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U.S. capital markets developments in 2017: Small changes can make a big difference

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Most of the developments coming from the U.S. Securities and Exchange Commission (the SEC) in 2017 that are of particular interest to Canadians are more procedural than substantive in nature, with little in the way of significant change in the Canada-U.S. cross-border regulatory landscape. Nevertheless, Canadian issuers registered with the SEC who report their financial statements in International Financial Reporting Standards (IFRS) will certainly feel the pinch of at least one procedural change starting with their next annual report filing with the SEC.

Tag, you're it!

For many years, SEC registrants reporting their financial statements using U.S. generally accepted accounting principles (U.S. GAAP) have been required to prepare a second version in an interactive data format, "tagged" with eXtensible Business Reporting Language (XBRL) coding. Canadian and other foreign private issuers reporting their financial statements using IFRS were able to escape this requirement, because the SEC had not yet approved a "taxonomy," or coding scheme, for IFRS.

This year, the other shoe dropped when the SEC announced that an XBRL taxonomy for IFRS had finally been approved. As a result, all Canadian issuers filing reports with the SEC will be required to include financial statements in XBRL format, even if they prepare their financial statements in accordance with IFRS. This requirement will take effect beginning with annual reports filed in 2018 relating to fiscal years ending on or after December 15, 2017.

In addition, financial statements in XBRL format will be required as an exhibit to a registration statement filed under the U.S. *Securities Act of 1933* (1933 Act), but not in connection with an initial public offering (IPO). Financial statements in XBRL format will not be required as an exhibit to a 1933 Act registration statement that does not contain financial statements, such as a Form F-10 registration statement filed by a Canadian issuer under the U.S.-Canada Multijurisdictional Disclosure System (MJDS).

You'll just have to learn to settle for less

As we predicted last year, the SEC released final rules shortening the standard trade settlement window from three business days (T+3) to two business days (T+2), unless a longer settlement period is agreed to by the trade parties at the time of the transaction. Canada followed suit. The T+2 settlement cycle became effective for secondary market trading in both the United States and Canada on September 5, 2017.

No need to get hyper about hyperlinks

The SEC adopted a requirement for SEC registrants (including Canadian issuers filing a registration statement on MJDS Form F-10) to include a hyperlink to each exhibit listed in the exhibit index of their filings. The new rule came into effect on September 5, 2017.

Previously, someone seeking to retrieve and access an exhibit that had been incorporated by reference into a filing had to review the exhibit index to determine the filing in which the exhibit was included, and then had to search through all of the registrant's filings to locate the relevant one. This process was often time consuming and cumbersome.

The new requirement to include a hyperlink is a mechanical requirement that can usually be easily addressed by the commercial printer or other service provider preparing a document for filing with the SEC.

S-K and you shall receive

Regulation S-K provides the framework for most of the non-financial disclosure that U.S. public companies must include in their SEC filings, such as registration statements, annual and quarterly reports, and proxy statements. As part of its ongoing "disclosure effectiveness" project, the SEC proposed amendments to Regulation S-K to remove some disclosure requirements that it considered immaterial and unnecessary, and eliminated a number of duplicative requirements to discourage repetition.

If the proposed changes take effect, companies will be permitted to forgo discussion within their MD&A of the oldest period covered by financial statements included in a filing if it was included and discussed in a previous report and is no longer material. Further, companies will be permitted to omit information in their exhibits that is not material and would be competitively harmful without having to first seek confidential treatment from the SEC staff. Upon request, companies will be required to provide supplemental materials to the SEC staff similar to those currently required in a confidential treatment request.

The SEC has not proposed any changes to MJDS forms as part of this initiative, as these forms generally permit Canadian issuers to use Canadian disclosure documents to satisfy the SEC's registration and disclosure requirements instead of following the requirements in Regulation S-K.

Come on, tell us what you really think

The SEC approved a proposal by the Public Company Accounting Oversight Board (PCAOB) introducing rules that will require auditors to provide new information about the audit. These proposed rules are intended to make the auditor's report on a company's audited financial statements more informative and relevant to investors.

In addition to including the traditional opinion from the auditors stating the conclusion that the financial statements fairly present the issuer's financial position in accordance with generally accepted accounting principles, the new rules will require the auditor to discuss in the audit report any "critical audit matters" (CAMs) arising from the period's audit or to state that there were no CAMs. A CAM is a matter that was raised with the audit committee in the course of the audit because it involved especially challenging, subjective or complex auditor judgment.

The requirements related to CAMs apply to audits of large accelerated filers (which are companies with a public float over US$700 million) for fiscal years ending on or after June 30, 2019. For all other companies, the requirements will apply for fiscal years ending on or after December 15, 2020.

The changes will apply to Canadian issuers that are SEC registrants with audit reports prepared by their auditors in accordance with PCAOB standards, even if they report their financial statements using IFRS. Annual reports on Form 40-F should be unaffected for the time being as the financial statements in those reports may be audited using Canadian generally accepted auditing standards. However, it would not be surprising if Canadian generally accepted auditing standards eventually also adopt a similar requirement for disclosure of CAMs.

How many ways can you keep a secret?

There are now no fewer than three different ways to make a confidential SEC registration statement filing: the procedure available to foreign private issuers, the procedure available to emerging and high growth companies and this new procedure. The SEC announced that it will permit all companies to submit draft registration statements relating to IPOs for review on a non-public basis. The process will be available not only for IPOs, but also for most offerings made in the first year after a company has become an SEC reporting issuer.

An issuer conducting an IPO or an initial registration of a class of securities relying on this new confidential filing procedure must publicly file its registration statement, the initial non-public draft registration statement and all draft amendments at least 15 days before it conducts its road show or, if there is no road show, at least 15 days before the effective date of the registration statement.

In theory, Canadian issuers filing U.S. IPO registration statements under MJDS may take advantage of this new confidential filing procedure as well. However, it is unlikely to be of any practical benefit since MJDS filers are typically eligible for a three business day review period by the Canadian securities regulators and are typically not reviewed by the SEC. This means that most MJDS filings will be made too close to the road show or date of effectiveness to be entitled to any confidentiality period. Further, the Canadian securities regulators would also have to agree to keep the Canadian filing confidential (or else word would get out). In the past, the Canadian securities regulators have generally been prepared to accommodate a confidential review process in Canada when confidential treatment is available under the U.S. rules.

Vote early, not often

Citing the importance of corporate governance rights, the S&P Dow Jones Indices, among others, stopped admitting new companies with multiple voting shares to certain of its U.S. equity indices. The decision was made on the heels of Snap's IPO in which shares with no voting rights were issued. The ineligibility for U.S. companies with multiple voting shares to be included in these indices could prevent certain institutional investors from investing in them.

While Canadian issuers may not be directly affected by this development, as they would not have typically been eligible for inclusion in a U.S. equity index in any case, this development certainly demonstrates the endurance of the "one share one vote" governance principle.