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May 4, 2020

The Honorable Mike Crapo
Chairman
The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Maxine Waters
Chairwoman
The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
House of Representatives

Subject: *Securities and Exchange Commission: Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (Commission) entitled "Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities" (RIN: 3235-AM12). We received the rule on March 3, 2020. It was published in the *Federal Register* as a final rule on April 20, 2020. 85 Fed. Reg. 21940. The effective date of the rule is January 4, 2021.

According to the Commission, the final rule amends 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 Commission states the 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, according to the Commission, 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, the Commission states 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 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.

Enclosed is our assessment of the Commission's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shari Brewster, Assistant General Counsel, at (202) 512-6398.

A handwritten signature in black ink, reading "Shirley A. Jones". The signature is written in a cursive, flowing style.

Shirley A. Jones
Managing Associate General Counsel

Enclosure

cc: Vanessa A. Countryman
Secretary
Securities and Exchange Commission

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
SECURITIES AND EXCHANGE COMMISSION
ENTITLED
“FINANCIAL DISCLOSURES ABOUT GUARANTORS AND ISSUERS
OF GUARANTEED SECURITIES AND AFFILIATES WHOSE
SECURITIES COLLATERALIZE A REGISTRANT’S SECURITIES”
(RIN: 3235-AM12)

(i) Cost-benefit analysis

The Securities and Exchange Commission (Commission) stated the final rule would have general effects on efficiency, competition, and capital formation, among others. The Commission stated the final rule should both reduce the compliance cost for issuers and allow more efficient decision making by investors. According to the Commission, this may be true particularly to the extent that the final rule 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. Also, since, according to the Commission, the final rule amendments may increase the number of registered debt offerings, the Commission believes the investment opportunities available for different types of investors may be broadened and may allow for more efficient matching of investors with assets that meet their investment objectives and preferences. To the extent that the final rule amendments provide investors with streamlined and easier to understand financial information while maintaining the material completeness of the financial disclosures, the Commission expects that the financial disclosures that result from the final rule amendments would improve price discovery, enhance the allocative efficiency of markets, and facilitate capital formation.

The Commission also specified the benefits and costs of changes to two rules pursuant to this final rule. Regarding changes to Rule 3-10 of Regulation S-X, the Commission stated that as a result of the overall reduced burdens associated with the final rule, investors may benefit from access to more registered offerings that are structured to include guarantees and, accordingly, the additional protections that come with a registered offering. Also, according to the Commission, an increase in the overall use of guarantees could reduce structural subordination issues that arise. The Commission further stated the less burdensome disclosures under the final rule 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.

As for changes to Rule 3-16 of Regulation S-X, the Commission estimated the final rule will reduce the burden of having to provide separate financial statements of affiliates in comparison to the requirements under the existing rule and thereby provide issuers with the flexibility to structure their debt agreements with pledges of affiliate securities. According to the Commission, if, as a result of the final rule, debt agreements are no longer structured to avoid disclosure requirements about affiliates whose securities are pledged as collateral, investors would obtain the benefit of the collateral as well as the related disclosures, which would be subject to Section 11 liability. The Commission estimated 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. According to the Commission, 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. However, the Commission estimated the final rule may lead companies and investors to incur costs to adjust to the new disclosures.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

The Commission prepared a Regulatory Flexibility Analysis. The analysis included (1) a statement of the needs for and objectives of the final rule; (2) a statement of the significant issues raised by public comments; (3) a description of the of the small entities subject to the final rule; (4) the projected reporting, recordkeeping, and other compliance requirements; and (5) a statement on agency actions taken to minimize effect on small entities.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory commission, the Commission is not subject to the Act.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*

On October 2, 2018, the Commission published a proposed rule. 83 Fed. Reg. 49630. The Commission received over 30 comments on the proposed rule. The Commission responded to the comments in the final rule.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

The Commission determined that the final rule contains information collection requirements (ICRs) under the Act. The Commission stated it submitted the ICRs to the Office of Management and Budget (OMB) for review. The ICRs are associated with Regulation S-X (OMB Control No. 3235-0009); Regulation S-K (OMB Control No. 3235-0071); Form S-1 (OMB Control No. 3235-0065); Form S-4 (OMB Control No. 3235-0324); Form S-3 (OMB Control No. 3235-0073); Form S-11 (OBM Control No. 3235-0067); Form F-1 (OMB Control No. 3235-0258); Form F-3 (OMB Control No. 3235-0256); Form F-4 (OMB Control No. 3235-0325); Form 20-F (OMB Control No. 3235-0288); Form 10-K (OMB Control No. 3235-0063); Form 10-Q (OMB Control No. 3235-0070); Form SF-1 (OMB Control No. 3235-0707); Form SF-3 (OMB Control No. 3235-0690); Form 1-A (OMB Control No. 3235-0286); Form 1-K (OMB Control No. 3235-0720); and Form 1-SA (OMB Control No. 3235-0721). The Commission estimates the ICRs will require an average of 70 burden hours to complete for each filing, a reduction of 30 hours.

Statutory authorization for the rule

The Commission promulgated the final rule pursuant to section 2 of title 7; sections 5221 and 5461 of title 12; sections 77b, 77b note, 77c, 77d, 77e, 77f, 77g, 77h, 77j, 77k, 77r, 77s, 77z-2, 77z-3, 77aa, 77nn, 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78j-3, 78k, 78k-1, 78l, 78m, 78n, 78n-1,

78o, 78o-4, 78o-7 note, 78o-10, 78q, 78t, 78q-1, 78s, 78u-5, 78w, 78x, 78dd, 78ll, 78mm, 80a-2, 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-20, 80a-23, 80a-24, 80a-26, 80a-28, 80a-29, 80a-30, 80a-31, 80a-37, 80a-38, 80a-39, 80b-3, 80b-4, 80b-11, 7201 *et seq.*, and 8302 of title 15; section 1350 of title 18, United States Code; and sections 939A and 953 of Public Law 111-203; and sections 102, 107, 201, 401, 503, and 602 of Public Law 112-106; and section 72001 of Public Law 114-94.

Executive Order No. 12,866 (Regulatory Planning and Review)

As an independent regulatory commission, the Commission is not subject to the Order.

Executive Order No. 13,132 (Federalism)

As an independent regulatory commission, the Commission is not subject to the Order.