

August 6, 2018

## **SEC PROPOSES STREAMLINED FINANCIAL DISCLOSURES FOR CERTAIN GUARANTEED DEBT SECURITIES AND AFFILIATES WHOSE SECURITIES ARE PLEDGED TO SECURE A SERIES OF DEBT SECURITIES**

To Our Clients and Friends:

On July 24, 2018, the Securities and Exchange Commission (the "Commission") proposed amendments to Rules 3-10 and 3-16 of Regulation S-X (available [here](#)) (the "Proposal") in an effort to "simplify and streamline" the financial disclosures required in offerings of certain guaranteed debt and debt-like securities (collectively referred to as "debt securities"), as well as offerings of securities collateralized by securities of an affiliate of the registrant, registered under the Securities Act of 1933, as amended (the "Securities Act"). These proposed changes would, if implemented, facilitate greater speed to market for such public offerings, significantly reducing the Securities Act disclosure burdens for such registrants, as well as reducing the registrant's disclosure obligations in its subsequent annual and interim reports required under Securities Exchange Act of 1934, as amended (the "Exchange Act").

### ***Background***

*Current Alternative Disclosure Regime for Certain Guaranteed Debt Securities.* For purposes of the Securities Act and the Exchange Act, guarantees of securities are deemed separate securities from the underlying security that is guaranteed. As a result, absent an a regulatory exception or exemption, a prospectus prepared for a public offering of guaranteed debt securities registered under the Securities Act is required to include the full separate financial statements of (and disclosure regarding) each guarantor (in addition to those of the issuer of the guaranteed debt security) in the form and for the periods required for registrants under Regulation S-X, and each such guarantor (like the issuer of the guaranteed debt security) is also required to be registered under the Exchange Act and thereafter file annual and interim reports under that Act just as any other registrant. Recognizing the substantial burdens of such disclosures that would otherwise be imposed in connection with registered public offerings of certain guaranteed debt securities involving parent companies and their wholly-owned subsidiaries, much of which would be duplicative, the SEC has embraced exceptions (as currently set out in Regulation S-X Rule 3-10 ("S-X 3-10")) to instead permit the parent company in a qualifying offering of such guaranteed debt securities to file only its consolidated financial statements, together with certain condensed consolidating financial information ("Consolidating Financial Information") intended to allow investors to distinguish between the obligor and non-obligor components of the consolidated group of companies represented in the parent's consolidated financial statements. S-X 3-10 also requires the registrant to include specified textual disclosure, where applicable, about the limited nature of the assets and operations of the issuer, guarantor(s) or non-guaranteeing subsidiaries, as the case may be, and describing any material limitations on the ability of the parent or any guarantor to obtain funds (whether by dividend, loan or otherwise) from its subsidiaries and any other relevant

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limitations on any subsidiary's use of its fund (together with the Consolidating Financial Information, the "Alternative Disclosure"). The Alternative Disclosure is required to be included in a note to the parent's consolidated audited financial statements and must cover the same periods for which the parent is required to include its consolidated financial statements. The parent company is required to include the Alternative Disclosure in its annual and quarterly Exchange Act reports filed after the guaranteed debt securities are issued and to continue to do so as long as the securities remain outstanding, even for periods in which the issuer(s) and guarantors have no Exchange Act reporting obligation with respect to such securities. In addition, for certain significant recently-acquired subsidiary guarantors, S-X 3-10 currently requires that the registration statement for the offering include the separate audited financial statements for such subsidiaries' most recent fiscal year and unaudited financial statements for any interim period for which the parent is required to include its interim financial statements.

Pursuant to Rule 12h-5, each guarantor or issuer subsidiary in any such qualifying transaction is exempt from the separate ongoing Exchange Act reporting obligations otherwise applicable to a registrant.

