reduce the number of periods presented;
- expand the qualitative disclosures about the guarantees and the issuers and guarantors;
- eliminate quantitative thresholds for disclosure and require disclosure of additional information that would be material to holders of the guaranteed security;
- permit the Proposed Alternative Disclosures to be provided outside the footnotes to the parent company's audited annual and unaudited interim consolidated financial statements in the registration statement covering the offer and sale of the subject securities and any related prospectus, and in certain Exchange Act reports filed shortly thereafter;
- require that the Proposed Alternative Disclosures be included in the footnotes to the parent company's consolidated financial statements for annual and quarterly reports beginning with the annual report for the fiscal year during which the first bona fide sale of the subject securities is completed;
- eliminate the requirement to provide pre-acquisition financial statements of recently-acquired subsidiary issuers and guarantors; and

[71] Rule 1-02(bb)(1) of Regulation S-X.

- require the Proposed Alternative Disclosures for as long as the issuers and guarantors have an Exchange Act reporting obligation with respect to the guaranteed securities rather than for so long as the guaranteed securities are outstanding.

The proposed amendments would simplify and streamline the rule structure in several ways. Most significantly, under proposed Rules 3-10(a) and 3-10(a)(1) there would be only a single set of eligibility criteria that would apply to all issuer and guarantor structures instead of having separate sets of criteria in each of the five exceptions in existing Rules 3-10(b) through (f). Similarly, the requirements for the Proposed Alternative Disclosures would be included in a single location within proposed Rule 13-01, rather than spread among the multiple subsections of existing Rule 3-10. We believe these changes would simplify the rule structure and facilitate compliance.

Request for Comment

1. Would the proposed amendments to existing Rule 3-10 result in an increase in the number of registered debt offerings that include guarantees? Why or why not? How would increasing the number of registered debt offerings that include guarantees affect investors and issuers?
2. What factors do issuers consider when deciding whether to engage in a registered debt offering or an offering in the private market? Do issuers structure registered debt offerings to not include guarantees because of concerns about compliance with existing Rule 3-10? If so, what are the specific concerns? Are issuers choosing to engage in private debt offerings that include guarantees? If so, what exemptions or safe harbors are issuers using? If these issuers are relying on 17 CFR 230.144A ("Rule 144A"), do these

offerings typically include registration rights, or are they offered pursuant to Rule 144A without registration rights? Why or why not?

3. To what type of investors are issuers of registered debt offerings selling or marketing their securities – Qualified Institutional Buyers ("QIBs"), other institutional investors, or retail investors? What is the typical investor break down in this regard?

4. What factors do issuers consider in determining whether to structure a debt offering to include guarantees, and how are they considered?

5. How do investors use the Alternative Disclosures under existing Rule 3-10? For example, how do retail investors, institutional investors, or third parties, such as financial analysts, use the information? How would these investors use the Proposed Alternative Disclosures?

6. Would the proposed amendments to existing Rule 3-10 improve the disclosures provided to investors? If so, how? Are there other changes to the rule that we should consider that would improve disclosures to investors? If so, what are they and how would they improve disclosure?

7. Would the proposed amendments to existing Rule 3-10 make the rule less burdensome and, thereby, encourage issuers to structure debt offerings to include guarantees? Are there other changes to the rule that we should consider that would reduce compliance burdens for issuers but continue to provide the material information investors need to make informed investment decisions?

8. Would the proposed amendments to existing Rule 3-10 remove disclosures that investors or financial analysts rely on? If so, which disclosures? Would the removal of such disclosures have an effect on investor participation in registered debt offerings that

include guarantees?

9. What effects do registered debt offerings have on the covenants contained in the related indentures? Do private debt offerings typically contain more or fewer covenants in the related indentures? Why or why not? Would an issuer's offering of debt contain more covenants if offered privately than if offered publicly? Why or why not? What effects would the proposed rules have on the covenants contained in the related indentures?

10. Are there alternative approaches to disclosures about guarantors and guarantees that would benefit investors? If so, what are they and why? How would investors use the disclosures under these alternative approaches?

C. Conditions to Omit the Financial Statements of a Subsidiary Issuer or Guarantor

Under the proposed rules, the financial statements of a subsidiary issuer or guarantor could be omitted if the eligibility conditions contained in proposed Rules 3-10(a) and 3-10(a)(1) are met and the Proposed Alternative Disclosures specified in proposed Rule 13-01 are provided in the filing, as required by proposed Rule 3-10(a)(2). As proposed, the eligibility conditions would be that:

- the consolidated financial statements of the parent company have been filed;
- the subsidiary issuer or guarantor is a consolidated subsidiary of the parent company;
- the guaranteed security is a debt security; and
- one of the following eligible issuer and guarantor structures is applicable:
    - the parent company issues the security or co-issues the security, jointly and severally, with one or more of its consolidated subsidiaries; or
    - a consolidated subsidiary issues the security or co-issues the security with

one or more other consolidated subsidiaries of the parent company, and the security is guaranteed fully and unconditionally by the parent company.

1. Eligibility Conditions

a. Parent Company Financial Statements Condition

Proposed Rule 3-10 would continue to require the filing of the parent company's consolidated financial statements. Additionally, under the proposed amendments, "parent company" would still be defined as in the 2000 Release, with one change. The first two conditions would continue to be that the entity is: (1) an issuer or guarantor of the securities; and (2) an Exchange Act reporting company, or will become one as a result of the subject Securities Act registration statement. However, the third condition, that the entity owns, directly or indirectly, 100% of each subsidiary issuer and guarantor, would no longer be required for an entity to be considered the parent company.[72] Instead, the third condition would be that the entity consolidates each subsidiary issuer and guarantor in its consolidated financial statements.[73] For clarity, the definition of "parent company" would be included in proposed Rule 3-10(b)(1), stating that the parent company is the entity that meets the three aforementioned conditions.

Consistent with the note to existing Rule 3-10(a)(2), the financial statements of an entity that is not an issuer or guarantor of the registered security could not be substituted for those of the parent company. For example, it would not be appropriate to file, in substitution for the financial statements of the parent company, financial statements of an entity that files Exchange Act reports but is not an issuer or guarantor of the securities being registered even if the financial

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[72] *See* Section III.A.6. of the 2000 Release.

[73] *See* Section III.C.1.b, "Consolidated Subsidiary," below.

statements of that entity are virtually identical to those of the parent company, because the security holders cannot enforce payment of the obligation against that particular entity. Because we have included the definition of parent company in proposed Rule 3-10(b)(1), which clearly states that the parent company must be an issuer or guarantor of the guaranteed security, we do not believe the note to existing Rule 3-10(a)(2) is necessary and have removed it from the proposed rule.

Request for Comment

11. Is the proposed definition of "parent company" included in proposed Rule 3-10(b)(1) sufficiently clear? Why or why not? Are there other modifications to the proposed definition of "parent company" that would be appropriate? If so, what are they and why should they be included?

12. Are there other definitions of "parent company" that may differ from our proposed definition? If so, which definitions and what are the similarities or differences? How would any such differences affect issuers' ability to apply our rule? Should we make any modifications to the proposed definition of "parent company" in light of those other definitions?

13. Should the proposed rule include a requirement similar to the note to existing Rule 3-10(a)(2) that the financial statements of an entity that is not an issuer or guarantor of the registered security could not be substituted for those of the parent company, or does the proposed definition of "parent company" render such a requirement unnecessary?

b. Consolidated Subsidiary Condition

The 2000 Release states that the Commission was adopting the existing rule's definition of 100% owned "because it assures investors in the guaranteed securities that there is no

competing common equity interest in the assets or revenues of the subsidiary. This allows investors to evaluate the creditworthiness of the parent and subsidiary as a single, indivisible business."[74] The Commission explained that the risks associated with an investment in a parent company and its subsidiary issuers and/or guarantors would need to be identical to justify the use of the Alternative Disclosures in lieu of separate financial statements of each of those subsidiaries, and if a third party holds an interest in a subsidiary, those risks are not identical.[75]

A number of commenters suggested that existing Rule 3-10's 100%-owned condition be replaced,[76] suggesting various alternative conditions.[77] One commenter recommended permitting guarantor subsidiaries to be majority-owned instead of 100% owned, explaining that any risks associated with a minority investor could be addressed through disclosure,[78] and another stated that "as long as a registrant controls the subsidiary, a third party minority equity interest in the subsidiary's assets and earnings would not affect the subsidiary's creditworthiness from a debt holder's perspective."[79] One commenter recommended retaining the requirement.[80]

We continue to believe that a subsidiary issuer or guarantor should be controlled by the parent company and consolidated into the financial statements of the parent company to be eligible to omit its financial statements. However, having considered commenters' suggestions

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74 *See* Section III.A.1.a.i.(A) of the 2000 Release.

75 *See id.*

76 *See, e.g.*, letters from ABA-Committees, AB-NYC, Chamber, Comcast, EY, and SIFMA.

77 For example, some commenters recommended permitting subsidiary issuers and guarantors to be "wholly-owned" by the parent company as that term is defined in Rule 1-02(aa) of Regulation S-X, which states "[t]he term wholly owned subsidiary means a subsidiary substantially all of whose outstanding voting shares are owned by its parent and/or the parent's other wholly owned subsidiaries." *See* letters from ABA-Committees, AB-NYC, and EY.

78 *See* letter from SIFMA.

79 *See* letter from Comcast.

80 *See* letter from CalPERS.

and our experience since the adoption of the existing rule, it appears that the existence of non-controlling ownership interests in the subsidiary issuer or guarantor does not necessarily mean that separate financial statements are warranted.

We note that the existence of non-controlling interest holders generally does not alter the fundamental nature of the investment such that it should be evaluated similar to multiple investments in different issuers. Specifically, we believe that where a parent company is obligated as issuer or full and unconditional guarantor of a guaranteed security and it controls and includes the subsidiary issuer(s) and guarantor(s) in its consolidated financial statements, there is sufficient financial unity between the parent company and the related subsidiary with respect to the guaranteed debt security such that the consolidated financial statements of that parent company and the Proposed Alternative Disclosures would enable investors to evaluate and sufficiently assess the risks associated with an investment in such guaranteed debt security. In the event of default on the debt security, there could be circumstances where non-controlling interest holders may have the potential to influence certain matters affecting payments to holders of the guaranteed debt security. However, as one commenter suggested,[81] such risks, when material, can be addressed through disclosures tailored to those facts and circumstances[82] rather than requiring separate financial statements of the subsidiary issuer or guarantor.

Proposed Rule 3-10(a) would require the subsidiary issuer or guarantor to be a consolidated subsidiary of the parent company pursuant to the relevant accounting standards

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81 *See* letter from SIFMA.

82 *See* proposed Rules 13-01(a)(3) and (4).

already in use.[83] This proposed change would eliminate the distinction between subsidiaries in corporate form and those in other than corporate form, applying a consistent eligibility condition across entities. Also, certain subsidiary issuers and guarantors that are currently not eligible to omit their financial statements under existing Rule 3-10, such as consolidated subsidiary issuers or guarantors that have issued securities convertible into their own voting shares, would be eligible to omit their financial statements. The proposed amendments would instead require the parent company to provide disclosures that address the material risks, if any, associated with non-controlling interests in the subsidiary issuer or guarantor, including any risks arising from securities issued by the subsidiary that may be convertible into voting shares and may cause the percentage of non-controlling interest to increase, and to separately provide Summarized Financial Information attributable to those subsidiaries.

Specifically, proposed Rule 13-01(a)(3) would require, to the extent material, a description of any factors that may affect payments to holders of the guaranteed security, such as the rights of a non-controlling interest holder. In addition, proposed Rule 13-01(a)(4) would require separate disclosure of Summarized Financial Information for subsidiary issuers and guarantors affected by those factors. For example, if, through its ability to exercise significant influence[84] over a subsidiary guarantor, a non-controlling interest holder could materially affect payments to holders of the guaranteed security, the parent company would be required to disclose those factors and the Summarized Financial Information attributable to that subsidiary

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[83] For example, a parent company that prepares its financial statements in accordance with U.S. GAAP would apply ASC 810, *Consolidation*, and a parent company that qualifies as a foreign private issuer and prepares its financial statements in accordance with IFRS would apply IFRS 10, *Consolidated Financial Statements*.

[84] *See* ASC 323, *Investments – Equity Method and Joint Ventures*. Representation on the board of directors, participation in policy-making processes, and extent of ownership by an investor in relation to the concentration of other shareholdings are among the ways listed in ASC 323-10-15-6 that may indicate the ability to exercise significant influence over operating and financial policies of an investee.

guarantor. Because this disclosure would highlight the material repayment risks and financial information associated with consolidated issuers and guarantors with non-controlling interests, it may no longer be necessary to categorically prohibit such issuers and guarantors from being eligible to omit their financial statements under proposed Rule 3-10.

Request for Comment

14. Should the proposed rule use consolidation of the subsidiary issuer or guarantor under the applicable accounting standards as an eligibility condition? If not, what relationship between the parent company and subsidiary issuer or guarantor should the proposed rule use and why?

15. Would using consolidation of the subsidiary issuer or guarantor under the applicable accounting standards as an eligibility condition allow investors or financial analysts to adequately understand the credit risk of such subsidiary issuer or guarantor? Would the proposed use of consolidation allow investors or financial analysts to adequately understand these credit risks in lieu of the subsidiary issuer or guarantor's financial statements? Why or why not?

16. Should the proposed condition that each issuer and guarantor be a consolidated subsidiary of the parent company be limited such that it would not be available to certain types of entities? If so, what entities and why? For example, should an entity be ineligible if it is consolidated in the parent company's financial statements for reasons other than the parent company holding the majority of voting interests?[85]

17. Should a consolidated subsidiary that has issued and outstanding debt that is convertible

[85] Such circumstances may arise when, in accordance with ASC 810, *Consolidation*, the entity is a variable interest entity and the parent company is its primary beneficiary.

into its own voting shares not be eligible to omit its financial statements under the proposed rule? Why or why not? Should a consolidated subsidiary that has issued and outstanding debt that is convertible into its own voting shares, which, upon conversion, would result in the parent company losing control of that subsidiary, not be eligible to omit its financial statements under the proposed rule? Why or why not? Should a consolidated subsidiary that has issued and outstanding debt that is convertible into its own voting shares, which, upon conversation, would result in the parent company owning less than a particular percentage of the voting shares of that subsidiary, not be eligible to omit its financial statements under the proposed rule? If so, what should that percentage be and why?

18. Would any entities that meet the 100%-owned condition under existing Rule 3-10 not meet the proposed condition that an issuer or guarantor be a consolidated subsidiary of the parent company? If so, what are they and why would they not meet this condition?

c. Debt or Debt-Like Securities Condition

As discussed above,[86] the exceptions in existing Rules 3-10(b) through (f) are available only to issuers and guarantors of debt securities. We continue to believe the exceptions provided in Rule 3-10 should only be available for guaranteed debt and guaranteed preferred securities that have payment terms that are substantially the same as debt. In order to provide clarity, proposed Rule 3-10(a)(1) would state explicitly that the guaranteed security must be "debt or debt-like."

For additional clarity, proposed Rule 3-10(b)(2) would specify when a guaranteed security would be considered "debt or debt-like." Consistent with the guidance provided in the

[86] *See* Section II.H, "Securities to which Rule 3-10 Applies."

2000 Release,[87] a guaranteed security would be considered "debt or debt-like" under the proposed rule if:

- the issuer has a contractual obligation to pay a fixed sum at a fixed time; and
- where the obligation to make such payments is cumulative, a set amount of interest must be paid.

As is currently the case, the substance of the security's obligation will determine the availability of relief under Rule 3-10 rather than the form or title of the security. Accordingly, the proposed rule would clarify consistent with the 2000 Release,[88] that:

- Neither the form of the security nor its title will determine whether a security is debt or debt-like. Instead, the substance of the obligation created by the security will be determinative; and
- The phrase "set amount of interest" is not intended to mean "fixed amount of interest. " Floating and adjustable rate securities, as well as indexed securities, may meet the criteria specified in paragraph (b)(2)(ii) as long as the payment obligation is set in the debt instrument and can be determined from objective indices or other factors that are outside the discretion of the obligor.

Request for Comment

19. Should the proposed rule expressly state that the guaranteed security must be "debt or debt-like" and include a definition of that term? Why or why not?

20. Should we modify the proposed definition of "debt or debt-like"? If so, why, and how should it be modified?

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87 *See* Section III.A.4 of the 2000 Release.

88 *See* Section III.A.4.b.i of the 2000 Release.

21. Should we provide any additional guidance or instructions to the proposed definition of "debt or debt-like"? If so, why, and what additional guidance or instructions would be appropriate?

d. Eligible Issuer and Guarantor Structures Condition

Under the existing rule, an issuer and guarantor structure is eligible if it matches one of the specific issuer and guarantor structures in Rule 3-10(b) through (f). If an issuer or guarantor structure does not match one of those specific issuer and guarantor structures, it is ineligible, and the subsidiary issuers and guarantors must file separate financial statements. Eligibility would still be based on qualifying issuer and guarantor structures under the proposed amendments to Rule 3-10. However, the proposed amendments would simplify and streamline the existing rule by replacing the specific issuer and guarantor structures permitted under the five exceptions in existing Rules 3-10(b) through (f) with a broader two-category framework. Under this framework, an issuer and guarantor structure would be eligible if:

- the parent company issues the security or co-issues the security, jointly and severally, with one or more of its consolidated subsidiaries;[89] or
- a consolidated subsidiary issues the security, or co-issues it with one or more other consolidated subsidiaries of the parent company, and the security is guaranteed fully and unconditionally by the parent company.[90]

In a change from the existing exceptions, the status of subsidiary guarantors would not be specified in the proposed categories of eligible issuer and guarantor structures. Although one or more other subsidiaries of the parent company may, and we expect often would, guarantee the

[89] Proposed Rule 3-10(a)(1)(i).

[90] Proposed Rule 3-10(a)(1)(ii).

security, we believe the eligibility of an issuer and guarantor structure should depend on the role of the parent company. Accordingly, as discussed further in Section III.C.1.d.ii, "Role of Subsidiary Guarantors" below, separate financial statements of consolidated subsidiary guarantors may be omitted for each issuer and guarantor structure that is eligible under the proposed rule if the other conditions of proposed Rule 3-10 are met.

i. Role of Parent Company

Under the proposed amendments, the parent company's role as issuer, co-issuer, or full and unconditional guarantor with respect to the guaranteed security would determine whether the issuer and guarantor structure is eligible. Below we further describe conditions that a parent company must meet under the proposed rule.

(A) Parent Company Obligation is Not Limited or Conditional

Because the parent company's consolidated financial statements serve as the primary source of information for investors, we believe the parent company's obligation as either issuer or guarantor of the guaranteed security should not be conditional or limited. If the parent company's obligation was limited or conditional, focusing on the parent company's financial statements may not be sufficient for investors to evaluate the investment. For example, if a subsidiary issued securities guaranteed by its parent company, but that parent company's obligation under the guarantee's terms was less than the subsidiary's obligation, the parent company's financial statements supplemented with the Proposed Alternative Disclosures would not be sufficient. Instead, the separate financial statements of the subsidiary issuer would likely be material for investors to make an informed investment decision. Therefore, under the proposed amendments, the ability to provide the Proposed Alternative Disclosures in lieu of separate subsidiary issuer and guarantor financial statements would only be available when the

parent company's obligation is not limited or conditional.

Request for Comment

22. Should the eligibility of an issuer and guarantor structure under the proposed rule require the parent company's obligation not to be limited or conditional? Why or why not?

23. Are there circumstances where the parent company's consolidated financial statements are not the primary source of information for investors in these situations? If so, what are those circumstances, and what other sources of information would be material in making an investment decision?

24. Should the eligibility of an issuer and guarantor structure continue to depend on the status of subsidiary guarantors? If so, in what way? If not, why not?

(B) Parent Company as Issuer or Co-Issuer

Under the first category of eligible issuer and guarantor structures in proposed Rule 3-10(a)(1)(i), the parent company must issue the security or co-issue the security, jointly and severally, with one or more of its consolidated subsidiaries. When acting as the sole issuer, the parent company would be fully and unconditionally obligated for the full amount of any scheduled payments when they come due. Also, the parent company would be permitted to co-issue a security with one or more of its consolidated subsidiaries, but all co-issuers would be required to be jointly and severally liable under the guaranteed security. This would obligate each of the parent company and its subsidiary co-issuers to all legal responsibilities of an issuer, including making scheduled payments on the debt security in full when they come due. Under this category of eligible issuer and guarantor structures, the parent company would control each consolidated co-issuer, the financial information of the subsidiary co-issuer(s) would be reflected in the consolidated financial statements of the parent company, and the parent company would

be fully and unconditionally obligated to make payments in full when due under the guaranteed security. As such, we believe the parent company's consolidated financial statements would serve as the primary source of information for investors in these circumstances and, if all other eligibility conditions of the proposed rule were satisfied, that separate financial statements of the subsidiary co-issuers would be unnecessary. Supplemental information about the subsidiary co-issuer(s) would be included in the Proposed Alternative Disclosures.

Request for Comment

25. Should this first category of eligible issuer and guarantor structures under the proposed rule require the parent company to issue or co-issue the security, jointly and severally, with one or more of its consolidated subsidiaries? Why or why not?

26. Are there other conditions that should be included in this first permissible category of eligible issuer and guarantor structures? If so, what are they and why would they be appropriate?

27. If the parent company co-issues the guaranteed security with one or more of its consolidated subsidiaries, is separate financial information about issuer entities material to an investment decision? If so, why?

(C) Parent Company as Full and Unconditional Guarantor

Under the second category of eligible issuer and guarantor structures in proposed Rule 3-10(a)(1)(ii), a debt security issued by a parent company's consolidated subsidiary, or co-issued by more than one of the parent company's consolidated subsidiaries, must be fully and unconditionally guaranteed by that parent company. For purposes of the proposed rule, whether the parent company's guarantee is "full and unconditional" would be determined in the same

manner as in existing Rule 3-10(h)(2) and the 2000 Release[91] and would be included in proposed Rule 3-10(b)(3). Under this category of eligible issuer and guarantor structures, the parent company would control each consolidated subsidiary issuer, the financial information of the subsidiary issuer(s) would be reflected in the consolidated financial statements of the parent company, and the parent company would be fully and unconditionally obligated to make payments in full when due under the guaranteed security. In these circumstances, we believe the parent company's financial statements would serve as the primary source of information for investors and, if all other eligibility conditions of the proposed rule were satisfied, that separate financial statements of the subsidiary issuers would be unnecessary. Supplemental information about the subsidiary issuer(s) or co-issuer(s) would be included in the Proposed Alternative Disclosures.

Request for Comment

28. Should this second category of eligible issuer and guarantor structures under the proposed rule require parent company to fully and unconditionally guarantee the debt security that is either issued by that parent company's consolidated subsidiary, or co-issued by more than one of that parent company's consolidated subsidiaries? Why or why not?

29. Are there other conditions that should be included in this second permissible category of eligible issuer and guarantor structures? If so, what are they and why would they be appropriate?

30. Should we retain the existing definition of "full and unconditional"? Why or why not?

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91 *See* Section III.A.1.b of the 2000 Release.

ii. Role of Subsidiary Guarantors

As noted above,[92] one or more consolidated subsidiaries of the parent company could, and we expect often would, guarantee the securities in either of the two proposed eligible categories of issuer and guarantor structures. Existing Rule 3-10(b) through (f) specify the permissible roles of subsidiary guarantors in an issuer and guarantor structure and also impose certain conditions, such as the guarantees being full and unconditional and, where there are multiple guarantees, being joint and several.[93] A few commenters specifically addressed the conditions that subsidiary guarantees be "full and unconditional" and "joint and several." One commenter recommended the elimination of these conditions. According to this commenter, investors place less reliance on a guarantee that is not full and unconditional as a source of credit, and accordingly, financial statements of such a guarantor are even less important to an investor and should not be required.[94] Instead, the commenter recommended requiring separate disclosure of those subsidiaries providing lesser guarantees. Another commenter stated that the existing condition should remain unchanged.[95]

The 2000 Release stated that the Commission was adopting the definition of "full and unconditional," which was applicable to the guarantees of both subsidiaries and the parent company, with the intention of limiting the availability of the Alternative Disclosures to those

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92 *See* Section III.C.1.d, "Eligible Issuer and Guarantor Structures Condition."

93 Where there are multiple subsidiary guarantors, and the guarantee of one or more subsidiaries is not joint and several with other subsidiary guarantors, or as applicable, with the parent company's guarantee, note 4 to existing Rule 3-10(d) and note 3 to existing Rule 3-10(f) permit the use of Consolidating Information in lieu of providing separate financial statements of that subsidiary guarantor so long as each subsidiary whose guarantee is not joint and several is included in a separate column of the Consolidating Information.

94 *See* letter from SIFMA.

95 *See* letter from CalPERS.

situations where the payment obligations of the issuer and guarantor are essentially identical.[96] We continue to believe it is necessary for the guarantee of a parent company to be full and unconditional in order to rely on its consolidated financial statements as the primary source of information for investors. However, our experience since adoption of the existing rule in 2000 suggests that limitations or conditions on a subsidiary guarantee should not preclude the use of the Proposed Alternative Disclosures when the consolidated subsidiary guarantor is controlled by the parent company and the subsidiary guarantor's financial information is included in the parent company's consolidated financial statements. Instead, similar to existing Rule 3-10's approach to subsidiary guarantees that are not joint and several,[97] we believe such limitations and conditions on a subsidiary's guarantee could be highlighted for investors through incremental financial and non-financial disclosure in the Proposed Alternative Disclosures rather than requiring separate financial statements of the subsidiary guarantor.

Under the proposed rule, because the role of the parent company determines whether an issuer and guarantor structure is eligible, the role of subsidiary guarantors would be irrelevant for determining overall eligibility. As a result, the subsidiary guarantors' role in the issuer and guarantor structure would not need to be specified and the aforementioned conditions (the guarantees being full and unconditional and, where there are multiple guarantees, being joint and several) would no longer be imposed on subsidiary guarantors. Regardless, as stated in proposed Rule 3-10(a), if a subsidiary guarantor is consolidated in its parent company's consolidated

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96 *See* Section III.A.1.b of the 2000 Release.

97 Each of existing Rules 3-10(d)(3) and 3-10(f)(3) specify that all guarantees must be joint and several as a condition to permit the omission of the separate financial statements of subsidiary guarantors. However, if all other conditions of the applicable exception paragraph are met, Note 4 to existing Rule 3-10(d) and Note 3 to existing Rule 3-10(f) permit the omission of the separate financial statements of a subsidiary guarantor whose guarantee is not joint and several so long as the Consolidating Information includes a separate column for each such subsidiary guarantor.

financial statements, and the other conditions of proposed Rule 3-10 are met, including providing the disclosures about that subsidiary and its guarantee as specified in proposed Rule 13-01, the subsidiary's financial statements could be omitted.

The role of subsidiary guarantors and their guarantees would affect the required disclosure under the proposed rule. For example, the subsidiary guarantors would be required to be identified pursuant to proposed Rule 13-01(a)(1), and if the guarantees of those subsidiaries were not full and unconditional, disclosure of the limitations and conditions would be required by proposed Rule 13-01(a)(2), to the extent material.[98] Furthermore, proposed Rule 13-01(a)(4) would require separate disclosure of Summarized Financial Information applicable to subsidiary guarantors whose guarantees were not full and unconditional, to the extent material.[99]

Request for Comment

31. Would the proposed changes improve the disclosures for investors? Why or why not?

32. Proposed Rule 3-10(a)(1)(ii) specifies only that the parent company guarantee must be full and unconditional. Should the requirement that a guarantee be full and unconditional also extend to subsidiary guarantors? Why or why not?

33. Where there is more than one subsidiary guarantor, or when the parent company and one or more of its subsidiaries guarantees the security, should all guarantees be joint and several to be eligible to omit separate financial statements of subsidiary guarantors? Why or why not?

(A) Subsidiary Guarantee Release Provisions

One of the conditions a subsidiary guarantor must meet under the existing rule is that its

[98] *See* discussion in Section III.C.2.b, "Non-Financial Disclosures."

[99] *See* discussion in Section III.C.2.a.ii, "Presentation on a Combined Basis."

guarantee must be full and unconditional. A subsidiary's guarantee may have the characteristics of a full and unconditional guarantee at its inception except that there may be contractual provisions permitting the subsidiary to be released from that guarantee under certain circumstances. Such release provisions could cause the subsidiary's guarantee to fail to meet the requirement that the guarantee be full and unconditional because the potential elimination of the guarantee is a condition beyond the issuer's failure to pay. The staff has previously provided guidance that, under certain circumstances, a subsidiary whose guarantee could be released should be able to rely on existing Rule 3-10 so long as all other required conditions of the rule are met.[100] Several commenters recommended codifying this staff guidance into our rules.[101] As noted above,[102] because the nature of the guarantee of a subsidiary guarantor does not affect whether the issuer and guarantor structure is eligible under the proposed rule, a subsidiary guarantee would no longer be required to be full and unconditional. As such, the existence of subsidiary guarantee release provisions would not prevent that subsidiary guarantor from omitting its financial statements. However, to the extent material, such release provisions would be required to be disclosed pursuant to proposed Rule 13-01(a)(2)[103] and separate disclosure of Summarized Financial Information applicable to that subsidiary guarantor would be required by

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100 *See* U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., *Financial Reporting Manual* Section 2510.5, https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf (last updated Dec. 1, 2017). These circumstances include, for example, when: (1) the subsidiary is sold or sells all of its assets; (2) the subsidiary is declared "unrestricted" for covenant purposes; (3) the subsidiary's guarantee of other indebtedness is terminated or released; (4) the requirements for legal defeasance or covenant defeasance or to discharge the indenture have been satisfied; (5) the rating on the parent's debt securities is changed to investment grade; or (6) the parent's debt securities are converted or exchanged into equity securities. The staff guidance also indicates that subsidiary guarantees with such release provisions should not be characterized as full and unconditional without disclosure describing any qualifications to the subsidiary guarantees (*e.g.*, the circumstances in which they could be released). If the proposed changes described herein are adopted, this staff interpretation would no longer be applicable.

101 *See, e.g.*, letters from ABA-Committees, AB-NYC, and EY.

102 *See* Section III.C.1.d.ii, "Role of Subsidiary Guarantors."

103 *See* discussion in Section III.C.2.b, "Non-Financial Disclosures."

proposed Rule 13-01(a)(4).[104]

Request for Comment

34. Should the proposed rule specify that subsidiary guarantees must be full and unconditional except that certain subsidiary release provisions would be expressly permitted? If so, why? In this regard, which release provisions should be permitted in the proposed rule and why would they be appropriate?

iii. Treatment of Currently Eligible Issuer and Guarantor Structures Under Proposed Rule 3-10

The proposed amendments are not intended to reduce the types of entities or structures that would be able to rely on proposed Rule 3-10. We expect issuer and guarantor structures that are currently eligible under existing Rule 3-10 to be eligible under the two proposed categories of eligible issuer and guarantor structures. As shown in the table below, issuer and guarantor structures that currently fall under existing Rules 3-10(b), (c), or (d) would be eligible to omit their financial statements under the eligible categories in proposed Rules 3-10(a)(1)(i) or (ii), depending on the role of the parent company as either co-issuer or full and unconditional guarantor of the guaranteed security. Issuer and guarantor structures that currently fall under existing Rules 3-10(e) or (f), wherein the parent company is the sole issuer of the guaranteed security, would be able to rely on the first category in proposed Rule 3-10(a)(1)(i). We discuss the proposed amendments in greater detail below.

[104] *See* discussion in Section III.C.2.a.ii, "Presentation on a Combined Basis."

Existing Rule	Proposed Rule
Rules 3-10(b), 3-10(c), and 3-10(d)	Rule 3-10(a)(1)(i), if the subsidiary co-issued the security, jointly and severally, with its parent
	Rule 3-10(a)(1)(ii), if the subsidiary issued the security that is fully and unconditionally guaranteed by its parent
Rules 3-10(e) and 3-10(f)	Rule 3-10(a)(1)(i)

(A) Finance Subsidiary Issuer of Securities Guaranteed by its Parent Company

Existing Rule 3-10(b) applies when a "finance subsidiary," as that term is defined in existing Rule 3-10(h)(7), issues securities guaranteed by its parent company. This exception was included to address situations where a parent company directs one of its subsidiaries to issue debt securities that the parent company guarantees, and that subsidiary "has no assets, operations, revenues, or cash flows other than those related to the issuance, administration, and repayment of the security and any other securities guaranteed by its parent."[105] In such cases, the Commission has determined that detailed financial information about the finance subsidiary is unlikely to be material to an investment decision. Instead, an investor would look to the consolidated financial statements of the parent company that guaranteed the debt to evaluate the investment in the guaranteed security and generally not need additional information other than a brief narrative describing the arrangement.

Because the proposed amendments to Rule 3-10 do not focus on the role and nature of the subsidiary as a condition to eligibility, the proposed amendments would no longer require a subsidiary issuer or guarantor to be designated as a "finance subsidiary" in any particular circumstances. Likewise, the proposed amendments would remove the definition of "finance

[105] *See* Section III.A.6 of the 2000 Release.

subsidiary" from the existing rule, since it is not otherwise used in Regulation S-X. However, a finance subsidiary used to issue a debt security guaranteed by the parent company, would be addressed by proposed Rule 3-10(a)(1)(ii) or, if the security were to be co-issued, jointly and severally, with its parent, proposed Rule 3-10(a)(1)(i) would apply. We believe eliminating the provisions that apply only to finance subsidiaries, together with the other proposed changes, would simplify the rules while ensuring that they remain appropriately available for finance subsidiary arrangements. Furthermore, we generally expect detailed financial disclosures about those subsidiaries would not be material, given the nature and amounts of those subsidiaries' assets and operations.[106] While a parent company would be permitted to omit immaterial detailed financial disclosures, all other disclosures required by proposed Rule 13-01, such as the non-financial disclosures specified in proposed Rule 13-01(a)(1) though (3), would be required, to the extent material.

Request for Comment

35. Should we eliminate the "finance subsidiary" exception as proposed? Would the proposed elimination of the "finance subsidiary" exception under existing Rule 3-10(b) result in supplemental financial information about the finance subsidiary and its parent company being required under the proposed rule where it would not be required under the existing rule? If so, in what circumstances? Would such financial information be material to investors? Why or why not?

(B) Obligated Parent Company and Single Obligated Subsidiary

Existing Rule 3-10(c) applies when an "operating subsidiary" issues securities guaranteed

[106] *See* discussion and example within Section III.C.2.c, "When Disclosure is Required."

by its parent company. Existing Rule 3-10(h)(8) defines an "operating subsidiary" to differentiate it from a "finance subsidiary." Since the proposed amendments would remove the "finance subsidiary" distinction and definition, proposed Rule 3-10 likewise would no longer need to refer to or define "operating subsidiary." The operating subsidiary structure of existing Rule 3-10(c) would be covered in the issuer and guarantor structure in proposed Rule 3-10(a)(1)(ii) if the security were to be issued by the subsidiary or proposed Rule 3-10(a)(1)(i) if the security were to be co-issued, jointly and severally, with its parent company as contemplated in existing Note 3 to Rule 3-10(c).

Existing Rule 3-10(e) applies to a single subsidiary guarantor of securities issued by the parent company of that subsidiary. This structure would be included in the issuer and guarantor structure in proposed Rule 3-10(a)(1)(i). As discussed above,[107] the requirement in the existing rule that the subsidiary guarantor's guarantee be full and unconditional would not be a condition of eligibility under the proposed rule, but disclosure of any material limitations or conditions to the subsidiary guarantee would be required pursuant to proposed Rule 13-01(a)(2).

(C) Obligated Parent Company and Multiple Obligated Subsidiaries

Existing Rule 3-10(d) applies to a subsidiary that issues securities guaranteed by its parent company and one or more other subsidiaries of that parent company. Existing Rule 3-10(f) applies to multiple subsidiary guarantors of securities issued by the parent company of those subsidiaries. Both of these existing exceptions involve more than one of the parent company's subsidiaries that are obligated as guarantor or issuer of the guaranteed security, and require that all guarantees be joint and several as well as full and unconditional. For issuer and

[107] *See* Sections III.C.1.d.ii, "Role of Subsidiary Guarantors."

guarantor structures currently included in Rule 3-10(d), proposed Rule 3-10(a)(1)(ii) would apply if the guaranteed security were issued by a subsidiary and proposed Rule 3-10(a)(1)(i) would apply if the guaranteed security were co-issued, jointly and severally, with its parent company as contemplated in existing Note 3 to Rule 3-10(d). Proposed Rule 3-10(a)(1)(i) would apply to parent company issuer and subsidiary guarantor structures currently included in Rule 3-10(f).

