



# New Developments Summary

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## SEC simplifies financial disclosures in certain registered debt offerings

Final rule affects disclosures related to guarantors and collateralizations

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The SEC recently adopted the Final Rule, *Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities*, to eliminate certain prescriptive requirements currently in Rules 3-10 and 3-16 of Regulation S-X, and to focus instead on material, relevant, and decision-useful information. The amendments are intended to reduce burdens on registrants and to encourage issuers to offer guaranteed and collateralized securities on a registered basis, thereby reducing the cost of capital while increasing investor protection.

The Final Rule is effective on January 4, 2021. Early compliance is permitted.

## A. Overview

The [Final Rule](#) amends Regulation S-X, Rule 3-10, *Financial statements of guarantors and issuers of guaranteed securities registered or being registered*, and S-X Rule 3-16, *Financial statements of affiliates whose securities collateralize an issue registered or being registered*; relocates the disclosure requirements associated with issuers and guarantors of guaranteed securities in S-X Rule 3-10 to new S-X Rule 13-01, *Guarantors and issuers of guaranteed securities registered or being registered*; and also relocates all content in S-X Rule 3-16 to new S-X Rule 13-02, *Affiliates whose securities collateralize securities registered or being registered*.

These changes are based on the overarching principle that investors rely primarily on the consolidated financial statements of the parent company, as supplemented by information about subsidiary issuers and guarantors or affiliates whose securities are pledged in making their investment decisions.

The Final Rule simplifies the conditions required to omit separate financial statements of subsidiary issuers and guarantors, allows for reduced supplemental financial information about subsidiary issuers and guarantors as well as affiliates whose securities are collateralized, and expands qualitative disclosures about the guarantees or securities pledged as collateral as well as issuers, guarantors, or affiliates, as applicable. The amended rules also provide flexibility to include these disclosures within or outside the annual and interim financial statements in both registration statements and periodic reports. Further, the disclosures are required only for the most recent annual and year-to-date interim periods and only for as long as the issuer and guarantor have reporting obligations under the Securities Exchange Act of 1934 (Exchange Act) with respect to the guaranteed securities.

Consistent with the existing S-X Rules 3-10 and 3-16, the amended rules also apply to foreign private issuers, smaller reporting companies, and Regulation A issuers.

The Final Rule includes an Appendix (starting on page 250) summarizing the existing rules compared to the amended rules.

## B. Guarantors and issuers of registered guaranteed securities

### **Eligibility to omit separate financial statements**

S-X Rule 3-10 currently requires financial statements to be filed for all issuers and guarantors of securities that are registered or being registered under the Securities Act of 1933 (Securities Act). However, subsidiary issuers and guarantors could historically omit their separate financial statements and be exempt from separate Exchange Act reporting, provided certain conditions were met, including (1) they are 100 percent owned by the parent company, and (2) the guarantee is “full and unconditional” and, if multiple guarantees exist, they are joint and several.

S-X Rule 3-10 has been amended to replace the 100 percent owned condition with a condition that the subsidiary issuer or guarantor is consolidated in the parent company’s financial statements. In addition, if the parent company is a guarantor, only its guarantee needs to be “full and unconditional.”

The amended rules permit the omission of separate financial statements for subsidiary issuers and guarantors when both of the following conditions are met:

- Guaranteed security is debt or debt-like, and one of the following is applicable:
  - Parent company<sup>1</sup> issues or co-issues the security, jointly and severally, with one or more of its consolidated subsidiaries; or
  - Consolidated subsidiary issues or co-issues the security with one or more other consolidated subsidiaries of the parent company, and the security is fully and unconditionally<sup>2</sup> guaranteed by the parent company.
- The required financial and non-financial disclosures in new S-X Rule 13-01 are provided by the parent company.

### Debt or debt-like guaranteed securities

S-X Rule 3-10 will continue to apply to issuers and guarantors of guaranteed debt securities as well as guaranteed preferred securities that have payment terms that are substantially the same as debt. The amended rules specify that a guaranteed security is debt or debt-like if the issuer has a contractual obligation to pay a fixed sum at a fixed time and the obligation to make such payments is cumulative (a set amount of interest must be paid). The amendments also clarify that

- The determination of whether a security is debt or debt-like is neither based on the form of the security nor its title, but instead based on the substance of the obligation; and
- The phrase “set amount of interest” is not intended to mean “fixed amount of interest.” 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, floating and adjustable rate securities, as well as indexed securities, may meet the criteria in the amended rule.

