

three commenters supported the disclosure threshold as proposed.³⁹ In addition, many commenters stated that the “reasonably likely” threshold is an appropriate interpretation of the Sarbanes-Oxley Act.⁴⁰ Many commenters opposed the proposed threshold because they thought that it would be difficult for management to apply; yield voluminous disclosures; attribute undue prominence to information that is not important to investors; confuse or mislead investors; and elicit information that would not be comparable among firms.⁴¹ Some commenters indicated that the “reasonably likely” threshold is preferable because it would provide investors with the information that management considers important, as opposed to more speculative information that registrants would disclose under a lower threshold.⁴² Several commenters believed that it would be preferable to have consistency throughout MD&A by adopting the “reasonably likely” standard.⁴³

After considering the comments, we are adopting the “reasonably likely” disclosure threshold that we currently apply to other portions of MD&A disclosure.⁴⁴ We believe that the “reasonably likely” threshold best promotes the utility of the disclosure requirements by reducing the possibility that investors will be overwhelmed by voluminous disclosure of insignificant and possibly unnecessarily speculative information.⁴⁵ We have found no express reference in the legislative history conclusively demonstrating Congress’ intent in using the word

“may.” After considering the comments, we conclude that the “reasonably likely” standard focuses on the information most important to an understanding of a registrant’s off-balance sheet arrangements and their material effects on the registrant’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources. In addition, we are mindful of the potential difficulty that registrants would have faced in attempting to comply with the “remote” disclosure threshold set forth in the Proposing Release. We also believe that our use of a consistent disclosure threshold throughout MD&A will preclude the potential confusion that could result from disparate thresholds.

3. Proposed Disclosure Requirements

While some commenters supported the proposed disclosure requirements,⁴⁶ others believed the proposals to be overly prescriptive and detail-oriented.⁴⁷ Eight commenters stated that the proposed disclosure would be voluminous, would not be useful or would be confusing to investors.⁴⁸ Three commenters expressed concerns about the sensitivity and potential competitive harm of the required disclosures.⁴⁹ In addition, seven commenters suggested that we should adopt a more flexible, principles-based approach to the MD&A disclosures.⁵⁰

Another area of concern was whether it is feasible to expect a registrant to be able to obtain information about the activities of unconsolidated entities over which it may not have control.⁵¹ For example, some commenters believed that companies might be unable to obtain, monitor or evaluate certain information about unconsolidated entities that conduct off-balance sheet activities (e.g., certain multi-party conduits or third parties that benefit from a pre-existing guarantee of the registrant).⁵²

After carefully evaluating the comments, we are adopting disclosure requirements that are more consistent with the principles-based approach found in current MD&A rules. The

principle throughout the amendments is that the registrant should disclose information to the extent that it is necessary to an understanding of a registrant’s material off-balance sheet arrangements and their material effects on financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources. Consistent with traditional MD&A disclosure, management has the responsibility to identify and address the key variables and other qualitative and quantitative factors that are peculiar to, and necessary for, an understanding and evaluation of the company.⁵³ The amendments contain the following four specific items to bolster the principles-based approach. These items require disclosure of the following information to the extent necessary for an understanding of a registrant’s off-balance sheet arrangements and their effects:

- The nature and business purpose of the registrant’s off-balance sheet arrangements;⁵⁴

- The importance of the off-balance sheet arrangements to the registrant for liquidity, capital resources, market risk or credit risk support or other benefits;⁵⁵

- The financial impact of the arrangements on the registrant (e.g., revenues, expenses, cash flows or securities issued) and the registrant’s exposure to risk as a result of the arrangements (e.g., retained interests or contingent liabilities);⁵⁶ and

- Known events, demands, commitments, trends or uncertainties that affect the availability or benefits to the registrant of material off-balance sheet arrangements.⁵⁷

In addition, the amendments contain another principles-based requirement, similar to that used elsewhere in MD&A, that the registrant provide other information that it believes to be necessary for an understanding of its off-balance sheet arrangements and their material effects on the registrant’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.⁵⁸

KPMG, Lilly, NAREIT, NYBA, NY City Bar, Pfizer, PwC and S&C.

³⁹ See, e.g., the letters of Beard, CANICCOR and IMC.

⁴⁰ See, e.g., the letters of ABA, ACB, AICPA, CEG, Cleary, Compass, CSC, D&T, EEI, E&Y, Fried Frank, Lilly, NYBA, NY City Bar, Pfizer, PwC and S&C.

⁴¹ See, e.g., the letters of ACB, AICPA, ASCS, Boeing, CEG, Cleary, Compass, CSC, D&T, EEI, FEI, Fried Frank, ICAA, KPMG, Lilly, NAREIT, NYBA, NY City Bar, Pfizer, PwC and S&C.

⁴² See, e.g., the letters of Fried Frank, KPMG and Pfizer.

⁴³ See, e.g., the letters of ABA, ACB, AICPA, ASCS, CEG, CSC, D&T, Eaton, EEI, Fried Frank, FTNC, ICAA, Intel, KPMG, Lilly, NAREIT, NYBA, NY City Bar, Pfizer, PwC and S&C.

⁴⁴ See Discussion in Section III.B.

⁴⁵ In June 2002, we proposed amendments to require registrants to file current reports on Form 8-K in the event of the creation of a direct or contingent material financial obligation or the occurrence of an event triggering a direct or contingent material financial obligation. See Release No. 33-8106 (June 17, 2002) [67 FR 42914]. If adopted, those current reporting requirements will keep investors apprised of material contingent obligations arising from off-balance sheet arrangements even if these fall below the “reasonably likely” threshold that we are adopting for MD&A disclosure.

⁴⁶ See, e.g., the letters of ICI, IMC, D&T, NYBA, Pfizer and PwC.

⁴⁷ See, e.g., the letters of Cleary, CSC, FTNC, NY City Bar and S&C.

⁴⁸ See, e.g., the letters of ACB, AFP, Boeing, CSC, FTNC, Cleary, NY City Bar and S&C.

⁴⁹ See, e.g., the letters of AFP, Boeing and Pfizer.

⁵⁰ See, e.g., the letters of BDO, Cleary, CSC, FTNC, NY City Bar, Pfizer and S&C.

⁵¹ See, e.g., the letters of ABA, ACB, AICPA, Boeing, CSC, IMC, KPMG and Pfizer.

⁵² *Id.*

⁵³ See Release No. 33-6349 (Sept. 28, 1981).

⁵⁴ See, e.g., Item 303(a)(4)(i)(A) of Regulation S-K [17 CFR 229.303(a)(4)(i)(A)].

⁵⁵ See, e.g., Item 303(a)(4)(i)(B) of Regulation S-K [17 CFR 229.303(a)(4)(i)(B)].

⁵⁶ See, e.g., Item 303(a)(4)(i)(C) of Regulation S-K [17 CFR 229.303(a)(4)(i)(C)].

⁵⁷ See, e.g., Item 303(a)(4)(i)(D) of Regulation S-K [17 CFR 229.303(a)(4)(i)(D)].

⁵⁸ See, e.g., Item 303(a)(4)(i) of Regulation S-K [17 CFR 229.303(a)(4)(i)].