As discussed above,[108] while subsidiaries' guarantees would no longer be required to be full and unconditional or joint and several, and would not affect whether an issuer and guarantor structure is eligible under the proposed rule, the terms and conditions of the subsidiary guarantee, including any limitations and conditions, would be required to be disclosed as part of proposed Rule 13-01(a)(2), to the extent material.

Finally, under existing Rule 3-10, issuer and guarantor structures that include more than one subsidiary co-issuer do not explicitly fall into the existing exceptions. Currently, under those circumstances, a registrant would generally seek pre-filing relief from the Commission staff.[109] Multiple subsidiary co-issuers should not change the analysis as to what financial statement disclosures should be provided to investors, because, consistent with the other proposed eligible issuer and guarantor structures, the parent company controls each consolidated co-issuer, the financial information of the subsidiary co-issuers would be reflected in the consolidated financial statements of the parent company, and the parent company would be fully and unconditionally obligated to make payments in full when due under the guaranteed security. Therefore, proposed

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[108] *See* Section III.C1.d.ii, "Role of Subsidiary Guarantors."

[109] Upon request, pursuant to its delegated authority under Rule 3-13 of Regulation S-X, the staff has permitted the omission of separate subsidiary issuer and guarantor financial statements for issuer and guarantor structures that included more than one subsidiary co-issuer, provided the other conditions of existing Rule 3-10 were met.

Rule 3-10(a)(1)(i) would apply to such structures if the subsidiaries co-issued the guaranteed securities jointly and severally with the parent company. Proposed Rule 3-10(a)(1)(ii) would apply if the parent company is a full and unconditional guarantor of securities co-issued by the subsidiaries.

Request for Comment

36. Would any issuer and guarantor structures that are currently eligible under existing Rule 3-10 no longer be eligible under the proposed amendments? If so, what specific structures would not be eligible and why?

37. Should any issuer and guarantor structures that would be eligible under the proposed categories be disallowed? Should any issuer and guarantor structures that are ineligible under the proposed categories be allowed? If so, which ones and why?

2. Disclosure Requirements

Under existing Rule 3-10, one of the conditions to omitting separate financial statements of a subsidiary issuer or guarantor is providing the Alternative Disclosures in the footnotes to the parent company's consolidated financial statements. We are proposing to retain the requirement to provide Alternative Disclosures, with modifications, as we believe the disclosures are an important supplement to the consolidated parent company disclosures. If the eligibility conditions in proposed Rule 3-10(a) and (a)(1) are satisfied, a parent company must include the Proposed Alternative Disclosures specified in proposed Rule 13-01 in the relevant filing, but could omit the separate financial statements of subsidiary issuers and guarantors.[110] The proposed amendments would streamline and simplify the rule by including the Proposed Alternative Disclosures in a single location within proposed Rule 13-01 rather than having such

[110] This requirement is specified in proposed Rule 3-10(a)(2).

requirements in multiple subsections. The proposed amendments are described below.

a. Financial Disclosures

The Consolidating Information currently required by existing Rule 3-10 provides highly-detailed financial information about individual issuers and guarantors or groups of issuers and guarantors within the consolidated parent company, as well as non-guarantor subsidiaries.

Several commenters cited various challenges registrants face in preparing Consolidating Information, such as the complexities of the disclosures; that registrants' books and records often are not maintained on a basis that facilitates the preparation of the disclosures; that extensive manual processes are often necessary; and the difficulty, time, and costs to prepare the disclosures.[111] A number of commenters[112] suggested aligning the disclosure requirements of Rule 3-10 with disclosure practices of issuers and guarantors in the private debt markets that comply with Securities Act Rule 144A.[113] Some commenters stated that the type of information included in debt offerings under Rule 144A, which is less detailed than what is required by Consolidating Information, provides all the material information necessary for investors to make informed investment decisions.[114] For example, one commenter stated that the typical offering memorandum in a Rule 144A offering includes revenues, operating income (or a similar metric) when available, assets and liabilities of the issuers and guarantors as a consolidated group, and

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111 *See* letters from ABA-Committees, Anuradha, BDO, Cahill, CAQ, DT, EY, FedEx, GM, Grant, Headwaters, KPMG, Medtronic, and Noble-UK.

112 *See* letters from ABA-Committees, Davis Polk, EY, PwC, and SIFMA.

113 The majority of private debt offerings are conducted using Rule 144A, and 99% of Rule 144A offerings are debt offerings. Additionally, although most Regulation D offerings are equity offerings, a significant number include debt securities. *See Access to Capital and Market Liquidity Report,* at p. 38; Scott Bauguess *et al.*, U.S. Sec. & Exch. Comm'n, Div. of Econ. & Risk Analysis, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014* (Oct. 2015), https://www.sec.gov/dera/staff-papers/white-papers/30oct15_white_unregistered_offering.html.

114 *See, e.g.*, letters from ABA-Committees, Cahill, and Davis Polk.

the non-guarantor subsidiaries as a consolidated group.[115] Another commenter stated that it was "not aware of a single Rule 144A offering that has ever included [Rule 3-10]…financial statements that were not otherwise already available" and that the Consolidating Information is "routinely omitted in unregistered offerings."[116]

Prior to the adoption of existing Rule 3-10 in 2000, under Staff Accounting Bulletin No. 53 (1983) ("SAB 53"), subsidiary issuers were "permitted to include summarized financial information,"[117] which was presented for each subsidiary issuer or guarantor and did not exclude the financial information of non-guarantor subsidiaries consolidated by those subsidiary issuers and guarantors. In discussing its reasons in the 2000 Release for requiring Consolidating Information instead of summarized financial information, the Commission highlighted that the summarized financial information in SAB 53 did not allow for the more complete and independent assessment of a subsidiary's financial condition that may be necessary in the case of "more complex" guarantee structures.[118] Additionally, the Commission noted that SAB 53 disclosures could result in a high number of sets of summarized financial information, which would be burdensome for the parent company and would not likely be useful to investors.[119]

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115 *See* letter from Cahill.

116 *See* letter from Davis Polk.

117 *See* Section III.A.3.a of the 2000 Release.

118 In the 2000 Release, the Commission stated that SAB 53 "did not contemplate more complex guarantee structures where investors must assess the subsidiary's financial condition more completely and independently of its parent company and other subsidiaries of its parent company," and also stated that "summarized financial information is inadequate for this purpose. For example, although cash flow information is significant in assessing creditworthiness, summarized financial information includes no cash flow information." *See id.*

119 In discussing the use of the summarized financial information in SAB 53 to address disclosures involving multiple guarantors, the Commission, in the 2000 Release, stated "[m]any structures presented to the staff involved a subsidiary issuer, a parent company guarantor, multiple subsidiary guarantors, and multiple subsidiaries that are not guarantors. Other structures involved more than 100 subsidiary guarantors. [SAB 53 disclosures in such structures would have included]…more than 100 sets of summarized financial information. Not only would that disclosure have been burdensome for the registrant to provide, it is unlikely to have been useful to investors." *See* Section III.A.3.a of the 2000 Release. Other reasons cited by the Commission for

In considering changes to the existing Rule 3-10 disclosure requirements, we have sought to improve the disclosure provided to investors by focusing on the material information needed to make an informed investment decision while reducing the cost and burdens for registrants in providing the information. Our experience since the adoption of the existing Rule 3-10 in 2000 suggests that the level of information required by Consolidating Information, although detailed, could be better focused on what is material to an investment decision. Additionally, we believe that many of the reasons for requiring Consolidating Information instead of summarized financial information highlighted by the Commission in the 2000 Release could be addressed without requiring the use of Consolidating Information, thereby addressing the concerns noted above regarding the burdens associated with issuers' preparation of Consolidating Information.

Accordingly, as discussed below,[120] the financial disclosure requirements in proposed Rule 13-01 are tailored to the type of material information, in addition to the parent company's consolidated financial statements, that we believe investors in registered offerings need to make informed investment decisions about guaranteed debt securities. In seeking to identify the material information investors need, we have considered commenters' suggestion that we look to the disclosures provided in the Rule 144A debt markets. In this regard, we note that the proposed disclosures would be more detailed than that typically provided in exempt offerings, in which investors have the ability to request additional information from potential issuers when they deem it necessary, such as additional financial information about the issuers and guarantors or qualitative disclosures pertaining to the issuer and guarantor structure. Under the proposed revisions, registrants would:

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requiring Consolidating Information in the 2000 Release are discussed in Sections III.C.2.a.i, "Level of Detail," and III.C.2.a.ii, "Presentation on a Combined Basis," below.

[120] *See* Section III.C.2.a.i, "Level of Detail."

- be required to provide Summarized Financial Information rather than Consolidating Information;
- be required to provide disclosure about the Obligor Group without financial information of non-obligated entities (financial information of each issuer and guarantor could be combined into a single column); and
- be permitted to reduce the number of periods presented.

As a result of the proposed revisions, the instructions for preparing Consolidating Information in existing Rule 3-10(i) would be eliminated.

i. Level of Detail

Unless a brief narrative is permitted, existing Rule 3-10 requires Consolidating Information, which includes all major captions of the balance sheet, income statement, and cash flow statement that Article 10 requires to be shown separately in interim financial statements. As noted above, a number of commenters recommended reducing the level of detail in financial disclosures by replacing the Consolidating Information with summarized financial information in the notes to the parent company's financial statements.[121]

The Commission stated in the 2000 Release that Consolidating Information "provides the same level of detail about the financial position, results of operations, and cash flows of subsidiary issuers and subsidiary guarantors that investors are accustomed to obtaining in interim financial statements of a registrant."[122] In our experience, this level of detail about subsidiary issuers and guarantors occupies multiple pages of a parent company's financial statements,

[121] *See* letters from BDO, CAQ, DT, EY, Grant, and KPMG.

[122] *See* Section III.A.3.a of the 2000 Release.

potentially obscuring important information contained therein.[123] We believe the required supplemental financial information about issuers and guarantors should instead be focused on the information that is most likely to be material to an investment decision. If additional line items beyond those specifically required are material to an investment decision, they would be required to be disclosed as well. Proposed Rule 13-01(a)(4) would therefore require Summarized Financial Information, which would include select balance sheet and income statement line items. Disclosure of additional line items of financial information beyond what is specified in proposed Rule 13-01(a)(4) would be required by proposed Rule 13-01(a)(5), to the extent they are material to an investment decision. For example, if a material amount of reported revenues of the obligated entities are derived from transactions with related parties, such as other non-issuer and non-guarantor subsidiaries of the parent company, disclosure of such related party revenues would be required. This Summarized Financial Information and any additional disclosures that would be required based on materiality would supplement the parent company's consolidated financial statements and would simplify compliance and reduce costs for preparers, while providing investors with more streamlined and easier to understand financial information that is material to an investment decision.

While investors are provided cash flow information at the parent company consolidated level, supplemental cash flow information about subsidiary issuers and guarantors is not typically included in disclosures provided in the Rule 144A debt markets.[124] This leads us to believe that investors in a registered offering look primarily to a parent company's consolidated cash flow information to assess creditworthiness where the parent is the primary obligor or its

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123 *See also* letter from BDO ("In some cases, the value of the alternative disclosure may be overshadowed by its multi-column voluminous nature.").

124 *See* letters from ABA-Committees, Cahill, Davis Polk, and PwC.

guarantor obligation is full and unconditional. Based on this observation, and the difficulties and significant costs associated with the preparation of cash flow information for inclusion in Consolidating Information highlighted by several commenters,[125] supplemental cash flow information would not be a required disclosure under the proposed rule.

Request for Comment

38. Should the Proposed Alternative Disclosures require Summarized Financial Information rather than Consolidating Information? Would the Summarized Financial Information, along with the other disclosures required by proposed Rule 13-01, provide the financial information investors need to make an informed investment decision with respect to the guaranteed security?

39. How would issuers and investors be affected by requiring Summarized Financial Information? Are there particular items in Consolidating Information that investors need to make informed investment decisions that would not be provided separately through Summarized Financial Information? Is there any such financial information that underwriters would still require? If so, what would be the effect on the costs associated with the offering?

40. Would additional line items of financial information beyond what would be required by Summarized Financial Information help investors make informed investment decisions? If so, what line items and why? For example, should the proposed rule specifically

[125] *See, e.g.*, letter from GM ("There are many challenges when preparing the Consolidating Information, in particular the consolidating statement of cash flows. Our underlying books and records are not based on a guarantor/non-guarantor structure, and due to a centralized cash management function numerous intercompany transactions exist. These factors complicate the preparation of Consolidating Information prepared 'as if' the registrant was a stand-alone entity. These intercompany transactions require extensive analysis and manual reclassification adjustments to permit the preparation of the Consolidating Information, resulting in excessive complexity and effort relative to the limited benefits of providing this information to investors."). *See also* letters from ABA-Committees, CAQ, Grant, KPMG, and PwC.

require supplemental summarized cash flow information resulting from operating, financing, and investing activities? Would issuers face challenges in providing such information?

41. Do investors need summarized cash flow information about issuers and guarantors in addition to the parent company's consolidated cash flow statements to make informed investment decisions about guaranteed securities? If so, how is it used? If not, why not?

ii. Presentation on a Combined Basis

Consolidating Information distinguishes the assets, liabilities, operations, and cash flows of each category of parent and subsidiaries as issuer, guarantor, or non-guarantor. Comments varied with respect to whether and how the financial information of the entities in the issuers and guarantors should be grouped. Some commenters suggested permitting disclosure of financial information of either the Obligor Group or the non-obligated entities as groups,[126] other commenters recommended requiring disclosure of both groups separately,[127] and another commenter suggested several possible groupings.[128] Other commenters stated that investors use the existing Rule 3-10 disclosures to evaluate separately the likelihood of payment by the issuer and guarantors.[129]

The Commission observed in the 2000 Release that there were "complex guarantee structures where investors must assess the subsidiary's financial condition more completely and

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126 *See, e.g.*, letters from BDO and EY.

127 *See, e.g.*, letters from CAQ and KPMG.

128 This commenter suggested the Commission consider summarized financial information related only to: (1) the issuers separately and the combined guarantor subsidiaries separately; (2) the issuers and guarantors on a combined basis: or (3) the guarantor subsidiaries. *See* letter from DT.

129 *See, e.g.*, letters from CalPERS and CFA.

independently of its parent company and other subsidiaries of its parent company."[130] The Commission also stated that it was "requiring [Consolidating Information] because it clearly distinguishes the assets, liabilities, revenues, expenses, and cash flows of the entities that are legally obligated under the indenture from those that are not" and "[i]t also facilitates analysis of trends affecting subsidiary issuers and subsidiary guarantors and relationships among the various components of a consolidated organization."[131] We continue to believe it is important to clearly distinguish in the supplemental financial information the entities obligated under the guaranteed security from those that are not obligated. Along with some commenters, however, we believe investors focus largely on whether payment will be made in full on the dates specified in the guaranteed security, rather than whether payment comes from an issuer or one or more guarantors in the same consolidated group.[132] We therefore believe that it is appropriate for our disclosure rules to focus on the obligated entities as a group, and that the parent company should be able to provide financial disclosures that convey information about the Obligor Group on a combined, rather than disaggregated, basis. Accordingly, the proposed rule would permit the parent company to present the Summarized Financial Information of the parent company issuer or guarantor, each consolidated subsidiary issuer, and each consolidated subsidiary guarantor, on a combined basis. Proposed Rule 13-01(a)(4) would require intercompany transactions between issuers and guarantors presented on a combined basis to be eliminated.

We recognize that there may be circumstances in which separate financial information about certain issuers and guarantors is material to an investment decision. Accordingly, when information provided in response to proposed Rule 13-01 is applicable to one or more, but not

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130 *See* Section III.A.3.a of the 2000 Release.

131 *See id.*

132 *See, e.g.*, letters from BDO and EY.

all, issuers and guarantors, proposed Rule 13-01(a)(4) would require, to the extent it is material, separate disclosure of Summarized Financial Information for the issuers and guarantors to which the information applies. For example, if a subsidiary's guarantee were limited to a particular dollar amount, disclosure of that limitation would be required by proposed Rule 13-01(a)(2). In that case, separate disclosure of the Summarized Financial Information specified in proposed Rule 13-01(a)(4) would be required for that subsidiary guarantor, if material.

Because non-guarantor subsidiaries are not obligated to make payments as either issuer or guarantor, we do not believe separate supplemental disclosure of their financial information as required under the existing rule is likely to be material to an investment decision. As such, the proposed rule would no longer require separate disclosure of the financial information of non-guarantor subsidiaries.

In order to present the assets, liabilities, and operations of the Obligor Group accurately, it is necessary to exclude the financial information of subsidiaries not obligated under the guaranteed security. Within Consolidating Information under the existing rule, a parent company should present investments in all subsidiaries based upon their proportionate share of the subsidiary's net assets,[133] and subsidiary issuer or guarantor columns should present investments in certain subsidiaries, including but not limited to non-guarantor subsidiaries, under the equity method of accounting.[134] This presentation avoids presenting the financial information of a non-issuer or non-guarantor subsidiary as though it were an issuer or guarantor. We continue to believe that the financial information of non-issuer and non-guarantor subsidiaries should be excluded from the Summarized Financial Information of the Obligor

[133] *See* Rule 3-10(i)(3) of Regulation S-X.

[134] *See* Rule 3-10(i)(5) of Regulation S-X.

Group, even if those non-issuer and non-guarantor subsidiaries would be consolidated by an issuer or guarantor. We have included a corresponding requirement in proposed Rule 13-01(a)(4). However, the proposed rule would allow the parent company to determine which method best meets the objective of excluding the financial information of non-issuer and non-guarantor subsidiaries from the Proposed Alternative Disclosures, so long as the selected method is disclosed and used for all non-issuer and non-guarantor subsidiaries for all classes of guaranteed securities for which the disclosure is required, and is reasonable in the circumstances.[135] For example, the parent company could exclude the assets, liabilities, and operations of non-issuer and non-guarantor subsidiaries by using the equity method of accounting for those subsidiaries.

As discussed above,[136] separate disclosure of the Summarized Financial Information of one or more subsidiary issuers or guarantors may be necessary under the proposed rule. In this case, the same method of excluding a non-issuer's or non-guarantor's financial information from the Summarized Financial Information of the Obligor Group would also be required for the subsidiary issuers or guarantors whose financial information is presented separately. For example, if a subsidiary's guarantee is limited and its Summarized Financial Information is presented separately from that of the combined Obligor Group, that subsidiary guarantor's

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[135] This proposed amendment may result in decreased comparability in the combined Summarized Financial Information of the Obligor Group between parent companies that elect to use different methods of excluding the financial information of their non-issuer and non-guarantor subsidiaries. In proposing this change, we considered the costs to the parent company of requiring the use of a specific method of accounting for non-issuer and non-guarantor subsidiaries to remove their financial information from the combined Obligor Group, particularly if that parent company's systems are not designed to readily produce such information. *See, e.g.*, letters from CAQ, EY, Grant, KPMG, and PwC (highlighting the challenges of this requirement under the existing rule). We expect any decrease of comparability to be limited, as most line items required to be disclosed in Summarized Financial Information would be unaffected by the use of different methods for this purpose (*e.g.*, current assets, current liabilities, net sales or gross revenues and gross profit).

[136] *See* Section III.C.2.a.ii, "Presentation on a Combined Basis."

financial information should be excluded from the Obligor Group information consistent with the method selected for excluding the financial information of non-issuer and non-guarantor subsidiaries from the Obligor Group information.

Request for Comment

42. Should we permit the financial disclosure of the Obligor Group to be combined within the proposed Summarized Financial Information? Why or why not? If not, what groupings of issuers and guarantors should be required or permitted, and why? How would this impact the information for investment decisions? Are there specific circumstances where separate information should be required?

43. Does presentation of the financial information of non-guarantor subsidiaries provide investors with information they need to make informed investment decisions? Do investors use the financial information of non-obligated entities as part of their investment analyses? For example, do investors consider ratios or any similar derivation of the information from the non-obligated entities? If so, how is it used and in what circumstances? Should Summarized Financial Information of the non-obligated entities also be provided? Why or why not?

44. Should we require a specific method of accounting (*e.g.*, the equity method) to be used to exclude the financial information of non-obligated subsidiaries from the Summarized Financial Information of the Obligor Group instead of permitting the parent company to choose? If so, what method should we require, and why? If not, why? If we do not prescribe a specific method, should we limit the permissible methods to those concepts included within U.S. GAAP, or IFRS, as applicable? Alternatively, should we limit the permissible methods to concepts included within U.S. GAAP, or IFRS, as applicable,

only when the Proposed Alternative Disclosures are placed in the parent company's financial statements? How would allowing different methods affect the disclosures for investors?

iii. Periods to Present

In addition to the parent company's consolidated information, the supplemental information included in the Proposed Alternative Disclosures would help facilitate an investor's evaluation of whether the entities in the Obligor Group have the ability to make payments as required under the guaranteed security, including what assets are available to satisfy those obligations. We believe the required periods of Summarized Financial Information of the Obligor Group should be based on the most recent financial information. Instead of the periods specified in Rules 3-01 and 3-02 of Regulation S-X required by the existing rule, the proposed rule would require Summarized Financial Information only as of, and for, the most recently completed fiscal year and year-to-date interim period ("interim period"), if applicable. When used in conjunction with the parent company's consolidated financial statements, we believe the most recent full fiscal year and interim period should provide investors the additional information that is material to an investment decision in the guaranteed security and would eliminate unnecessary compliance costs for registrants.

Commenters recommended limiting disclosure to the current year, citing challenges recasting prior period information for circumstances such as legal-entity mergers and discontinued operations.[137] A number of commenters stated that interim reporting of the Proposed Alternative Disclosures should only be required if material changes have occurred

[137] *See* letters from Medtronic and PwC.

since the most recent annual period that is required to be presented.[138] However, we believe that the most recent interim period should be provided so that investors can make decisions based on the most recent information available.

Lastly, because Item 1 of Part I of Form 10-Q[139] requires a registrant to provide the information required by Rule 10-01 of Regulation S-X, we are proposing to add Rule 10-01(b)(9) to require compliance with Rules 3-10 and 13-01.

Request for Comment

45. What periods of presentation are material for investors when evaluating the credit risk of the Obligor Group?

46. Should the required periods of Summarized Financial Information of the Obligor Group be based on the most recent financial information? Why or why not? If so, what periods should be considered "most recent," and why?

47. Should we require additional periods of Summarized Financial Information beyond the most recent fiscal year and interim period? Why or why not? If yes, which periods and why?

48. Rather than requiring disclosure of the most recent interim period, should the proposed rule focus on significant changes similar to Rule 10-01(a)(5) of Regulation S-X, which allows registrants to apply judgment and omit details of accounts that have not changed significantly in amount or composition since the end of the most recently completed fiscal year? Why or why not?

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[138] *See* letters from BDO, CAQ, CFA, Comcast, DT, EY, GM, Grant, KPMG, and Medtronic. In making this suggestion, several of these commenters made reference to Rule 10-01(a)(5) of Regulation S-X, which allows registrants to apply judgment and omit details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year. *See* Rule 10-01(a)(5) of Regulation S-X.

[139] 17 CFR 249.308a.

b. Non-Financial Disclosures

When Consolidating Information is presented, the existing rule requires limited non-financial disclosures about the issuers and guarantors and the guarantees,[140] restricted net assets,[141] and certain types of restrictions on the ability of the parent company or any guarantor to obtain funds from their subsidiaries.[142] Although the Request for Comment asked if there is different or additional information that investors need about guarantors and issuers of guaranteed securities, we received no comments on non-financial disclosures.

In addition to proposing amendments to existing Rule 3-10 for financial disclosures, we are also proposing amendments to require specific non-financial disclosures. We are proposing these amendments to enhance the information provided about subsidiary issuers and guarantors, particularly in light of our proposal to require Summarized Financial Information for these subsidiaries. Proposed Rules 13-01(a)(1) through (3) would require certain disclosures, to the extent material,[143] about the issuers and guarantors, the terms and conditions of the guarantees, and how the issuer and guarantor structure and other factors may affect payments to holders of the guaranteed securities. Although a parent company must provide narrative disclosure under the existing requirements, we believe the proposed requirements would result in enhanced narrative disclosures that would improve investor understanding of the issuers, guarantors, and guarantees, and make the financial disclosures they accompany easier to understand. While the proposed requirements are composed of the items we believe are most likely to be material to an

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[140] Existing Rules 3-10(i)(8)(i)-(iii) requires disclosure, if true, that each subsidiary issuer or subsidiary guarantor is 100% owned by the parent company, that all guarantees are full and unconditional, and where there is more than one guarantor, that all guarantees are joint and several.

[141] Rule 3-10(i)(10) of Regulation S-X.

[142] Rule 3-10(i)(9) of Regulation S-X.

[143] *See* discussion within Section III.C.2.c, "When Disclosure is Required."

investor, there may be additional facts and circumstances specific to particular issuers and guarantors that would be material to holders of the guaranteed security. In that case, similar to existing Rule 3-10(i)(11),[144] proposed Rule 13-01(a)(5) would require disclosure of those facts and circumstances.[145] Additionally, when a non-financial disclosure is applicable to one or more, but not all, issuers and guarantors, proposed Rule 13-01(a)(4) would require, to the extent it is material, separate disclosure of Summarized Financial Information for the issuers and guarantors to which it applies.[146]

Request for Comment

49. Are the proposed non-financial disclosures material to an investment decision? Should we explicitly require any non-financial disclosures in addition to what is proposed? If so, what information and why?

c. When Disclosure is Required

One of the conditions that must be met under existing Rule 3-10 to be eligible to omit the financial statements of a subsidiary issuer and guarantor is providing the Alternative Disclosures. If certain numerical thresholds are met, including that the parent company has "no independent assets or operations" and that all non-issuer and non-guarantor subsidiaries are "minor,"[147] the Alternative Disclosures may take the form of a brief narrative in lieu of detailed Consolidating

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144 Existing Rule 3-10(i)(11)(i) specifies that the parent company "[m]ay not omit any financial and narrative information about each guarantor if the information would be material for investors to evaluate the sufficiency of the guarantee," and existing Rule 3-10(i)(11)(ii) states that the disclosure "[s]hall include sufficient information so as to make the financial information presented not misleading."

145 *See* discussion within Section III.C.2.c, "When Disclosure is Required."

146 *See* discussion within Section III.C.2.ii, "Presentation on a Combined Basis."

147 Rules 3-10(h)(5) and (6) specify the numerical thresholds that must not be exceeded for a parent company to have "no independent assets or operations," and for a subsidiary to be "minor," respectively. *See* additional discussion above in Section II.F, "Exceptions."

Information, but some type of the Alternative Disclosures is always required.[148] Under these thresholds, minor changes in circumstances can result in dramatically different disclosures being required. A number of commenters indicated that these thresholds are unnecessarily restrictive.[149]

Instead of using the existing rule's numerical thresholds to determine the form and content of disclosure, we believe investors should receive all disclosures specified in the proposed rule, unless such information is immaterial. As such, the proposed amendments would eliminate the "no independent assets or operations" and "minor" numerical thresholds, as well as the brief narrative form of Alternative Disclosures, and instead require financial and non-financial disclosures to the extent material to holders of the guaranteed security.[150] For example, under the proposed rule, the Summarized Financial Information of the Obligor Group could be omitted if the parent company's consolidated financial statements do not differ in any material respects from the Obligor Group.[151] As another example, if a finance subsidiary issues securities that are guaranteed by its parent company, the Summarized Financial Information could be omitted because the finance subsidiary has no independent material debt-paying ability and has

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148 *See* discussion of existing requirements in Section II.F, "Exception Paragraphs."

149 *See* letters from ABA-Committees, AB-NYC, CAQ, DT, EY, FedEx , KPMG, and PwC.

150 This requirement is specified in proposed Rule 13-01(a). Whether a disclosure specified in proposed Rule 13-01 may be omitted or whether additional disclosure would be required by proposed Rule 13-01(a)(5), discussed below, depends on whether the disclosure would be material to a reasonable investor. The Supreme Court in *TSC v. Northway* held that a fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *See TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

151 For example, a parent company issuer could have guarantor subsidiaries as well as non-guarantor subsidiaries. If the non-guarantor subsidiaries are immaterial such that the combined Summarized Financial Information of the Obligor Group was not materially different from the corresponding amounts in the parent company's consolidated financial statements, Summarized Financial Information could be omitted. However, if at a later time, non-guarantor subsidiaries become a larger part of the parent company's business such that the combined Summarized Financial Information of the Obligor Group is materially different from the corresponding amounts in the parent company's consolidated financial statements, the parent company would then be required to provide such Summarized Financial Information.

no material assets or operations other than those related to the issuance, administration, and repayment of the guaranteed security. While the disclosures specified in proposed Rule 13-01(a)(1) through (4) may be omitted if immaterial to holders of the guaranteed security, for clarity, proposed Rule 13-01(a)(4) requires the registrant to disclose a statement that those financial disclosures have been omitted and the reason(s) why the disclosures are not considered to be material.

Existing Rules 3-10(i)(11)(i) and (ii), respectively, require disclosure of any financial and narrative information about each guarantor if it would be material for investors to evaluate the sufficiency of the guarantee, and disclosure of sufficient information to make the financial information presented not misleading. This disclosure is required when Consolidating Information is disclosed.

While we have proposed specific financial and non-financial disclosures, there may be other information about the guarantees, issuers, and guarantors that could be material to holders of the guaranteed security. Accordingly, proposed Rule 13-01(a)(5) would require disclosure of any information that would be material to holders of the guaranteed security, rather than the sufficiency of the guarantee as stated in the existing rule. This requirement would apply in all cases, including when the proposed Summarized Financial Information is omitted in accordance with the proposed rule.

Request for Comment

50. Should we eliminate the existing numerical thresholds for disclosure, such as the parent company having "no independent assets or operations" and/or that all non-issuer and non-guarantor subsidiaries are "minor," and instead use a materiality standard to determine the appropriate level of disclosure? Would this cause difficulty in practice? If so, what

are those difficulties and how can they be avoided? Would further guidance be necessary? If so, please explain what guidance is needed. Would the elimination of the numerical thresholds and use of a materiality standard result in a loss of material information that investors currently use to analyze these securities? If so, what material information would be lost and would it be material information necessary for an investor's investment decision? Would this principles-based approach result in different levels of disclosure provided by issuers who, for example, may be in similar industries or have similar operations? If so, how would investors view such differences in making investment decisions?

51. Should any additional disclosures be specifically required if default on the guaranteed security reaches a certain level of likelihood? If so, what type of disclosures and when should they be provided?

52. Are the proposed rules sufficiently clear about what disclosures should be provided and when? If not, how should the rules be revised to ensure clarity?

d. Location of Proposed Alternative Disclosures and Audit Requirement

The primary source of financial information provided to investors—the consolidated financial statements of the parent company—is required to be audited as specified in Regulation S-X.[152] Existing Rule 3-10 requires the Alternative Disclosures to be included in the notes to the parent company's consolidated financial statements, thereby requiring them to be audited for the same periods. A few commenters specifically addressed whether the Alternative Disclosures, as

[152] Rules 3-01 and 3-02 of Regulation S-X.

revised by their suggestions, should be audited, and those recommendations were mixed.[153]

The Proposed Alternative Disclosures would provide incremental detail as a supplement to the parent company's audited annual and unaudited interim consolidated financial statements to facilitate an analysis of the parts of the consolidated enterprise that are obligated to make payments as issuers or guarantors. We believe the supplemental nature of this information supports providing parent companies with the flexibility to provide the Proposed Alternative Disclosures inside or outside of the consolidated financial statements in registration statements covering the offer and sale of the guaranteed debt securities and any related prospectus, as well as annual and quarterly Exchange Act periodic reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. This proposed optionality should reduce costs and burdens for parent companies and reduce the potential for delay in offerings that exists under the existing rule due to the need to prepare audited Alternative Disclosures. Parent companies using this proposed option to provide the disclosures outside the consolidated financial statements may be able to register guaranteed debt offerings and go to market more quickly than under the existing rule. This may allow parent companies to more promptly access favorable market conditions. If a parent company elects to provide the Proposed Alternative Disclosures outside its audited financial statements, the disclosures would be required in specified prominent locations in its offering documents and periodic reports.

Accordingly, the note to proposed Rule 13-01(a) would allow the parent company to provide the Proposed Alternative Disclosures in a footnote to its consolidated financial statements or, alternatively, in management's discussion and analysis of financial condition and

[153] For example, one commenter suggested its recommended disclosures be provided on an unaudited basis, *see* letter from WhiteWave, whereas another commenter suggested requiring, on an audited basis, the type of information typically included on an unaudited basis in offering memoranda for Rule 144A debt offerings. *See* letter from ABA-Committees.

results of operations ("MD&A"),[154] in its registration statement covering the offer and sale of the subject securities and any related prospectus, and in Exchange Act reports on Forms 10-K and 10-Q[155] required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. If a parent company elects to provide the disclosures in its audited financial statements, the Proposed Alternative Disclosures would be required to be audited.[156] If not otherwise included in the consolidated financial statements or in the MD&A, the parent company would be required to include the Proposed Alternative Disclosures in its prospectus immediately following "Risk Factors," if any, or otherwise, immediately following pricing information described in Item 503(c) of Regulation S-K. Beginning with the parent company's annual report filed on Form 10-K for the fiscal year during which the first bona fide sale of the subject securities is completed, however, the parent company would be required to provide the Proposed Alternative Disclosures in a footnote to its consolidated financial statements in its annual and quarterly reports.

The increased flexibility that would be afforded to the parent company in choosing where to locate the Proposed Alternative Disclosures during the fiscal year in which the first bona fide sale of the subject securities is completed gives rise to certain disclosure location considerations. If the parent company were to elect to provide the Proposed Alternative Disclosures in its financial statements, consistent with the existing rule, the disclosures would be subject to annual audit, interim review, and internal control over financial reporting requirements. By doing so,

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154 *See* Item 303 of Regulation S-K.

155 These proposed amendments also apply to foreign private issuers and issuers offering securities pursuant to Regulation A and the forms applicable to such entities. *See* Section III.D, "Application of Proposed Amendments to Certain Types of Issuers," below.

156 Regardless of where the Proposed Alternative Disclosures are presented in the filing, U.S. GAAP requires disclosure in the financial statements of the pertinent rights and privileges of the various securities outstanding. *See* ASC 470-10-50-5 and ASC 505-10-50-3.

investors and other users may benefit to the extent that they consider the information included in the financial statements more reliable because it is subject to these audit and other requirements. Also consistent with the existing rule, Proposed Alternative Disclosures located in the financial statements would be subject to XBRL tagging requirements.[157] The parent company may incur additional costs to comply with these tagging requirements, whereas investors and other users may benefit from more readily-available information in structured formats.

In contrast, if the parent company were to elect to provide the Proposed Alternative Disclosures outside its financial statements during this time period, it would not incur costs to comply with these requirements, but investors would not benefit from the enhanced reliability of information included in the financial statements. In addition, the safe harbor under the Private Securities Litigation Reform Act of 1995 ("PSLRA") would not be available for the disclosures if provided in the financial statements, but would be available for disclosure provided in other sections of the filing, such as the MD&A.[158] If the safe harbor is available, a parent company may be more likely to supplement its disclosures, which would benefit investors. When provided outside of the financial statements, the Proposed Alternative Disclosures would be subject to the parent company's disclosure controls and procedures and related certification requirements.

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[157] On June 28, 2018, the Commission adopted rule and form amendments to require filers, on a phased in basis, to use the Inline XBRL format for financial statement information and risk/return summary information. *See Inline XBRL Filing of Tagged Data*, Release No. 33-10514 (Jun. 28, 2018).

