

liquidity, capital expenditures or capital resources is not reasonably likely to occur. Consistent with other disclosure threshold determinations that management must make in drafting MD&A, the assessment must be objectively reasonable, viewed as of the time the determination is made.¹⁰¹

C. Disclosure About Off-Balance Sheet Arrangements

The amendments require a registrant to disclose the material facts and circumstances that provide investors with a clear understanding of a registrant's off-balance sheet arrangements and their material effects. To provide flexibility to registrants and to filter out disclosure of insignificant details, the amendments require disclosure of enumerated information only to the extent necessary to an understanding of a registrant's off-balance sheet arrangements and their material effects on financial condition, changes in financial condition, revenues and expenses, results of operations, liquidity, capital expenditures and capital resources. In addition to the enumerated information, the discussion must include such other information that the registrant believes is necessary for an understanding of its off-balance sheet arrangements and the specified material effects.¹⁰² The disclosure shall generally cover the most recent fiscal year, but it also should address changes from the previous year where such discussion is necessary to an understanding of the disclosure.¹⁰³

Under the amendments, a registrant must disclose the nature and business purpose of the off-balance sheet arrangements.¹⁰⁴ This disclosure should explain to investors why a registrant engages in off-balance sheet arrangements and should provide the information that investors need to understand the business activities advanced through a registrant's off-balance sheet arrangements. For example, a registrant may indicate that the arrangements enable the company to lease certain facilities rather than acquire them, where the latter would require the registrant to recognize a liability for the financing. Other possible disclosure under this requirement may indicate that the off-

balance sheet arrangement enables the registrant to readily obtain cash through sales of groups of loans to a trust; to finance inventory, transportation or research and development costs without recognizing a liability; or to lower borrowing costs of unconsolidated affiliates by extending guarantees to their creditors.

Under the amendments, a registrant must discuss the importance of its off-balance sheet arrangements to its liquidity, capital resources, market risk support, credit risk support or other benefits.¹⁰⁵ This disclosure should provide investors with an understanding of the importance of off-balance sheet arrangements to the registrant as a financial matter. For example, if a registrant materially relies on off-balance sheet arrangements for its liquidity and capital resources, a registrant may be required to disclose how often it securitizes financial assets, to what degree its securitizations are a material source of liquidity, whether it has materially increased or decreased securitizations from past periods and to explain such increase or decrease. Together with the other disclosure requirements, registrants should provide information sufficient for investors to assess the extent of the risks that have been transferred and retained as a result of the arrangements.

In addition, the disclosure should provide investors with insight into the overall magnitude of a registrant's off-balance sheet activities, the specific material impact of the arrangements on a registrant and the circumstances that could cause material contingent obligations or liabilities to come to fruition. Disclosure is required to the extent material and necessary to investors' understanding of:

- The amounts of revenues, expenses, and cash flows of the registrant arising from the arrangements;
- The nature and total amount of any interests retained, securities issued and other indebtedness incurred by the registrant in connection with such arrangements; and
- The nature and amount of any other obligations or liabilities (including contingent obligations or liabilities) of the registrant arising from the arrangements that are, or are reasonably likely to become, material and the triggering events or circumstances that could cause them to arise.¹⁰⁶

The discussion also must identify any known event, demand, commitment,

trend or uncertainty that will, or is reasonably likely to, result in the termination, or material reduction in availability to the registrant, of its off-balance sheet arrangements that provide the registrant with material benefits.¹⁰⁷ Under this requirement, a registrant must disclose, for example, any material contractual provisions calling for the termination or material reduction of an off-balance sheet arrangement. The disclosure also should address factors that are reasonably likely to affect the registrant's ability to continue using off-balance sheet arrangements that provide it with material benefits. For example, if a registrant's credit rating were to fall below a certain level, some off-balance sheet arrangements may require the registrant to purchase the assets or assume the liabilities of an unconsolidated entity. In addition, a change in a registrant's credit rating could either preclude or materially reduce the benefits to the registrant of engaging in off-balance sheet arrangements. In such cases, the registrant will have to disclose known circumstances that are reasonably likely to cause its credit rating to fall to the specified level and discuss the material consequences of the drop in ratings. In addition, the registrant must discuss the course of action that it has taken or proposes to take in response to a termination or material reduction in the availability of an off-balance sheet arrangement that provides material benefits.

The amendments contain a principles-based requirement stating that a registrant must provide other information that it believes to be necessary for an understanding of its off-balance sheet arrangements and the material effects of these arrangements on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.¹⁰⁸ The disclosure should provide investors with management's insight into the impact and proximity of the potential material risks that are reasonably likely to arise from material off-balance sheet arrangements.

The amendments instruct registrants to aggregate off-balance sheet arrangements in groups or categories that provide information in an efficient and understandable manner and avoid repetition and disclosure of immaterial

¹⁰¹ See Release No. 33-6835 (May 18, 1989) [54 FR 22427].

¹⁰² See, e.g., Item 303(a)(4)(i) of Regulation S-K [17 CFR 229.303(a)(4)(i)].

¹⁰³ See, e.g., Instruction 4 to paragraph 303(a)(4) of Regulation S-K [17 CFR 229.303]. Compare Instruction 1 to Item 303(a) of Regulation S-K [17 CFR 229.303].

¹⁰⁴ See, e.g., Item 303(a)(4)(i)(A) of Regulation S-K [17 CFR 229.303(a)(4)(i)(A)].

¹⁰⁵ See, e.g., Item 303(a)(4)(i)(B) of Regulation S-K [17 CFR 229.303(a)(4)(i)(B)].

¹⁰⁶ See, e.g., Item 303(a)(4)(i)(C) of Regulation S-K [17 CFR 229.303(a)(4)(i)(C)].

¹⁰⁷ See, e.g., Item 303(a)(4)(i)(D) of Regulation S-K [17 CFR 229.303(a)(4)(i)(D)].

¹⁰⁸ See, e.g., Item 303(a)(4)(i) of Regulation S-K [17 CFR 229.303(a)(4)(i)].