Notwithstanding the advantages offered by the exception provided by S-X 3-10, the conditions to the current regulation, including that the subsidiaries be 100% owned by the parent and that all guarantees be full and unconditional, the often time-consuming process of producing and auditing the Consolidating Financial Information, as well as the requirement that the parent continue to include the Alternative Disclosure for as long as any of the guaranteed debt securities remain outstanding, have limited the range of subsidiaries that are used as guarantors, delayed offerings and/or led to reliance on Rule 144A for life offer structures for some guaranteed debt offerings to avoid registration.

*Current Disclosure Requirements for Securities Collateralized by Affiliate Securities.* Current Regulation S-X Rule 3-16 ("S-X 3-16") requires a registrant to provide separate audited annual financial statements, as well as unaudited interim financial statements, for each affiliate whose securities constitute a "substantial portion"<sup>[1]</sup> of the collateral pledged for such registrant's registered securities as though such affiliate were itself a registrant, and thereafter file annual and interim reports under the Exchange Act for such affiliate. The production of the financial statements required by S-X 3-16 is often time consuming and costly to the issuer and the requirement is triggered entirely by the outcome of the substantial portion test, without regard to the comparative importance of the relevant affiliate to the registrant's business and operations as a whole or the materiality of such financial statements to an investment decision. To avoid the burden of preparing separate full financial statements for each affiliate whose securities are pledged as collateral, issuers often reduce collateral packages or structure collateralized securities as unregistered offerings. Additionally, debt agreements are sometimes structured to specifically release collateral if and when such collateral may trigger the S-X 3-16 financial statement requirements.

## ***Proposed Amendments***

In the SEC's effort to streamline the disclosure requirements in connection with certain guaranteed debt securities offered and sold in public offerings registered under the Securities Act, as well as simplify the current number of myriad offer structures entitled to disclosure relief, the amendments proposed to S-X 3-10 would:

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- replace the current detailed list of offer structures permitted relief under S-X 3-10 with a more simple requirement that the debt securities be either:
  - issued by the parent or co-issued by the parent, jointly and severally, with one or more of its consolidated subsidiaries; or
  - issued by a consolidated subsidiary of the parent (or co-issued with one or more other consolidated subsidiaries of the parent) and fully and unconditionally guaranteed by the parent;
- replace the condition currently included in S-X 3-10 that a subsidiary issuer or guarantor be 100% owned by the parent company, requiring instead that the subsidiary merely be *consolidated* in the parent company's consolidated financial statements in accordance with U.S. GAAP or, in the case of foreign private issuer, IFRS (as promulgated by the IASB). As a result, in addition to 100% owned subsidiaries, controlled subsidiaries and joint ventures which are consolidated in the parent's financial consolidated financial statements could be added as issuers or guarantors in such offerings and take advantage of the reduced disclosure permitted under the Proposal, provided the other conditions of the revised regulation are met;
- modify the requirement that all guarantees be full and unconditional, requiring only that the parent guarantee (in the case of a subsidiary issuer) be full and unconditional. The proposal would thereby allow greater flexibility with the extent and nature of guarantees to be given by subsidiary guarantors, provided the terms and limitations of such guarantees are adequately disclosed;
- eliminate the Consolidating Financial Information currently required to be included in the registration statement and the parent's Exchange Act annual and (where applicable) quarterly reports under S-X 3-10, and, in lieu thereof, add a new Rule 13-01 of Regulation S-X requiring such parent companies to include (i) certain summary financial information (the "Summary Financial Information") for the parent and guarantors (the "Obligor Group") on a combined basis (after eliminating intercompany transactions among members of this Obligor Group), and (ii) certain non-financial disclosures, including expanded qualitative disclosures about the guarantees and factors which could limit recovery thereunder, and any other quantitative or qualitative information that would be material to making an investment decision about the guaranteed debt securities (the Summary Financial Information and such non-financial disclosures, the "Proposed Alternative Disclosure");
- require that the Summary Financial Information conform to the current provisions of Regulation S-X Rule 1-02(bb) and include summarized information as to the assets, liabilities and results of operations of the Obligor Group only;
- reduce the periods for which the Summary Financial Information must be provided, requiring such information for only the most recent fiscal year and any interim period for which consolidated financial statements of the parent are otherwise required to be included;