[158] Pub. L. 104-67, 109 Stat. 737 (1995). Since the PSLRA does not provide a safe harbor for forward-looking information located within the financial statements, a parent company presenting the Proposed Alternative Disclosures in its financial statements may be less likely to voluntarily supplement those disclosures with forward-looking information as compared with disclosures made outside the financial statements. However, a parent company retains the option of providing forward-looking information outside its financial statements so that such information is covered by the safe harbor.

Request for Comment

53. Should the proposed rule permit the parent company to provide the Proposed Alternative Disclosures outside its financial statements in the proposed circumstances described above? Alternatively, should the parent company be permitted to provide the Proposed Alternative Disclosures outside its financial statements in all circumstances? What are the potential benefits or concerns for investors and issuers with either approach?

54. Would requiring the Proposed Alternative Disclosures to be included in a footnote to the parent company's audited annual and unaudited interim financial statements beginning with its annual report filed on Form 10-K or Form 20-F for the fiscal year during which the first bona fide sale of the guaranteed securities is completed be useful to investors? If so, why? If not, why not? What are the potential benefits or concerns for investors and issuers with either approach?

55. Would requiring the Proposed Alternative Disclosures to be audited or reviewed present costs or challenges for parent companies? If so, what are they? For example, would it cause delays in the offering process?

56. Should the proposed rule specify where in a filing the Proposed Alternative Disclosures must appear if the parent company chooses not to include them in its financial statements? Why or why not? If yes, are the locations required by the note to proposed Rule 13-01(a) appropriate? If so, why? If not, why not? Where should the Proposed Alternative Disclosures be disclosed, and why is that location appropriate?

57. Would issuers be more likely to voluntarily provide supplemental information in addition to the required Proposed Alternative Disclosures to the extent the PSLRA applied to such supplemental information? Why or why not? What would that additional supplemental

information be?

58. Should the proposed rule instead require the Proposed Alternative Disclosures to be provided in the parent company's financial statements in the subject registration statement and subsequent Exchange Act periodic reports for the fiscal year in which the first bona fide sale of the subject securities is completed, but permit the parent company to provide the Proposed Alternative Disclosures outside its financial statements in subsequent Exchange Act periodic reports? If so, why? If not, why not? Does the answer change the larger the parent company is? Why or why not? Would investors and issuers benefit from such a requirement? Why or why not? Should the Proposed Alternative Disclosures be required to be included in the parent company's financial statements for a different period of time before the parent company is permitted to provide them outside its financial statements? If so, what time period and why?

59. Should the note to proposed Rule 13-01(a) apply differently to emerging growth companies?[159] Why or why not? For example, should there be different filings or periods of time if the parent company is an emerging growth company? If so, what should be different and why? How would investors and issuers be affected?

e. Recently-Acquired Subsidiary Issuers and Guarantors

Existing Rule 3-10(g) requires pre-acquisition audited financial statements of a recently acquired subsidiary issuer or guarantor in certain circumstances. One commenter noted that the information provided for recently acquired subsidiary issuers and guarantors is more detailed

[159] 17 CFR 230.405 ("Rule 405") under the Securities Act defines an emerging growth company as an issuer that had total gross revenues of less than $1.07 billion during its most recently completed fiscal year. It retains that status for five years after its initial public offering unless its revenues rise above $1.07 billion, it issues more than $1 billion of non-convertible debt in a three year period, or it qualifies as a large accelerated filer pursuant to 17 CFR 240.12b-2 ("Rule 12b-2") under the Exchange Act.

than the information required for the other subsidiary issuers and guarantors.[160] Another commenter made a similar observation but also noted that these financial statements will only be included at the time the issuers and guarantors are first registering the guaranteed security, at which time the probability of the guarantee being invoked would usually be remote.[161] Several commenters recommended eliminating the requirement to provide audited pre-acquisition financial statements of recently-acquired issuers and guarantors but differed on whether any other disclosure should be provided, and, if so, what type.[162]

Commenters also noted that, in addition to being presented with a far greater level of detail than is required for existing subsidiary issuers and guarantors in the Alternative Disclosures under existing Rule 3-10, these pre-acquisition audited financial statements are burdensome and costly for preparers.[163] Additionally, 17 CFR 210.3-05 ("Rule 3-05") of Regulation S-X already requires pre-acquisition audited financial statements of an acquired business to be provided if it exceeds specified thresholds of significance,[164] which one

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160 *See* letter from DT.

161 *See* letter from PwC.

162 *See, e.g.*, letters from CAQ, DT, EY, Grant, KPMG, PwC, and SIFMA. A few commenters recommended rescinding the requirement altogether. *See* letters from EY and SIFMA. Several commenters suggested requiring disclosure about recently acquired issuer and guarantor subsidiaries to mirror what is required for other issuer and guarantor subsidiaries (*i.e.*, form and content of Alternative Disclosures). *See* letters from CAQ, DT, Grant, KPMG, and PwC.

163 *See, e.g.*, letters from PwC (stating that a "company can incur significant costs and effort to prepare such financial statements that will never be required again") and EY ("The requirements to provide separate pre-acquisition financial statements of recently acquired guarantors under S-X Rule 3-10(g) are unnecessary and potentially burdensome."). *See also* letters from CAQ, DT, Grant, and KPMG.

164 Rule 3-05 specifies requirements for pre-acquisition financial statements of an acquired or to be acquired significant "business." Registrants determine whether a "business" has been acquired by applying Rule 11-01(d) of Regulation S-X, and whether an acquisition is significant by using the investment, asset, and income tests described in Rule 1-02(w) of Regulation S-X. If the parent company is a smaller reporting company, Rule 8-04 specifies requirements for pre-acquisition financial statements of an acquired or to be acquired significant business, including the tests used to determine if an acquisition is significant. Recently-acquired subsidiary issuers and guarantors would typically be considered a "business" because separate entities, subsidiaries, or divisions are presumed to be businesses. The requirements of Rule 3-05 overlap with Rule 3-10(g) if a parent company files a registration statement in connection with the offering of guaranteed debt or debt-like securities

commenter indicated is sufficient for investors.[165]

Based on these observations, and our belief that existing requirements under Rule 3-05 provide sufficient information in this context, we do not believe the pre-acquisition financial statements of recently-acquired subsidiary issuers and guarantors required by existing Rule 3-10(g) are necessary. We are therefore proposing to delete existing Rule 3-10(g). Although we are not proposing to require specific disclosures about recently-acquired subsidiary issuers and guarantors in lieu of pre-acquisition financial statements, information about these recently-acquired subsidiaries would be required if material to an investment decision in the guaranteed security pursuant to proposed Rule 13-01(a)(5).

Due to the proposed deletion of Rule 3-10(g), we also propose a conforming change to remove paragraph (b) of Rule 12h-5.[166]

Request for Comment

60. Should we eliminate the existing requirement to provide pre-acquisition financial statements of recently-acquired subsidiary issuers and guarantors? Why or why not? Alternatively, should the proposed rule require some other type of disclosure about recently-acquired subsidiary issuers and guarantors instead of pre-acquisition financial statements? If so, what type of disclosure and in what instances should it be required?

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and acquires a subsidiary issuer or guarantor. However, the significance test under Rule 3-10(g) measures significance based on the purchase price of the recently acquired subsidiary issuer or guarantor relative to the size of the offering, which often results in a requirement to provide financial statements at a far lower level of significance than under Rule 3-05. The proposed elimination of Rule 3-10(g) would generally result in an investor receiving pre-acquisition financial statements of a recently-acquired subsidiary issuer or guarantor only if it exceeded the thresholds of significance specified in Rule 3-05 or 8-04, as applicable.

165 *See* letter from SIFMA.

166 If the proposed removal of paragraph (b) of existing Rule 12h-5 is adopted, a subsidiary issuer or guarantor that was previously required to provide pre-acquisition financial statements pursuant to existing Rule 3-10(g) but was exempt from Exchange Act reporting by paragraph (b) of existing Rule 12h-5 would continue to be exempt from Exchange Act reporting through proposed Rule 12h-5.

For example, should disclosure of pre-acquisition financial information about recently-acquired subsidiary issuers and guarantors mirror that of existing subsidiary issuers and guarantors?

f. Continuous Reporting Obligation

An issuer of securities is required to file Exchange Act reports with the Commission under Section 13(a), with respect to any class of securities registered pursuant to Sections 12(b) or 12(g), or for any class of securities for which it has a reporting obligation under Section 15(d) of the Exchange Act.[167] Section 12(b) registration is required only for so long as the class of securities is listed for trading on a national securities exchange.[168] An issuer incurs a Section 15(d) reporting obligation for each class of securities that is the subject of a Securities Act registration statement that becomes effective or is required to be updated under Securities Act Section 10(a)(3).[169] Section 15(d)(1)[170] provides that if, at the beginning of any subsequent fiscal year, the securities of any class to which the registration statement relates are held of record by fewer than 300 persons, or in the case of a bank, a savings and loan holding company,[171] or bank holding company,[172] by fewer than 1,200 persons, the registrant's Section 15(d) reporting obligation is automatically suspended with respect to that class.[173] Rule 12h-3 permits registrants to suspend a Section 15(d) reporting obligation at any time during a fiscal year

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[167] Section 12(g) registration is triggered when an issuer exceeds specified asset and ownership thresholds with respect to a class of equity securities and does not apply to securities subject to Rule 3-10.

[168] Accordingly, Section 12(b) reporting obligations are terminated when, for example, the class no longer qualifies for exchange listing or the registrant determines to no longer list the securities on a national securities exchange.

[169] 15 U.S.C. 78 j(a)(3).

[170] 15 U.S.C. 78o(d)(1).

[171] As that term is defined in Section 10 of the Home Owners' Loan Act, 12 U.S.C. 1461.

[172] As that term is defined in Section 2 of the Bank Holding Company Act of 1956, 12 U.S.C. 1841.

[173] The automatic statutory suspension of an issuer's Section 15(d) reporting obligation is not available as to any fiscal year in which the issuer's Securities Act registration statement becomes effective or is required to be updated pursuant to Section 10(a)(3) of the Securities Act.

provided the conditions of the rule are met.[174]

The Commission explained in the 2000 Release that the parent company must continue to provide the Alternative Disclosures in its periodic reports for as long as the subject securities are outstanding.[175] This disclosure requirement continues to apply to the parent company even if the reporting obligation of its subsidiary issuer or guarantor with respect to the subsidiary's guaranteed securities or subsidiary's guarantees could be suspended under either Section 15(d) or Rule 12h-3 of the Exchange Act.

A number of commenters indicated that a parent company should be able to cease providing the Alternative Disclosures for its subsidiary issuers and guarantors at the same time that a subsidiary's reporting obligation under Section 15(d) of the Exchange Act with respect to the subject security could be suspended.[176] Some of these commenters noted that requiring a parent company to continue providing the Alternative Disclosures once its subsidiary issuers' and guarantors' obligations to file reports could be suspended under Section 15(d) or Rule 12h-3 is inconsistent with other reporting rules.[177] One commenter stated, the "disparate treatment is illogical, and should be harmonized by expressly allowing registrants to cease providing the

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[174] Rule 12h-3 provides that the duty to file reports under Section 15(d) for a class of securities is suspended immediately upon the filing of a certification on Form 15, provided that the issuer has fewer than 300 holders of record, fewer than 500 holders of record where the issuer's total assets have not exceeded $10 million on the last day of each of the preceding three years, or, in the case of a bank, a savings and loan holding company, or a bank holding company, 1,200 holders of record; the issuer has filed its Section 13(a) reports for the most recent three completed fiscal years, and for the portion of the year immediately preceding the date of filing the Form 15 or the period since the issuer became subject to the reporting obligation; and a registration statement has not become effective or was required to be updated pursuant to Exchange Act Section 10(a)(3) during the fiscal year.

[175] *See* Section III.C.1 of the 2000 Release ("The parent company periodic reports must include the modified financial information permitted by paragraphs (b) through (f) of Rule 3-10. The parent company periodic reports must contain this information for as long as the subject securities are outstanding.").

[176] *See* letters from ABA-Committees, BDO, CAQ, Chamber, DT, EY, KPMG, PwC, SIFMA, and Simpson.

[177] *See* letters from ABA-Committees, DT, EY, PwC, SIFMA, and Simpson (noting that a continuous reporting obligation appears inconsistent with the reporting obligation of a registrant that provides separate financial statements because that registrant may stop providing the separate financial statements, even if the debt is outstanding).

information called for by the Rule 3-10 accommodations when the [reporting obligation related to the] guaranteed security is [suspended] pursuant to Section 15(d) of the Exchange Act."[178] Additionally, some commenters[179] stated that this requirement unnecessarily burdens registrants and "acts as a disincentive for registrants to engage in public debt offerings as opposed to offerings under Rule l44A or pursuant to other Securities Act exceptions."[180]

We are proposing that a parent company be permitted to cease providing the Proposed Alternative Disclosures if the corresponding subsidiary issuer's or guarantor's Section 15(d) obligation is suspended automatically by operation of Section 15(d)(1) or through compliance with Rule 12h-3. To implement this change, the proposed rule would eliminate the statement in existing Rule 3-10(a) that "[e]very issuer of a registered security that is guaranteed and every guarantor of a registered security must file the financial statements required for a registrant by Regulation S-X." As proposed, if a subsidiary issuer or guarantor is required to file financial statements required by Regulation S-X with respect to the guarantee or guaranteed security, the subsidiary may omit such financial statements if it complies with conditions set forth in proposed Rule 3-10. The parent company would be able to cease providing the Proposed Alternative Disclosures for a subsidiary issuer or guarantor that is not required to file financial statements required by Regulation S-X with respect to the guarantee or guaranteed security.

As described above, Section 12(b) registration is required for so long as a class of securities is listed for trading on a national securities exchange. As a continued condition of eligibility to omit the financial statements of a subsidiary issuer or guarantor, a parent company must continue providing the Proposed Alternative Disclosures for so long as the subsidiary issuer

178 *See* letter from SIFMA.

179 *See* letters from DT and Simpson.

180 *See* letter from Simpson.

or guarantor has a Section 12(b) reporting obligation with respect to the guarantee or guaranteed security. If the subsidiary issuer's or guarantor's reporting obligation with respect to the guarantee or guaranteed security is terminated under Section 12(b), the parent may cease providing the Alternative Disclosures once the subsidiary issuer's and guarantor's Section 15(d) obligation is suspended automatically by operation of Section 15(d)(1) or through compliance with Rule 12h-3.

Under the proposed rule, which is consistent with the 2000 Release,[181] if a subsidiary issuer or guarantor with an Exchange Act reporting obligation for the guaranteed securities would initially be eligible to omit its financial statements, because it would meet the requirements of proposed Rule 3-10 and could rely on proposed Rule 12h-5, but later ceased to satisfy those requirements (*e.g.*, it ceases to be a consolidated subsidiary of the parent company), that subsidiary would then be required to begin filing Exchange Act reports for the period during which it ceased to satisfy the requirements of proposed Rule 3-10.[182] Also, the subsidiary would be required to present the financial statements that are required by Regulation S-X at the time a report is due, and would not be able to present the Proposed Alternative Disclosures that proposed Rule 3-10 would have allowed it to present for historical periods.

Request for Comment

61. Would the proposed changes to Rule 3-10(a) achieve the intended result of permitting a parent company to cease providing the Proposed Alternative Disclosures if each subsidiary issuer's and guarantor's reporting obligation is suspended automatically by operation of Section 15(d)(1) or through compliance with Rule 12h-3? If not, why, and

[181] *See* Section III.C.3. of the 2000 Release.

[182] Additionally, a subsidiary issuer or guarantor should consider promptly filing a Form 8-K or a Form 6-K to report this change in circumstance.

what changes are necessary to achieve that result?

62. We expect that the proposed changes to both eligibility to provide the Proposed Alternative Disclosures and the content of the Proposed Alternative Disclosures would reduce the burden on a parent company's periodic reporting. In light of these proposed changes, should we continue to require the parent company to provide the Proposed Alternative Disclosures in its periodic reports for as long as the subject securities are outstanding? Why or why not?

63. If the proposed amendments are adopted, should there be a phase-in period for parent companies that provide the Alternative Disclosures under existing Rule 3-10 in reliance on Rule 12h-5? If so, why would such a phase-in be needed? How long should that phase-in period be? Should it begin with the beginning of the first fiscal year after adoption of the proposals? Should we permit early adoption? If so, why or why not?

64. Should the proposed rule include a requirement to provide current notification to investors when a subsidiary issuer or guarantor fails to meet the conditions of proposed Rule 3-10 and must begin reporting pursuant to the Exchange Act? If so, what should that requirement be? If not, why not?

D. Application of Proposed Amendments to Certain Types of Issuers

Rule 3-10's requirements apply to several categories of issuers, including foreign private issuers,[183] smaller reporting companies ("SRCs"),[184] and issuers offering securities pursuant to Regulation A. The proposed amendments also would apply to these types of issuers, because, for the reasons discussed above, we believe investors would benefit from the simplified and

[183] *See* 17 CFR 230.405, 240.3b-4 (defining "foreign private issuer").

[184] *See* 17 CFR 230.405, 240.12b-2 (defining "smaller reporting company").

improved disclosures that would result from the proposed amendments and the cost of providing the disclosures would be reduced for these types of issuers. In certain circumstances, Rule 3-10 also applies to the financial information of third parties provided by issuers of asset-backed securities ("ABS"). We also believe the proposed amendments should be extended to the financial information of such third parties for the reasons discussed above.

Request for Comment

65. Should the proposed changes to Rule 3-10 also apply to these types of issuers? If so, why? If not, why not? Do investors in guaranteed securities issued by these types of issuers require additional, different, or less information to make informed investment decisions than would be required by the proposed rule? If so, what information and why?

66. How frequently do these types of issuers issue guaranteed securities? Is there a reason to believe they may offer them more often under the proposed rules? Why or why not?

67. Are other conforming changes to the proposed rules necessary for them to apply to these types of issuers? If so, what changes are necessary and why?

68. Should the proposed amendment that would permit the parent company to provide the Proposed Alternative Disclosures outside the footnotes to its audited annual and unaudited interim consolidated financial statements in its registration statement covering the offer and sale of the guaranteed securities and any related prospectus, and in Exchange Act annual and quarterly reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed apply differently to these types of issuers? Why or why not? For example, are there different filings or periods of time that the parent company should be permitted to provide the Proposed Alternative Disclosures outside of its financial statements for these types of issuers? As

another example, should the proposed rule prescribe different locations outside the financial statements where the Proposed Alternative Disclosures should be provided for these types of issuers? In each case, what are they and why? How would investors and issuers be affected?

1. Foreign Private Issuers

Under the proposal, foreign private issuers would continue to be required to comply with Rule 3-10, and would also be required to comply with proposed Rule 13-01. As foreign private issuers would be required to provide the disclosures specified in proposed Rule 13-01, Instruction 1 to Item 8 of Form 20-F would be amended to specifically require compliance with Article 13, which would include proposed Rule 13-01. We are also proposing amendments to conform Forms F-1 and F-3 to the streamlined structure of proposed Rule 3-10(a). General Instruction I.B of Form F-1 and the note to General Instruction I.A.5 of Form F-3 contain eligibility requirements for the use of these forms applicable to issuers and guarantors of guaranteed securities that are majority-owned subsidiaries. Rather than the current form language stating that Rule 3-10 specifies the financial statements that are required, we are proposing to amend these forms to instead state that the requirements of Rule 3-10 are applicable to financial statements for those subsidiary issuers or guarantors.

Existing Rule 3-10(a)(3) includes a reference, solely for convenience, directing foreign private issuers to Item 8.A of Form 20-F rather than having them go first to Rules 3-01 and 3-02 to determine the periods for which financial statements are required.[185] We propose to simplify the rule by deleting this reference.

[185] Rule 3-01(h) of Regulation S-X and Rule 3-02(d) of Regulation S-X direct foreign private issuers to Item 8.A of Form 20-F.

Also, existing Rule 3-10(i)(12) requires a parent company that prepares its financial statements on a comprehensive basis other than U.S. GAAP or IFRS as issued by the International Accounting Standards Board to reconcile Consolidating Information to U.S. GAAP. Because of the supplemental nature of the Proposed Alternative Disclosures and the requirement in Item 18 of Form 20-F that the parent company's consolidated financial statements be reconciled to U.S. GAAP, we do not believe continuing to include a requirement to reconcile the financial information included in the Proposed Alternative Disclosures to U.S. GAAP is necessary. Although the reconciliation requirement would be eliminated, proposed Rule 13-01(a)(5) would require the parent company to disclose any other quantitative or qualitative information that would be material to making an investment decision with respect to the guaranteed security.

Request for Comment

69. Should a parent company that prepares its financial statements on a comprehensive basis other than U.S. GAAP or IFRS as issued by the International Accounting Standards Board be required to reconcile the proposed financial disclosures specified in proposed Rule 13-01(a)(4) to U.S. GAAP, similar to the requirement of existing Rule 3-10(i)(12)? If so, why? If not, why not?

2. Smaller Reporting Companies

Note 3 to Rule 8-01 of Regulation S-X requires compliance with existing Rule 3-10 if the subsidiary of an SRC issues securities guaranteed by the SRC or the subsidiary guarantees securities issued by the SRC, except that the periods presented are those required by Rule 8-02 of Regulation S-X.[186] Because the subsidiary issuer or guarantor is itself a registrant, it is required

[186] Rule 8-02 of Regulation S-X.

to file financial statements meeting the requirements of Regulation S-X. Such financial statements may be prepared in accordance with Article 8 of Regulation S-X so long as the subsidiary issuer or guarantor qualifies as an SRC.[187] Consistent with the existing rule, if the conditions of proposed Rule 3-10 are satisfied, the subsidiary issuer's or guarantor's financial statements may be omitted. While the substance of this requirement would not change, we are proposing amendments to Note 3 to Rule 8-01 to conform it to the streamlined structure of proposed Rule 3-10(a). Rather than stating that the subsidiary issuer or guarantor of the SRC issuer or guarantor must present financial statements as required by existing Rule 3-10, Note 3 to Rule 8-01 would instead state that the requirements of proposed Rule 3-10 are applicable to financial statements of the subsidiary issuer or guarantor. In addition, we are proposing to add a sentence to Note 3 to Rule 8-01 to require an SRC to provide the disclosures specified in proposed Rule 13-01. Lastly, because Item 1 of Part I of Form 10-Q permits an SRC to provide the information required by Rule 8-03 of Regulation S-X if it does not provide the information required by Rule 10-01, we are proposing to add Rule 8-03(b)(7) to require compliance with Rules 3-10 and 13-01.

3. Offerings pursuant to Regulation A

In connection with offerings made pursuant to Regulation A,[188] Forms 1-A,[189] 1-K,[190] and 1-SA[191] direct an entity ("Regulation A Issuer") to present financial statements of a subsidiary that issues securities guaranteed by the parent company or guarantees securities issued by the

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187 17 CFR 229.10(f).

188 17 CFR 230.251-263.

189 17 CFR 239.90.

190 17 CFR 239.91.

191 17 CFR 239.92.

parent company as required by Rule 3-10 for the same periods as the Regulation A Issuer's financial statements,[192] because under these circumstances such subsidiary issuers or guarantors would themselves be Regulation A Issuers. Consistent with existing requirements, if the conditions of proposed Rule 3-10 are satisfied, the subsidiary issuer's or guarantor's financial statements may be omitted. While the substance of this requirement would not change, we are proposing amendments to Forms 1-A, 1-K, and 1-SA to conform the requirements to the streamlined structure of proposed Rule 3-10(a). Rather than stating that the subsidiary issuer or guarantor of the parent company must present financial statements as required by existing Rule 3-10, Forms 1-A, 1-K, and 1-SA would instead state that the requirements of proposed Rule 3-10 are applicable to financial statements of the subsidiary issuer or guarantor. Additionally, the proposed amendments would modify each form to require the disclosures specified in proposed Rule 13-01 and specify the location of the disclosures, similar to the proposed note to Rule 13-01(a) but consistent with the requirements of Regulation A. However, if a parent company elects to provide the disclosures in its audited financial statements, the Proposed Alternative Disclosures would be required to be audited.

4. Issuers of Asset-backed Securities – Third Party Financial Statements

The disclosure items for issuers of ABS, set forth in Regulation AB,[193] specify circumstances when an ABS issuer must provide financial information for certain third parties[194]

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[192] Forms 1-A and 1-K also specify the audit requirements applicable to financial statements of other entities, which includes those of subsidiary issuers and guarantors of an issuer offering guaranteed securities pursuant to Regulation A. We are not proposing any changes to these audit requirements for circumstances where the separate financial statements of subsidiary issuers and guarantors are filed.

[193] 17 CFR 229.1100 *et seq*.

[194] These third parties include: (1) significant obligors of pool assets, 17 CFR 229.1112(b); (2) entities that provide credit enhancement and other support, except for certain derivative instruments, 17 CFR 229.1114(b)(2); and (3) certain derivative instrument counterparties, 17 CFR 229.1115(b). Depending on the specified measures of significance, the financial information required for these third parties ranges from selected financial data

in its filings. For example, under Regulation AB, financial information about significant obligors of pool assets and guarantors of those pool assets may be required. In lieu of providing the financial information of certain unrelated significant obligors, if certain conditions are met, Item 1100(c)(2) of Regulation AB permits the ABS issuer to reference the significant obligor's Exchange Act reports (or, for certain circumstances, its parent's Exchange Act reports) on file with the Commission. One of these conditions is that the significant obligor meets one of the categories of eligible significant obligors specified in Item 1100(c)(2)(ii) of Regulation AB. Of these eligible categories, two relate to pool assets guaranteed by a parent or subsidiary of the significant obligor, as outlined in Items 1100(c)(2)(ii)(C) and (D). For these two categories, Item 1100(c)(2)(ii) permits an ABS issuer to reference Exchange Act reports containing the parent's consolidated financial statements if the information requirements of Rule 3-10 of Regulation S-X and certain other conditions are satisfied.

We are proposing conforming amendments to Items 1100(c)(2)(ii)(C) and (D) of Regulation AB because we are proposing to relocate the disclosure requirements associated with issuers and guarantors of guaranteed securities to proposed Rule 13-01. Thus, rather than refer to the information requirements of Rule 3-10, Items 1100(c)(2)(ii)(C) and (D) would instead state that disclosures specified in proposed Rule 13-01 must be provided in the reports to be referenced and that financial statements of the subsidiary third party or subsidiary guarantor, as applicable, may be omitted if the requirements of proposed Rule 3-10 are satisfied. The function of the eligible categories in Items 1100(c)(2)(ii)(C) and (D) would not change under the proposed revisions.

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required by Item 301 of Regulation S-K to audited financial statements meeting the requirements of Regulation S-X (except Rule 3-05 and Article 11 of Regulation S-X).

Additionally, we are proposing conforming amendments to Items 1112, 1114, and 1115 of Regulation AB and Item 504 of Regulation S-K because the citations to Regulation S-X in those item requirements refer to Regulation S-X as encompassing "210.01 through 210.12-29." Those citations would be updated to include proposed Article 13 of Regulation S-X.

IV. Rule 3-16 of Regulation S-X

Rule 3-16 contains requirements for affiliates whose securities are pledged as collateral for securities registered or being registered. Existing Rule 3-16 requires a registrant to provide separate annual and interim[195] financial statements for each affiliate whose securities constitute a "substantial portion" of the collateral for any class of securities registered or being registered as if the affiliate were a separate registrant ("Rule 3-16 Financial Statements").[196] Rule 1-02(b) of Regulation S-X defines an "affiliate" by stating that an "affiliate of, or a person affiliated with, a specific person is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified" (emphasis in original).[197] In practice, affiliates whose securities collateralize a registered security are almost always consolidated subsidiaries of that registrant.

Whether an affiliate's portion of the collateral is a "substantial portion" is determined by comparing the highest amount among the aggregate principal amount, par value, book value, or market value of the affiliate's securities to the principal amount of the securities registered or being registered. If the highest of those values equals or exceeds 20 percent of the principal amount of the securities registered or being registered for any fiscal year presented by the

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[195] Rule 3-16 Financial Statements are not required in quarterly reports, such as on Form 10-Q. *See* Section III.A.6. of the 2000 Release.

[196] Rule 3-16(a) of Regulation S-X. These financial statements are required to be provided for the periods required by Rules 3-01 and 3-02 of Regulation S-X.

[197] Rule 1-02(b) of Regulation S-X.

registrant, Rule 3-16 Financial Statements are required.[198]

The requirements in existing Rule 3-16 have remained unchanged for many years,[199] and we are proposing changes to improve the disclosures required by the rule.

V. Proposed Amendments to Rule 3-16 and Relocation to Rule 13-02

A. Overarching Principle

Our proposed amendments to Rule 3-10 are based on the principle that investors in guaranteed securities rely primarily on the consolidated financial statements of the parent company as supplemented by details about the subsidiary issuers and guarantors when making investment decisions. Similarly, we believe that the consolidated financial statements of the registrant are the most relevant information for investors when making investment decisions about that registrant's securities that are collateralized by securities of its affiliate(s). The pledge of collateral is a residual equity interest that could potentially be foreclosed upon only in the event of default and almost always relates to an affiliate whose financial information is already included in the registrant's consolidated financial statements.[200] While we believe information about the affiliate(s) whose securities are pledged as collateral is material for an investor to consider potential outcomes in the event of foreclosure, we believe that separate financial statements of each such affiliate are not material in most situations. Rather, we believe the nature and extent of disclosures about the affiliate(s) and the related collateral arrangement

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198 Rule 3-16(b) of Regulation S-X.

199 *See Separate Financial Statements Required by Regulation S-X*, Release No. 33-6359 (Nov. 6, 1981) [46 Fed. Reg. 56171 (Nov. 16, 1981)].

200 Generally, in the event of default, the holders of debt without the benefit of a pledge of collateral are comparatively disadvantaged. In the event of default, a holder of a debt security can make claims for payment directly against the issuer. Unpledged assets of an issuer's subsidiaries would generally only be indirectly accessible to the holder through bankruptcy proceedings, subordinate to direct claims against those subsidiaries or their assets. A debt security that is secured by a pledge of collateral typically allows a holder to make direct claims to that collateral in the event of default.

should be consistent with the supplemental nature of the information and better balanced with the cost of providing such disclosures.

B. Overview of the Proposed Changes

Although affiliates whose securities are pledged as collateral are not registrants with respect to the collateralized security, and are not generally subject to the related reporting requirements, existing Rule 3-16 requires financial statements as if the affiliates were registrants. This requirement is more onerous than those that apply to other forms of credit enhancements, such as the Alternative Disclosures permitted under existing Rule 3-10 or the disclosures required by Rule 4-08(b) of Regulation S-X for assets that are pledged.[201] Additionally, while the importance of the collateral to an investor may vary widely from situation to situation, the existing rule requires full, audited financial statements for the affiliate in all circumstances when the "substantial portion" threshold is met, but no disclosure if the threshold is not met. For example, Rule 3-16 Financial Statements may be required if a registrant issues a small amount of debt securities, even though an affiliate may be only a small percentage of the registrant's assets and operations, but may not be required if a registrant issues a substantial amount of debt securities, even though an affiliate constitutes a large percentage of a registrant's assets and operations.

A number of commenters stated that debt offerings are often structured to avoid or limit Rule 3-16 disclosures by reducing the amount of collateral an investor might receive in the event of default, resulting in reduced collateral packages, or are otherwise structured as unregistered offerings.[202] Other commenters indicated that debt agreements may be structured to specifically

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[201] Rule 4-08(b) of Regulation S-X. Rule 4-08(b) requires disclosure of the approximate amounts of assets mortgaged, pledged, or otherwise subject to lien and a brief identification of the obligations collateralized.

[202] *See, e.g.*, letters from ABA-Committees, Cahill, Chamber, Davis Polk, DT, and EY.

release an affiliate's securities from collateral if and when their inclusion would trigger the requirements of existing Rule 3-16.[203] Another commenter indicated that the requirements of existing Rule 3-16 often make it uneconomical to secure publicly-offered bonds with pledges of stock.[204]

We are proposing to replace the existing requirement—that a registrant provide separate financial statements for each affiliate whose securities are pledged as collateral—with a requirement that a registrant provide financial and non-financial disclosures about the affiliate(s) and the collateral arrangement as a supplement to the registrant's consolidated financial statements. The supplemental nature of this information, similar to the proposed disclosures for issuers and guarantors of guaranteed securities discussed above, supports providing registrants with the flexibility to provide the proposed disclosures inside or outside the registrant's audited annual and unaudited interim financial statements in registration statements covering the offer and sale of the collateralized securities and any related prospectus, as well as annual and quarterly Exchange Act periodic reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed.[205] Accordingly, the disclosure

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203 *See, e.g.*, letters from Covenant, Davis Polk, KPMG, and PwC.

204 *See* letter from Davis Polk.

205 Similar to the proposed disclosures for issuers and guarantors of guaranteed securities discussed above, the note to proposed Rule 13-02(a) would allow the registrant to provide the disclosures required by this section in a footnote to its consolidated financial statements or alternatively, in MD&A in its registration statement covering the offer and sale of the subject securities and any related prospectus, and in Exchange Act reports on Form 10-K, Form 20-F, and Form 10-Q required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. If not otherwise included in the consolidated financial statements or in MD&A, the registrant would be required to include the disclosures in its prospectus immediately following "Risk Factors," if any, or otherwise, immediately following pricing information described in Item 503(c) of Regulation S-K. The registrant, however, would be required to provide the disclosures in a footnote to its consolidated financial statements in its annual and quarterly reports beginning with its annual report filed on Form 10-K or Form 20-F for the fiscal year during which the first bona fide sale of the subject securities is completed. If the registrant elects to provide the proposed disclosures in its financial statements, the disclosures would be subject to annual audit, interim review, internal control over financial reporting, and XBRL tagging requirements. *See* Section III.C.2.d, "Location of Proposed Alternative Disclosures and Audit Requirement."

requirements in Rule 3-16 would be amended and relocated to proposed Rule 13-02, in new Article 13 of Regulation S-X.

Additionally, instead of requiring disclosure only when the pledged securities meet or exceed a numerical threshold relative to the securities registered or being registered under the existing rule's "substantial portion" test, the proposed amendments would require disclosure unless they are immaterial to holders of the collateralized security. Further, the proposed changes would require disclosure of any additional information about the collateral arrangement and each affiliate whose security is pledged as collateral that would be material to holders of the collateralized securities. We believe these proposed disclosures would enable an investor to evaluate the potential outcomes in the event of foreclosure, would reduce costs and burdens on registrants, and may facilitate the use of debt structures that include pledges of affiliate securities, resulting in improved collateral packages being available to investors. The proposed disclosure requirements are discussed further below.

Request for Comment

70. Should the proposed amendments to Rule 3-16 be based on the approach described above? If so, why? If not, what approach should be used and why?

71. Would the proposed amendments to existing Rule 3-16 result in an increase in the number of registered debt offerings that include pledges of affiliate securities as collateral? Why or why not? How would increasing the number of registered debt offerings that include pledges of affiliate securities affect investors and issuers?

72. Do issuers structure registered debt offerings to not include pledges of affiliate securities

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These proposed amendments would also apply to foreign private issuers and issuers offering securities pursuant to Regulation A and the forms applicable to such entities. *See* Section V.F, "Application of Proposed Amendments to Certain Types of Issuers," below.

as collateral because of concerns about compliance with existing Rule 3-16? If so, what are the specific concerns? Are issuers choosing to engage in private debt offerings that include pledges of affiliate securities as collateral?

73. What factors do issuers consider in determining whether to structure a debt offering to include pledges of affiliate securities as collateral, and how are they considered?

74. How do investors use the Rule 3-16 Financial Statements? For example, how do retail investors, institutional investors, or third parties, such as financial analysts, use the information? How would these investors use the proposed disclosures specified in proposed Rule 13-02?

75. Would the proposed amendments to existing Rule 3-16 improve the disclosures provided to investors? If so, how? Are there other changes to the rule that we should consider that would improve disclosures to investors? If so, what are they and how would they improve disclosure?

76. Would the proposed amendments to existing Rule 3-16 make the rule less burdensome and, thereby, encourage issuers to structure debt offerings to include pledges of affiliate securities as collateral? Are there other changes to the rule that we should consider that would reduce compliance burdens for issuers but continue to provide the material information investors need to make informed investment decisions?