While the Final Rule focuses on the role of the parent company in determining the eligibility of the issuer and guarantor structure in order to omit their separate financial statements, the role of subsidiary issuers and guarantors affects what disclosures are required.

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<sup>1</sup> Consistent with the definition in SEC Release 33-7878 (issued in 2000), S-X Rule 3-10(b)(1) defines a “parent company” as an 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.

<sup>2</sup> Consistent with the definition in existing S-X Rule 3-10, 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.

### **Subsidiary issuers or guarantors that have issued convertible securities**

Subsidiary issuers and guarantors that have issued securities convertible into their own voting shares may omit separate financial statements under the new rules, provided other eligibility conditions are met. However, the parent company is required to provide disclosures about material risks associated with noncontrolling interests as well as summarized financial information attributable to those subsidiaries, to the extent they are material.

### **Supplemental financial and non-financial disclosures**

The Final Rule removes the alternative disclosure requirements in existing S-X Rule 3-10 and creates a new single location for the supplemental financial and non-financial disclosure requirements in new S-X Rule 13-01. The amendments streamline and simplify the disclosure requirements by reducing the amount of financial information and periods presented, allowing for a combined presentation of the summarized financial information<sup>3</sup> for the obligor group, and allowing the financial and non-financial information to be disclosed, to the extent material, either within or outside the parent company's financial statements.

#### ***Summarized financial information (including periods to present)***

The amendments replace the requirement to present condensed consolidating financial statements, comprised of balance sheets and statements of income, comprehensive income, and cash flows for all periods presented, with summarized financial information of the obligor group (issuers and guarantors only) for the most recently completed fiscal year and any subsequent interim period.

The Final Rule includes the following provisions related to the summarized financial information:

- It may be presented on a combined basis and needs to be accompanied by a brief description of the basis of presentation.
- Intercompany balances and transactions between the issuer and guarantors for whom the information is presented on a combined basis need to be eliminated.
- Investment in subsidiaries (and the related equity in earnings) that are not a guarantor needs to be excluded.
- Amounts due to and from, as well as transactions with, related parties and subsidiaries that are not guarantors need to be presented separately.

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<sup>3</sup> Summarized financial information is presented as specified in S-X Rule 1-02(bb)(1).

### Disclosure of additional line items

The parent company may need to disclose additional line items when such information is material to making an investment decision or to prevent the information presented from being misleading.

For example, if substantially all of the guarantor's noncurrent assets are comprised of goodwill and intangible assets, such line items need to be disclosed separately if the parent company concludes that such disclosure is material for investors in evaluating the sufficiency of the guarantee.

New S-X Rule 13-01 requires separate disclosure of summarized financial information for subsidiary issuers and guarantors in certain situations. These situations include when there are restrictions on guarantees provided by certain subsidiaries or when other factors affect the payments to holders of guaranteed securities and such restrictions or factors apply to one or more, but not all, issuers or guarantors.

If the guarantors are subject to the same restrictions, summarized information for such guarantors may be presented on a combined basis. In limited circumstances, narrative disclosure may be sufficient in lieu of summarized financial information.

The parent company may omit summarized financial information if it is not material, or if one of the following is true and disclosed:

- Assets, liabilities, and results of operations of the combined issuers and guarantors of the security are not materially different than the amounts in the parent company's consolidated financial statements;
- Combined issuers and guarantors, excluding investments in subsidiaries that are not issuers or guarantors, have no material assets, liabilities, or result of operations;
- The issuer is a finance subsidiary<sup>4</sup> of the parent company, the parent company has fully and unconditionally guaranteed the security, and no other subsidiary of the parent company guarantees the securities; or
- The issuer is a finance subsidiary that co-issued the security, jointly and severally, with the parent company, and no other subsidiary of the parent company guarantees the security.

### ***Non-financial disclosures***

The non-financial disclosure requirements in new S-X Rule 13-01 include providing a description of the issuers and guarantors as well as the terms and conditions of the guarantees, including where subsidiary guarantees are not full and unconditional or where there are multiple guarantees that are not joint and

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<sup>4</sup> Note to paragraph S-X Rule 13-01(a)(4)(vi)(C) and (D) states that a "finance subsidiary" is a subsidiary that has no assets or operations other than those related to the issuance, administration, and repayment of the security being registered and any other securities guaranteed by its parent company.

several. As noted above, separate summarized financial information may be required for subsidiaries to whom such conditions apply.

