

HOW SHOULD COMPANIES UPDATE RISK FACTORS AND MD&A DURING A GLOBAL TRADE WAR?

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As companies prepare to file Form 10-Qs, they should give special attention to risk factors in light of recently announced global tariffs. The situation is particularly challenging due to the fluid environment, including the possibility of retaliatory tariffs by foreign nations, as well as for negotiation or adjustments to tariffs by the U.S. and other countries.

Form 10-Q calls for disclosure of any material changes from risk factors as disclosed in the last Form 10-K. In our [July 29, 2020 post](#), we provided guidance to companies for updating risk factors included in a prior 10-Q when filing a second or third quarter 10-Q in the same fiscal year.

In addition, companies are instructed to address “known trends and uncertainties” in MD&A and to provide “such further information . . . as may be necessary to make the required statements, in the light of the circumstances under which they were made not misleading” pursuant to Rule 12b-20. Similar to [SEC staff guidance relating to Covid disclosures](#), companies should consider disclosing the impact of tariffs through the eyes of management, including, to the extent material:

- The effects on operations, liquidity and capital resources.
- Operational changes, such as changes to suppliers or manufacturing locations or substitutions of parts or raw materials.
- Known trends, events or uncertainties that are reasonably likely to have a material impact on the company results of operations or financial position.

As no two companies will likely experience the same effects, we identify below some of the factors to consider when developing risk factors for upcoming filings.

WIDE-RANGING EFFECTS OF GLOBAL TARIFFS AND POTENTIAL MITIGATION ACTIONS

- Magnitude of the company’s business subject to tariffs.

- Ability to mitigate tariffs through alternative sourcing or manufacturing, subject to potential shortages or longer lead times, particularly for companies whose supply chains depend on countries facing high tariffs, such as China, Cambodia and Vietnam.
- Ability to allocate tariff costs to counterparties under contract provisions, including pricing, force majeure, change in law and hardship clauses.
- Ability to implement duty savings or other sourcing strategies to mitigate the aggregate burden of tariffs.
- Ability to reclassify goods or other imported items on their declarations to customs authorities.
- Importance of accurately tracing supply chains to avoid fines or higher tariffs, as well as eligibility for government contracts.
- Ability to raise prices.
- Impact on profitability and/or margins.

POTENTIAL FOR ECONOMIC SLOWDOWN AND POSSIBLE CONSEQUENCES

- Potential increased likelihood of recession.
- Potential for significant reduction in consumer confidence and customer demand – particularly if combined with persistent or increased risk of inflation.
- Revaluation of credit markets and potential impact on interest rates.
- Potential for increases in problem loans and losses for lenders and stricter credit requirements for borrowers.
- Lower equity valuations and potential slowdown in capital markets.
- Effect of changes in the valuation of the U.S. dollar and other currencies.

BROAD RANGE OF UNCERTAINTIES

- Whether foreign nations will seek to negotiate or retaliate, particularly in light of dueling threats by China and the Administration.
- Whether the Administration will increase or expand tariffs against nations that retaliate.
- Willingness of U.S. to reconsider or adjust tariffs, including granting exemptions for particular goods or nations.

- Uncertain duration of trade conflicts.
- Legal challenges to the Administration’s authority to impose its tariff regime, including the applicability of IEEPA or the nondelegation or major questions doctrines.
- Whether Congress pursues proposed legislation to curtail Presidential authority to impose tariffs.
- Uncertain impact on the perception or reputation of U.S. products or services in foreign markets.
- Uncertainty for future capital expenditures or investment, pending clarity on global trade prospects.

FORWARD-LOOKING STATEMENT DISCLAIMERS

Similar to risk factors, companies should review the substance and priority of factors included in their FLS disclaimers, with careful attention to tailoring the listed factors to the specific forward-looking statements in the filing.

REFINING DISCLOSURE CONTROLS AND PROCEDURES

In order to prepare their disclosures, companies should:

- Utilize appropriate disclosure controls and procedures, and seek input from relevant constituencies, including operating units, procurement/sourcing teams, the law department and finance, to determine the scope and depth of impacts.
- Review each of the 10-K risk factors to evaluate which ones might need to be updated or supplemented or whether new ones should be added.
- Confer with IR and senior management to assess the state of existing knowledge and understanding by investors of the company’s situation and prospects.
- Review the most recent filings by other companies, particularly competitors or companies in adjacent industries, to benchmark risks they view as material.

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As with any disclosure, the best approach will depend on each company’s particular facts and circumstances. One size does not fit all. Ideally, the approach selected would represent the one that most effectively communicates the risks to investors.

When preparing risk factors, companies should remain mindful of the SEC's previously stated view that presenting risks as merely hypothetical can be misleading if the risk has actually occurred in the past. In the case of a Form 10-Q, this could become a concern if a company fails to update a material risk that had been presented in the Form 10-K as merely theoretical or hypothetical but subsequently materialized before the 10-Q filing. While Commissioners Peirce and Uyeda have questioned whether updating risk factors is always required, the Supreme Court recently decided not to hear a case presenting the issue. In light of the pervasive effects of a potential trade war, a careful review of 10-K risk factors, along with other steps listed above, can help to address that concern.

RELATED PRACTICE AREAS

- Securities & Corporate Governance
- International Trade

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