77. Would the proposed amendments to existing Rule 3-16 result in issuers omitting disclosures that investors or financial analysts rely on? If so, which disclosures? Would such a change in the disclosures have an effect on investor participation in registered debt offerings that include pledges of affiliate securities as collateral?

78. Are there alternative approaches to disclosures about affiliates whose securities are

pledged as collateral that would benefit investors? If so, what are they and why? How would investors use the disclosures under these alternative approaches? How would such approaches impact issuers?

79. Should the proposed rule permit the registrant to provide the proposed disclosures outside its financial statements in the proposed circumstances described ? Alternatively, should the registrant be permitted to provide the proposed disclosures outside its financial statements in all circumstances? What are the potential benefits or concerns for investors and issuers with either approach?

80. Would requiring the proposed disclosures to be included in a footnote to the registrant's audited annual and unaudited interim financial statements beginning with its annual report filed on Form 10-K or Form 20-F for the fiscal year during which the first bona fide sale of the guaranteed securities is completed be useful to investors? If so, why? If not, why not? What are the potential benefits or concerns for investors and issuers with either approach?

81. Would requiring the proposed disclosures to be audited or reviewed present costs or challenges for registrants? If so, what are they? For example, would it cause delays in the offering process?

82. Should the proposed rule specify where in a filing the disclosures required by proposed Rule 13-02 must appear if the registrant chooses not to include them in its financial statements? Why or why not? If yes, are the locations required by the Note to proposed Rule 13-02(a) appropriate? If so, why? If not, why not? Where should these disclosures be located and why is that location appropriate?

83. Would issuers be more likely to voluntarily provide supplemental information in addition

to the required proposed disclosures to the extent the PSLRA applied to such supplemental information? Why or why not?

84. Should the note to proposed Rule 13-02(a) apply differently to emerging growth companies? Why or why not? For example, should there be different filings or periods of time if the registrant is an emerging growth company? If so, what should be different and why? How would investors and issuers be affected?

C. Financial Disclosures

1. Level of Detail

Existing Rule 3-16 requires separate financial statements of each affiliate whose securities constitute a substantial portion of the collateral. Commenter recommendations for the type of financial disclosure that should be provided about such affiliates were varied. For example, one commenter expressed its support for the existing requirements,[206] and another suggested elimination of the existing rule.[207] A number of commenters recommended allowing disclosures other than separate financial statements,[208] and some specifically suggested requiring summarized financial information.[209]

The affiliates whose securities are pledged as collateral are almost always consolidated subsidiaries of the registrant, and their financial information is thus already reflected in the registrant's consolidated financial statements. We therefore believe the required supplemental financial information about such affiliates should be focused on the information that is most

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[206] This commenter supported requiring financial statements as though the affiliate were a registrant, despite the fact that the collateral pledge is not considered a separate security. *See* letter from CalPERS.

[207] This commenter stated that it is not aware of a single Rule 144A offering that has included Rule 3-16 financial statements that were not otherwise already available. *See* letter from Davis Polk.

[208] *See, e.g.*, letters from BDO, CAQ, Chamber, Covenant, DT, EY, KPMG, and PwC.

[209] *See, e.g.*, letters from ABA-Committees, BDO, Chamber, and EY.

likely to be material to an investment decision. As such, proposed Rule 13-02(a)(4) would require Summarized Financial Information, a widely understood and common set of requirements, for each such affiliate, which would include select balance sheet and income statement line items.[210] Disclosure of additional line items of financial information beyond what is specified in proposed Rule 13-02(a)(4) would be required by proposed Rule 13-02(a)(5) if they are material to an investment decision. For example, if a material amount of reported revenues of the affiliate(s) are derived from transactions with related parties, such as other subsidiaries of the registrant whose securities are not pledged as collateral, disclosure of such related party revenues would be required. When used in conjunction with the consolidated financial statements of the registrant, we believe this supplemental disclosure of select balance sheet and income statement line items of the affiliate(s) whose securities are pledged would provide the information investors need to evaluate the potential outcomes in the event of foreclosure. We believe this proposed amendment also would significantly simplify compliance efforts and reduce costs for preparers.

One commenter suggested retaining a financial statement requirement when the affiliate is not a guarantor and is either a non-subsidiary controlled affiliate of the registrant or a controlling affiliate of the issuer.[211] We are not proposing to retain such a requirement because practice has demonstrated that affiliates whose securities are pledged as collateral are almost always consolidated subsidiaries of the registrant. In the rare circumstances where the affiliate is not a consolidated subsidiary of the registrant, proposed Rule 13-02(a)(5) would require the registrant to provide any other quantitative or qualitative information that would be material to

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[210] As with proposed Rule 13-01(a)(4), the Summarized Financial Information is the information specified in Rule 1-02(bb)(1) of Regulation S-X.

[211] *See* letter from Cahill.

making an investment decision with respect to the collateralized security.[212] Because the unconsolidated affiliate's financial information is not included in the registrant's consolidated financial statements, we would expect disclosure beyond what is specified in proposed Rule 13-02(a)(1) through (4) to be provided in these circumstances. In this regard, separate financial statements of the unconsolidated affiliate may be necessary if material to an investment decision.[213]

Request for Comment

85. Should the proposed rule require Summarized Financial Information about the affiliates whose securities are pledged as collateral rather than separate financial statements of each such affiliate? Why or why not? Would the Summarized Financial Information, along with the other disclosures required by proposed Rule 13-02, provide the financial information investors need to make an informed investment decision with respect to the collateralized security? Should the proposed rule require a different type of information be provided about such affiliates? How would investors use this information to assess the value of affiliate securities pledged as collateral?

86. How would issuers and investors be affected by requiring Summarized Financial Information? Are there particular items in Rule 3-16 Financial Statements that investors need to make informed investment decisions that would not be provided separately through Summarized Financial Information? Is there any such financial information that underwriters would still require? If so, what would be the effect on the costs associated with the offering?

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[212] *See* Section V.E, "When Disclosure is Required."

[213] *See* proposed Rule 13-02(a)(5). *See also* Rule 3-13 of Regulation S-X.

87. An affiliate whose securities are pledged as collateral for a registrant's securities is almost always a consolidated subsidiary of the registrant. Should our requirements specifically address the rare circumstances where the affiliate is not a consolidated subsidiary of a registrant? If so, what should those requirements be and why? For example, should we require separate financial statements of such unconsolidated affiliates?

88. Would additional line items of financial information beyond what would be required by Summarized Financial Information help investors make informed investment decisions? If so, what line items and why? For example, should the proposed rule specifically require supplemental summarized cash flow information resulting from operating, financing, and investing activities? Would issuers face challenges in providing such information?

89. Do investors need summarized cash flow information about affiliates whose securities are pledged as collateral in addition to the registrant's consolidated cash flow statements to make informed investment decisions about collateralized securities? If so, how is it used? If not, why not?

2. Presentation on a Combined Basis

The existing test used to determine whether the securities of an affiliate constitute a "substantial portion" of the collateral for securities registered or being registered is required to be performed for each affiliate whose securities are pledged. The views of commenters were mixed regarding whether financial disclosures about affiliates whose securities are pledges should be combined. For example, one commenter recommended financial disclosures of each affiliate be

required,[214] another recommended that we permit financial information to be combined in certain circumstances,[215] and another recommended separate or combined presentation.[216]

When the securities of more than one affiliate that is consolidated in the registrant's financial statements are pledged as collateral, we believe disclosure of the financial information of such affiliates on a combined basis would provide investors with the material information they need to assess the value of possible recoveries from the pledged securities in a more clear and streamlined manner than if individual sets of financial information were required for each such affiliate. We note that the existing requirements can result in potentially confusing disclosure about the extent of collateral. For example, when the securities of a registrant's subsidiary ("Subsidiary A") are pledged as collateral and the securities of an entity consolidated by Subsidiary A ("Subsidiary B") are also pledged, separate Rule 3-16 Financial Statements may be required for both Subsidiary A and Subsidiary B. In such a scenario, Subsidiary B's assets, liabilities, operations, and cash flows would be included twice (i.e., in the financial statements of both Subsidiary A and Subsidiary B). We believe disclosure on a combined basis of all consolidated affiliates whose securities are pledged would address this potential confusion. Furthermore, in the event of default by the registrant, we would expect an investor to make claims to all of the affiliate securities that are pledged.

Accordingly, we believe an investor could more effectively and efficiently assess the value of possible recoveries from the securities pledged as collateral by evaluating the combined financial information of the group of consolidated affiliates whose securities are pledged as

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214 *See* letter from PwC.

215 This commenter recommended that we permit the combining of the financial information of affiliates whose ownership percentages are essentially the same. *See* letter from EY.

216 *See* letter from DT.

opposed to performing this assessment for each such affiliate individually. As such, our proposed amendments would permit a registrant to disclose the financial information of such consolidated affiliates on a combined rather than individual basis. Proposed Rule 13-02(a)(4) would require intercompany transactions between affiliates presented on a combined basis to be eliminated. Unlike the proposed amendments to Rule 13-01, because the securities pledged as collateral are an equity interest in that pledgor affiliate, the financial information of all subsidiaries that would be consolidated by that affiliate would be included in the Summarized Financial Information presented pursuant to proposed Rule 13-02(a)(4), even if the securities of those subsidiaries are not pledged as collateral.[217]

We recognize that there may be circumstances where separate financial information about certain affiliates is material to an investment decision. Accordingly, when the information provided in response to proposed Rule 13-02 is applicable to one or more, but not all, affiliates, proposed Rule 13-02(a)(4) would require, if it is material, separate disclosure of Summarized Financial Information for the affiliates to which it is applicable. For example, if securities of one, but not all, of the affiliates that are pledged as collateral are subject to a contractual or statutory delay from being transferred to the holder of the collateralized security in the event of default, disclosure of these facts and circumstances would be required by proposed Rule 13-02(a)(2). In that case, proposed Rule 13-02(a)(4) would require separate disclosure of the Summarized Financial Information specified in proposed Rule 13-02(a)(4) for that affiliate, if material.

[217] Proposed Rule 13-01 prohibits combining the financial information of non-issuer and non-guarantor subsidiaries of issuers and guarantors with that of issuers and guarantors in the Proposed Alternative Disclosures in order to distinguish the financial information of entities that are legally obligated to pay from those that are not. Proposed Rule 13-02 relates to pledged residual equity interests in affiliates as opposed to guarantees to pay, and as such, no similar prohibition is necessary.

Generally, a pledge of an affiliate's securities as collateral includes all of the outstanding ownership interests in that affiliate, which are held directly or indirectly by the entity issuing the debt securities. There could be circumstances where either the pledge of collateral does not include all of the outstanding ownership interests in the affiliate held by the issuing entity, or certain ownership interests in the affiliate are held by a third party and therefore unpledged. In such cases, disclosure of these facts and circumstances would be required by proposed Rule 13-02(a)(5). If such circumstances are applicable to one or more, but not all, affiliates, proposed Rule 13-02(a)(4) would require, if it is material, separate disclosure of Summarized Financial Information for the affiliates to which it is applicable.

Request for Comment

90. Is separate financial information of each affiliate whose securities are pledged as collateral material information necessary for an investor to assess the value of the collateral? If so, why? If not, why not? How would providing the information of each such affiliate on a combined basis affect this assessment? Are there specific circumstances where separate information should be required?

91. Should we permit the financial disclosure of the consolidated affiliates whose securities are pledged as collateral to be combined within the proposed Summarized Financial Information? Why or why not? Alternatively, should combined disclosure of the proposed Summarized Financial Information only be permitted under certain circumstances? If so, under which circumstances should it be permitted and why?

3. Periods to Present

Proposed Rule 13-02(a)(4) would require the disclosure of Summarized Financial Information as of, and for, the most recently ended fiscal year and interim period included in the

registrant's consolidated financial statements. When used in connection with the registrant's consolidated financial statements, we believe the most recent full fiscal year and interim period should provide investors the information that is material in evaluating possible recoveries from the pledged securities of affiliate(s) in the event of default. Under the existing rule, Rule 3-16 Financial Statements are not required in quarterly reports, such as on Form 10-Q.[218] One commenter suggested that interim information may not be meaningful given it is currently only required in certain registration statements but not in subsequent Forms 10-Q.[219] However, we believe that the most recent interim period should be provided so that investors can make decisions based on the most recent information available. As such, the disclosures would be required in quarterly filings, such as Form 10-Q. Because Item 1 of Part I of Form 10-Q requires a registrant to provide the information required by Rule 10-01 of Regulation S-X, we are proposing to add Rule 10-01(b)(10) to require compliance with proposed Rule 13-02.

Request for Comment

92. What periods of presentation of supplemental financial information about affiliates whose securities are pledged as collateral are material for investors when evaluating the collateralized security?

93. Should the required periods of supplemental financial information of affiliates whose securities are pledged as collateral be based on the most recent financial information? Why or why not? If so, what periods should be considered "most recent," and why?

94. Should the proposed rule require any additional periods of Summarized Financial Information beyond the most recent fiscal year and interim period? Why or why not? If

[218] *See* Section III.A.6 of the 2000 Release.

[219] *See* letter from DT.

yes, which periods and why?

95. Rather than requiring disclosure of the most recent interim period, should the proposed rule focus on significant changes similar to Rule 10-01(a)(5) of Regulation S-X, which allows registrants to apply judgment and omit details of accounts that have not changed significantly in amount or composition since the end of the most recently completed fiscal year? Why or why not?

D. Non-Financial Disclosures

Under the existing rule, a registrant is not required to provide non-financial disclosures about the affiliates and the collateral arrangement unless they would be included as part of the Rule 3-16 Financial Statements. Although the Request for Comment asked if there is different or additional information that investors need about affiliates whose securities collateralize registered securities, we received no commentary on non-financial disclosures.

In addition to proposing amendments to the financial information required about the affiliates whose securities are pledged as collateral, the proposed rule would also require specific non-financial disclosures to be provided. We are proposing these changes to enhance the material information provided about the affiliates whose securities are pledged and the pledged securities, particularly in light of our proposal to require Summarized Financial Information for these affiliates. Proposed Rules 13-02(a)(1) through (3) would require certain non-financial disclosures, to the extent material,[220] about the securities pledged as collateral, each affiliate whose securities are pledged, the terms and conditions of the collateral arrangement, and whether a trading market exists for the pledged securities.

We believe the proposed requirements would result in enhanced narrative disclosures that

[220] *See* discussion within Section V.E, "When Disclosure is Required."

would improve investor understanding of the affiliates and the collateral arrangement(s), and make the financial disclosures they accompany easier to understand. While the proposed requirements comprise the items we believe are most likely to be material to an investor, there may be additional facts and circumstances specific to particular affiliates that would be material to holders of the collateralized security. In that case, proposed Rule 13-02(a)(5) would require disclosure of those facts and circumstances.[221] Additionally, when a non-financial disclosure is applicable to one or more, but not all, affiliates, proposed Rule 13-02(a)(4) would require, if it is material, separate disclosure of Summarized Financial Information for the affiliates to which it is applicable.[222]

Request for Comment

96. Are the proposed non-financial disclosures material to an investment decision? Should we explicitly require any non-financial disclosures in addition to what is proposed? If so, what information and why?

E. When Disclosure is Required

As discussed above,[223] existing Rule 3-16 requires separate financial statements for each affiliate whose securities are pledged as collateral when those securities constitute a "substantial portion" of the collateral. If the numerical thresholds specified in the rule are not met, no disclosure is required. At the same time, if the numerical thresholds are met, Rule 3-16 Financial Statements may be required even though the affiliate represents an insignificant portion of the registrant's consolidated financial statements. Several commenters recommended revising the existing "substantial portion" test by making the denominator the amount of the collateralized

[221] *See* discussion within Section V.E, "When Disclosure is Required."

[222] *See* discussion within Section V.C.2, "Presentation on a Combined Basis."

[223] *See* Section IV, "Rule 3-16 of Regulation S-X."

securities originally issued, not the amount outstanding as of the reassessment date,[224] or raising the threshold from 20% to 50%.[225] Another commenter suggested considering whether other indicators of significance besides "market value"[226] may be appropriate given the challenges of performing the "market value" calculation as part of determining whether the collateral constitutes a "substantial portion."[227]

Instead of revising the existing "substantial portion" of collateral test, we propose to replace this test with one based on materiality, similar to the framework in proposed Rule 13-01.[228] Under this approach, investors would be provided with disclosure unless it is immaterial, whereas under the existing rule, no disclosure would be provided unless the collateral represented a "substantial portion." We believe any incremental burden to registrants of being required to provide the disclosures specified in proposed Rule 13-02 in instances where the securities pledged as collateral did not meet the "substantial portion" numerical threshold under the existing rule is justified by the benefit of investors receiving the disclosures specified in proposed Rule 13-02 and the reduced costs to registrants of providing such proposed disclosures as compared to the existing Rule 3-16 Financial Statements.

Proposed Rule 13-02(a) would require the disclosures specified in proposed Rule 13-

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[224] *See, e.g.*, letters from BDO, CAQ, DT, EY, KPMG, and PwC. Several of these commenters noted that, because the denominator of the "substantial portion of the collateral" test is based on the outstanding principal balance of the registered debt, the significance of the tested affiliates will tend to increase as the principal obligation is reduced.

[225] *See* letter from SIFMA. This commenter noted that the introduction to existing Rule 3-16(a) states that the rule shall apply to affiliates whose securities constitute a "substantial" portion of the collateral and asserted that, in other contexts, "substantial" is understood to be well above 20%.

[226] Rule 3-16(b) of Regulation S-X.

[227] *See* letter from DT.

[228] Whether a disclosure specified in proposed Rule 13-02 may be omitted or whether additional disclosure would be required by proposed Rule 13-02(a)(5), as discussed below, depends on whether it would be material to a reasonable investor. *See* Section III.C.2.i, "Level of Detail," above.

02(a)(1) through (4) to the extent material to holders of the collateralized security. For example, under the proposed rule, if the Summarized Financial Information of the combined affiliates required by proposed Rule 13-02(a)(4) is not materially different from corresponding amounts in the registrant's consolidated financial statements, the information could be omitted. As another example, if the securities of an affiliate pledged as collateral do not represent a material amount of collateral to an investor, the investor would likely not require detailed disclosures about that affiliate or the collateral arrangement because the collateral provides little, if any, credit support, and therefore such information could be omitted. While the disclosures specified in proposed Rule 13-02(a)(1) through (4) may be omitted if not material to holders of the collateralized security, for clarity, proposed Rule 13-02(a)(4) requires the registrant to disclose a statement that those financial disclosures have been omitted and the reasons why the disclosures are not material.

Conversely, there may be additional information about the collateral arrangement and affiliates beyond the financial disclosures specified in proposed Rule 13-02(a)(4) or the non-financial disclosures specified in proposed Rules 13-02(a)(1) through (3) that would be material to holders of the collateralized security. Accordingly, proposed Rule 13-02(a)(5) would require disclosure of any quantitative or qualitative information that would be material to making an investment decision with respect to the collateralized security. For example, additional financial information beyond what is required by Summarized Financial Information would be required if that information is material to an investor that holds the collateralized security.

Request for Comment

97. Should we eliminate the existing "substantial portion" test for determining whether disclosure is necessary and instead use a materiality standard to determine the appropriate

level of disclosure? Would this cause difficulty in practice? If so, what are those difficulties and how can they be avoided? Would further guidance be necessary? If so, please explain what guidance is needed. Would the elimination of the "substantial portion" test and use of a materiality standard result in a loss of information that investors currently use to analyze these securities? If so, what information would be lost and would it be material for an investor's understanding or an investment decision?

98. Should the proposed rule also permit the financial disclosures specified in proposed Rule 13-02(a)(4) to be omitted if the amount of collateral pledged does not exceed a specified level of significance? Why or why not? If so, how should significance be determined, and what should the level of significance be?

99. Should any additional disclosures be specifically required if default on the collateralized security reaches a certain level of likelihood? If so, what type of disclosure and when should it be provided?

100. Are the proposed rules sufficiently clear about what disclosures should be provided and when? If not, how should the rules be revised to ensure clarity?

F. Application of Proposed Amendments to Certain Types of Issuers

Rule 3-16's requirements apply to several categories of issuers, including foreign private issuers, SRCs, and issuers offering securities pursuant to Regulation A. The proposed amendments would also apply to these types of issuers, because, for the reasons discussed above, we believe investors would benefit from the simplified and improved disclosures that would result from the proposed amendments and the cost of providing the disclosures would be reduced for these types of issuers.

Request for Comment

101. Should the proposed changes to Rule 3-16 also apply to these types of issuers? If so, why? If not, why not? Do investors in securities that include pledges of affiliate securities as collateral issued by these types of issuers require additional, different, or less information to make informed investment decisions than would be required by the proposed rule? If so, what information and why?

102. How frequently do these types of issuers issue securities that include pledges of affiliate securities as collateral? Is there a reason to believe they may offer them more often under the proposed rules? Why or why not?

103. Are other conforming changes to the proposed rules necessary for them to apply to these types of issuers? If so, what changes are necessary and why?

104. Should the proposed amendment that would permit the registrant to provide the proposed disclosures outside the footnotes to its audited annual and unaudited interim consolidated financial statements in its registration statement covering the offer and sale of the collateralized securities and any related prospectus, and in Exchange Act annual and quarterly reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed apply differently to these types of issuers? Why or why not? For example, are there different filings or periods of time that the registrant should be permitted to provide the proposed disclosures outside of its financial statements for these types of issuers? As another example, should the proposed rule prescribe different locations outside the financial statements where the proposed disclosures should be provided for these types of issuers? In each case, what are they and why? How would investors and issuers be affected?

1. Foreign Private Issuers

Foreign private issuers are required to comply with existing Rule 3-16, and would continue to be required to comply with the disclosures specified in proposed Rule 13-02. Instruction 1 to Item 8 of Form 20-F would be amended to specifically require compliance with Article 13, which would include proposed Rule 13-02.

2. Smaller Reporting Companies

Note 4 to Rule 8-01 of Regulation S-X requires financial statements to be presented as required by Rule 3-16 for an SRC's affiliate whose securities constitute a substantial portion of the collateral for securities registered or being registered, except that the periods presented are those required by Rule 8-02. As we are proposing to eliminate Rule 3-16 and require the disclosures specified in proposed Rule 13-02, SRCs would be required to comply with proposed Rule 13-02. A corresponding change to Note 4 to Rule 8-01 is therefore being proposed. Additionally, as proposed Rule 13-02(a)(4) specifies the periods of Summarized Financial Information that would be required to be presented, no reference in Note 4 to Rule 8-01 to the periods required by Rule 8-02 is necessary and would be removed. Lastly, because Item 1 of Part I of Form 10-Q permits a SRC to provide the information required by Rule 8-03 of Regulation S-X if it does not provide the information required by Rule 10-01, we are proposing to add Rule 8-03(b)(8) to require compliance with proposed Rule 13-02.

3. Offerings pursuant to Regulation A

In connection with offerings made pursuant to Regulation A, Forms 1-A and 1-K direct a Regulation A Issuer to comply with Rule 3-16 for the same periods as the Regulation A Issuer's financial statements and specifies the applicable audit requirements. Accordingly, we propose to replace the existing requirement in the forms that Regulation A Issuers comply with Rule 3-16

with a requirement to provide the disclosures specified in proposed Rule 13-02 and specify the location of the disclosures, similar to the proposed note to Rule 13-02(a) but consistent with the requirements of Regulation A.[229] Additionally, consistent with the discussion above about requiring registrants to comply with proposed Rule 13-02 in filings made on Form 10-Q, a requirement to comply with proposed Rule 13-02 would be added to Form 1-SA.

VI. General Request for Comment

We request and encourage any interested person to submit comments on any aspect of the proposal, other matters that might have an impact on the amendments and any suggestions for additional changes. Comments are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis, particularly quantitative information as to the costs and benefits, and by alternatives to the proposals where appropriate. Where alternatives to the proposals are suggested, please include information as to the costs and benefits of those alternatives.

VII. Economic Analysis

A. Introduction

As discussed above, we are proposing amendments to the financial disclosure requirements in Rules 3-10 and 3-16 of Regulation S-X to improve those requirements for both investors and registrants. These proposed amendments may result in simplified disclosures that highlight information that is material to investment decisions. They may also serve to reduce existing regulatory burdens that otherwise inhibit registrants from engaging in registered debt offerings that are backed by guarantees or collateral and may unnecessarily restrict the set of investment opportunities available to some investors. The discussion below addresses the potential economic effects of the proposed amendments, including the likely benefits and costs,

[229] If a Regulation A Issuer elects to provide the proposed disclosures in its audited financial statements, such disclosures would be required to be audited.

as well as the likely effects on efficiency, competition, and capital formation, measured against a baseline that includes both current regulatory requirements and current market practices. We also discuss the potential economic effects of certain alternatives to the proposed amendments. Throughout this analysis, we draw on academic studies and incorporate public comments, where appropriate.

We are mindful of the costs and benefits of our rules. Section 2(b) of the Securities Act, Section 3(f) of the Exchange Act, Section 2(c) of the Investment Company Act, and Section 202(c) of the Investment Advisers Act require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in (or, with respect to the Investment Company Act, consistent with) the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[230] Additionally, Exchange Act Section 23(a)(2) requires us, when adopting rules under the Exchange Act, to consider, among other things, the impact that any new rule would have on competition and not to adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the Exchange Act.[231]

B. Baseline and Affected Parties

The existing regulatory requirements of Rules 3-10 and 3-16 under Regulation S-X have been described above[232] and have prompted registrants to adopt disclosure practices and business practices specifically designed to comply with or avoid these requirements. We analyze the economic effects of the proposed amendments by assessing their impact on affected parties as compared to the current state of the disclosure regime, including both existing disclosure

[230] 15 U.S.C. 77b(b), 78c(f), 80a-2(c), and 80b-2(c).

[231] 15 U.S.C. 78w(a)(2).

[232] *See* Section II for Rule 3-10 and Section IV for Rule 3-16.

requirements and available exemptions, where applicable. The parties that are likely to be affected by the proposed amendments include issuers and guarantors of guaranteed debt securities, issuers of debt securities collateralized by securities of issuers' affiliate(s), and investors in each of these types of securities.[233]

1. Market Participants

The first main group of market participants affected by the proposed amendments consists of issuers and guarantors of guaranteed debt securities and issuers of debt securities collateralized by securities of the issuer's affiliates. These issuers would be affected because the disclosure called for by the proposed amendments would differ from the content and format of financial information currently required to be presented in registered debt offerings and in certain ongoing reporting. The proposed amendments may also alter the capital raising decisions of potential issuers.

The second group of market participants affected by the proposed amendments consists of investors in these securities. These investors can be divided into three main categories: (1) QIBs;[234] (2) institutional investors (other than QIBs); and (3) non-institutional (retail) investors. In addition to the change in content and location of the disclosed information presented to them, which is discussed below in Section VII.C.1.b, the impact on these investors would also depend on whether there is a change in the number of registered debt offerings by new issuers, issuers that previously offered debt securities under Rule 144A, or both, as a result of the proposed

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[233] While the proposed amendments would apply to registered investment companies, and could thereby affect registered investment advisers, based on staff experience, we believe registered investment companies are unlikely to engage in the activities addressed by the proposed amendments. Accordingly, we also we believe the proposed amendments are unlikely to affect registered investment advisers.

[234] 17 CFR 230.144A(a)(1).

amendments. Currently, there are four approaches that issuers often use when issuing guaranteed or collateralized debt securities. First, issuers may offer registered guaranteed and/or collateralized debt securities and provide the required disclosures under existing Rules 3-10 and 3-16. Second, issuers may opt to privately offer the debt securities with guarantees or pledges of affiliate securities as collateral under Rule 144A with registration rights. This may allow issuers to access the capital markets more quickly than if they had to comply with existing requirements at initial issuance. Issuers do, however, have to provide the disclosures required by existing Rules 3-10 and 3-16 when the privately issued notes are exchanged for registered notes. Third, issuers may opt to privately offer securities under Rule 144A without registration rights. Under this approach, issuers do not have to provide disclosures required by existing Rules 3-10 and 3-16, but issuers and investors are not afforded the benefits of registration. Fourth, issuers may structure a registered offering to not include guarantees or pledges of affiliated securities as collateral. Here, while issuers would not have to provide disclosures required by existing Rules 3-10 and 3-16, they may incur a higher cost of capital than if they had structured their debt agreements with these credit enhancements.

Only QIBs can participate in Rule 144A offerings; retail and institutional investors are unable to participate in such offerings. Furthermore, collateralized debt offerings are often structured to avoid or limit Rule 3-16 disclosures by reducing the amount of collateral investors might receive in the event of default, resulting in reduced collateral packages. Overall, investors may experience both a change in the number of investment opportunities available, as well as a change in the information presented to them in registered offerings.

2. Market Conditions

To provide context for debt securities offerings likely to be impacted by this proposal,

Table 1 provides estimates of the number and dollar amount of all registered debt offerings and Rule 144A debt offerings per year since 2013.[235] The dollar volume of registered debt and Rule 144A offerings appears to have increased in recent years, which may be a result of improving macroeconomic conditions and a low interest rate environment.[236]

Table 1: Registered Debt and Rule 144A Debt Offerings from 2013 – 2017

	Registered Debt		Rule 144A	
Year	No. of offerings[237]	$ Amount (bil)	No. of Offerings	$ Amount (bil)
2013	1,509	1,052	969	512
2014	1,597	1,113	920	530
2015	1,560	1,206	808	575
2016	1,639	1,329	785	526
2017	1,853	1,298	995	657

Source: DERA staff analysis

Studies looking at registered debt offerings and debt offerings made under Rule 144A find that the two offerings have distinct characteristics. Issuers offering debt securities under Rule 144A have, on average, lower credit quality and higher information asymmetry than registered debt offerings,[238] conditions that may increase the likelihood that investors require

[235] These estimates are based on staff analysis of data from the Mergent database. Data specific to offerings of guaranteed securities and offerings of securities collateralized by the securities of an issuer's affiliate(s) is unavailable. We begin our sample in the post-financial crisis timeframe in order to exclude capital raising concerns, liquidity shocks, and other constraints that are exogenous to our baseline analysis.

For perspective, the amount of funding obtained through the registered debt market on an annual basis is much larger than that obtained through the registered equity market. *See Access to Capital and Market Liquidity Report*.

[236] *See id.*

[237] Number of offerings does not include registered exchanges of debt securities previously issued privately with registration rights.

[238] *See, e.g.*, Matteo P. Arena, *The Corporate Choice Between Public Debt, Bank Loans, Traditional Private Debt Placements, and 144A Debt Issues*, 36 Rev. of Quantitative Fin. & Acct. 391 (2011).

guarantees and collateral relative to investment grade issuers who may not need such credit enhancements. This is consistent with studies that have found the cost of capital associated with debt offerings made under Rule 144A to be higher than the cost of capital in registered debt offerings.[239] According to these studies, there are two main benefits of Rule 144A offerings: (1) the speed of issuance, given the absence of a registration requirement; and (2) relative high liquidity, given the possibility to exchange the securities for registered securities.[240]

As discussed above,[241] Rule 3-10 requires that every issuer of a registered security that is guaranteed and every guarantor of a registered security file the financial statements required for a registrant by Regulation S-X, except under certain circumstances when Alternative Disclosures are permitted. There are two forms of Alternative Disclosures prescribed by the rule: (1) Consolidating Information; and (2) a brief narrative. Consolidating Information is the most common type of alternative disclosure under Rule 3-10. Table 2 presents data on the number of unique registrants and filings that included Consolidating Information under Rule 3-10 for the period 2013 -2017;[242] the data is consistent with estimates provided by one commenter.[243]

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239 *See* George W. Fenn, *Speed of Issuance and the Adequacy of Disclosure in the 144A High-Yield Debt Market*, 56 J. of Fin. Econ. 383 (2000); Miles Livingston & Lei Zhou, *The Impact of Rule 144A Debt Offerings Upon Bond Yields and Underwriter Fees*, 31 Fin. Mgmt. 5 (2002); Susan Chaplinsky & Latha Ramchand, *The Impact of SEC Rule 144A on Corporate Debt Issuance by International Firms*, 77 J. of Bus. 1073 (2004); Usha R. Mittoo & Zhou Zhang, *The Evolving World of Rule 144A Market: A Cross-Country Analysis* (2010) (unpublished working paper) (University of Manitoba, Winnipeg MD). The studies of Fenn (2000) and Chaplinsky and Ramchand (2004) find the yield premium decreased over time, whereas the study of Livingston and Zhou (2002) and unpublished working paper of Mittoo and Zhang (2011) do not observe that trend. Mittoo and Zhang (2011), however, find that the yield premium increased after the Sarbanes-Oxley Act was enacted.

240 *See, e.g.*, Fenn, note 239 above.

241 *See* Section II.A, "Background."

242 To identify these disclosures, we searched all Forms 10-K, 10-Q, 20-F, 40-F, S-1, S-4, and F-4 and their amendments using XBRL tags most commonly associated with Consolidating Information. The amounts in the table represent the number of annual, quarterly, and periodic filings including amendments that are unique for the covered period in each calendar year from 2013-2017.

243 *See* letter from EY. The commenter identified 494 registrants that provided Consolidating Information by searching for keywords on Form 10-K filings only. If we limit our search to Form 10-K filings in 2013, we reach a similar number, which we believe provides validity to our methodology.

Table 2: Estimated Number of Unique Registrants and Filings Including Consolidating Information under Rule 3-10

Year	Number of Unique Registrants	Number of Total Filings	10-K	10-Q	20-F	40-F	S-1	S-4	F-4
2013	533	1834	431	1339	12	0	15	34	3
2014	530	1861	461	1360	10	0	9	21	0
2015	500	1750	437	1288	9	0	5	11	0
2016	469	1641	417	1199	8	0	1	16	0
2017	403	1430	369	1043	5	1	1	11	0

Source: DERA staff analysis of Edgar Filings

The second and less common form of Alternative Disclosures under existing Rule 3-10 is a brief narrative. While we believe the number of filings including the brief narrative form of Alternative Disclosure is smaller than the number of filings using Consolidating Information,[244] we are unable to determine that number due to methodological and data extraction challenges.[245]

As discussed above,[246] under existing Rule 3-16, a registrant is required to provide Rule 3-16 Financial Statements for each affiliate whose securities, which are pledged as collateral, constitute a substantial portion of the collateral for any class of securities registered or being registered. Table 3 presents data on the number of filings and unique registrants that included

[244] As described in Section II.F, "Exceptions," the brief narrative form of Alternative Disclosures is available for three situations. One of these situations is when a parent company uses a finance subsidiary to issue securities that the parent company guarantees, which in our experience is limited and generally for convenience purposes. As several commenters noted, the other situations permitting the brief narrative form of Alternative Disclosures require additional restrictive conditions to be met, which greatly limit the circumstances in which they can be used. *See, e.g.*, letters from ABA-Committees, AB-NYC, CAQ, DT, EY, FedEx, KPMG, and PwC. Based on our experience, we believe there are fewer instances of the brief narrative form of Alternative Disclosures than Consolidating Information.

[245] These narrative disclosures are typically no more than a paragraph in length and vary in content based on the three scenarios under which the brief narrative can be provided. We conducted text searches of EDGAR filings in an attempt to accurately identify issuers providing narrative disclosure under Rule 3-10. However, given the variation in phrasing in these paragraphs, the search did not produce meaningful results.

[246] *See* Section IV, "Rule 3-16 of Regulation S-X."

Rule 3-16 Financial Statements since 2013. The number of registrants remained steady over this period. Due to the manual process by which we attained these estimates, there are likely more registrants providing Rule 3-16 Financial Statements than are reflected here.[247] However, based on the comments we received, we do not expect the number to be significantly larger.[248]

Table 3: Estimated Number of Unique Registrants and Filings Including Rule 3-16 Financial Statements

Year	Number of Unique Registrants	Number of Total Filings	10-K	20-F
2013	7	7	6	1
2014	7	7	6	1
2015	7	7	6	1
2016	7	7	6	1
2017	7	7	6	1

Source: DERA staff analysis of EDGAR filings

Request for Comment

105. Are there reliable sources of information or robust means of estimating the proportion of Rule 144A offerings that do not include registration rights versus those that do include registration rights? If so, please describe these sources and methods.