The new rules also require disclosure of how payments to holders of the guaranteed security may be affected by the composition of and relationships among issuers, guarantors, and subsidiaries of the company that are nonissuers or nonguarantors of the security, as well as a description of other factors affecting payments.

### ***Recently acquired subsidiary issuer or guarantor***

S-X Rule 3-10(g) currently requires a Securities Act registration statement to include certain pre-acquisition financial statements for a recently acquired subsidiary issuer or guarantor that is not reflected in the parent company's audited results for at least nine months and whose net book value or purchase price, whichever is greater, is 20 percent or more of the principal amount of the securities being registered.

The Final Rule amends the significance computation for a recently acquired subsidiary issuer or guarantor and eliminates the requirement to present separate financial statements of such issuer or guarantor. The significance computation is now consistent with how significance is determined for an acquired business pursuant to Regulation S-X, Rule 3-05, *Financial statements of businesses acquired or to be acquired*.

If the parent company acquires a significant<sup>5</sup> business subsequent to the date of its most recent balance sheet included in a registration statement filed for guaranteed securities, and if the acquired business or one or more of its subsidiaries is an issuer or a guarantor, pre-acquisition summarized financial information of the recently acquired issuer or guarantor must be disclosed in that registration statement.

### **Significance exceeds 20 percent but not 50 percent**

Pre-acquisition summarized financial information for a significant acquired business may be required in a registration statement for debt securities prior to the requirement to include financial statements pursuant to S-X Rule 3-05.

### ***Materiality***

Under the Final Rule, the disclosure requirements in S-X Rule 3-10 and new S-X Rule 13-01 are principles-based. Parent companies must include additional financial and narrative information for each guarantor if the information is material for investors to evaluate the sufficiency of the guarantee, or to make the presented financial and non-financial information not misleading. The rules also permit the parent company to omit any disclosures that management believes are immaterial.

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<sup>5</sup> The acquired business is "significant" if it meets any of the conditions in the definition of a significant subsidiary in S-X Rule 1-02(w), substituting 20 percent for 10 percent.

### ***Location of the disclosures***

New S-X Rule 13-01 permits the parent company to provide the required disclosures in a footnote to its consolidated financial statements or outside the financial statements in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). If not included in the financial statements or MD&A, the disclosures are required to be located in the prospectus immediately following either "Risk Factors," if any, or pricing information.

### **Presenting required disclosures outside the financial statements**

If the parent company elects to provide the required disclosures outside the financial statements, these disclosures will be derived from the same internal accounting records and will be subject to the registrant's disclosure controls and procedures as well as management certification requirements.

### ***Exchange Act reporting***

Existing S-X Rule 3-10 requires the parent company to continue to include the alternative disclosures in its periodic reports for as long as the securities are outstanding. The amended rules eliminate this requirement and allow the parent company to exclude financial and non-financial disclosures if the corresponding subsidiary issuer's or guarantor's obligation under Section 15(d) of the Exchange Act could be suspended. However, the amended rules would continue to require a parent company to provide the financial and non-financial disclosures for securities that are traded on a national securities exchange.

## **C. Affiliates whose securities collateralize a registrant's securities**

Consistent with the amendments related to guaranteed securities, the Final Rule replaces the requirement in S-X Rule 3-16 to provide the separate financial statements of affiliates with financial and non-financial disclosures about the affiliates and collateral agreements as required in new S-X Rule 13-02. The non-financial disclosures required in the new rules include disclosing a description of the following items:

- Securities pledged as collateral and the affiliates whose securities are pledged
- The terms and conditions of the collateral arrangement
- The trading market for the affiliate's securities pledged as collateral or a statement that there is no market

New S-X Rule 13-02 contains provisions similar to S-X Rule 13-01 related to materiality, summarized financial information, location of the disclosures, recently acquired businesses whose securities are collateralized, and other non-financial disclosures.

## **D. Effective date**

The Final Rule is applicable to registration statements first filed on or after January 4, 2021. Early compliance is permitted. The amendments apply to Exchange Act periodic reports as follows:

- *For an issuer that was required to comply with the amendments in a registration statement:* Applicable to all Exchange Act periodic reports for periods ending after the registration statement becomes effective.

- *For all other Exchange Act issuers:* Applicable in the annual report on Form 10-K or Form 20-F for fiscal years ending after January 4, 2021 and quarterly reports on Form 10-Q for quarterly periods ending after January 4, 2021.

Existing S-X Rule 3-16 will continue to apply to registrants with respect to securities issued and outstanding on or before January 4, 2021 in situations where they were not required to provide affiliate's separate financial statements.

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