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- permit the parent flexibility as to the location of the Summary Financial Information and other Proposed Alternative Disclosures, including in the notes to its consolidated financial statements, in the "management's discussion and analysis of financial condition and results of operations" or immediately following "risk factors" (if any) or the pricing information in the Securities Act registration statement and related prospectus and in Exchange Act reports on Forms 10-K, 20-F and 10-Q required to be filed during the fiscal year in which the first bona fide sale of the guaranteed debt securities is completed. By permitting such flexibility, the parent issuers may realize greater speed to market for such offering as the Summary Financial Information would not be required to be audited if located outside the notes to its consolidated financial statements;
- by allowing a parent company the option to exclude the Summary Financial Information from the notes to its audited financial statements, such parent may realize greater speed to market for such offerings as the Summary Financial Information would not be required to be audited as part of the offer process;
- such Summary Financial Information would, however, be required to be included in a footnote to the parent's annual and (where applicable) quarterly reports (and thus audited), beginning with its annual report filed on Form 10-K or 20-F for the fiscal year during which the first bona fide sale of the guaranteed debt securities is completed. Thus, for example, for guaranteed debt securities issued in the second quarter of fiscal 2018, the Summary Financial Information would first be required to be included in the notes to the parent's financial statements filed in its annual report filed on Form 10-K for its fiscal year 2019;
- eliminate the current requirement that, for so long as the guaranteed debt securities remain outstanding, a parent company continue to include the Consolidating Financial Information within its annual and interim reports (including for periods in which the Obligor Group is not then subject to the reporting requirements of the Exchange Act). Under the Proposal, the Summary Financial Information and other Proposed Alternative Disclosures would not be required to be included in the parent's annual and quarterly reports for such periods in which the Obligor Group is not then subject to the reporting requirements of the Exchange Act. Nonetheless, some parent companies with an Obligor Group that issues guaranteed debt securities on a regular basis may elect to continue to prepare and include the Revised Alternative Disclosure in its Exchange Act reports to ensure a more rapid access to the market for future transactions; and
- eliminate, with respect to recently-acquired subsidiary guarantors or issuers, the current requirement under S-X 3-10 that the parent include in the registration statement for the offering separate audited financial statements for the most recent fiscal year of the recently-acquired subsidiary (as well as separate unaudited interim financial statements for any relevant interim periods). Note, however, that other provisions of Regulation S-X regarding the impact of recent material acquisitions and the potential requirement thereunder to include separate financial statements of the acquired entity (and, in some cases, pro forma consolidated financial information regarding the acquisition) remain unchanged by the Proposal.

The proposed amendments to S-X 3-16 would:

- replace the existing requirement to provide separate financial statements for each affiliate whose securities are pledged as collateral with a requirement to include the Summary Financial Information and any additional non-financial information material to investment decisions about the affiliate(s) (if more than one affiliate, such information could be provided on a combined basis) and the collateral arrangement(s). The elimination of the requirement to include the affiliate's separate audited financial statements would significantly decrease the cost and burden of an offering secured by the securities of an affiliate of the registrant;
- permit the proposed financial and non-financial affiliate disclosures to be located in filings in the same manner (and for reports for the same corresponding periods) as described above for the disclosures related to guarantors and guaranteed securities, which would bring the level and type of disclosure for collateralized securities in line with other forms of credit enhancement; and
- replace the requirement to provide disclosure only when the pledged securities meet or exceed a numerical threshold relative to the securities registered or being registered with a requirement to provide the applicable disclosures in all cases, unless they are immaterial to holders of the collateralized security, which would replace the arbitrary numerical cutoff with a consideration of materiality to investors.