[247] There are no XBRL tags specific to Rule 3-16. To identify these disclosures, we searched all Forms 10-K, 10-Q, 20-F, 40-F, S-1, S-3, S-4, S-11, F-1, F-3, F-4, 10, 1-A, 1-K, and 1-SA and their amendments using a text search on the word combination "Rule 3-16." We applied different text search combinations and found that using "Rule 3-16" offered the most accurate search results. Even so, we received hundreds of false hit returns. These were mainly registrants mentioning "Rule 3-16" as part of a description of collateral release provisions. That is, if Rule 3-16 were triggered, the debt agreement would release the collateral that triggered Rule 3-16. This is consistent with one commenter who noted that issuers use such release provisions to avoid compliance with Rule 3-16. *See* letter from PwC. We manually sifted through these false returns to identify the positive results listed in Table 3.

[248] One commenter noted that Rule 3-16 application is rarely seen in practice, *see* letter from BDO, while another commenter noted that many deals are intentionally structured to avoid Rule 3-16 by using Rule 144A and not providing registration rights. *See* letter from Covenant.

106. What is the current level of participation of non-QIB and retail investors in registered offerings of corporate debt? Are there reliable sources of information or robust means of estimating the proportion of registered versus unregistered debt offerings held by different investor types such as QIBs and non-QIBs? If so, please describe these sources and methods.

107. How do investors and other market participants currently use the information required to be disclosed by Rules 3-10 and 3-16? Are these disclosures generally consumed directly by investors? Is information derived from these disclosures made available to investors by financial analysts or other third party service providers?

C. Anticipated Economic Effects

In this section we discuss the anticipated economic benefits and costs of the proposed amendments to Rules 3-10 and 3-16.

1. Proposed Amendments to Rule 3-10 and Partial Relocation to Rule 13-01

We received a number of comments indicating that the existing requirements often lead registered debt agreements to be structured in such a way as to avoid compliance with Rule 3-10,[249] thereby depriving certain investors of the opportunity to invest in guaranteed securities. Similarly, others noted that issuers who have not previously issued guaranteed debt securities often are deterred by the associated compliance costs and prefer instead to issue securities privately through Rule 144A.[250] In light of these comments, we expect the proposed amendments to benefit issuers and investors. For example, as a result of the overall reduced burdens associated with the proposed amendments, investors may benefit from access to more

[249] *See, e.g.*, letters from CAQ and KPMG.

[250] *See, e.g.*, letter from Cahill.

registered offerings that are structured to include guarantees and, accordingly, the additional protections that come with Section 11 liability for disclosures made in those offerings. Also, an increase in the overall use of guarantees could reduce structural subordination issues that arise. Typically, all of a parent company's subsidiaries support the parent company's debt-paying ability. However, in the event of default, the holders of debt without the benefit of guarantees are comparatively disadvantaged. In the event of default, a holder of a guaranteed debt security issued by a parent company can make claims for payment directly against the issuer and its subsidiary guarantors. The assets of non-guarantor subsidiaries typically would be accessible by the debtholder only indirectly through a bankruptcy proceeding. In such a proceeding, absent a guarantee, the claims of the debtholder would be structurally subordinate to the claims of other creditors, including trade creditors of the non-guarantor subsidiaries. The less burdensome disclosures under the proposed amendments may lead to greater use of guarantees to address these structural subordination issues, which could result in more efficient risk sharing within corporate groups and potentially a lower cost of capital for registrants.

Furthermore, the less burdensome disclosures may lead issuers to register the initial offerings of guaranteed securities rather than opting to issue them under Rule 144A with registration rights. Issuers may be able to comply with the proposed rule and access the capital markets more quickly than under the existing Rule 3-10 requirements. These issuers would not incur costs associated with exchanging the privately issued debt securities for registered guaranteed debt securities.

a. Eligibility Conditions to Omit Financial Statements of Subsidiary Issuer or Guarantor

As detailed in Section III.C.1.b, "Consolidated Subsidiary," we propose to replace one of the conditions that must be met to be eligible to omit the separate financial statements of a

subsidiary issuer or guarantor—that the subsidiary issuer or guarantor be 100% owned by the parent company—with a condition that the subsidiary issuer or guarantor be consolidated in the parent company's consolidated financial statements. This proposed change would permit the parent company to omit the separate financial statements of a consolidated subsidiary issuer or guarantor even if third parties hold non-controlling ownership interests in that subsidiary issuer or guarantor. However, the proposed rule would require, to the extent material, a description of any factors that may affect payments to holders of the guaranteed security, such as the rights of a non-controlling interest holder.

In addition to the proposed change from 100% owned to consolidation, we are proposing changes to simplify the Rule's eligibility conditions. Namely, as discussed in Section III.C.1.d, "Eligible Issuer and Guarantor Structures Condition," the proposed amendments would replace the five specific issuer and guarantor structures currently eligible under the existing rule with a broader two-category framework. Under these changes, separate financial statements of consolidated subsidiary guarantors may be omitted for each issuer and guarantor structure that is eligible. Additionally, unlike the existing rule, the nature of the subsidiary guarantees, including whether the guarantee is full and unconditional or joint and several, would no longer impact the eligibility to omit separate subsidiary financial statements and instead would only impact the extent of disclosure in the Proposed Alternative Disclosures.

Overall, these proposed amendments would permit a broader scope of issuers and guarantors to be eligible to provide the Proposed Alternative Disclosures in lieu of separate financial statements of each subsidiary issuer and guarantor than under existing Rule 3-10. This, in turn, would reduce the compliance costs associated with preparation of disclosures for these

registered debt offerings and ongoing periodic reporting.[251] To the extent there are more issuers and guarantors that are eligible to provide the less burdensome Proposed Alternative Disclosures in lieu of separate financial statements of each subsidiary issuer and guarantor under proposed Rule 3-10, these entities may be more likely to register their debt offerings, either at the outset or through an exempt offering with registration rights. As a result, some issuers may realize a lower cost of capital. Such an outcome would be consistent with previous studies that have found the cost of capital associated with registered debt offerings to be lower than that of private offerings made under Rule 144A,[252] although other issuer characteristics indicative of creditworthiness would remain relevant with respect to the cost of capital, regardless of offering method. Additionally, subsidiary issuers and guarantors that are currently required to file separate financial statements because they do not meet existing Rule 3-10's eligibility criteria would have reduced compliance costs to the extent they meet the revised eligibility criteria under proposed Rule 3-10 and the Proposed Alternative Disclosures are provided in lieu of their separate financial statements.

Certain investors could also benefit from the proposed amendments to the eligibility conditions. If issuers opt to register debt offerings, rather than structure them as private offerings

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[251] Commenters highlighted the significant time and cost associated with preparing the Alternative Disclosures. *See, e.g.*, letters from Cahill, FedEx, and Noble-UK. Noble-UK estimated that compliance with Rule 3-10 requires the equivalent of approximately two full time employees across its organization. FedEx estimated that compliance requires approximately 280 hours per year. Based on this commenter's estimate of compliance hours, estimated compliance costs under the existing rule amount to $97,000 per year (calculated as 280 hours x Compliance Attorney at $348 per hour = $97,440 per year). The per hour figure for a Compliance Attorney is taken from SIFMA's 2013 Management & Professional Earnings in the Securities Industry, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead and adjusted for inflation. *See* Sec. Indus. and Fin. Mkts. Ass'n (SIFMA), *Management & Professional Earnings in the Securities Industry* (2013), https://www.sifma.org/resources/research/management-and-professional-earnings-in-the-securities-industry-2013. For purposes of the Paperwork Reduction Act of 1995 ("PRA"), 44 U.S.C. 3501 *et seq.*, we estimate that the proposed amendments to Rule 3-10 would result in an overall reduction of 30 burden hours for each form affected by the proposed amendments. *See* Section VIII.B.1, "Rule 3-10," below.

[252] *See* discussion and references within Section VII.B.2, "Market Conditions."

using Rule 144A, then new investors—namely, non-QIB institutional investors and retail investors who cannot participate in Rule 144A offerings—would be eligible to participate in the offerings. To the extent that the proposed amendments to the eligibility conditions encourage additional registered debt offerings, more investment opportunities would be made available, and a resulting increase in market participation would improve the overall competitiveness and efficiency of the capital markets. Furthermore, these debt offerings would benefit investors by extending to them the protections associated with registration.

We expect little, if any, adverse effect on issuers and guarantors of guaranteed debt securities from these proposed amendments. We also believe the adverse effects on investors, if any, are likely to be limited. Under the existing rule, investors receive separate financial statements of subsidiary issuers and guarantors if these entities are not 100% owned by the parent company. If these subsidiaries are consolidated in the parent company's financial statements and all other conditions of proposed Rule 3-10 are met, investors may no longer receive the separate financial statements of these subsidiary issuers and guarantors. In such cases, although investors would not receive the detailed information about each such subsidiary issuer or guarantor included in the separate financial statements, a parent company would be required to provide, to the extent material, financial and non-financial information for consolidated subsidiary issuers and guarantors with non-controlling interests, as well as a description of any factors associated with non-controlling interest holders that may affect payments to holders of the guaranteed security. Where all eligibility conditions of the proposed rule are met, we believe the Proposed Alternative Disclosures would provide the information investors need to make informed investment decisions with respect to a guaranteed security.

Several commenters supported modifying the 100% owned condition in the existing rule

for reasons consistent with the analysis above.[253] One commenter recommended we eliminate this condition and instead require separate disclosure of subsidiaries providing lesser guarantees,[254] whereas another commenter stated that the existing requirement should remain unchanged.[255]

b. Disclosure Requirements

As detailed in Section III.C.2, "Disclosure Requirements," one of the conditions in the existing rule for omitting separate financial statements of a subsidiary issuer or guarantor is providing the Alternative Disclosures in the footnotes to the parent company's consolidated financial statements. The proposed rule would retain the requirement to provide the Alternative Disclosures, but with modifications. We address below the proposed amendments related to the Alternative Disclosures (the Proposed Alternative Disclosures).

i. Financial and Non-Financial Disclosures

As described in Section III.C.2.a, "Financial Disclosures," we propose to simplify the financial disclosures required by current Rule 3-10 by replacing Consolidating Information with a requirement to provide Summarized Financial Information. The level of detail currently required in Consolidating Information often contributes to multiple pages of detail in the parent company's financial statements. The proposed Summarized Financial Information would focus on the information that is most likely to be material to an investment decision. If additional line items, beyond what is required in the Summarized Financial Information are material, they would be required to be disclosed.

The proposed amendments should simplify the disclosures and reduce the cost of

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253 *See, e.g.*, letters from ABA-Committees, AB-NYC, Chamber, EY, SIFMA, and PwC.

254 *See* letter from SIFMA.

255 *See* letter from CalPERS.

compliance and could engender further benefits. For example, academic literature finds that simplified financial statements are associated with more efficient price discovery,[256] and that investors underreact more to firms with less readable financial disclosures.[257] More generally, we believe the proposed amendments would provide investors with streamlined and easier to understand financial information that we believe is material to an investment decision. Thus, to the extent that the proposed amendments have their intended effect, reducing complexity while maintaining the material completeness of financial disclosures, we anticipate that the financial disclosures that result from the proposed amendments would improve price discovery, enhance the allocative efficiency of markets, and facilitate capital formation.

We are also proposing that a parent company be permitted to provide financial disclosures about the Obligor Group on a combined basis rather than on a disaggregated basis. Additionally, if non-financial disclosure provided in response to proposed Rule 13-01 were applicable to one or more, but not all, guarantors, such as where a subsidiary's guarantee is limited to a particular dollar amount, separate disclosure of Summarized Financial Information for one or more issuers and guarantors would be required, to the extent material.

To the extent that investors are indifferent about whether payment under the guaranteed security comes from the issuer or one or more guarantors in the same consolidated group, or both, the disclosure resulting from the proposed amendments would not adversely impact investment decisions and could offer investors more readable, streamlined financial information. To the extent that increased readability without loss of material information would facilitate

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256 *See* Brian P. Miller, *The Effects of Reporting Complexity on Small and Large Investor Trading*, 85 Acct. Rev. 2107 (2010).

257 *See* Haifeng You & Xiao-jun Zhang, *Financial Reporting Complexity and Investor Underreaction to 10-K Information*, 14 Rev. of Acct. Stud. 559 (2009); Alastair Lawrence, *Individual Investors and Financial Disclosure*, 56 J. of Acct. & Econ. 130 (2013).

investor evaluation of whether the entities in the Obligor Group have the ability to make payments as required under the guaranteed security, the proposed amendments would promote the efficiency of security prices and investor portfolios. Consistent with potential benefits from these changes, a growing body of academic literature finds that financial statement readability affects the information environment and that more readable statements are associated with lower cost of debt capital and reduced bond rating agency disagreement.[258]

The proposed rule also requires that Summarized Financial Information be provided only for the most recently completed fiscal year and year-to-date interim period, if applicable, included in the parent company's consolidated financial statements, rather than for the additional periods specified under existing Rules 3-01 and 3-02 of Regulation S-X. This is intended to preserve information that is material to an investment decision while reducing compliance costs for registrants. This proposed change is consistent with commenter views. The commenters that discussed the number of annual periods for disclosure recommended limiting disclosure to the current year, citing challenges recasting prior period information for circumstances such as legal entity mergers and discontinued operations. Others cited significant costs to issuers from requiring additional periods.[259]

In addition, we are proposing to require non-financial disclosures to supplement the proposed financial disclosures with additional information that may be material to an investment decision. This would include material information about how payments to holders of guaranteed

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[258] *See* Samuel B. Bonsall & Brian P. Miller, *The Impact of Narrative Disclosure Readability on Bond Ratings and the Cost of Debt*, 22 Rev. of Acct. Stud. 608 (2017).

[259] *See, e.g.*, letters form BDO, Headwaters, Medtronic, and PwC. Headwaters noted that Alternative Disclosure composed approximately 15% of the entire financial disclosure in its most recent Form 10-K and approximately 28% of the entire financial disclosure in its most recent Form 10-Q. Medtronic indicated that it has one staff person on its external reporting team that spends over 80% of his or her time preparing Rule 3-10 related information in support of quarterly filings.

securities may be affected by such things as the issuer and guarantor structure, the terms and conditions of the guarantees, the impact of non-controlling ownership interests, or other factors specific to the offering. These proposed amendments should enhance the information provided to investors about the investment without imposing significant burdens on registrants. Overall, this should lead to greater transparency and reduce information asymmetries between issuers and investors.

Despite being unable to estimate the number of filings that provide brief narrative disclosures under the existing Alternative Disclosure, we do not expect parent companies to incur significant costs to provide the Proposed Alternative Disclosures. For example, where Alternative Disclosures under the current rule would constitute only a brief narrative, we generally believe separate financial disclosures about the issuers and guarantors of the guaranteed securities likely would not be material and therefore could be omitted under the proposed amendments. Finally, as with any change to reporting format and presentation of information, the recommended proposals may lead companies and investors to incur costs to adjust to the new disclosures. As further discussed below, we do not expect such costs to be substantial.

ii. When Disclosure is Required

As explained in Section III.C.2.c, "When Disclosure is Required," we propose eliminating the numerical thresholds of existing Rule 3-10 that are used to determine the form and content of disclosure. Instead, all proposed disclosures would be required unless such information would not be material to holders of the guaranteed security. While numerical thresholds may be easier to apply than a materiality standard that requires judgment, this change would allow for a more principles-based disclosure approach that is more tailored to the specific

circumstances and the needs of investors.[260] Allowing the parent company to omit immaterial information would lower the costs of disclosure relative to existing requirements and may help focus investor attention on decision-relevant information. However, this change could also increase the risk that a parent company would omit, potentially inadvertently, value-relevant information. In such instances, investors may make suboptimal investment decisions. Omitting material information, however, would subject issuers and guarantors to increased litigation risk, providing incentive for issuers to make careful determinations on the form and content of disclosures.

In certain settings, there is academic evidence that allowing issuers to make principles-based disclosure decisions using a materiality criterion is consistent with investor preferences.[261] However, there is also evidence of investor benefits from rules-based reporting standards.[262] While the proposed amendments could result in reduced comparability across registrants and transactions, using a principles-based standard could benefit investors by allowing registrants to tailor their disclosure to provide material information to them. The proposed amendment also accords with a number of commenters who indicated that existing thresholds are overly restrictive.[263]

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[260] A number of academic studies have explored the use of bright-line thresholds and "when material" disclosure standards. The majority of these papers highlight a preference for principles-based "when material" standard. *See generally, e.g.*, Eugene A. Imhoff Jr. & Jacob K. Thomas, *Economic Consequences of Accounting Standards: The Lease Disclosure Rule Change*, 10 J. of Acct. & Econ. 277 (1988) (providing evidence that management modifies existing lease agreements to avoid crossing bright-line threshold for lease capitalization).

[261] *See* Usha Rodrigues & Mike Stegemoller, *An Inconsistency in SEC Disclosure Requirements? The Case of the "Insignificant" Private Target*, 13 J. of Corp. Fin. 251 (2007) (providing evidence, in the context of mergers and acquisitions, that bright-line thresholds can deviate from investor preferences).

[262] *See* Mark W. Nelson, *Behavioral Evidence on the Effects of Principles- and Rules-Based Standards*, 17 Acct. Horizons 91 (2003); *see also* Katherine Schipper, *Principles-Based Accounting Standards*, 17 Acct. Horizons 61 (2003). These studies note potential advantages of rules-based accounting standards, including: increased comparability among firms, increased verifiability for auditors, and reduced litigation for firms.

[263] *See* letters from ABA-Committees, AB-NYC, CAQ, DT, EY, FedEx, KPMG, and PwC.

iii. Location of Proposed Alternative Disclosures and Audit Requirement

The proposed amendments would allow the parent company the choice of whether to provide the Proposed Alternative Disclosures in the financial statement footnotes or elsewhere in the registration statement covering the offer and sale of the guaranteed debt and any related prospectus, as well as annual and quarterly Exchange Act periodic reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. If the parent company were to provide the Proposed Alternative Disclosures in its financial statements in its registration statement and in certain Exchange Act periodic reports required to be filed during fiscal year in which the first bona fide sale of the subject securities is completed, consistent with the existing rule, the disclosures would be subject to annual audit, interim review, and internal control over financial reporting requirements. Investors may perceive this choice of placement to mean the disclosures are more reliable than if they were not in the financial statements at the time of registration.

In contrast, if the parent company were to provide the Proposed Alternative Disclosures outside its financial statements in its registration statement and in certain Exchange Act periodic reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed, lower compliance costs would likely result with respect to these filings. While we generally would expect lower compliance costs, disclosures outside the financial statements may result in certain costs to parent companies, such as legal costs or due diligence activities (*e.g.*, comfort letters). Additionally, this proposed optionality may reduce the potential for delay in offerings that exists under the current rule due to the need to prepare audited Alternative Disclosures. Parent companies using this proposed option to provide the disclosures outside the consolidated financial statements may be able to register guaranteed debt offerings

and go to market more quickly than under the existing rule. This may allow parent companies to more promptly access favorable market conditions. Although these disclosures are supplemental in nature, investors may nevertheless be adversely impacted as these disclosures would not immediately benefit from the enhanced accuracy and reliability associated with information that is included in the financial statements at registration. To the extent that investors prefer these initial disclosures to be included in the parent company's financial statements, their willingness to invest may be influenced or they may discount the information provided in the unaudited portion of the disclosure, potentially reducing the amount of information incorporated into security prices and increasing the issuer's cost of capital.[264]

Additionally, the amount of information that investors receive in the registration statement and in certain Exchange Act periodic reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed could be affected by the choice of placement. The safe harbor for forward-looking information under PSLRA is not available for disclosures provided in the financial statements. A parent company providing the Proposed Alternative Disclosures outside its financial statements may be more likely to voluntarily supplement those required disclosures with forward-looking information, as compared to a parent company that provides the Proposed Alternative Disclosures in its financial statements. Such supplemental forward-looking information, if provided, could benefit investors. The relocation of disclosures may also affect the prominence of the disclosures. Some academic research provides indirect evidence that users may treat information differently

[264] One commenter noted that supplemental information typically included in offering memoranda for Rule 144A debt offerings, including revenues, operating income, assets and liabilities of the non-guarantor group, is provided on an unaudited basis. *See* letter from ABA-Committees. If QIBs currently do not require such supplemental disclosures to be audited in 144A debt offerings, the costs outlined above would not be expected to apply to this group of investors.

depending on the location of the disclosure.[265]

If a parent company provides the Proposed Alternative Disclosures in its financial statements, consistent with the existing rule, such disclosures would be subject to XBRL requirements. Because the machine-readable nature of XBRL disclosures facilitates aggregation, comparison, and large-scale analysis of reported information through automated means, investors stand to benefit from enhanced analysis capabilities, particularly in the comparison of disclosures across issuers and time periods. The parent company may incur additional costs to comply with these tagging requirements. In contrast, Proposed Alternative Disclosures provided outside the financial statements would not be subject to XBRL tagging requirements. Investors would not benefit from the enhanced analysis capabilities and the parent company would not incur the related costs to comply with the tagging requirements. In general, we believe the incremental cost of tagging the Proposed Alternative Disclosures in XBRL, and hence the incremental cost savings of not having to tag the proposed Alternative Disclosures likely would be relatively low, as issuers already would have software or processes in place for tagging financial statement information.

Finally, while a parent company is afforded a choice of where to locate disclosures in its registration statement and in certain Exchange Act periodic reports required to be filed during fiscal year in which the first bona fide sale of the subject securities is completed, beginning with

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[265] For instance, research shows a weaker relation between equity prices and disclosed items in the notes to the financial statements versus recognized items on the face of the financial statements. *See, e.g.*, Maximilian A. Müller, Edward J. Riedl & Thorsten Sellhorn, *Recognition versus Disclosure of Fair Values*, 90 Acct. Rev. 2411 (2015) (showing a lower association between equity prices and disclosed investment property fair values relative to recognized investment property fair values and finding that reduced information processing costs and higher readability mitigates the discount applied to disclosed fair values); Hassan Espahbodi et al., *Stock Price Reaction and Value Relevance of Recognition versus Disclosure: The Case of Stock-Based Compensation*, 33 J. of Acct. & Econ. 343 (2002) (examining the equity price reaction to the announcements related to accounting for stock-based compensation to assess the value relevance of recognition (on the face of the financial statements) versus disclosure (in the notes to the financial statements) and concluding that recognition and disclosure are not substitutes).

its annual report filed on Form 10-K or Form 20-F for the fiscal year during which the first bona fide sale of the subject securities is completed, the parent company would be required to locate the disclosures within the footnotes to its consolidated financial statements, which are subject to applicable annual audit, interim review, and internal control over financial reporting. Because this requirement would be consistent with existing location requirements, we do not anticipate economic effects from this requirement as compared to the current state except, as discussed above that there may be decreases in costs attributable to the more simplified and streamlined proposed disclosures.

iv. Recently Acquired Subsidiary Issuers and Guarantors

We are proposing to delete the requirement to provide pre-acquisition audited financial statements of a recently acquired subsidiary issuer or guarantors. The existing requirement for pre-acquisition financial statements of recently-acquired subsidiary issuers or guarantors calls for far greater detail than what is required for any other subsidiary issuer and guarantor.[266] As discussed in Section III.C.2.e, "Recently-Acquired Subsidiary Issuers and Guarantors," we believe Rule 3-05 of Regulation S-X, which requires audited pre-acquisition financial statements of an acquired business to be provided if the acquired subsidiary exceeds specified thresholds of significance, provides sufficient information in this context such that the pre-acquisition financial statements of recently-acquired subsidiary issuers and guarantors required by existing Rule 3-10(g) are unnecessary.

In addition, the trigger for pre-acquisition financial statements of a recently-acquired subsidiary issuer or guarantor under existing Rule 3-10(g) is based on the significance of the

[266] Some commenters also noted the inconsistency in that information required for recently acquired subsidiary issuers and guarantors is more detailed than information required for other subsidiary issuers and guarantors. *See, e.g.*, letters from DT and PwC.

acquired subsidiary compared to the size of the offering. This may lead issuers to provide audited financial statements of a recently-acquired subsidiary that is small relative to its consolidated parent company. The proposed changes would address these circumstances.

We believe the proposed amendment would reduce the compliance burden for preparers without reducing material information for investors, since material information about recently acquired subsidiaries would be required by Rule 3-05 and proposed Rule 13-01(a)(5). Furthermore, to the extent that investors find the information provided under the existing requirement redundant, as it overlaps with Rule 3-05, eliminating the existing requirement would streamline disclosures. Academic research suggests that individuals invest more in firms with more concise financial disclosures.[267] Thus, to the extent that the proposed amendments alleviate duplication and do not affect the completeness of financial disclosures, the resulting disclosures could result in improved price discovery, enhance the allocative efficiency of the market, and facilitate capital formation.

v. Continuous Reporting Obligation

As discussed in Section III.C.2.f, "Continuous Reporting Obligation," we are proposing that a parent company be permitted to cease providing the Proposed Alternative Disclosures in its ongoing reporting if the corresponding subsidiary issuer's or guarantor's reporting obligation under Section 13 and/or Section 15(d) of the Exchange Act with respect to the guaranteed securities is terminated or suspended. This amendment would reduce compliance costs without loss of material information for investors. To the extent that the existing requirements impose unnecessary burdens by requiring a parent company to continue providing the Alternative Disclosures beyond when the subsidiary would have to report with respect to the guaranteed

[267] *See* Lawrence, note 257 above.

securities,[268] or otherwise deter issuers and guarantors from engaging in public debt offerings to avoid such reporting obligations,[269] this amendment would remove such inefficiencies. Commenters generally supported the proposed amendment, noting inconsistencies between the existing requirement and other reporting rules,[270] and suggesting that it likely deters registration of debt offerings.[271]

2. Proposed Amendments to Rule 3-16 and Relocation to Rule 13-02

As discussed in detail in Section V.B, "Overview of the Proposed Changes," although affiliates whose securities are pledged as collateral are not registrants with respect to the collateralized security, Rule 3-16, when triggered, requires financial statements as if such affiliates were registrants. We are proposing to replace the existing requirement to provide separate financial statements for each affiliate whose securities are pledged as collateral with financial and non-financial disclosures about the affiliate(s) and the collateral arrangement, where material, as a supplement to the consolidated financial statements of the registrant that issues the collateralized security.

Debt agreements are often structured to avoid the requirements of Rule 3-16 by either structuring the debt agreement to release any pledge of affiliate securities as collateral if and when such pledge triggers the requirements under Rule 3-16, or by not including pledges of affiliate securities as collateral altogether.[272] In such circumstances, investors may demand a higher interest rate from issuers to compensate for the absence of collateral, potentially

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[268] *See* letters from DT and Simpson.

[269] *See* letter from Simpson.

[270] *See* letters from ABA-Committees, DT, EY, PwC, SIFMA, and Simpson.

[271] *See* letters from DT and Simpson.

[272] *See* letters from ABA-Committees, Cahill, Chamber, Covenant, Davis, DT, and EY.

increasing the cost of capital to issuers. The proposed amendments would reduce the burden of having to provide separate financial statements of affiliates under the existing rule and provide issuers with the flexibility to structure their debt agreements with pledges of affiliate securities. If, as a result of the proposed amendments, debt agreements are no longer structured to avoid Rule 3-16 requirements, investors would obtain the benefit of both the collateral and the related disclosures, all of which would be subject to Section 11 liability. This flexibility may also permit issuers to attract investors that prefer to invest in obligations where collateral is fully available and not subject to the release mechanisms designed to avoid Rule 3-16 requirements. By appealing to a broader range of investors and providing more attractive collateral arrangements, registrants may be able to obtain a lower cost of capital.

As discussed above for the Proposed Amendments to Rule 3-10, Proposed Rule 13-02 would provide flexibility to place the proposed disclosures within the notes to the financial statements or in specified prominent locations outside the financial statements in registration statements covering the offer and sale of the collateralized debt securities and any related prospectus, as well as annual and quarterly Exchange Act periodic reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. For registrants that include the proposed disclosures in their financial statements, such information would be subject to applicable annual audit, interim review, and internal control over financial reporting requirements. Investors may perceive this choice of placement as making the disclosure more reliable than if it were placed outside of the financial statements. To the extent that investors prefer these disclosures to be located in the registrant's financial statements, this choice may influence their willingness to invest. Registrants could attempt to influence such willingness by including the proposed disclosures in their financial statements. Also consistent

with the proposed amendments to Rule 3-10, the registrant would, however, be required to provide the proposed disclosures in a footnote to its consolidated financial statements in its annual and quarterly reports beginning with its annual report filed for the fiscal year during which the first bona fide sale of the subject securities is completed. This requirement would be consistent with existing location requirements, and we do not anticipate economic effects as compared to the current state.

Finally, as with any change to reporting format and presentation of information, the proposed amendments may lead companies and investors to incur costs to adjust to the new disclosures, as further discussed below.

a. Financial Disclosures

i. Level of Detail

As discussed in Section V.C.1, "Level of Detail," affiliates whose securities are pledged as collateral are almost always consolidated subsidiaries of the registrant,[273] and their financial information is thus already reflected in the registrant's consolidated financial statements. We propose to require Summarized Financial Information for each such affiliate and disclosure of additional financial information if material to holders of the collateralized security. For registrants, this would reduce compliance costs by reducing the amount of information needed to be prepared and disclosed.[274] For investors, we do not anticipate significant costs since material information would still be required to be provided. The simplified disclosures would highlight

[273] In the rare circumstances where the affiliate is not a consolidated subsidiary of the registrant, proposed Rule 13-02(a)(5) would require the registrant to provide any other quantitative or qualitative information that would be material to making an investment decision with respect to the collateralized security. In this regard, separate financial statements of the unconsolidated affiliate may be necessary if material to an investment decision. *See* additional discussion in Section V.C.1, "Level of Detail."

[274] For purposes of the PRA, we estimate that the proposed amendments to Rule 3-16 would result in an overall reduction of 30 burden hours for each form (other than Form 10-Q) affected by the proposed amendments. *See* Section VIII.B.2, "Rule 3-16," below.

material information needed to make informed investment decisions and therefore would enable investors to process information more efficiently and make more informed investment decisions.

ii. Presentation on a Combined Basis

We are proposing to permit a registrant to provide the Summarized Financial Information of consolidated affiliates that are pledged as collateral on a combined rather than individual basis. Additional disclosure specific to an affiliate would be required, if material. As with the effects of the proposed amendments to Rule 3-10 discussed above, we believe the simplified disclosures in the proposed amendments to Rule 3-16 would both lower compliance costs for issuers and provide investors with more streamlined and concise disclosures that would promote more efficient decision-making by investors. We do not anticipate significant costs to investors since material information would still be required to be provided.

iii. Periods to Present

The proposed amendments would require the disclosure of Summarized Financial Information for the most recently ended fiscal year and year-to-date interim period included in the registrant's consolidated financial statements. Rule 3-16 financial statements are not currently required in quarterly reports, and as such, registrants would incur costs to provide this additional interim disclosure.[275] We believe the proposed amendments would benefit investors by providing them with the most recent information to ensure informed investment decisions.

b. Non-Financial Disclosures

We are proposing to require non-financial information about affiliates whose securities are pledged as collateral and the collateral arrangements, to the extent material. While we did

[275] For purposes of the PRA, we estimate that the proposed amendments to Rule 3-16 would result in an increase of 70 burden hours per Form 10-Q filing. *See* Section VIII.B.2, "Rule 3-16," below.

not receive comments on non-financial disclosures, we do not believe this proposed amendment would impose undue costs for issuers, as the majority of the information required to be disclosed under the proposed amendments should be readily available or attainable.[276] We believe investors would benefit because the proposed amendment would supplement the financial disclosures with additional, material information, thereby rendering the combined financial and non-financial disclosures more informative for investment decisions.

c. When Disclosure is Required

Rather than utilizing existing numerical thresholds, disclosure of the proposed financial and non-financial disclosures would be required if material to holders of the collateralized security. To the extent the numerical thresholds under the existing rule result in disclosure of unnecessary or immaterial information, investors may benefit from reduced search costs and the facilitation of more efficient information processing.[277] Further, we believe that, compared to existing rule requirements, the proposed amendments to Rule 3-16 would reduce compliance costs for issuers and increase the likelihood of registration.

D. Anticipated Effects on Efficiency, Competition, and Capital Formation

Several commenters noted that the need to comply with existing disclosure requirements often makes issuers structure registered offerings to avoid triggering Rules 3-10 or 3-16, or avoid registration altogether.[278] As discussed above, and as a general matter, we believe the proposed

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[276] The content of the proposed non-financial disclosures consists of basic information about the collateral arrangement and the entities involved. We do not expect such information, which is generally available from debt agreements, would impose a significant burden on a registrant to prepare.

[277] *See* David Hirschleifer & Siew Hong Teoh, *Limited Attention, Information Disclosure, and Financial Reporting*, 36 J. of Acct. and Econ. 337 (2003) (developing a theoretical model where investors have limited attention and processing power). The authors show that with partially attentive investors, means of presenting information may have an impact on stock price reactions, misvaluation, long-run abnormal returns, and corporate decisions.

[278] *See, e.g.*, letters from BDO, Cahill, Covenant, and PwC.

amendments would improve the content, format, and focus of required registrant disclosures. This should both reduce the compliance cost for issuers and allow more efficient decision-making by investors. This may be true particularly to the extent that the proposed amendments result in more efficient and effective dissemination of material information to investors and increase the efficiency of investor processing and usage of this information. Further, the proposed rule amendments may affect issuers' registration choices. This, in turn, could broaden the investment opportunities available for different types of investors and may allow for more efficient matching of investors with assets that meet their investment objectives and preferences. Retail investors could additionally be indirectly affected through their investments managed by institutional investors, who would have greater access to a broader range of investment opportunities in the registered debt market. To the extent that the proposed amendments ease registration burdens for issuers, there could be an increase in the number of registered offerings. If such issuers would not have otherwise issued debt securities under Rule 144A, this would result in an increase in capital formation. If such issuers would have otherwise issued debt under Rule 144A, it is possible that a switch to a registered offering would lower the issuers' cost of capital while also providing investors with the enhanced protections afforded by registered offerings.

Finally, rather than be 100% owned by the parent company, the proposed amendments allow for the subsidiary issuer or guarantor to be consolidated in the parent company's consolidated financial statements as one of the conditions that must be met in order to be eligible to omit separate subsidiary issuer and guarantor financial statements. To the extent that the proposed amendments expand the scope of subsidiary issuers and guarantors that meet Rule 3-10 eligibility requirements, the proposed amendments may promote greater competition among

issuers and guarantors of guaranteed debt securities. This may enable more registrants, especially those on the margins, to compete on better terms. However, we do not anticipate the overall impact on competition to be substantial.

E. Consideration of Reasonable Alternatives

We discuss below potential alternatives to the proposed amendments to existing Rules 3-10 and 3-16.

1. Alternative to Proposed Amendments to Existing Rule 3-10

An alternative to the proposed amendments to Rule 3-10 would be to permit the Proposed Alternative Disclosures be provided if the subsidiary issuers and/or guarantors were "wholly owned" by the parent company, as defined in Rule 1-02(aa) of Regulation S-X.[279] Using "wholly owned" as the parent company ownership threshold, rather than the existing 100% ownership requirement, would likely permit more subsidiary issuers and guarantors to use the Alternative Disclosures as compared to the existing rule, but would be less flexible than the proposed amendments, as detailed above. As a result, we believe the proposed amendments would better serve to enhance efficiency, competition, and capital formation.

