

ClientAlert

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Consider Financial Crisis Impact When Updating Risk Factors

Public companies should consider whether they need to revise the risk factors in their upcoming Form 10-K filings to reflect the impact of the global economic crisis. This client alert outlines the applicable SEC rules and suggests some topics that public companies might consider in reviewing their risk factors for this purpose.

The current financial crisis is so significant that it seems unlikely that public companies will be able to satisfy SEC reporting requirements without addressing its impact in the Form 10-K:

- Item 303(a)(i) of Regulation S-K requires Management's Discussion and Analysis of Financial Condition and Results of Operations ("**MD&A**") to "identify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way."
- Item 503(c) of Regulation S-K requires a discussion of risk factors, specifically "the most significant factors that make the offering speculative or risky."

MD&A will no doubt be the primary focus for most of the discussion concerning the impact of the economic crisis. But reporting companies should not overlook risk factors in their upcoming Form 10-Ks, even if they concluded that there was no need to update them in their most recent Form 10-Qs or, as a number of companies did, in Form 8-Ks. Companies may find the ever-expanding crisis has affected them or their securities in new or unanticipated ways. For example, some companies that considered updating risk factors in their most recent Form 10-Qs may have decided that they were only affected generically, such as by a decline in stock price, and that risk was already disclosed or did not need to be. However, for companies whose stock prices have continued to deteriorate, there may be related consequences that could become material, such as goodwill impairment, loss of S-3 eligibility, loss of WKSI status, defaults under covenants in debt indentures or loan agreements or even delisting by the exchange on which its securities trade.

In evaluating the need to update risk factors, a reporting company should focus on how the crisis has or may affect it or its securities in a material way. It should not put too much emphasis on macroeconomic trends and uncertainties at the expense of company-specific disclosures about how these trends or uncertainties could impact the company or its securities. That could be potentially misleading, particularly if general economic conditions are "blamed" or used as "cover"

for business problems they did not cause or aggravate in any material respect. And, the SEC staff generally discourages generic or non-company-specific risks in any event.

Each reporting company necessarily needs to do its own evaluation of how it or its securities has been or may be affected by the economic crisis. There is no "one-size-fits-all" list for risk factors for this situation. As a starting point, however, it is often helpful to see what other companies have done. Accordingly, we reviewed Form 10-Qs (or in the case of September 30 fiscal year filers, Form 10-Ks) recently filed by a variety of companies in industry segments in which our firm represents a number of clients, with a view to identifying topics that a broad cross-section of companies might consider in evaluating what, if any, risk factors should be updated in their next Form 10-K in light of the crisis.¹

The chart below summarizes the topics discussed in updated risk factors when that topic was addressed by more than 1% of the companies covered by the survey and the new or revised risk factor appeared to be linked to the economic crisis (rather than other company or industry issues). Given the significant differences among some of the industries covered by the survey, the chart summarizes the results as follows:

General	-	Companies in the aerospace/defense, automotive parts, consumer products, manufacturing and technology industries.
Energy	-	Companies in the electric power generation industry, including renewable energy and public utility companies.
Financial Services	-	Banks, broker/dealers, insurance companies, hedge funds and consumer finance companies.

¹ Our survey covered 116 companies that updated risk factors in Form 10-Q filings for the quarter ended September 30, 2008 (or Form 10-K filings for September 30 fiscal year filers). Many companies did not update risk factors in their Form 10-Qs, so the survey may not represent a statistically significant cross-section of likely risk factors that the industries covered will be using in their upcoming Form 10-Ks. The survey reviewed companies in the following industries:

- Aerospace & Defense
- Automotive Parts
- Consumer Products
- Energy (including renewable energy)
- Financial Services
- Industrial Products and Manufacturing
- Semiconductors and Related Technology

These industries were selected because they cover a broad range of our clients. These industries, or the companies selected, may not represent a statistically significant cross-section of the economy or reporting companies generally. Of the companies surveyed, approximately 78% were large accelerated filers, 10% were accelerated filers and 12% were non-accelerated filers or smaller reporting companies. Different results might have been obtained if we had sampled a larger number of smaller reporting companies or non-accelerated filers.

Risk Factors Addressed For Crisis Impact	Percent of General	Percent of Energy	Percent of Financial Services	Percent of All Surveyed Companies
Stock price volatility	8.57%	22.45%	12.50%	15.52%
Credit availability				
Direct credit availability	40.00%	65.31%	34.38%	49.14%
Customer/supplier credit	45.71%	28.57%	<1.0%	25.86%
Cost of credit	31.43%	40.82%	12.50%	30.17%
Debt downgrades	2.86%	10.20%	3.13%	6.03%
Commercial paper and bank funding	5.71%	24.49%	3.13%	12.93%
Assessing creditworthiness of customers	<1.0%	4.08%	12.50%	5.17%
Liquidity	17.14%	40.82%	46.88%	35.34%
Contract counterparty default risk				
Customers	28.57%	28.57%	<1.0%	20.69%
Suppliers	22.86%	8.16%	<1.0%	10.34%
Lenders	22.86%	22.45%	<1.0%	16.38%
Derivatives counterparties	2.86%	4.08%	12.50%	6.03%
Other (e.g., generic default risks not listed above)	<1.0%	32.65%	50.00%	27.59%
General business development				
Capital expenditures	5.71%	20.41%	<1.0%	10.34%
Expansion	14.29%	10.20%	<1.0%	8.62%
Acquisitions/sales of assets	5.71%	10.20%	9.38%	8.62%
Decrease in demand				
Company's products	65.71%	24.49%	34.38%	39.66%
Retail consumer	22.86%	6.12%	<1.0%	9.48%
Delay in payment of accounts receivables	22.86%	12.24%	<1.0%	12.07%
Insurance carrier default risk	8.57%	<1.0%	18.75%	7.76%
Pension funding	5.71%	16.33%	6.25%	10.34%
Asset write-down / goodwill impairment	5.71%	4.08%	12.50%	6.90%
Rating downgrades	2.86%	6.12%	40.63%	14.66%
Foreign currency/exchange rate risks	8.57%	4.08%	3.13%	5.17%
Commodity price risk	5.71%	22.45%	<1.0%	11.21%
Increased government regulation	2.86%	6.12%	50.00%	17.24%
Industry consolidation	<1.0%	2.04%	21.88%	6.90%
Others	34.29%	44.90%	81.25%	51.72%

Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:

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