Set forth below, we summarizing the current requirements, and proposed changes to such requirements, for the use of abbreviated disclosure for subsidiary issuer/guarantors of certain guaranteed debt securities and for issuers of securities collateralized by securities of affiliates.

## **Guaranteed Debt Securities: Summary of Current Requirements for Abbreviated Disclosure and Proposed Revisions**

	<b>Current Provisions of S-X 3-10:</b>	<b>Proposed Provisions:</b>
<b>Offer Structures Permitted Disclosure Relief</b>	(i) Finance subsidiary issuer of debt securities guaranteed by parent; (ii) Operating subsidiary issuer of debt securities guaranteed by parent; (iii) Subsidiary issuer of debt securities guaranteed by parent and one or more other subsidiaries;	Debt securities: (i) Issued by parent or co-issued by parent, jointly and severally, with one or more of its consolidated subsidiaries; or (ii) Issued by a consolidated subsidiary of parent (or co-issued with one or more other consolidated subsidiaries) and fully and unconditionally guaranteed by parent.

	<b>Current Provisions of S-X 3-10:</b>	<b>Proposed Provisions:</b>
	(iv) Single subsidiary guarantor of debt securities issued by parent; or  (v) Multiple subsidiary guarantors of debt securities issued by parent.	
<b>Conditions to Relief</b>	<ul style="list-style-type: none"> <li>· Each subsidiary issuer or guarantor must be 100% owned by parent; and</li> <li>· All guarantees must be full and unconditional</li> </ul>	<ul style="list-style-type: none"> <li>· Subsidiary issuer/guarantors must be consolidated in the parent's consolidated financial statements.</li> <li>· Only the parent guarantee, if any, must be full and unconditional.</li> </ul>
<b>Alternative Disclosure</b>	<ul style="list-style-type: none"> <li>· Condensed Consolidating Financial Information, and certain textual disclosure</li> </ul>	<ul style="list-style-type: none"> <li>· Summary Financial Information for Obligor Group on a combined basis (after eliminating transactions between Obligor) and certain textual disclosure</li> </ul>
<b>Periods for which Disclosure Required in Registration Statement</b>	<ul style="list-style-type: none"> <li>· For each year and any interim periods for which parent is required to include financial statements</li> </ul>	<ul style="list-style-type: none"> <li>· The most recent fiscal year and any interim period for which the parent is required to include financial statements</li> </ul>
<b>Locations of Disclosure</b>	<ul style="list-style-type: none"> <li>· The Alternative Disclosure must be included in the notes to the parent's audited consolidated financial statements (and in its unaudited interim financial statements where such financial statements are required to be included)</li> </ul>	<ul style="list-style-type: none"> <li>· In the Registration Statement and in Exchange Act reports filed during the fiscal year in which the debt securities are first bona fide offered to the public, the parent has the choice of including them in the notes to its consolidated financial statements or elsewhere, including within "management's discussion</li> </ul>

	<b>Current Provisions of S-X 3-10:</b>	<b>Proposed Provisions:</b>
		<p>and analysis of financial condition and results of operations" or immediately following "risk factors"</p> <ul style="list-style-type: none"> <li>For the parent's annual report for the fiscal year in which the debt securities were first offered to the public, and all Exchange Act reports required to be filed thereafter, the Proposed Alternative Disclosures must be included in the notes to the parent's consolidated financial statements</li> </ul>
<b>How Long is Exchange Act Disclosure Required</b>	<ul style="list-style-type: none"> <li>For so long as any of the debt securities remain outstanding</li> </ul>	<ul style="list-style-type: none"> <li>Only for periods in which the Obligor is required to file Exchange Act reports in respect of the debt securities</li> </ul>
<b>Additional Requirements For Recently Acquired Subsidiary Guarantor/Issuers</b>	<ul style="list-style-type: none"> <li>Parent must include separate audited financial statements of the recently acquired subsidiary issuer/guarantor for the most recent fiscal and any interim period for which the parent is required to include financial statements</li> </ul>	<ul style="list-style-type: none"> <li>No separate financial statements of a recently acquired subsidiary issuer/guarantor is required for relief under the Proposal</li> </ul>