2. Alternatives Common to Proposed Amendments to Existing Rule 3-10 and Existing Rule 3-16

One alternative to each set of proposed amendments would be to require that the Proposed Alternative Disclosures, or the disclosures specified in proposed Rule 13-02, as applicable, be located in the audited annual and unaudited interim financial statement footnotes of the parent company, or registrant, as applicable, in all filings. Under this alternative, the parent company or registrant would not have a choice of whether to locate the proposed

[279] Rule 1-02(aa) of Regulation S-X ("The term *wholly owned subsidiary* means a subsidiary substantially all of whose outstanding voting shares are owned by its parent and/or the parent's other wholly owned subsidiaries." (Emphasis in original.)).

disclosures outside its consolidated financial statements in registration statements covering the offer and sale of the guaranteed or collateralized debt securities and any related prospectus, or in annual and quarterly Exchange Act periodic reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. On the one hand, this could increase investor confidence in the disclosed information and provide the benefits of XBRL tagging. On the other hand, the cost to a parent company or registrant associated with preparing registration statements and certain periodic reports would be higher with this alternative than if the disclosures were provided outside of the financial statements. Furthermore, the flexibility of going to market more quickly would not be available under this alternative. This could limit the incentives to pursue registered offerings compared to the proposed amendments, and those registrants that do pursue registered offerings may be less likely to issue guarantees, or pledge affiliate securities as collateral, given the additional cost associated with including the proposed disclosures in the financial statements. Additionally, a parent company or registrant may be less likely to voluntarily supplement the disclosures with forward-looking information because the safe harbor for forward-looking information under PSLRA is not available for disclosures provided in the financial statements. As discussed above,[280] guarantees and pledges of affiliate securities as collateral serve, in part, to reduce investor risk of structural subordination. Overall, we believe the benefits to investors of enhanced access to registered offerings with guarantees and pledges of affiliate securities as collateral, together with the benefits of reduced compliance burdens for issuers, justify forgoing the benefits of requiring these disclosures to be located in the financial statements of the parent company, or registrant, as applicable, included in registration statements covering the offer and sale of the guaranteed or collateralized debt

[280] *See* Section VII.C.1, "Proposed Amendments to Rule 3-10 and Partial Relocation to Rule 13-01."

securities and any related prospectus, as well as annual and quarterly Exchange Act periodic reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. However, we solicit comment on this point and the potential benefits and concerns for registrants and investors of requiring the proposed disclosures to be located in the notes to the financial statements in all filings.

A second related alternative to each set of the proposed rules would be to allow the parent company or registrant to provide the Proposed Alternative Disclosures, or the disclosures specified in proposed Rule 13-02, as applicable, outside the financial statement footnotes in all filings. On the one hand, if the parent company or registrant opts to disclose the information outside the financial statements, the cost to a parent company or registrant associated with preparing the information would be lower with this alternative than if the disclosures were provided in the financial statements. This could incentivize the pursuit of registered offerings with guarantees or collateral, given the flexibility and associated reduced costs. While we generally would expect lower compliance costs, disclosures outside the financial statements may result in certain costs to parent companies and registrants, such as legal costs or due diligence activities (*e.g.*, comfort letters). Additionally, a parent company or registrant may be more likely to voluntarily supplement the disclosures with forward-looking information because the safe harbor for forward-looking information under PSLRA is not available for disclosures provided in the financial statements. On the other hand, allowing the parent company or registrant the flexibility of disclosing outside the financial statements may reduce investor confidence in the disclosed information, as this information would not be subject to annual audit, interim review, and internal control over financial reporting requirements. As a result, this alternative could

reduce investor confidence in the disclosed information and may affect their willingness to invest.

While we acknowledge that providing additional flexibility to the parent company or registrant in the location of the disclosures would likely further reduce the compliance burdens associated with registered offerings with guarantees or collateral, investors may demand a higher expected return if they perceive reduced reliability of the Proposed Alternative Disclosure. The potential for higher borrowing costs may encourage issuers to voluntarily include the Proposed Alternative Disclosures or proposed disclosures, as applicable, in the financial statements of the parent company, or registrant, as applicable. We solicit comment on this point and the potential benefits and concerns for registrants and investors of providing flexibility to locate the Proposed Alternative Disclosures outside the financial statements in all filings.

Finally, a third alternative relevant to each set of proposed amendments would be to require Summarized Financial Information to be provided for the same periods as the parent company or registrant, as applicable, instead of the most recent annual and interim period as proposed. While this alternative would increase the amount of information available to investors, the additional information may not be material in making informed investment decisions. As discussed above,[281] prior studies have suggested that simpler disclosures may benefit investors by reducing search costs and facilitating more efficient information processing. Moreover, including additional historical periods would result in higher costs to registrants when preparing registration information and ongoing reporting. We do not believe the potential benefit to investors of this additional historical information justifies the potential cost to the registrants.

[281] *See* note 256 and accompanying text.

F. Request for Comment

We request comment on all aspects of our economic analysis, including the potential costs and benefits of the proposed amendments and alternatives thereto, and whether the rules, if adopted, would promote efficiency, competition, and capital formation or have an impact on investor protection. Commenters are requested to provide empirical data, estimation methodologies, and other factual support for their views, in particular, on costs and benefits estimates.

VIII. Paperwork Reduction Act

A. Background

Certain provisions of our rules and forms that would be affected by the proposed amendments contain "collection of information" requirements within the meaning of the PRA.[282] The Commission is submitting the proposal to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[283] The hours and costs associated with preparing and filing the forms and reports constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number. Compliance with the information collections is mandatory. Responses to the information collections are not kept confidential and there is no mandatory retention period for the information disclosed. The titles for the affected collections of information are:[284]

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[282] *See* note 251 above.

[283] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

[284] As noted above, while the proposed amendments would apply to registered investment companies, and could thereby affect registered investment advisers, based on staff experience, we believe registered investment companies are unlikely to engage in the activities addressed by the proposed amendments. Accordingly, we are not revising the burden estimates for the forms and reports filed by these types of entities.

- "Regulation S-K" (OMB Control No. 3235-0071);[285]
- "Regulation S-X" (OMB Control No. 3235-0009);
- "Form S-1"[286] (OMB Control No. 3235-0065);
- "Form S-3"[287] (OMB Control No. 3235-0073);[288]
- "Form S-4"[289] (OMB Control No. 3235-0324);
- "Form S-11"[290] (OBM Control No. 3235-0067);
- "Form F-1" (OMB Control No. 3235-0258);
- "Form F-3" (OMB Control No. 3235-0256);
- "Form F-4"[291] (OMB Control No. 3235-0325);
- "Form 10"[292] (OMB Control No. 3235-0064);
- "Form 20-F" (OMB Control No. 3235-0288);
- "Form 40-F"[293] (OMB Control No. 3235-0381);
- "Form 10-K"[294] (OMB Control No. 3235-0063);
- "Form 8-K"[295] (OMB Control No. 3235-0060);[296]

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[285] The paperwork burdens for Regulation S-K and Regulation S-X are imposed through the forms that are subject to the requirements in these regulations and are reflected in the analysis of those forms. To avoid a PRA inventory reflecting duplicative burdens, and for administrative convenience, we estimate that the proposed amendments would not impose an incremental burden for these regulations.

[286] 17 CFR 239.11.

[287] 17 CFR 239.13.

[288] The paperwork burdens for Form S-3 and Form F-3 are imposed through the forms from which they incorporate by reference and are reflected in the analysis of those forms. To avoid a PRA inventory reflecting duplicative burdens and for administrative convenience, we assign a one-hour burden to each of these forms.

[289] 17 CFR 239.25.

[290] 17 CFR 239.18.

[291] 17 CFR 239.34.

[292] 17 CFR 249.210.

[293] 17 CFR 249.240f.

[294] 17 CFR 249.310.

- "Regulation 14A"[297] and "Schedule 14A"[298] (OMB Control No. 3235-0059);[299]
- "Regulation 14C"[300] and "Schedule 14C"[301] (OMB Control No. 3235-0057);[302]
- "Form 10-Q" (OMB Control No. 3235-0070);
- "Form SF-1"[303] (OMB Control No. 3235-0707);
- "Form SF-3"[304] (OMB Control No. 3235-0690);
- "Form 1-A"[305] (OMB Control No. 3235-0286);
- "Form 1-K"[306] (OMB Control No. 3235-0720); and
- "Form 1-SA"[307] (OMB Control No. 3235-0721).

The regulations, schedules, and forms listed above were adopted under the Securities Act and/or the Exchange Act. These regulations, schedules, and forms set forth the disclosure

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295 17 CFR 249.308.

296 The paperwork burdens for Form 8-K is imposed through the forms from which they incorporate by reference and are reflected in the analysis of those forms. To avoid a PRA inventory reflecting duplicative burdens and for administrative convenience, we estimate that the proposed amendments would not impose an incremental burden for this form.

297 17 CFR 240.14a-1 *et seq.*

298 17 CFR 240.14a-101.

299 As described below, our estimates for Form 10-K take into account the burden that would be incurred by including the proposed disclosure in the annual report directly or incorporating by reference from a proxy or information statement. To avoid a PRA inventory reflecting duplicative burdens, we estimate that the proposed disclosure would not impose an incremental burden for proxy statements on Schedule 14A.

300 17 CFR 240.14c-1 *et seq.*

301 17 CFR 240.14c-101.

302 As described below, our estimates for Form 10-K take into account the burden that would be incurred by including the proposed disclosure in the annual report directly or incorporating by reference from a proxy or information statement. To avoid a PRA inventory reflecting duplicative burdens, we estimate that the proposed disclosure would not impose an incremental burden for information statements on 14C.

303 17 CFR 239.44.

304 17 CFR 239.45.

305 17 CFR 239.90.

306 17 CFR 239.91.

307 17 CFR 239.92.

requirements for registration statements, periodic and current reports, distribution reports, and proxy and information statements filed by registrants to help investors make informed investment and voting decisions.

We are proposing amendments to the disclosure requirements in Rules 3-10 and 3-16 of Regulation S-X to better align those requirements with the needs of investors and to simplify and streamline the disclosure obligations of registrants. We are proposing to amend both rules and relocate part of Rule 3-10 and all of Rule 3-16 to new Article 13 in Regulation S-X, which would be composed of proposed Rules 13-01 and 13-02. We also are proposing to make conforming amendments to Items 504, 1100, 1112, 1114, and 1115 of Regulation S-K; Forms F-1, F-3, 1-A, 1-K, and 1-SA under the Securities Act; and Rule 12h-5 and Form 20-F under the Exchange Act. These amendments are intended to provide investors with the information that is important given the specific facts and circumstances, make the disclosures easier to understand, and reduce the costs and burdens to registrants.

B. Summary of the Proposed Amendments Impact on Collection of Information

In this section, we summarize the proposed amendments and their general impact on the paperwork burdens associated with the forms listed above. In the subsequent section below, we provide the revised burden estimates of each affected form.

1. Rule 3-10

The proposed amendments to Rule 3-10 would replace the Consolidating Information required by existing Rule 3-10 with Summarized Financial Information of the Obligor Group. Several commenters noted that preparing and providing Consolidated Information is particularly

challenging, complex, and costly.[308] Among other things, the Proposed Alternative Disclosures would permit a parent company to: (1) exclude the financial information of non-obligated entities; (2) reduce the number of periods to be presented; and (3) provide the information of each issuer and guarantor on a combined, rather than disaggregated, basis. These changes would reduce a parent company's paperwork burden by permitting the parent company to exclude information unnecessary to an investment decision as compared to the existing rule. In certain circumstances, the paperwork burden could be reduced even further because registrants would not be required to recast prior period information, which commenters noted can be particularly challenging.[309]

Existing Rule 3-10 requires the Alternative Disclosures to be included in the notes to the parent company's consolidated financial statements, thereby requiring the Alternative Disclosures to be audited for the same periods. The proposed amendments would revise this requirement so that parent companies may provide the Proposed Alternative Disclosures outside their financial statement footnotes in a registration statement covering the offer and sale of the subject securities and any related prospectus, and in Exchange Act annual and quarterly reports required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed, but require the Proposed Alternative Disclosures to be included in the footnotes to the parent company's consolidated financial statements for annual and quarterly reports beginning with the annual report for the fiscal year during which the first bona fide sale of the subject securities is completed. This amendment could reduce the burdens associated with preparing the Proposed Alternative Disclosures because the information would not need to be

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[308] *See, e.g.*, letters from ABA-Committees, Anuradha, BDO, Cahill, CAQ, DT, EY, FedEx, GM, Grant, Headwaters, KPMG, Medtronic, and Noble-UK.

[309] *See, e.g.*, letters from Medtronic and PwC.

immediately audited or tagged. However, this amendment could result in certain legal and due diligence costs (*e.g.*, comfort letters).

Whether a parent company would elect to provide the Proposed Alternative Disclosures outside its financial statement footnotes likely would depend on the company's specific facts and circumstances and, as discussed above,[310] we believe there could be reasons for companies to elect either option. In addition, any reduction in paperwork burden associated with such an election would be incremental, as the parent company would still incur expenses to prepare audited financial information. Given these considerations, and to avoid overestimating the overall paperwork burden reduction associated with the proposed amendments, we are not estimating a specific burden reduction for this aspect of the proposed amendments. However, we solicit comment on whether it would be appropriate to do so, and, if so, how we might estimate such a reduction.

The existing rule also requires a parent company to provide the Alternative Disclosures as a condition to omitting the separate financial statements of a subsidiary issuer or guarantor. In most cases, the Alternative Disclosures consist of Consolidating Information, but the Alternative Disclosures may consist of a brief narrative if certain numerical thresholds are met. The proposed amendments would eliminate these separate categories of Alternative Disclosures. Instead, the proposed amendments would require a parent company to provide all financial and non-financial disclosures specified in proposed Rule 13-01 to the extent they are material to a holder of the guaranteed security. The proposed amendments would also require disclosure of any additional information that would be material to a holder of the guaranteed security.

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[310] *See* Sections III.C.2.d, "Location of Proposed Alternative Disclosures and Audit Requirement," and VII.C.1.b.iii, "Location of Proposed Alternative Disclosures and Audit Requirement."

While the proposed amendments would eliminate some disclosure that may be required by the existing rule, they would also require other disclosure that may not be required by the existing rule. For example, if a numerical threshold is met under the existing rule, disclosure is required even if that disclosure is immaterial to an investment decision. The proposed amendments would not require that disclosure if it was not material, which would reduce the parent company's paperwork burden. Conversely, if a numerical threshold is not met under the existing rule, disclosure is not required unless that information is necessary to make the disclosure provided not misleading.[311] The proposed amendments would require that disclosure in all cases, to the extent material, which could increase the parent company's paperwork burden.

We have estimated the number of filings that include Consolidating Information under Rule 3-10, but we are unable to identify accurately the issuers providing narrative disclosures under Rule 3-10 because the language of those disclosures varies based on facts and circumstances.[312] However, we do not believe that the proposed amendments would affect the paperwork burden for filings that include the narrative disclosures under existing Rule 3-10 because registrants that provide these narrative disclosures would be permitted to provide similar information under the proposed amendments.

Further, under the proposed amendments, parent companies would no longer be required to provide the pre-acquisition financial statements of recently-acquired subsidiary issuers and guarantors, as is currently required by existing Rule 3-10(g). Disclosure may be required under the proposed rule, however, if it is material to an investment decision in the guaranteed security. This aspect of the proposed amendments would decrease the overall paperwork burden of the

311 *See* 17 CFR 230.408(a), 240.12b-20.

312 *See* Section VII.B.2, "Baseline and Affected Parties—Market Conditions."

affected forms. This reduction would be mitigated somewhat, however, because parent companies would still be required to provide information about any recently-acquired subsidiaries when it is material.

Finally, we are proposing amendments to require specific non-financial disclosures, where material, about the issuers and guarantors, the terms and conditions of the guarantees, and how the issuer and guarantor structure and other factors may affect payments to holders of the guaranteed securities. These disclosures would enhance the information provided about subsidiary issuers and guarantors and would be more comprehensive than the similar disclosures a parent company must provide under existing Rule 3-10. These additional disclosures, therefore, could incrementally increase a parent company's existing paperwork burden.

Considering the various impacts to the existing collection of information requirements outlined above, we estimate that the proposed amendments to Rule 3-10 would reduce the overall paperwork burden for registrants. Moreover, some aspects of the proposed amendments could reduce the paperwork burden significantly. For example, Consolidating Information, which includes multiple columns and typically occupies several pages of a parent company's filing, would be replaced with the Proposed Alternative Disclosures, which we expect in most cases would consist of one or two pages of disclosure in a parent company's filing. Overall, therefore, we estimate that the proposed amendments would reduce the paperwork burden for registrants by approximately 30 hours for each filing that includes the Proposed Alternative Disclosures in lieu of the existing Alternative Disclosures.

Although the proposed amendments would reduce the paperwork burden for any particular filing on an affected form that includes the existing Alternative Disclosures, not all filings on the affected forms include these disclosures because they are provided only in certain

instances.[313] Therefore, to estimate the overall paperwork burden reduction from the proposed amendments, we estimated the number of filings that include the Alternative Disclosures. To do so, we used a number of methods that varied based on the affected form.

As an initial step, we examined the XBRL tags most commonly associated with Consolidating Information. Not all filings include XBRL tags, so we estimated the number of all the affected forms that included XBRL tags and extrapolated the number of affected forms based on the percentage of filings that include XBRL tags. For example, in Section VII.B.2, "Market Conditions," using XBRL tags, we estimated that registrants filed 1,223 Form 10-Ks with the Alternative Disclosures in the last three calendar years from 2015 to 2017, which averages approximately 407.67 filings per year. However, over those three years, only approximately 86 percent of Forms 10-K included XBRL tags. For PRA purposes, therefore, we divided 407.67 by 0.86 to estimate that 474 filings per year included Alternative Disclosures over the last three years.

We were able to use this extrapolation method for Forms 10-K, 10-Q, S-1, 20-F, and 40-F, because the percentage of filings made on those forms that included XBRL tags was sufficient to make the extrapolation meaningful. The table below sets forth our estimates of the number of filings on these forms that included the Alternative Disclosures based on the XBRL tagging extrapolation method.

[313] We were not able to determine the number of filings that included the Alternative Disclosures with certainty because registrants are not required to state explicitly that the disclosures they are providing are meant to satisfy the requirements of Rule 3-10.

Table 4: Calculation of the Number of Filings on Affected Forms with the Alternative Disclosures Based on XBRL Tagging Extrapolation

	Number of Responses Over Three-Year Period Using XBRL Data (A)	Annual Average of Responses Using XBRL Data (B)	Percentage of Responses Tagged Using XBRL (C)	Annual Average of Responses (D) = (B) / (C)	Estimated Average Annual Responses (E)
10-K	1,223	407.67	.86	474.03	474
10-Q	3,530	1,176.67	.94	1,251.77	1,252
S-1	7	2.33	.24	9.71	10
20-F	17	5.67	.41	12.82	14
40-F	1	.33	.16	8.31	8

We also searched Forms S-4, S-11, 10, F-1, F-4, SF-1, SF-3, 1-A, 1-K, and 1-SA using XBRL tags most commonly associated with Consolidating Information. However, this extrapolation method did not provide meaningful results because registrants rarely include XBRL tags for these affected forms. For example, only one percent of Form S-4 filings include XBRL tags.[314] Therefore, to provide a more meaningful estimate of the number of these forms that include the Alternative Disclosures, we conducted separate database searches for filings of those forms over the last three calendar years using search terms similar to those used by a commenter.[315]

Based on these searches, we estimate that, over the last three calendar years from 2015 to 2017, there were on average 300 filings on Form S-4, 15 filings on Form S-11, 20 filings on Form 10, 15 filings on Form F-1, and 20 filings on Form F-4 that included the Alternative Disclosures. We were unable to find any filings on the remaining affected forms that included the Alternative Disclosures. Therefore, we estimate that no filings on those forms included the Alternative Disclosures. The table below sets forth our estimates of the number of filings on

[314] Similarly, only six percent of Form S-11, three percent of Form F-1, and three percent of Form 10 filings include XBRL tags.

[315] *See* letter from EY.

these forms that included the Alternative Disclosures based on the other database searches.

Table 5: Calculation of the Number of Filings on Affected Forms with the Alternative Disclosures Based on Database Searches

	Number of Responses Over Three-Year Period Using Database Searches (A)	Annual Average of Responses Using Database Searches (B) = (A) / 3	Estimated Average Annual Responses (C)
S-4	300	100	100
S-11	15	5	5
10	20	6.67	7
F-1	15	5	5
F-4	20	6.67	7
1-A	0	0	0
1-K	0	0	0
1-SA	0	0	0
SF-1	0	0	0
SF-3	0	0	0

Although the proposed amendments to Rule 3-10 would reduce the paperwork burden for each individual affected form, the proposed amendments could cause the number of affected forms filed to change over a period of time. One commenter[316] stated that the high compliance costs associated with preparing the Rule 3-10 financial information leads many companies to issue debt securities privately. Again, we believe that the proposed amendments would encourage potential issuers to conduct registered debt offerings or private offerings with registration rights. Therefore, we believe that the number of registration statements and periodic reports filed on affected forms that include the Proposed Alternative Disclosures would increase.

For example, we believe the number of issuers and guarantors eligible to provide the Proposed Alternative Disclosures would increase in lieu of providing separate financial statements of each subsidiary issuer and guarantor because the proposed amendments would replace the 100%-owned condition with one requiring that the subsidiary issuer/guarantor be a

[316] Letter from Cahill

consolidated subsidiary of the parent company pursuant to the relevant accounting standards it already uses and eliminate the requirement that guarantees of subsidiary guarantors be full and unconditional. If some of those eligible issuers and guarantors conduct registered debt offerings or private offerings with registration rights instead of conducting offerings privately and without registration rights, the number of registration statements and associated periodic reports filed on affected forms would necessarily increase when measured over a period of time.

Conversely, other aspects of the proposed amendments would lead to a decrease in the number of periodic reports filed on affected forms when measured over time. For example, under existing Rule 3-10, if a parent company conducts a registered debt offering or private offering with registration rights and the subsidiary issuer or guarantor is not 100%-owned, but is instead consolidated into the parent company's financial statements, or if the subsidiary guarantor's guarantee is not full and unconditional, the subsidiary must file its own periodic reports. The subsidiary is required to file a registration statement for the transaction, which is usually combined with its parent's registration statement, so the number of registration statements filed with the Proposed Alternative Disclosures would not decrease as a result of this aspect of the proposed amendments. However, under the proposed amendments, if that parent company provides the Proposed Alternative Disclosures, and meets the other conditions of proposed Rule 3-10, its subsidiaries would be exempt from periodic reporting under Rule 12h-5. Therefore, fewer periodic reports on affected forms would be filed, which would decrease those forms' paperwork burden when measured over a period of time.

As another example, existing Rule 3-10 requires a parent company to include the Alternative Disclosures of its subsidiary issuers and guarantors in its periodic reports for so long as the guaranteed securities are outstanding. The proposed amendments would permit the parent

company to cease providing the Proposed Alternative Disclosures in its periodic reports if the corresponding Section 15(d) obligations of its subsidiary issuers and guarantors are suspended. Therefore, we expect that parent companies would provide the Proposed Alternative Disclosures in fewer filings, which would reduce the paperwork burden for periodic reports on affected forms when measured over a period of time.

Overall, we believe that the decrease in the number of periodic reports filed on affected forms due to the change in ongoing reporting requirements would be largely mitigated, and perhaps offset, by the number of periodic reports that would increase due to the filing of new registration statements. Consequently, to avoid overestimating the paperwork reduction associated with the proposed amendments, we are not adjusting our existing estimate for the number of periodic reports filed on affected forms. However, we solicit comment on whether and, if so, how we should make an adjustment to this estimate in light of the proposed amendments.

Although we believe the number of periodic reports filed on affected forms would remain steady, we estimate that the number of registration statements that include the Proposed Alternative Disclosures, as opposed to those that presently include the existing Alternative Disclosures, would increase. As discussed in Section VII.B.2, "Market Conditions," we note that issuers have conducted approximately half as many Rule 144A debt offerings as registered debt offerings. We do not believe that all the issuers that conducted Rule 144A would conduct registered debt offerings as a result of the proposed amendments, but we estimate that there would be a 33 percent increase in registration statements filed based on the proposed amendments. Therefore, we estimate that there would be an additional three filings on Form S-

1,[317] 33 filings on Form S-4,[318] two filings on Form S-11,[319] two filings on Form 10,[320] two filings on Form F-1,[321] and two filings on Form F-4 per year.[322] Further, we estimated above that 14 filings on Form 20-F included the existing Alternative Disclosures. We estimate that half of those filings were registration statements. Therefore, we estimate there would be an additional two registration statements filed on Form 20-F per year.[323]

Finally, to determine the paperwork burden for an issuer to file a registration statement with the Proposed Alternative Disclosures, we first estimated the number of burden hours required for an issuer to provide the existing Alternative Disclosures. A number of commenters provided examples of the burdens required to prepare and process the existing Alternative Disclosures,[324] but only one commenter quantified the number of hours.[325] This commenter indicated that it required 280 hours per year to prepare and review its Alternative Disclosures.[326] We note that this commenter is relatively large and not necessarily representative of the size of all reporting companies. Therefore, for PRA purposes, we estimate that the existing Alternative Disclosures require an average of 100 burden hours to prepare and process. However, we solicit

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317 Ten current filings on Form S-1 x 0.33 = 3.3 filings, which rounds to 3 filings.

318 One hundred current filings on Form S-4 x 0.33 = 33 filings.

319 Five current filings on Form S-11 x 0.33 = 1.65 filings, which rounds to two filings.

320 Seven current filings on Form 10 x 0.33 = 2.31 filings, which rounds to two filings.

321 Five current filings on Form F-1 x 0.33 = 1.65 filings, which rounds to two filings.

322 Seven current filings on Form F-4 x 0.33 = 2.31 filings, which rounds to two filings.

323 Seven current fillings on Form 20-F x .033 = 2.31 filings, which rounds to two filings.

324 *See, e.g.*, letters from EY, FedEx, Medtronic, and Noble-UK.

325 Letter from FedEx.

326 *Id.* The commenter noted that it would require 280 hours to prepare and review its Consolidating Information. As discussed above, the existing Alternative Disclosures may include either Consolidating Information or brief narrative disclosure, and we do not believe that the proposed amendments would affect the paperwork burden for filings that include the narrative disclosure under existing Rule 3-10 because registrants that provide these narrative disclosures would be permitted to provide similar information under the proposed amendments.

comment on the number of burden hours required to prepare the Alternative Disclosures. If the Proposed Alternative Disclosures would reduce an issuer's burden by 30 hours, as compared to the issuer providing the existing Alternative Disclosures, we estimate that the Proposed Alternative Disclosures would require 70 hours to prepare and process.

2. Rule 3-16

Existing Rule 3-16 requires separate Rule 3-16 Financial Statements for each affiliate whose securities constitute a "substantial portion" of the collateral for any class of registered securities as if the affiliate were a separate registrant. The proposed amendments related to Rule 3-16 would replace this requirement with a requirement for a registrant to provide Summarized Financial Information of those affiliates on a combined basis, pursuant to proposed Rule 13-02, if the affiliates are consolidated subsidiaries of the registrant. If additional line items of financial information are material to an investment decision, the registrant would be required to disclose that information as well. In addition, the proposed amendments would require, to the extent material, certain non-financial disclosures about the securities pledged as collateral, each affiliate whose securities are pledged, the terms and conditions of the collateral arrangement, and whether a trading market exists for the pledged securities.

We believe that these amendments would reduce the paperwork burden for the affected forms because Summarized Financial Information is less detailed than separate financial statements and, therefore, is less costly and burdensome to prepare. Further, we believe the registrant's ability to present Summarized Financial Information on a combined basis with its consolidated affiliates would reduce the registrant's paperwork burden because the registrant would not be required to prepare and disclose each of its affiliates' financial statements separately. However, because proposed Rule 13-02 requires certain financial information that

may not otherwise be required in the Summarized Financial Information and additional non-financial disclosures, when material, the expected paperwork burden reduction may be somewhat mitigated.

Existing Rule 3-16 requires the Rule 3-16 Financial Statements of an affiliate to be audited for the periods required by Rules 3-01 and 3-02 of Regulation S-X. Similar to the proposed amendments to Rule 3-10, the proposed amendments related to Rule 3-16 would permit a registrant to provide the disclosures in proposed Rule 13-02 outside its financial statements in a registration statement covering the offer and sale of the subject securities and any related prospectus, and in Exchange Act annual and quarterly reports required to be filed during the fiscal year in which the first sale of the subject securities is completed, but require the proposed disclosures to be included in the footnotes to the registrant's consolidated financial statements for annual and quarterly reports beginning with the annual report for the fiscal year during which the first bona fide sale of the subject securities is completed. Therefore, if provided outside the registrant's financial statements, the proposed Rule 13-02 disclosures would not be audited or tagged, which could reduce the burdens associated with preparing this information. Whether a registrant would elect to provide the disclosures outside its financial statement footnotes likely would depend on the company's specific facts and circumstances and, as discussed above,[327] we believe there could be reasons for companies to elect either option. In addition, any reduction in paperwork burden associated with such an election would be incremental, as the registrant would still incur expenses to prepare audited financial information. Given these considerations, and to avoid overestimating the overall paperwork burden reduction associated with the proposed

[327] Sections V.B, "Overview of the Proposed Changes," and VII.C.2 "Proposed Amendments to Rule 3-16 and Relocation to Rule 13-02."

amendments, we are not estimating a specific additional burden reduction for this aspect of the proposed amendments. However, we solicit comment on whether it would be appropriate to do so and, if so, how we might estimate such a reduction.

The proposed amendments would require registrants to provide Summarized Financial Information of affiliates as of, and for, the most recently-ended fiscal year and interim period included in their consolidated financial statements. Under existing Rule 3-16, financial statements of affiliates are required for the periods specified in Rules 3-01 and 3-02 of Regulation S-X. This aspect of the proposed amendments, therefore, would reduce the paperwork burden for registrants by reducing the number of periods required to be presented.

Overall, we estimate that the proposed amendments related to Rule 3-16 would reduce the current paperwork burden by approximately 30 hours for each affected form except for quarterly reports on Form 10-Q. Existing Rule 3-16 requires registrants to include interim period Rule 3-16 Financial Statements when the financial statements are presented in registration statements, but it does not require Rule 3-16 Financial Statements in quarterly reports on Form 10-Q. The proposed amendments related to Rule 3-16 would require financial information in quarterly reports on Form 10-Q, which would increase registrants' paperwork burden for that form. We estimate that the proposed amendments related to Rule 3-16 would increase the current paperwork burden by approximately 70 hours[328] for each affected quarterly report on Form 10-Q.

As with the proposed amendments to Rule 3-10, although the proposed amendments related to Rule 3-16 would reduce the paperwork burden for each individual affected form,

[328] This figure corresponds to the 70 burden hours we estimate will be required to prepare and process the proposed Rule 13-02 information in connection with the filing of a registration statement. *See* discussion below.

except for Form 10-Q, the proposed amendments could cause the number of affected forms filed over a period of time to change. A number of commenters stated that, due to the costs and burdens associated with preparing the information, collateralized debt offerings are often unregistered or structured to avoid or limit Rule 3-16 disclosures.[329] We believe that the proposed amendments would encourage potential issuers to conduct additional registered collateralized debt offerings because the costs of complying with proposed Rule 13-02 could be less than the costs required to comply with existing Rule 3-16. As the number of these registered offerings increases, the number of affected forms filed would also increase over a period of time.

As discussed in Section VII.B.2, "Market Conditions," over the last three calendar years from 2015 to 2017, approximately seven filings per year have included Rule 3-16 Financial Statements, with six of those filings on Form 10-K and one on Form 20-F. However, a number of filings on affected forms include references to Rule 3-16 even though they do not include Rule 3-16 Financial Statements.[330] As commenters indicated, indenture agreements frequently include provisions that release collateral requirements if their inclusion would trigger Rule 3-16 Financial Statements.[331]

We do not believe that all the filings on affected forms that reference Rule 3-16 but do not include Rule 3-16 Financial Statements would include the proposed Rule 13-02 information, but we believe many would include this information. For PRA purposes, we estimate that the

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329 *See, e.g.*, letters from ABA-Committees, Cahill, Chamber, Covenant, Davis Polk, DT, KPMG, EY, and PwC.

330 We estimate that, over the last three calendar years, approximately 21 filings on Form 10-K included Rule 3-16 Financial Statements and an additional 15 filings on that form referenced Rule 3-16 but did not include Rule 3-16 Financial Statements. Also, three filings on Form 20-F included Rule 3-16 Financial Statements and no other filings on that form referenced Form 3-16. Further, 25 filings on Form 10-Q, 11 filings on Form S-1, 35 filings on Form S-4, one filing on Form S-11, one filing on Form 10, and one filing on Form 1-A referred to Rule 3-16 but did not include Rule 3-16 Financial Statements. No filings on the other affected forms referenced the rule.

331 *See, e.g.*, letters from Davis, KPMG, and PwC.

proposed amendments would result in approximately 33 percent of the registration statements that reference Rule 3-16 but do not include Rule 3-16 Financial Statements providing the proposed Rule 13-02 information. As such, we estimate that approximately ten additional registration statements would include the proposed Rule 13-02 information, with four of those filings on Form S-4[332] and one each on Forms S-1,[333] S-11, 10, 1-A, F-1, and F-4.[334]

Further, we do not believe that all registrants that file additional registration statements with the proposed Rule 13-02 information would be new registrants, so we do not believe there would be an additional ten filings on Form 10-K. We estimate that 33 percent of the registrants that file additional registration statements with the proposed Rule 13-02 information would be new registrants, so an additional three filings on Form 10-K would include the proposed Rule 13-02 information.[335] Also, we estimate that two additional filings on Form 20-F, one registration statement and one annual report, would include the proposed Rule 13-02 information.

Estimating the number of additional filings on Form 10-Q requires a separate determination because the proposed amendments would require that proposed Rule 13-02 information be included in quarterly reports on Form 10-Q. Rule 3-16 Financial Statements are

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[332] We estimated this figure by multiplying the average number of filings per year from the last three calendar years on Form S-4 that referenced Rule 3-16 but did not include the Rule 3-16 Financial Statements (12 filings) by 0.33. The average annual number of filings on Form S-4 that referenced Rule 3-16 but did not include the Rule 3-16 Financial Statements is 11.67, which rounds to 12.

[333] We estimated this figure by multiplying the average number of filings per year from the last three calendar years on Form S-1 that referenced Rule 3-16 but did not include the Rule 3-16 Financial Statements (four filings) by 0.33. The average annual number of filings on Form S-1 that referenced Rule 3-16 but did not include the Rule 3-16 Financial Statements is 1.33, which rounds to one.

[334] Over the last three calendar years, one filing on Form S-11, one filing on Form 10, and one filing on Form 1-A referred to Rule 3-16 but did not include Rule 3-16 Financial Statements. Therefore, we estimate that one additional filing on each of these forms would include the proposed Rule 13-02 information. Also, although there were no filings on Forms F-1 and F-4 that referenced Rule 3-16 in the last three calendar years, one filing on Form F-1 and two filings on Form F-4 referenced Rule 3-16 in calendar years 2013 and 2014, so we estimated that one additional filing on each of these forms would include the proposed Rule 13-02 information.

[335] Thirty-three percent of ten is 3.33, which rounds to three.

not required in quarterly reports on Form 10-Q under existing Rule 3-16. To estimate the number of additional filings on Form 10-Q that would include the proposed Rule 13-02 information, we look to the estimated number of filings on Form 10-K. For every Form 10-K, a registrant would be required to file three quarterly reports on Form 10-Q. Assuming that six filings on Form 10-K would be made each year with the proposed Rule 13-02 information,[336] we estimate that 18 quarterly reports on Form 10-Q per year would be filed with the proposed Rule 13-02 information.

Finally, to determine the paperwork burden for a registrant to file a registration statement with the proposed Rule 13-02 information, we estimated the number of burden hours required for an issuer to provide the existing Rule 3-16 Financial Statements. Unlike for Rule 3-10, no commenter provided an estimate for the cost of Rule 3-16 Financial Statements. For PRA purposes, we estimate that the Rule 3-16 Financial Statements require an average of 100 burden hours, which is the same estimate we use for the hours required to prepare and process the Alternative Disclosures under existing Rule 3-10. However, we solicit comment on the number of burden hours required to prepare the Rule 3-16 Financial Statements. If proposed Rule 13-02 would reduce a registrant's burden by 30 hours, as compared to the registrant providing the existing Rule 3-16 Financial Statements, we estimate that the proposed Rule 13-02 information would require 70 hours to prepare and process.

C. Burden and Cost Estimates for the Proposed Amendments

Below we estimate the aggregate change in paperwork burden as a result of the proposed amendments, both in terms of the change to existing responses as well as the effect of additional

[336] This figure was determined by adding the two current filings on Form 10-K that include Rule 3-16 Financial Statements with the estimated four additional filings on Form 10-K that would include proposed Rule 13-02 information.

responses. These estimates represent the average burden for all registrants, both large and small. In deriving our estimates, we recognize that the burdens will likely vary among individual registrants based on a number of factors, including the nature of their business. The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take a registrant to prepare and review disclosure required under the proposed amendments. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the registrant internally is reflected in hours.

For purposes of the PRA, we estimate that 75% of the burden of preparation of Forms 10-K, 10-Q, 1-A, and 1-K is carried by the registrant internally and that 25% of the burden of preparation is carried by outside professionals retained by the company at an average cost of $400 per hour.[337] Additionally, we estimate that 25% of the burden of preparation for Forms 10, S-1, S-3, S-4, S-11, SF-3, F-1, F-3, F-4, 20-F, and 40-F and is carried by the registrant internally and that 75% of the burden of preparation is carried by outside professionals retained by the company at an average cost of $400 per hour. Finally, we estimate that 85% of the burden of preparation of Form 1-SA is carried by the registrant internally and that 15% of the burden of preparation is carried by outside professionals retained by the company at an average cost of $400 per hour.

The tables below illustrate the change to the total annual compliance burden of affected forms, in hours and in costs, as a result of the proposed amendments.

[337] We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $400 per hour. This estimate is based on consultations with several registrants, law firms and other persons who regularly assist registrants in preparing and filing reports with the Commission.

Table 6: Calculations of Change in Burden Estimates of Current Responses Due to Proposed Amendments to Rule 3-10

	Number of Current Affected Responses (A)	Burden Hour Change per Current Affected Response (B)	Change in Burden Hours for Current Affected Responses (C) = (A) x (B)	Change in Company Hours for Current Affected Responses (D) = (C) x 0.75, 0.25, or 0.85	Change in Professional Hours for Current Affected Responses (E) = (C) x 0.25, 0.75, or 0.15	Change in Professional Costs for Current Affected Responses (F) = (E) x $400
10-K	474	(30)	(14,220)	(10,665)	(3,555)	($1,422,000)
10-Q	1,252	(30)	(37,560)	(28,170)	(9,390)	($3,756,000)
S-1	10	(30)	(300)	(75)	(225)	($90,000)
20-F	14	(30)	(420)	(105)	(315)	($126,000)
40-F	8	(30)	(240)	(60)	(180)	($72,000)
S-4	100	(30)	(3,000)	(750)	(2,250)	($900,000)
S-11	5	(30)	(150)	(37.5)	(112.5)	($45,000)
10	7	(30)	(210)	(52.5)	(157.5)	($63,000)
F-1	5	(30)	(150)	(37.5)	(112.5)	($45,000)
F-4	7	(30)	(210)	(52.5)	(157.5)	($63,000)
1-A	0	---	---	---	---	---
1-K	0	---	---	---	---	---
1-SA	0	---	---	---	---	---
SF-1	0	---	---	---	---	---
SF-3	0	---	---	---	---	---

Table 7: Calculations of Change in Burden Estimates of Additional Responses Due to Proposed Amendments to Rule 3-10

	Number of Additional Affected Responses (A)	Burden Hour Change per Additional Affected Response (B)	Change in Burden Hours for Additional Affected Responses (C) = (A) x (B)	Change in Company Hours for Additional Affected Responses (D) = (C) x 0.25	Change in Professional Hours for Additional Affected Responses (E) = (C) x 0.75	Change in Professional Costs for Additional Affected Responses (F) = (E) x $400
10-K	0	---	---	---	---	---
10-Q	0	---	---	---	---	---
S-1	3	70	210	52.5	157.5	$63,000
20-F	2	70	140	35	105	$42,000
40-F	0	---	---	---	---	---
S-4	33	70	2,310	577.5	1,732.5	$693,000
S-11	2	70	140	35	105	$42,000
10	2	70	140	35	105	$42,000
F-1	2	70	140	35	105	$42,000
F-4	2	70	140	35	105	$42,000
1-A	0	---	---	---	---	---
1-K	0	---	---	---	---	---
1-SA	0	---	---	---	---	---
SF-1	0	---	---	---	---	---
SF-3	0	---	---	---	---	---

Table 8: Calculations of Change in Burden Estimates of Current Responses Due to Proposed Amendments to Rule 3-16

	Number of Current Affected Responses (A)	Burden Hour Change per Current Affected Response (B)	Change in Burden Hours for Current Affected Responses (C) = (A) x (B)	Change in Company Hours for Current Affected Responses (D) = (C) x 0.75, 0.25, 0.85	Change in Professional Hours for Current Affected Responses (E) = (C) x 0.25, 0.75, or 0.15	Change in Professional Costs for Current Affected Responses (F) = (E) x $400
10-K	7	(30)	(210)	(157.5)	(52.5)	($21,000)
10-Q	0	---	---	---	---	---
S-1	0	---	---	---	---	---
20-F	1	(30)	(30)	(7.5)	(22.5)	($9,000)
40-F	0	---	---	---	---	---
S-4	0	---	---	---	---	---
S-11	0	---	---	---	---	---
10	0	---	---	---	---	---
F-1	0	---	---	---	---	---
F-4	0	---	---	---	---	---
1-A	0	---	---	---	---	---
1-K	0	---	---	---	---	---
1-SA	0	---	---	---	---	---
SF-1	0	---	---	---	---	---
SF-3	0	---	---	---	---	---

Table 9: Calculations of Change in Burden Estimates of Additional Responses Due to Proposed Amendments to Rule 3-16

	Number of Additional Affected Responses (A)	Burden Hour Change per Additional Affected Response (B)	Change in Burden Hours for Additional Affected Responses (C) = (A) x (B)	Change in Company Hours for Additional Affected Responses (D) = (C) x 0.75, 0.25, or 0.85	Change in Professional Hours for Additional Affected Responses (E) = (C) x 0.25, 0.75, or 0.15	Change in Professional Costs for Additional Affected Responses (F) = (E) x $400
10-K	3	70	210	157.5	52.5	$21,000
10-Q	18	70	1,260	945	315	$126,000
S-1	1	70	70	17.5	52.5	$21,000
20-F	2	70	140	35	105	$42,000
40-F	0	---	---	---	---	---
S-4	4	70	280	70	210	$84,000
S-11	1	70	70	17.5	52.5	$21,000
10	1	70	70	17.5	52.5	$21,000
F-1	1	70	70	17.5	52.5	$21,000
F-4	1	70	70	17.5	52.5	$21,000
1-A	1	70	70	52.5	17.5	$7,000
1-K	0	---	---	---	---	---
1-SA	0	---	---	---	---	---
SF-1	0	---	---	---	---	---
SF-3	0	---	---	---	---	---

Table 10: Calculations for Incremental Paperwork Burden under the Proposed Amendments to Rules 3-10 and 3-16 (Current Responses + Additional Responses)

	Number of Total Affected Responses Under Proposed Rule 3-10 (A)[338]	Number of Total Affected Responses Under Proposed Rule 3-16 (B)[339]	Change in Burden Hours for Total Affected Responses Under Proposed Rule 3-10 (C)[340]	Change in Burden Hours for Total Affected Responses Under Proposed Rule 3-16 (D)[341]	Change in Company Hours for Total Affected Responses Under Proposed Rule 3-10 (E)[342]	Change in Company Hours for Total Affected Responses Under Proposed Rule 3-16 (F)[343]	Change in Professional Hours for Total Affected Responses Under Proposed Rule 3-10 (G)[344]	Change in Professional Hours for Total Affected Responses Under Proposed Rule 3-16 (H)[345]	Change in Professional Costs for Total Affected Responses Under Rule 3-10 (I)[346]	Change in Professional Costs for Total Affected Responses Under Rule 3-16 (J)[347]
10-K	474	10	(14,220)	0	(10,665)	0	(3,555)	0	($1,422,000)	$0
10-Q	1,252	18	(37,560)	1,260	(28,170)	945	(9,390)	315	($3,756,000)	$126,000
S-1	13	1	(90)	70	(22.5)	17.5	(67.5)	52.5	($27,000)	$21,000
20-F	16	3	(280)	110	(70)	27.5	(210)	82.5	($84,000)	$33,000
40-F	8	0	(240)	---	(60)	---	(180)	---	($72,000)	---
S-4	133	4	(690)	280	(172.5)	70	(517.5)	210	($207,000)	$84,000
S-11	7	1	(10)	70	(2.5)	17.5	(7.5)	52.5	($3,000)	$21,000
10	9	1	(70)	70	(17.5)	17.5	(52.5)	52.5	($21,000)	$21,000
F-1	7	1	(10)	70	(2.5)	17.5	(7.5)	52.5	($3,000)	$21,000
F-4	9	1	(70)	70	(17.5)	17.5	(52.5)	52.5	($21,000)	$21,000
1-A	0	1	---	70	---	52.5	---	17.5	---	$7,000
1-K	0	0	---	---	---	---	---	---	---	
1-SA	0	0	---	---	---	---	---	---	---	
SF-1	0	0	---	---	---	---	---	---	---	
SF-3	0	0	---	---	---	---	---	---	---	

338 Table 6, Column (A) + Table 7, Column (A)

339 Table 8, Column (A) + Table 9, Column (A)

340 Table 6, Column (C) + Table 6, Column (C)

341 Table 8, Column (C) + Table 9, Column (C)

342 Table 6, Column (D) + Table 7, Column (D)

343 Table 8, Column (D) + Table 9, Column (D)

344 Table 6, Column (E) + Table 7, Column (E)

345 Table 8, Column (E) + Table 9, Column (E)

346 Table 6, Column (F) + Table 7, Column (F)

347 Table 8, Column (F) + Table 9, Column (F)

Table 11: Incremental Paperwork Burden under the Proposed Amendments to Rules 3-10 and 3-16

	Number of Affected Responses (A)[348]	Change in Burden Hours of Affected Response (B)[349]	Change in Company Hours (C)[350]	Change in Professional Hours (D)[351]	Change in Professional Costs (E)[352]
10-K	484	(14,220)	(10,665)	(3,555)	($1,422,000)
10-Q	1,270	(36,300)	(27,225)	(9,075)	($3,630,000)
S-1	14	(20)	(5)	(15)	($6,000)
20-F	19	(170)	(42.5)	(127.5)	($51,000)
40-F	8	(240)	(60)	(180)	($72,000)
S-4	137	(410)	(102.5)	(307.5)	($123,000)
S-11	8	60	15	45	$18,000
10	10	0	0	0	0
F-1	8	60	15	45	$18,000
F-4	10	0	0	0	0
1-A	1	70	52.5	17.5	$7,000
1-K	0	---	---	---	---
1-SA	0	---	---	---	---
SF-1	0	---	---	---	---
SF-3	0	---	---	---	---

348 Table 10, Columns (A) + (B)

349 Table 10, Columns (C) + (D)

350 Table 10, Columns (E) + (F)

351 Table 10, Columns (G) + (H)

352 Table 10, Columns (I) + (J)

Table 12: Requested Paperwork Burden under the Proposed Amendments to Rules 3-10 and 3-16[353]

	Current Burden			Program Change			Requested Change in Burden		
	Current Annual Responses (A)	Current Burden Hours (B)	Current Cost Burden (C)	Number of Affected Responses (D)[354]	Change in Company Hours (E)[355]	Change in Professional Costs (F)[356]	Annual Responses (G) = (A) + (D)	Burden Hours (H) = (B) + (E)	Cost Burden (I) = (C) + (F)
10-K	8,137	14,596,183	$1,950,114,190	484	(10,665)	($1,422,000)	8,621	14,585,518	$1,948,692,190
10-Q	22,907	3,271,578	$436,240,908	1,270	(27,225)	($3,630,000)	24,117	3,244,353	$432,610,908
S-1	901	151,143	$181,371,300	14	(5)	($6,000)	915	151,138	$181,365,300
20-F	725	480,226	$576,270,600	19	(42.5)	($51,000)	744	480,184	$576,219,600
40-F	160	17,197	$20,636,800	8	(60)	($72,000)	168	17,137	$20,564,800
S-4	551	565,282	$678,338,304	137	(102.5)	($123,000)	688	565,180	$678,215,304
S-11	64	12,529	$15,034,368	8	15	$18,000	72	12,544	$15,052,368
10	216	11,783	$14,140,051	10	0	0	226	11,783	$14,140,051
F-1	63	26,980	$32,375,700	8	15	$18,000	71	26,995	$32,393,700
F-4	39	14,245	$17,093,700	10	0	0	49	14,245	$17,093,700
1-A	250	140,813	$18,775,200	1	52.5	$7,000	251	140,866	$18,782,200
1-K	188	84,600	$11,280,000	0	---	---	188	84,600	$11,280,000
1-SA	188	29,952	$2,113,872	0	---	---	188	29,952	$2,113,872
SF-1	6	2,076	$2,491,200	0	---	---	6	2,076	$2,491,200
SF-3	71	24,548	$29,457,900	0	---	---	71	24,548	$29,457,900

D. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;
- Evaluate the accuracy of our assumptions and estimates of the burden of the proposed collection of information;
- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;
- Evaluate whether there are ways to minimize the burden of the collection of

353 The figures in Table 12, Columns (G), (H), and (I) have been rounded to the nearest whole number.

354 From Table 11, Column (A)

355 From Table 11, Column (C)

356 From Table 11, Column (F)

information on those who respond, including through the use of automated collection techniques or other forms of information technology; and

- Evaluate whether the proposed amendments would have any effects on any other collection of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct their comments to the Office of Management and Budget, Attention: Desk Officer for the U.S. Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to, Brent J. Fields, Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549, with reference to File No. S7-19-18. Requests for materials submitted to OMB by the Commission with regard to the collection of information requirements should be in writing, refer to File No. S7-19-18 and be submitted to the U.S. Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington DC 20549. OMB is required to make a decision concerning the collection of information requirements between 30 and 60 days after publication of the proposed amendments. Consequently, a comment to OMB is best assured of having its full effect if the OMB receives it within 30 days of publication.

IX. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[357] we solicit data to determine whether the proposed amendments constitute a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

[357] Pub. L. No. 104-121, tit. II, 110 Stat. 857 (1996).

- An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

Commenters should provide comment and empirical data on (a) the potential annual effect on the U.S. economy; (b) any increase in costs or prices for consumers or individual industries; and (c) any potential effect on competition, investment, or innovation.

X. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Act Analysis has been prepared in accordance with the Regulatory Flexibility Act.[358] It relates to the proposed amendments to the financial disclosure requirements in Rules 3-10 and 3-16 of Regulation S-X to improve those requirements for both investors and registrants.

A. Reasons for, and Objectives of, the Proposing Action

The purpose of the proposed amendments to Rules 3-10 and 3-16 is to better align those requirements with the needs of investors and to simplify and streamline the disclosure obligations of registrants. The proposed changes would include amending both rules and relocating part of Rule 3-10 and all of Rule 3-16 to new Article 13 in Regulation S-X, which would be comprised of proposed Rules 13-01 and 13-02. These changes are intended to provide investors with the information that is important given the specific facts and circumstances, make the disclosures easier to understand, and reduce the costs and burdens to registrants. The reasons for, and objectives of, the proposed amendments are discussed in more detail in Sections I through III above.

[358] 5 U.S.C. 601 *et seq.*

B. Legal Basis

We are proposing the rule and form amendments contained in this release under the authority set forth in Sections 3, 6, 7, 8, 9, 10, 19(a), and 28 of the Securities Act of 1933, as amended and Sections 3(b), 12, 13, 15(d), 23(a), and 36 of the Securities Exchange Act of 1934, as amended.

C. Small Entities Subject to the Proposed Rules

The proposed changes would affect some registrants that are small entities. The Regulatory Flexibility Act defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."[359] For purposes of the Regulatory Flexibility Act, under our rules, an issuer, other than an investment company or an investment adviser, is a "small business" or "small organization" if it had total assets of $5 million or less on the last day of its most recent fiscal year and is engaged or proposing to engage in an offering of securities that does not exceed $5 million.[360] We estimate that there are 1,196 issuers that file with the Commission, other than investment companies and investment advisers, that may be considered small entities and are potentially subject to the proposed amendments.[361]

D. Reporting, Recordkeeping, and Other Compliance Requirements

As noted above, the purpose of the proposed amendments to Rules 3-10 and 3-16 is to better align those requirements with the needs of investors and to simplify and streamline the disclosure obligations of registrants. Proposed Rule 3-10 would continue to permit the omission of separate financial statements of subsidiary issuers and guarantors when certain conditions are

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359 5 U.S.C. 601(6).

360 *See* 17 CFR 230.157 under the Securities Act and 17 CFR 240.0-10(a) under the Exchange Act.

361 This estimate is based on staff analysis of XBRL data submitted by filers, other than co-registrants, with EDGAR filings of Forms 10-K, 20-F, and 40-F and amendments filed during the calendar year 2017 and a staff analysis of Forms 1-A and 1-K filed during the calendar year 2017.

met and the parent company provides the Proposed Alternative Disclosures. While the conditions that must be met to omit separate subsidiary issuer or guarantor financial statements would continue to be located in proposed Rule 3-10, the disclosure requirements would be relocated to proposed Rule 13-01 contained in new Article 13 of Regulation S-X. The proposed amendments would:

- replace the condition that a subsidiary issuer or guarantor be 100% owned by the parent company with a condition that it be consolidated in the parent company's consolidated financial statements;
- replace Consolidating Information with Summarized Financial Information of the Obligor Group, which may be presented on a combined basis, and reduce the number of periods presented;
- expand the qualitative disclosures about the guarantees and the issuers and guarantors;
- eliminate quantitative thresholds for disclosure and require disclosure of additional information that would be material to a holder of the guaranteed security;
- permit the Proposed Alternative Disclosures to be provided outside the footnotes to the parent company's audited annual and unaudited interim consolidated financial statements in a registration statement covering the offer and sale of the subject securities and any related prospectus, and in certain Exchange Act reports filed shortly thereafter;
- require that the Proposed Alternative Disclosures be included in the footnotes to the parent company's consolidated financial statements for annual and quarterly

reports beginning with the annual report for the fiscal year during which the first bona fide sale of the subject securities is completed;

- eliminate the requirement to provide pre-acquisition financial statements of recently-acquired subsidiary issuers and guarantors; and
- require the Proposed Alternative Disclosures for as long as the issuers and guarantors have an Exchange Act reporting obligation with respect to the guaranteed securities rather than for so long as the guaranteed securities are outstanding.

The proposed amendments to Rule 3-10 would simplify and streamline the rule structure in several ways. Most significantly, under proposed Rules 3-10(a) and 3-10(a)(1) there would be only a single set of eligibility criteria that would apply to all issuer and guarantor structures instead of having separate sets of criteria contained in each of the five exceptions in existing Rules 3-10(b) through (f). Similarly, the requirements for the Proposed Alternative Disclosures would be included in a single location within proposed Rule 13-01, rather than spread among the multiple subsections of existing Rule 3-10.

Proposed Rule 3-16 would replace the rule's existing requirement to provide separate financial statements for each affiliate whose securities are pledged as collateral with 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. Similar to the proposed disclosures for issuers and guarantors of guaranteed securities under Rule 3-10, the disclosure requirements in Rule 3-16 would be amended and relocated to proposed Rule 13-02, in new Article 13 of Regulation S-X.

Additionally, instead of requiring disclosure only when the pledged securities meet or

exceed a numerical threshold relative to the securities registered or being registered under the existing rule's "substantial portion" test, the proposed amendments would require disclosure to the extent material to a holder of the collateralized security. Further, the proposed amendments would require disclosure of any additional information about the collateral arrangement and each affiliate whose security is pledged as collateral that would be material to a holder of the collateralized securities. We believe these proposed disclosures would enable an investor to evaluate the potential outcomes in the event of foreclosure, would reduce costs and burdens on registrants, and may facilitate the use of debt structures that include pledges of affiliate securities, resulting in improved collateral packages being available to investors.

Many of the proposed changes would simplify and streamline existing disclosure requirements in ways that are expected to reduce compliance burdens for all registrants, including small entities. Some of the proposed changes would incrementally increase compliance costs for registrants, although we do not expect these additional costs to be significant. In addition, compliance with the proposed amendments would require the use of professional skills, including accounting and legal skills. The proposed amendments are discussed in detail in Sections II and III above. We discuss the economic impact including the estimated costs and burdens, of the proposed amendments to all registrants, including small entities, in Sections VII and VIII above.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe that the proposed amendments would not duplicate, overlap, or conflict with other federal rules.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish

our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements that take into account the resources available to small entities;
- Clarifying, consolidating, or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

We believe the proposed amendments would simplify and streamline disclosure requirements in ways that are expected to reduce compliance burdens for all registrants, including small entities. We do not believe that the proposed amendments would impose any significant new compliance obligations. Accordingly, we do not believe it is necessary to exempt small entities from all or part of the proposed amendments. We note in this regard that the Commission's existing disclosure requirements provide for scaled disclosure requirements and other accommodations for small entities, and the proposed amendments would not alter these existing accommodations. We are, however, soliciting comment on whether the amendments should permit additional or different flexibility for SRCs and other types of issuers to locate the Proposed Alternative Disclosures outside the financial statements in light of the burdens associated with annual audit, interim review, and internal control over financial reporting requirements.

Finally, with respect to using performance rather than design standards, the proposed amendments generally contain elements similar to performance standards, which we believe is appropriate because it would allow registrants to omit financial information that is not necessary

for an investment decision based on facts and circumstances applicable to that registrant and offering. For example, under the proposed amendments, the Summarized Financial Information of the Obligor Group that generally would be required could be omitted if it is not materially different from corresponding amounts in the parent company's consolidated financial statements. This and other performance standards included in the proposed amendments would reduce compliance burdens for all registrants, including small entities.

G. Request for Comment

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- how the proposed rule and form amendments can achieve their objective while lowering the burden on small entities;
- the number of small entity companies that may be affected by the proposed rule and form amendments;
- the existence or nature of the potential effects of the proposed amendments on small entity companies discussed in the analysis; and
- how to quantify the effects of the proposed amendments.

Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of that effect. Comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rules are adopted, and will be placed in the same public file as comments on the proposed rules themselves.

XI. Statutory Authority and Text of Proposed Rule and Form Amendments

The amendments contained in this release are being proposed under the authority set forth in Sections 3, 6, 7, 8, 10, 19(a), and 28 of the Securities Act, as amended, and Sections 3(b), 12, 13, 15(d), 23(a), and 36 of the Exchange Act.

List of Subjects in 17 CFR Parts 210, 229, 239, 240 and 249

Reporting and recordkeeping requirements, Securities.

TEXT OF THE PROPOSED AMENDMENTS

For the reasons set out in the preamble, the Commission is proposing to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 210 – FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. The authority citation for part 210 reads as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77nn(25), 77nn(26), 78c, 78j-1, 78l, 78m, 78n, 78o(d), 78q, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-20, 80a-29, 80a-30, 80a-31, 80a-37(a), 80b-3, 80b-11, 7202 and 7262, and sec. 102(c), Pub. L. 112-106, 126 Stat. 310 (2012), unless otherwise noted.

2. Revise § 210.3-10 to read as follows:

§ 210.3-10 Financial statements of guarantors and issuers of guaranteed securities registered or being registered.

(a) If an issuer or guarantor of a guaranteed security that is registered or being registered is required to file financial statements required by Regulation S-X with respect to the guarantee or guaranteed security, such financial statements may be omitted if the issuer or guarantor is a consolidated subsidiary of the parent company, the parent company's consolidated financial

statements have been filed, and the conditions in paragraphs (a)(1) and (a)(2) of this section have been met:

(1) The guaranteed security is debt or debt-like and;

(i) The parent company issues the security or co-issues the security, jointly and severally, with one or more of its consolidated subsidiaries; or

(ii) A consolidated subsidiary issues the security or co-issues the security with one or more other consolidated subsidiaries of the parent company, and the security is guaranteed fully and unconditionally by the parent company.

(2) The parent company provides the disclosures specified in §210.13-01.

(b) *Definitions.* For the purposes of this section and §210.13-01:

(1) The "parent company" is the entity that:

(i) Is an issuer or guarantor of the guaranteed security;

(ii) Is, or as a result of the subject Securities Act registration statement will be, an Exchange Act reporting company; and

(iii) Consolidates each subsidiary issuer and/or subsidiary guarantor of the guaranteed security in its consolidated financial statements.

(2) A security is "debt or debt-like" if it has the following characteristics:

(i) The issuer has a contractual obligation to pay a fixed sum at a fixed time; and:

(ii) Where the obligation to make such payments is cumulative, a set amount of interest must be paid.

Notes to Paragraph (b)(2): 1. Neither the form of the security nor its title will determine whether a security is debt or debt like. Instead, the substance of the obligation created by the security will be determinative.

2. The phrase “set amount of interest” is not intended to mean “fixed amount of interest.” Floating and adjustable rate securities, as well as indexed securities, may meet the criteria specified in paragraph (b)(2)(ii) as long as the payment obligation is set in the debt instrument and can be determined from objective indices or other factors that are outside the discretion of the obligor.

(3) A guarantee is “full and unconditional,” if, when an issuer of a guaranteed security has failed to make a scheduled payment, the guarantor is obligated to make the scheduled payment immediately and, if it does not, any holder of the guaranteed security may immediately bring suit directly against the guarantor for payment of all amounts due and payable.

3. Remove and reserve § 210.3-16.

4. Amend § 210.8-01 by revising Note 3 and Note 4 to read as follows:

§ 210.8-01 Preliminary Notes to Article 8.

* * * * *

Note 3 to § 210.8: The requirements of § 210.3-10 are applicable to financial statements for a subsidiary of a smaller reporting company that issues securities guaranteed by the smaller reporting company or guarantees securities issued by the smaller reporting company. Disclosures about guarantors and issuers of guaranteed securities registered or being registered must be presented as required by § 210.13-01.

Note 4 to § 210.8: Disclosures about a smaller reporting company’s affiliates whose securities collateralize any class of securities registered or being registered and the related collateral arrangement must be presented as required by § 210.13-02.

* * * * *

5. Amend § 210.8-03 by adding paragraphs (b)(7) and (b)(8) to read as follows:

§ 210.8-03 Interim Financial Statements.

* * * * *

(7) *Financial Statements of and Disclosures About Guarantors and Issuers of Guaranteed Securities*. The requirements of § 210.3-10 are applicable to financial statements for a subsidiary of a smaller reporting company that issues securities guaranteed by the smaller reporting company or guarantees securities issued by the smaller reporting company. Disclosures about guarantors and issuers of guaranteed securities registered or being registered must be presented as required by § 210.13-01.

(8) *Disclosures About Affiliates Whose Securities Collateralize an Issuance*. Disclosures about a smaller reporting company's affiliates whose securities collateralize any class of securities registered or being registered and the related collateral arrangement must be presented as required by § 210.13-02.

* * * * *

6. Amend § 210.10-01 by adding paragraphs (b)(9) and (b)(10) to read as follows:

§ 210.10-01 Interim Financial Statements.

* * * * *

(9) The requirements of § 210.3-10 are applicable to financial statements for a subsidiary of the registrant that issues securities guaranteed by the registrant or guarantees securities issued by the registrant. Disclosures about guarantors and issuers of guaranteed securities registered or being registered must be presented as required by § 210.13-01.

(10) Disclosures about a registrant’s affiliates whose securities collateralize any class of securities registered or being registered and the related collateral arrangement must be presented

as required by § 210.13-02.

* * * * *

7. Add new subpart Article 13 to Regulation S-X to read as follows:

§ 210.13 Financial and Non-Financial Disclosures for Certain Securities Registered or Being Registered.

8. Add § 210.13-01 to read as follows:

§ 210.13-01 Guarantors and issuers of guaranteed securities registered or being registered.

(a) For each class of guaranteed security registered or being registered for which the registrant is the parent company (as that term is defined in § 210.3-10(b)(1)), provide the following disclosures to the extent material to holders of the guaranteed security:

(1) Identification of the issuers and guarantors of the guaranteed security;

(2) A description of the terms and conditions of the guarantees, and how payments to holders of the guaranteed security may be affected by the composition of and relationships among the issuers, guarantors, and subsidiaries of the parent company that are not issuers or guarantors of the guaranteed security;

(3) A description of other factors that may affect payments to holders of the guaranteed security, such as contractual or statutory restrictions on dividends, guarantee enforceability, or the rights of a noncontrolling interest holder;

(4) Summarized financial information as specified in § 210.1-02(bb)(1) of each issuer and guarantor of the guaranteed security. The summarized financial information of each such issuer and guarantor consolidated in the parent company's consolidated financial statements may be presented on a combined basis with the summarized financial information of the parent company. Intercompany transactions between issuers and guarantors whose summarized financial information is presented on a combined basis

shall be eliminated. If the information provided in response to the requirements of this section is applicable to one or more, but not all, issuers and/or guarantors, separately disclose the summarized financial information applicable to those issuers and/or guarantors. The financial information of subsidiaries that are not issuers or guarantors shall not be combined with that of issuers and guarantors. The method selected to present investments in subsidiaries that are not issuers or guarantors shall be disclosed and used for all such subsidiaries for all of the classes of guaranteed securities for which disclosure is required by this section, and shall be reasonable in the circumstances. Disclose this summarized financial information as of and for the most recently ended fiscal year and interim period included in the parent company's consolidated financial statements. If the disclosure required by this paragraph is omitted because it is not material to holders of the guaranteed security, disclose a statement to that effect and the reasons therefore; and

(5) Any other quantitative or qualitative information that would be material to making an investment decision with respect to the guaranteed security.

Note to paragraph (a): The parent company may elect to provide the disclosures required by this section in a footnote to its consolidated financial statements or alternatively, in management's discussion and analysis of financial condition and results of operations described in Item 303 of Regulation S-K (§ 229.303 of this chapter) in its registration statement covering the offer and sale of the subject securities and any related prospectus, and in Exchange Act reports on Form 10-K, Form 20-F, and Form 10-Q (§ 249.310, § 249.220f, and § 249.308a of this chapter) required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. If not otherwise included in the consolidated financial statements or in management's discussion and analysis of financial

condition and results of operations, the parent company must include the disclosures in its prospectus immediately following "Risk Factors," if any, or otherwise, immediately following pricing information described in Item 503(c) of Regulation S-K (§ 229.503(c) of this chapter). However, the parent company must provide the disclosures in a footnote to its consolidated financial statements in its annual and quarterly reports beginning with its annual report filed on Form 10-K or Form 20-F for the fiscal year during which the first bona fide sale of the subject securities is completed.

9. Add § 210.13-02 to read as follows:

§ 210.13-02 Affiliates whose securities collateralize securities registered or being registered.

(a) For each class of security registered or being registered that is collateralized by a security of the registrant's affiliate or affiliates, provide the following disclosures to the extent material to holders of the collateralized security:

(1) A description of the security pledged as collateral and each affiliate whose security is pledged as collateral;

(2) A description of the terms and conditions of the collateral arrangement, including the events or circumstances that would require delivery of the collateral;

(3) A description of the trading market for the affiliate's security pledged as collateral or a statement that there is no market;

(4) Summarized financial information as specified in § 210.1-02(bb)(1) of each affiliate whose securities are pledged as collateral. The summarized financial information of each such affiliate consolidated in the registrant's financial statements may be presented on a combined basis. Intercompany transactions between affiliates whose summarized financial information is presented on a combined basis shall be eliminated. If the

information provided in response to the requirements of this section is applicable to one or more, but not all, affiliates, separately disclose the summarized financial information applicable to those affiliates. Disclose this summarized financial information as of and for the most recently ended fiscal year and interim period included in the registrant's consolidated financial statements. If the disclosure required by this paragraph is omitted because it is not material to holders of the collateralized security, disclose a statement to that effect and the reasons therefore; and

(5) Any other quantitative or qualitative information that would be material to making an investment decision with respect to the collateralized security.

Note to paragraph (a): The registrant may elect to provide the disclosures required by this section in a footnote to its consolidated financial statements or alternatively, in management's discussion and analysis of financial condition and results of operations described in Item 303 of Regulation S-K (§ 229.303 of this chapter) in its registration statement covering the offer and sale of the subject securities and any related prospectus, and in Exchange Act reports on Form 10-K, Form 20-F, and Form 10-Q (§ 249.310, § 249.220f, and § 249.308a of this chapter) required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. If not otherwise included in the consolidated financial statements or in management's discussion and analysis of financial condition and results of operations, the registrant must include the disclosures in its prospectus immediately following "Risk Factors," if any, or otherwise, immediately following pricing information described in Item 503(c) of Regulation S-K (§ 229.503(c) of this chapter). However, the registrant must provide the disclosures in a footnote to its consolidated financial statements in its annual and quarterly reports beginning with its annual

report filed on Form 10-K or Form 20-F for the fiscal year during which the first bona fide sale of the subject securities is completed.

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K

10. The authority citation for part 229 reads as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78l, 78m, 78n, 78n-1, 78o, 78u-5, 78w, 78ll, 78 mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11 and 7201 *et seq.*; 18 U.S.C. 1350; sec. 953(b), Pub. L. 111-203, 124 Stat. 1904 (2010); and sec. 102(c), Pub. L. 112-106, 126 Stat. 310 (2012).

11. Amend Instruction 6 of § 229.504 to read as follows:

§ 229.504 (Item 504) Use of proceeds.

* * * * *

6. Where the registrant indicates that the proceeds may, or will, be used to finance acquisitions of other businesses, the identity of such businesses, if known, or, if not known, the nature of the businesses to be sought, the status of any negotiations with respect to the acquisition, and a brief description of such business shall be included. Where, however, pro forma financial statements reflecting such acquisition are not required by Regulation S-X (17 CFR 210.01 *et seq.*), including Rule 8-05 for smaller reporting companies, to be included in the registration statement, the possible terms of any transaction, the identification of the parties thereto or the nature of the business sought need not be disclosed, to the extent that the registrant reasonably determines that public disclosure of such information would jeopardize the acquisition. Where Regulation S-X, including Rule 8-04 for smaller reporting companies, as applicable, would require financial

statements of the business to be acquired to be included, the description of the business to be acquired shall be more detailed.

* * * * *

12. Amend paragraphs (c)(2)(ii)(C), (D), and (F) of § 229.1100 to read as follows:

§ 229.1100 (Item 1100) General.

* * * * *

(C) If the third party does not meet the conditions of paragraph (c)(2)(ii)(A) or (c)(2)(ii)(B) of this section and the pool assets relating to the third party are fully and unconditionally guaranteed by a direct or indirect parent of the third party, General Instruction I.C.3 of Form S-3 or General Instruction I.A.5(iii) of Form F-3 is met with respect to the pool assets relating to such third party and the disclosures specified in Rule 13-01 of Regulation S-X (§ 210.13-01) have been provided in the reports to be referenced. Financial statements of the third party may be omitted if the requirements of Rule 3-10 of Regulation S-X (§ 210.3-10) are satisfied.

(D) If the pool assets relating to the third party are guaranteed by a wholly owned subsidiary of the third party and the subsidiary does not meet the conditions of paragraph (c)(2)(ii)(A) or (c)(2)(ii)(B) of this section, the criteria in either paragraph (c)(2)(ii)(A) or paragraph (c)(2)(ii)(B) of this section are met with respect to the third party and the disclosures specified in Rule 13-01 of Regulation S-X (§ 210.13-01) have been provided in the reports to be referenced. Financial statements of the subsidiary guarantor may be omitted if the requirements of Rule 3-10 of Regulation S-X (§ 210.3-10) are satisfied.

* * * * *

(F) The third party is a U.S. government-sponsored enterprise, has outstanding securities held by non-affiliates with an aggregate market value of $75 million or more, and makes information

publicly available on an annual and quarterly basis, including audited financial statements prepared in accordance with generally accepted accounting principles covering the same periods that would be required for audited financial statements under Regulation S-X (§§ 210.1-01 *et seq.*) and non-financial information consistent with that required by Regulation S-K (§§ 229.10 *et seq.* of this chapter).

* * * * *

13. Amend paragraph (b)(2) of § 229.1112 to read as follows:

§ 229.1112 (Item 1112) Significant obligors of pool assets.