## Summary of Current Disclosure Requirements for Securities Collateralized by Securities of Affiliates and the Proposed Revisions

	<b>Current Provisions of S-X 3-16:</b>	<b>Proposed Provisions:</b>
<b>Offer Structure Triggering Disclosure Requirement</b>	<ul style="list-style-type: none"> <li>Securities issued by a registrant and collateralized with the securities of its affiliates where such</li> </ul>	<ul style="list-style-type: none"> <li>Securities issued by a registrant and collateralized with the securities of its affiliates, unless such</li> </ul>



	<b>Current Provisions of S-X 3-16:</b>	<b>Proposed Provisions:</b>
	collateral constitutes a "substantial portion" of the collateral for any class of securities	collateral is immaterial to making an investment decision about the registrant's securities
<b>Additional Disclosure Required</b>	<ul style="list-style-type: none"> <li>If the pledged securities of an affiliate constitute a "substantial portion" of the collateral for the secured class of securities, separate audited annual financial statements, as well as unaudited interim financial statements, for such affiliate as though such affiliate were itself a registrant</li> </ul>	<ul style="list-style-type: none"> <li>Summary Financial Information with respect to any affiliate whose securities are pledged to secure a class of securities, and any additional non-financial information material to investment decisions about the affiliate(s) and the collateral arrangement</li> </ul>
<b>Basis of Presentation</b>	<ul style="list-style-type: none"> <li>Separate financial statements for each affiliate whose securities constitute a "substantial portion" of the collateral</li> </ul>	<ul style="list-style-type: none"> <li>Summary Financial Information of affiliates consolidated in the registrant's financial statements can be presented on combined basis</li> <li>If information is applicable to a subset of affiliates (but not all) separate Summary Financial Information required for such affiliates</li> </ul>
<b>Periods for which Disclosure Required in Registration Statement</b>	<ul style="list-style-type: none"> <li>For each year and any interim period as if affiliate were a registrant</li> </ul>	<ul style="list-style-type: none"> <li>The most recent fiscal year and any interim period for which the registrant is required to include consolidated financial statements</li> </ul>
<b>Locations of Disclosure</b>	<ul style="list-style-type: none"> <li>Separate financial statements required to be included in the registration statement in the</li> </ul>	<ul style="list-style-type: none"> <li>In the Registration Statement and in Exchange Act reports filed during the fiscal year in which the first bona fide sale</li> </ul>



	<b>Current Provisions of S-X 3-16:</b>	<b>Proposed Provisions:</b>
	<p>registrant's annual report on Form 10-K or 20-F</p> <ul style="list-style-type: none"> <li>• Disclosure not required in quarterly reports of the registrant</li> </ul>	<p>is completed, the registrant has the choice of including them in the notes to its consolidated financial statements or elsewhere, including within "management's discussion and analysis of financial condition and results of operations" or immediately following "risk factors"</p> <ul style="list-style-type: none"> <li>• For the registrant's annual report for the fiscal year in which the first sale was completed, and all Exchange Act reports required to be filed thereafter, the required information must be included in the notes to the registrant's consolidated financial statements</li> </ul>

The SEC is seeking public comments on its proposal for a period of 60 days from July 24, 2018. Comments can be submitted on the internet at <http://www.sec.gov/rules/other.shtml>; via email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov) (File Number S7-19-18 should be included on the subject line); or via mail to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

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[1] *E.g.*, if the aggregate principal amount, par value or book value of the pledged securities as carried by the issuer of the collateralized securities, or market value, equals 20% or more of the aggregate principal amount of the secured class of securities offered.



*Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact any member of the Gibson Dunn team, the Gibson Dunn lawyer with whom you usually work in the firm's Capital Markets or Securities Regulation and Corporate Governance practice groups, or the authors:*

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