* * * * *

(2) If pool assets relating to a significant obligor represent 20% or more of the asset pool, provide financial statements meeting the requirements of Regulation S-X (§§ 210.1-01 *et seq.*), except §210.3-05 of this chapter and Article 11 of Regulation S-X (§§ 210.11-01 *et seq.*), of the significant obligor. Financial statements of such obligor and its subsidiaries consolidated (as required by § 240.14a-3(b)) shall be filed under this item.

* * * * *

14. Amend paragraph (b)(2)(ii) of § 229.1114 to read as follows:

§ 229.1114 (Item 1114) Credit enhancement and other support, except for certain derivatives instruments.

* * * * *

(ii) If any entity or group of affiliated entities providing enhancement or other support described in paragraph (a) of this section is liable or contingently liable to provide payments representing 20% or more of the cash flow supporting any offered class of the asset-backed securities, provide financial statements meeting the requirements of Regulation S-X (§§ 210.1-01 *et seq.*), except §210.3-05 and Article 11 of Regulation S-X (§§ 210.11-01 *et seq.*), of such entity or group of

affiliated entities. Financial statements of such enhancement provider and its subsidiaries consolidated (as required by § 240.14a-3(b)) shall be filed under this item.

* * * * *

15. Amend paragraph (b)(2) of § 229.1115 to read as follows:

§ 229.1115 (Item 1115) Certain derivatives instruments.

* * * * *

(2) If the aggregate significance percentage related to any entity or group of affiliated entities providing derivative instruments contemplated by this section is 20% or more, provide financial statements meeting the requirements of Regulation S-X (§§ 210.1-01 *et seq.*), except § 210.3-05 of this chapter and Article 11 of Regulation S-X (§§ 210.11-01 *et seq.*), of such entity or group of affiliated entities. Financial statements of such entity and its subsidiaries consolidated (as required by § 240.14a-3(b)) shall be filed under this item.

* * * * *

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

16. The authority citation for part 239 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m,78n, 78o(d), 78o-7, 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37; and sec. 107, Pub. L. 112-106, 126 Stat. 312, unless otherwise noted.

17. Amend paragraph (b) of § 239.31 to read as follows:

§ 239.31 Form F-1, registration statement under the Securities Act of 1933 for securities of certain foreign private issuers.

* * * * *

(b) If a registrant is a majority-owned subsidiary, which does not itself meet the conditions of

these eligibility requirements, it shall nevertheless be deemed to have met such conditions if its parent meets the conditions and if the parent fully guarantees the securities being registered as to principal and interest. Note: In such an instance the parent-guarantor is the issuer of a separate security consisting of the guarantee which must be concurrently registered but may be registered on the same registration statement as are the guaranteed securities. Both the parent-guarantor and the subsidiary shall each disclose the information required by this Form as if each were the only registrant except that if the subsidiary will not be eligible to file annual reports on Form 20-F after the effective date of the registration statement, then it shall disclose the information specified in Form S-1 (§ 239.11 of this chapter). The requirements of Rule 3-10 of Regulation S-X (§ 210.3-10 of this chapter) are applicable to financial statements for a subsidiary of a parent company that issues securities guaranteed by the parent company.

18. Amend Form F-1 (referenced in § 239.31) by revising Instruction I.B under "General Instructions" to read as follows:

Note: The text of Form F-1 does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM F-1

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form F-1

* * * * *

B. If a registrant is a majority-owned subsidiary, which does not itself meet the conditions of

these eligibility requirements, it shall nevertheless be deemed to have met such conditions if its parent meets the conditions and if the parent fully guarantees the securities being registered as to principal and interest. Note: In such an instance the parent-guarantor is the issuer of a separate security consisting of the guarantee which must be concurrently registered but may be registered on the same registration statement as are the guaranteed securities. Both the parent-guarantor and the subsidiary shall each disclose the information required by this Form as if each were the only registrant except that if the subsidiary will not be eligible to file annual reports on Form 20-F after the effective date of the registration statement, then it shall disclose the information specified in Forms S-1 (§ 239.11 of this chapter). The requirements of Rule 3-10 of Regulation S-X (§ 210.3-10 of this chapter) are applicable to financial statements for a subsidiary of a parent company that issues securities guaranteed by the parent company.

* * * * *

19. Amend Note to paragraph (a)(5) of § 239.33 to read as follows:

§ 239.33 Form F-3, for registration under the Securities Act of 1933 of securities of certain foreign private issuers offered pursuant to certain types of transactions.

* * * * *

Note to paragraph (a)(5): In the situations described in paragraphs (a)(5)(iii), (a)(5)(iv), and (a)(5)(v) of this section, the parent or majority-owned subsidiary guarantor is the issuer of a separate security consisting of the guarantee, which must be concurrently registered, but may be registered on the same registration statement as are the guaranteed non-convertible securities. Both the parent and majority-owned subsidiary shall each disclose the information required by this Form as if each were the only registrant except that if the majority-owned subsidiary will not be eligible to file annual reports on Form 20-F or Form 40-F (§ 249.220f or § 249.240f of this chapter) after the effective date of the registration statement, then it shall disclose the

information specified in Form S-3 (§ 239.13). The requirements of Rule 3-10 of Regulation S-X are applicable to financial statements of a subsidiary of a parent company that issues securities guaranteed by the parent company or guarantees securities issued by the parent company.

* * * * *

20. Amend Form F-3 (referenced in § 239.33) by revising the note to Instruction I.A.5 under "General Instructions" to read as follows:

Note: The text of Form F-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM F-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

GENERAL INSTRUCTIONS

* * * * *

I. Eligibility Requirements for Use of Form F-3

* * * * *

A. Registration Requirements

* * * * *

5. Majority-owned Subsidiaries. If a registrant is a majority-owned subsidiary, security offerings may be registered on this Form if:

* * * * *

Note: In the situation described in paragraphs I.A.5(iii), I.A.5(iv), and I.A.5(v) above, the parent or majority-owned subsidiary guarantor is the issuer of a separate security consisting of the

guarantee, which must be concurrently registered, but may be registered on the same registration statement as are the guaranteed non-convertible securities. Both the parent or majority-owned subsidiary shall each disclose the information required by this Form as if each were the only registrant except that if the majority-owned subsidiary will not be eligible to file annual reports on Form 20-F or Form 40-F after the effective date of the registration statement, then it shall disclose the information specified in Form S-3. The requirements of Rule 3-10 of Regulation S-X are applicable to financial statements for a subsidiary of a parent company that issues securities guaranteed by the parent company or guarantees securities issued by the parent company.

* * * * *

21. Amend Form 1-A (referenced in § 239.90) by revising paragraph (b)(7) of Part F/S to read as follows:

Note: The text of Form 1-A does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 1-A

REGULATION A OFFERING STATEMENT UNDER THE SECURITIES ACT OF 1933

* * * * *

Part F/S

* * * * *

(b) Financial Statements for Tier 1 Offerings

* * * * *

(7) *Financial Statements of and Disclosures About Other Entities.* The circumstances described

below may require you to file financial statements of, or provide disclosures about, other entities in the offering statement. The financial statements of other entities must be presented for the same periods as if the other entity was the issuer as described above in paragraphs (b)(3) and (b)(4) unless a shorter period is specified by the rules below. The financial statements of other entities shall follow the same audit requirement as paragraph (b)(2) of this Part F/S:

(i) *Financial Statements of and Disclosures About Guarantors and Issuers of Guaranteed Securities.* The requirements of Rule 3-10 of Regulation S-X are applicable to financial statements of a subsidiary that issues securities guaranteed by the "parent company," as that term is defined in Rule 3-10 of Regulation S-X, or guarantees securities issued by the parent company. However, the reference in Rule 3-10(a) of Regulation S-X to "an issuer or guarantor of a guaranteed security that is registered or being registered is required to file financial statements required by Regulation S-X with respect to the guarantee or guaranteed security" instead refers to "an issuer or guarantor of a guaranteed security that is qualified or being qualified pursuant to Regulation A is required to file financial statements required by Part F/S of Form 1-A with respect to the guarantee or guaranteed security." The parent company must also provide the disclosures required by Rule 13-01 of Regulation S-X. The parent company may elect to provide these disclosures in a footnote to its consolidated financial statements or alternatively, in management's discussion and analysis of financial condition and results of operations described in Item 9 of Form 1-A in its offering statement on Form 1-A filed in connection with the offer and sale of the subject securities.

(ii) *Disclosures About Affiliates Whose Securities Collateralize an Issuance.* Disclosures about an issuer's affiliates whose securities collateralize any class of securities being offered must be provided as required by Rule 13-02 of Regulation S-X. The issuer may elect to provide

these disclosures in a footnote to its consolidated financial statements or alternatively, in management's discussion and analysis of financial condition and results of operations described in Item 9 of Form 1-A in its offering statement on Form 1-A filed in connection with the offer and sale of the subject securities.

* * * * *

22. Amend Form 1-K (referenced in § 239.91) by revising paragraph Item 7(g) of Part II to read as follows:

Note: The text of Form 1-K does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 1-K

* * * * *

PART II

* * * * *

Item 7. Financial Statements

* * * * *

(g) *Financial Statements of and Disclosures About Other Entities.* The circumstances described below may require you to file financial statements of, or provide disclosures about, other entities. The financial statements of other entities must be presented for the same periods as the issuer's financial statements described above in paragraphs (d) and (e) unless a shorter period is specified by the rules below.

(1) *Financial Statements of and Disclosures About Guarantors and Issuers of Guaranteed Securities.* The requirements of Rule 3-10 of Regulation S-X are applicable to financial statements of a subsidiary that issues securities guaranteed by the "parent company," as that term

is defined in Rule 3-10 of Regulation S-X, or guarantees securities issued by the parent company. However, the reference in Rule 3-10(a) of Regulation S-X to "an issuer or guarantor of a guaranteed security that is registered or being registered is required to file financial statements required by Regulation S-X with respect to the guarantee or guaranteed security" instead refers to "an issuer or guarantor of a guaranteed security that is qualified or being qualified pursuant to Regulation A is required to file financial statements required by Item 7 of Part II of Form 1-K with respect to the guarantee or guaranteed security." The parent company must also provide the disclosures required by Rule 13-01 of Regulation S-X. The parent company may elect to provide these disclosures in a footnote to its consolidated financial statements or alternatively, in management's discussion and analysis of financial condition and results of operations described in Item 9 of Form 1-A in reports on Form 1-K and Form 1-SA required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. However, the parent company must provide the disclosures in a footnote to its consolidated financial statements in its annual and semiannual reports beginning with its annual report filed on Form 1-K for the fiscal year during which the first bona fide sale of the subject securities is completed.

(2) *Disclosures About Affiliates Whose Securities Collateralize an Issuance.* Disclosures about an issuer's affiliates whose securities collateralize any class of securities being offered must be provided as required by Rule 13-02 of Regulation S-X. The issuer may elect to provide these disclosures in a footnote to its consolidated financial statements or alternatively, in management's discussion and analysis of financial condition and results of operations described in Item 9 of Form 1-A in reports on Form 1-K and Form 1-SA required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. However, the

issuer must provide the disclosures in a footnote to its consolidated financial statements in its annual and semiannual reports beginning with its annual report filed on Form 1-K for the fiscal year during which the first bona fide sale of the subject securities is completed.

* * * * *

23. Amend Form 1-SA (referenced in § 239.92) by revising Item 3(e) to read as follows:

Note: The text of Form 1-SA does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 1-SA

* * * * *

INFORMATION TO BE INCLUDED IN REPORT

* * * * *

Item 3. Financial Statements

* * * * *

(e) Financial Statements of and Disclosures About Other Entities. The circumstances described below may require you to file financial statements of, or provide disclosures about, other entities. These financial statements and disclosures may be unaudited.

(1) Financial Statements of and Disclosures About Guarantors and Issuers of Guaranteed Securities. The requirements of Rule 3-10 of Regulation S-X are applicable to financial statements of a subsidiary that issues securities guaranteed by the "parent company," as that term is defined in Rule 3-10 of Regulation S-X, or guarantees securities issued by the parent company. However, the reference in Rule 3-10(a) of Regulation S-X to "an issuer or guarantor of a guaranteed security that is registered or being registered is required to file financial

statements required by Regulation S-X with respect to the guarantee or guaranteed security" instead refers to "an issuer or guarantor of a guaranteed security that is qualified or being qualified pursuant to Regulation A is required to file financial statements required by Item 3 of Form 1-SA with respect to the guarantee or guaranteed security." The parent company must also provide the disclosures required by Rule 13-01 of Regulation S-X. The parent company may elect to provide these disclosures in a footnote to its consolidated financial statements or alternatively, in management's discussion and analysis of financial condition and results of operations described in Item 9 of Form 1-A in reports on Form 1-K and Form 1-SA required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. However, the parent company must provide the disclosures in a footnote to its consolidated financial statements in its annual and semiannual reports beginning with its annual report filed on Form 1-K for the fiscal year during which the first bona fide sale of the subject securities is completed.

(2) Disclosures About Affiliates Whose Securities Collateralize an Issuance. Disclosures about an issuer's affiliates whose securities collateralize any class of securities being offered must be provided as required by Rule 13-02 of Regulation S-X. The issuer may elect to provide these disclosures in a footnote to its consolidated financial statements or alternatively, in management's discussion and analysis of financial condition and results of operations described in Item 9 of Form 1-A in reports on Form 1-K and Form 1-SA required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. However, the issuer must provide the disclosures in a footnote to its consolidated financial statements in its annual and semiannual reports beginning with its annual report filed on Form 1-K for the fiscal year during which the first bona fide sale of the subject securities is completed.

PART 240 — GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

24. The authority citation for part 240 reads as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq.; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1887 (2010); and secs. 503 and 602, Pub. L. 112-106, 126 Stat. 326 (2012), unless otherwise noted.

25. Amend § 240.12h-5 to read as follows:

§ 240.12h-5 Exemption for subsidiary issuers of guaranteed securities and subsidiary guarantors.

Any issuer of a guaranteed security, or guarantor of a security, that is permitted to omit financial statements by § 210.3-10 of Regulation S-X of this chapter is exempt from the requirements of Section 13(a) or 15(d) of the Act (15 U.S.C. 78m(a) or 78o(d)).

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

26. The authority citation for part 249 reads as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.;* 12 U.S.C. 5461 *et seq.;* 18 U.S.C. 1350; Sec. 953(b), Pub. L. 111-203, 124 Stat. 1904; Sec. 102(a)(3), Pub. L. 112-106, 126 Stat. 309 (2012); Sec. 107, Pub. L. 112-106, 126 Stat. 313 (2012), and Sec. 72001, Pub. L. 114-94, 129 Stat. 1312 (2015), unless otherwise noted.

27. Amend Form 20-F (referenced in § 249.220f) by revising Instruction 1 to Item 8 to read as follows:

Note: The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

* * * * *

Instructions to Item 8:

1. This item refers to the company, but note that under Rules 3-05, 3-09, 3-10, and 3-14 and Article 13 of Regulation S-X, you also may have to provide financial statements or financial information for entities other than the issuer. In some cases, you may have to provide financial statements for a predecessor. See the definition of "predecessor" in Exchange Act Rule 12b-2 and Securities Act Rule 405.

* * * * *

By the Commission.

July 24, 2018

Brent J. Fields

Secretary

Note: Appendix A to the preamble will not appear in the Code of Federal Regulations.

APPENDIX A

FINANCIAL DISCLOSURES ABOUT GUARANTORS AND ISSUERS OF GUARANTEED SECURITIES AND AFFILIATES WHOSE SECURITIES COLLATERALIZE A REGISTRANT'S SECURITIES

For ease of reference, set forth below is a table summarizing the main features of existing Rule 3-10 and Rule 3-16 and the proposed rules. This is only a summary of certain requirements contained in the Commission's rules and regulations, as well as a summary of certain proposed rules; it is not a substitute for the rules and regulations or for the proposed rules. Registrants should refer to the existing rules and to the proposed rule text for the full requirements and the description of those requirements in the release. The changes we are proposing include amending both rules and relocating part of Rule 3-10 and all of Rule 3-16 to new Article 13 in Regulation S-X, which would comprise proposed Rules 13-01 and 13-02.

	Summary of Existing Rule 3-10	**Summary of Proposed Rules**
Financial Statement Requirement & Omission of Subsidiary Issuer and Guarantor Financial Statements	Rule 3-10(a) states that every issuer of a registered security that is guaranteed and every guarantor of a registered security must file the financial statements required for a registrant by Regulation S-X. Rules 3-10(b) – (f) set forth five exceptions to this general rule, which permit the omission of separate financial statements of subsidiary issuers and guarantors when certain conditions are met, including that the parent company provides the Alternative Disclosures.	Each issuer of a registered security that is guaranteed and each guarantor of a registered security must file the financial statements required for a registrant by Regulation S-X; however, proposed Rule 3-10(a) would no longer contain this express statement. Proposed Rule 3-10(a) would continue to permit the omission of separate financial statements of subsidiary issuers and guarantors when certain conditions are met, including that the parent company provides the Proposed Alternative Disclosures.

Rule Structure & Eligible Issuer and Guarantor Structures	Rules 3-10(b) through (f) set forth the five exceptions. Each exception specifies the eligible structures to which it applies, and the conditions that must be met. In each case, the parent company must provide the Alternative Disclosures. Eligible issuer and guarantor structures: • a finance subsidiary issues securities that its parent company guarantees (Rule 3-10(b)); • an operating subsidiary issues securities that its parent company guarantees (Rule 3-10(c)); • a subsidiary issues securities that its parent company and one or more other subsidiaries of its parent company guarantee (Rule 3-10(d)); • a parent company issues securities that one of its subsidiaries guarantees (Rule 3-10(e)); or • a parent company issues securities that more than one of its subsidiaries guarantees (Rule 3-10(f)).	The proposed rules would replace the exceptions in existing Rule 3-10(b) through (f). Proposed Rule 3-10(a) would permit the separate financial statements of a subsidiary issuer or guarantor to be omitted if the eligibility conditions in proposed Rules 3-10(a) and 3-10(a)(1) are met and the Proposed Alternative Disclosures specified in proposed Rule 13-01 are provided in the filing, as required by proposed Rule 3-10(a)(2). Proposed Rule 3-10(a)(1) sets forth the eligible structures. Eligible issuer and guarantor structures: • the parent company issues the security or co-issues the security, jointly and severally, with one or more of its consolidated subsidiaries (Proposed Rule 3-10(a)(1)(i)); or • a consolidated subsidiary issues the security, or co-issues it with one or more other consolidated subsidiaries of the parent company, and the security is guaranteed fully and unconditionally by the parent company (Proposed Rule 3-10(a)(1)(ii)). The role of subsidiary guarantors would not be specified in the proposed categories of structures; however, the proposed rules are intended to cover the structures permitted in existing Rules 3-10(b) through (f).

Conditions to Omit Separate Subsidiary Issuer and Guarantor Financial Statements	If an issuer and guarantor structure matches one of the exceptions in Rules 3-10(b) through (f), the conditions in the applicable exception paragraph must be met, including: • consolidated financial statements of the parent company have been filed; • each subsidiary issuer and guarantor is "100% owned" by the parent company; • each guarantee is "full and unconditional" and, where there are multiple guarantees, joint and several; and • the parent company provides the Alternative Disclosures in its financial statement footnotes. Additionally, the 2000 Release states the guaranteed security must be debt or debt-like.	The applicable conditions, set forth in proposed Rule 3-10, include: • consolidated financial statements of the parent company have been filed (proposed Rule 3-10(a)); • the subsidiary issuer or guarantor is a consolidated subsidiary of the parent company (proposed Rule 3-10(a)); • the guaranteed security is debt or debt-like (proposed Rule 3-10(a)(1)); • the issuer and guarantor structure must match one of the eligible issuer and guarantor structures (proposed Rule 3-10(a)(1)(i) or (ii)); and • the parent company provides the Proposed Alternative Disclosures (proposed Rule 3-10(a)(2)).
Parent Company Financial Statements Condition	The identity of the parent company will vary based on the particular corporate structure; however, the 2000 Release stated three conditions must be met before an entity can be considered a "parent company," including that the entity: • is an issuer or guarantor of the subject securities; • is an Exchange Act reporting company, or will be one as a result of the subject Securities Act registration statement; and • owns 100% of each subsidiary issuer or guarantor directly or indirectly.	"Parent company" would be defined in proposed Rule 3-10(b)(1) and require that the entity: • is an issuer or guarantor of the guaranteed security; • is an Exchange Act reporting company, or will become one as a result of the subject Securities Act registration statement; and • consolidates each subsidiary issuer and/or guarantor in its consolidated financial statements.

Ownership Condition	The exceptions in Rules 3-10(b) through (f) require that each subsidiary issuer or guarantor must be 100% owned by the parent company to omit its separate financial statements.	Proposed Rule 3-10(a) would require that the subsidiary issuer or guarantor be a consolidated subsidiary of the parent company pursuant to the relevant accounting standards already in use. Proposed Rule 13-01(a)(3) would require, to the extent material, a description of any factors that may affect payments to holders of the guaranteed security, such as the rights of a non-controlling interest holder. Proposed Rule 13-01(a)(4) would require separate disclosure of Summarized Financial Information for subsidiary issuers and guarantors affected by those factors.
Debt or Debt-Like Security Definition:	Rule 3-10 does not define when a security is "debt or debt-like;" however, the 2000 Release described characteristics of a debt or debt-like security, including: • the issuer has a contractual obligation to pay a fixed sum at a fixed time; and • where the obligation to make such payments is cumulative, a set amount of interest must be paid.	Proposed Rule 3-10(a)(1) would state explicitly that the guaranteed security must be "debt or debt-like" and proposed Rule 3-10(b)(2) would state that a guaranteed security would be considered "debt or debt-like" if: • the issuer has a contractual obligation to pay a fixed sum at a fixed time; and • where the obligation to make such payments is cumulative, a set amount of interest must be paid.
Subsidiary Guarantee	The exceptions in Rule 3-10(b) through (f) specify that a guarantee be full and unconditional and,	The parent company's role with respect to the guaranteed security would determine whether the

Eligibility Requirements	when there are multiple guarantees, be joint and several. The requirements are imposed on the guarantee regardless of whether the guarantor is the parent company or a subsidiary.	structure is eligible to provide the Proposed Alternative Disclosures. The parent company must be the issuer or full and unconditional guarantor of the guaranteed security (proposed Rules 3-10(a)(1)(i) and (ii)). If a subsidiary guarantee is not full and unconditional, or where there are multiple guarantees, not joint and several, disclosure of such terms and conditions would be required by proposed Rule 13-01(a)(2), to the extent material. Proposed Rule 13-01(a)(4) would require separate disclosure of the Summarized Financial Information for subsidiary guarantor(s) to which such terms and conditions apply, to the extent material.
Alternative Disclosures & Proposed Alternative Disclosures	To be eligible to omit the separate financial statements of a subsidiary issuer or guarantor, each exception in Rules 3-10(b) through (f) requires that the parent company must provide the Alternative Disclosures in the footnotes to its consolidated financial statements. The form and content of the Alternative Disclosures are determined based on the facts and circumstances and are either a brief narrative or Consolidating Information. Specific elements of Consolidating Information are discussed below. Alternative Disclosures may consist of a brief narrative instead of Consolidating Information when:	The proposed rule would replace the brief narrative form and Consolidating Information form of Alternative Disclosure with the Proposed Alternative Disclosures specified in proposed Rule 13-01. Specific elements of the Proposed Alternative Disclosures are discussed below. The Proposed Alternative Disclosures would be required in all cases, to the extent material to holders of the guaranteed security (proposed Rule 13-01(a)). Additionally, proposed Rule 13-01(a)(5) would require disclosure of any quantitative or qualitative information that would be material to making an investment decision with respect to the guaranteed security.

	• the subsidiary is a finance subsidiary, and the parent company is the only guarantor of the securities; • the parent company of the subsidiary issuer has no independent assets or operations, the parent company guarantees the securities, no subsidiary of the parent company guarantees the securities, and any subsidiaries of the parent company other than the issuer are minor; and • the parent company issuer has no independent assets or operations and all of the parent company's subsidiaries, other than minor subsidiaries, guarantee the securities.	
Consolidating Information and Proposed Alternative Disclosures – Level of Detail	The instructions for preparing Consolidating Information are specified in Rule 3-10(i). Consolidating Information includes all major captions of the balance sheet, income statement, and cash flow statement that are required to be shown separately in interim financial statements prepared under Article 10 of Regulation S-X. Rules 3-10(i)(11)(i) and (ii), respectively, require disclosure of any financial and narrative information about each guarantor if it would be material for investors to evaluate the sufficiency of the guarantee, and disclosure of sufficient information to make the financial information presented not misleading.	The proposed rule would require the Proposed Alternative Disclosures specified in proposed Rule 13-01. Proposed Rule 13-01(a)(4) would require, for each issuer and guarantor, Summarized Financial Information, as specified in Rule 1-02(bb) of Regulation S-X, which would include select balance sheet and income statement line items. Disclosure of additional line items of financial information beyond what is specified in proposed Rule 13-01(a)(4) would be required by proposed Rule 13-01(a)(5), to the extent material. If the disclosures required by proposed Rule 13-01(a)(4) are omitted because they are immaterial, proposed Rule 13-01(a)(4) requires disclosure to that effect and the reasons.

Consolidating Information and Proposed Alternative Disclosures – Combined Basis	The applicable exception in Rule 3-10(c) through (f) specifies the columns of information that must be presented, and Rule 3-10(i)(6) describes circumstances when additional columns are required. To distinguish the assets, liabilities, operations, and cash flows of the entities that are legally obligated to make payments under the guarantee from those that are not, the columnar presentation must show: • a parent company's investments in all consolidated subsidiaries based upon its proportionate share of their net assets (Rule 3-10(i)(3)); and • subsidiary issuer and guarantor investments in certain consolidated subsidiaries using the equity method of accounting (Rule 3-10(i)(5).	Proposed Rule 13-01(a)(4) would permit the Summarized Financial Information of each issuer and guarantor consolidated in the parent company's consolidated financial statements to be presented on a combined basis with the Summarized Financial Information of the parent company. However, if information provided in response to disclosures specified in proposed Rule 13-01 is applicable to one or more, but not all, issuers and guarantors, proposed Rule 13-01(a)(4) would require, to the extent it is material, separate disclosure of Summarized Financial Information for the issuers and guarantors to which the information applies. The proposed rule would no longer require separate disclosure of the financial information of non-guarantor subsidiaries. Proposed Rule 13-01(a)(4) would allow the parent company to determine which method best meets the objective of excluding the financial information of non-issuer and non-guarantor subsidiaries from the Proposed Alternative Disclosures, so long as the selected method is disclosed and used for all non-issuer and non-guarantor subsidiaries for all classes of guaranteed securities for which the disclosure is required, and is reasonable in the circumstances.

Consolidating Information and Proposed Alternative Disclosures – Periods to Present	Consolidating Information must be provided as of, and for, the same periods as the parent company's consolidated financial statements (Rule 3-10(i)(2)).	Proposed Rule 13-01(a)(4) would require Summarized Financial Information to be provided as of, and for, the most recently ended fiscal year and year-to-date interim period, if applicable, included in the parent company's consolidated financial statements.
Consolidating Information and Proposed Alternative Disclosures – Non-Financial Disclosures	Rule 3-10 requires certain non-financial disclosures, including: • disclosure, if true, that each subsidiary issuer or subsidiary guarantor is 100% owned by the parent company, that all guarantees are full and unconditional, and where there is more than one guarantor, that all guarantees are joint and several (Rules 3-10(i)(8)(i) – (iii); • restricted net assets (Rule 3-10(i)(10); and • certain types of restrictions on the ability of the parent company or any guarantor to obtain funds from their subsidiaries (Rule 3-10(i)(9). Rules 3-10(i)(11)(i) and (ii), respectively, require disclosure of any financial and narrative information about each guarantor if it would be	Proposed Rules 13-01(a)(1) through (3) would require disclosures, to the extent material, about the issuers and guarantors, the terms and conditions of the guarantees, and how the issuer and guarantor structure and other factors may affect payments to holder of the guaranteed securities. Additionally, proposed Rule 13-01(a)(5) would require disclosure of any facts and circumstances specific to particular issuers and guarantors that would be material to holders of the guaranteed security that are not specifically required by proposed Rules 13-01(a)(1) through (3).

	material for investors to evaluate the sufficiency of the guarantee, and disclosure of sufficient information to make the financial information presented not misleading.	
Location and Audit Requirement of Alternative Disclosures and Proposed Alternative Disclosure	The exceptions in Rules 3-10(b) through (f) require the Alternative Disclosures to be included in the notes to the parent company's consolidated financial statements. Rule 3-10(i)(2) requires Consolidating Information to be audited for the same periods that the parent company financial statements are required to be audited.	The note to proposed Rule 13-01(a) would allow the parent company to provide the Proposed Alternative Disclosures in a footnote to its consolidated financial statements or alternatively, in MD&A in its registration statement covering the offer and sale of the subject securities and any related prospectus, and in Exchange Act reports on Form 10-K, Form 20-F, and Form 10-Q required to be filed during the fiscal year in which the first bona fide sale of the subject securities is completed. If a parent company elects to provide the disclosures in its audited financial statements, the Proposed Alternative Disclosures would be required to be audited. If not otherwise included in the consolidated financial statements or in MD&A, the parent company would be required to include the Proposed Alternative Disclosures in its prospectus immediately following "Risk Factors," if any, or otherwise, immediately following pricing information described in Item 503(c) of Regulation S-K. The parent company would be required to provide the Proposed Alternative Disclosures in a footnote to its consolidated financial statements in its annual and quarterly reports beginning with its annual report filed on Form 10-K or Form 20-F for the

		fiscal year during which the first bona fide sale of the subject securities is completed.
Recently-Acquired Subsidiary Issuers and Guarantors	If a parent company acquires a new subsidiary issuer or guarantor, Rule 3-10(g) requires the parent company to provide one year of audited pre-acquisition financial statements of the newly-acquired issuer or guarantor (and, if applicable, unaudited interim financial statements) when the: • parent company acquires the new subsidiary during or subsequent to one of the periods for which financial statements are presented in a Securities Act registration statement filed in connection with the offer and sale of the debt securities; • subsidiary is deemed "significant" (Rule 3-10(g)(1)(ii); and • subsidiary is not reflected in the audited consolidated results of the parent company for at least nine months of the most recent fiscal year (Rule 3-10(g)(1)).	The proposed rule would not include this requirement. Proposed Rule 13-01(a)(5) would require information about recently-acquired subsidiary issuers and guarantors if it would be material to an investment decision in the guaranteed security.
Exchange Act Reporting and Continuous Reporting Obligation	Subsidiary issuers and guarantors that avail themselves of an exception that allows for the Alternative Disclosures in lieu of separate financial statements are exempt from Exchange Act reporting by Rule 12h-5. The parent company, however, must continue to provide the Alternative Disclosures for as long as the guaranteed securities	Subsidiary issuers and guarantors that are permitted to omit their financial statements under proposed Rule 3-10 would continue to be exempt from Exchange Act reporting under Rule 12h-5. The proposed rule would permit a parent company to cease providing the Proposed Alternative Disclosures if the corresponding

	are outstanding. This obligation continues even if the subsidiary issuers and guarantors could have suspended their reporting obligations under Exchange Act Rule 12h-3 or Section 15(d) of the Exchange Act, had they chosen not to avail themselves of a Rule 3-10 exception and reported separately from the parent company.	subsidiary issuer's or guarantor's Section 15(d) obligation is suspended automatically by operation of Section 15(d)(1) or through compliance with Rule 12h-3. As a continued condition of eligibility to omit the financial statements of a subsidiary issuer or guarantor, a parent company must continue providing the Proposed Alternative Disclosures for so long as the subsidiary issuer or guarantor has a Section 12(b) reporting obligation with respect to the guarantee or guaranteed security.
	Summary of Existing Rule 3-16	**Summary of Proposed Rules**
Rule 3-16 Financial Statements and Proposed Disclosures	Rule 3-16(a) requires a registrant to provide separate annual and interim financial statements for each affiliate whose securities constitute a "substantial portion" of the collateral for any class of securities registered or being registered as if the affiliate were a separate registrant.	Under the proposed amendments, Rule 3-16 Financial Statements would be replaced with a requirement that a registrant provide the financial and non-financial disclosures about the affiliate(s) and the collateral arrangement specified in proposed Rule 13-02(a).
When Disclosure is Required	Rule 3-16 Financial Statements are required when an affiliate's securities constitute a "substantial portion" of the collateral for the securities registered or being registered. An affiliate's securities shall be deemed to constitute a "substantial portion" if the aggregate principal amount, par value, or book value of the securities as carried by the registrant, or the market value of such securities, whichever is the greatest, equals 20	Proposed Rule 13-02(a) would require the disclosures specified in proposed Rule 13-02(a)(1) through (4) in all cases, to the extent material to holders of the collateralized security. Additionally, proposed Rule 13-02(a)(5) would require disclosure of any quantitative or qualitative information that would be material to making an investment decision with respect to the collateralized security.

	percent or more of the principal amount of the secured class of securities (Rule 3-16(b)).	
Financial and Non-Financial Disclosures	Rule 3-16 Financial Statements are those that would be required if the affiliate were a separate registrant.	Proposed Rule 13-02(a)(4) would require, for each affiliate whose securities are pledged as collateral, Summarized Financial Information, as specified in Rule 1-02(bb) of Regulation S-X, which would include select balance sheet and income statement line items. Disclosure of additional line items of financial information beyond what is specified in proposed Rule 13-02(a)(4) would be required by proposed Rule 13-02(a)(5), to the extent material. If the disclosures required by proposed Rule 13-02(a)(4) are omitted because they are immaterial, proposed Rule 13-02(a)(4) requires disclosure to that effect and the reasons therefore. Proposed Rules 13-02(a)(1) through (3) would require certain non-financial disclosures, to the extent material, about the securities pledged as collateral, each affiliate whose securities are pledged, the terms and conditions of the collateral arrangement, and whether a trading market exists for the pledged securities. Additionally, proposed Rule 13-02(a)(5) would require disclosure of any other quantitative or qualitative information that would be material to making an investment decision with respect to the collateralized security.

Combined Basis	Separate Rule 3-16 Financial Statements are required for each affiliate whose securities constitute a "substantial portion" of the collateral for securities registered or being registered.	Proposed Rule 13-02(a)(4) would permit the Summarized Financial Information of each affiliate consolidated in the registrant's consolidated financial statements to be presented on a combined basis. However, if information provided in response to disclosures specified in proposed Rule 13-02 is applicable to one or more, but not all, affiliates, proposed Rule 13-02(a)(4) would require, to the extent it is material, separate disclosure of Summarized Financial Information for the affiliates to which the information applies.
Periods Presented	Rule 3-16 Financial Statements are required for the same annual and interim periods as if the affiliate were a separate registrant. As such, the financial statements are required to be provided for the periods required by Rules 3-01 and 3-02 of Regulation S-X. However, Rule 3-16 Financial Statements are not required in quarterly reports, such as Form 10-Q.	Proposed Rule 13-02(a)(4) would require disclosure as of and for the most recently ended fiscal year and interim period included in the registrant's consolidated financial statements. Disclosure would be required in quarterly reports, such as Form 10-Q (proposed Rule 10-01(b)(10)).
Location and Audit Requirement of the Disclosure	Rule 3-16 Financial Statements are required to be audited for the periods required by Rules 3-01 and 3-02 of Regulation S-X.	The note to proposed Rule 13-02(a) would allow the registrant to provide the disclosures required by this section in a footnote to its consolidated financial statements or alternatively, in MD&A in its registration statement covering the offer and sale of the subject securities and any related prospectus, and in Exchange Act reports on Form 10-K, Form 20-F, and Form 10-Q required to be

		filed during the fiscal year in which the first bona fide sale of the subject securities is completed. If a registrant elects to provide the disclosures in its audited financial statements, the proposed disclosures would be required to be audited. If not otherwise included in the consolidated financial statements or in MD&A, the registrant would be required to include the disclosures in its prospectus immediately following "Risk Factors," if any, or otherwise, immediately following pricing information described in Item 503(c) of Regulation S-K. The registrant would be required to provide the disclosures in a footnote to its consolidated financial statements in its annual and quarterly reports beginning with its annual report filed on Form 10-K or Form 20-F for the fiscal year during which the first bona fide sale of the subject securities is completed.