

SEC Amends Disclosure Rules Regarding Business Description, Legal Proceedings, and Risk Factors

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On August 26, 2020, the Securities and Exchange Commission (SEC) adopted amendments to modernize disclosure requirements in Regulation S-K Item 101 (business description), Item 103 (legal proceedings), and Item 105 (risk factors). As we previously discussed [here](#), the SEC proposed the amendments in August 2019 to improve the readability of disclosure documents, discourage disclosure of immaterial or repetitive information, and simplify compliance efforts for registrants. The amendments have been adopted largely as proposed, with certain modifications.

The SEC stated that the amendments, while prescriptive in some respects, are intended to emphasize a principles-based approach to disclosure, which allows registrants to decide what information is material to investors, tailored to each registrant's individual facts and circumstances. Through implementation of the amendments, the SEC aims to "facilitate an understanding of a registrant's business, financial condition and prospects through the lens through which management and the board of directors manage and assess the performance of the registrant." The amendments are summarized below. Redlines reflecting the differences between the current and amended Items 101, 103, and 105 of Regulation S-K appear as Annexes A, B, and C, respectively.

General Development of Business — Item 101(a) of Regulation S-K

The amendments revise Item 101(a) primarily to:

- Implement a principles-based approach, requiring disclosure only of information material to an understanding of the general development of the business.
- Present a non-exhaustive list of topics to be considered for disclosure, if material, adding as a suggested topic any material changes to a previously disclosed business strategy.
 - The SEC declined to add a requirement to disclose business strategy annually, in favor of the principles-based disclosure approach, but stated that once a registrant has disclosed its business strategy, the SEC believes it is appropriate for the registrant to discuss changes to that strategy to the extent material to an

understanding of the development of the registrant's business.

- Eliminate the five-year time frame for this disclosure in favor of the materiality framework.
- Add a new provision allowing registrants to provide in filings after their initial filing an update focusing on material business developments since the last full discussion, rather than a full discussion of the development of their business. However:
 - If a registrant chooses to provide only an update, it must incorporate the most recent full discussion of the general development of its business by reference to a single previously filed document (including an active hyperlink).
 - A registrant that uses the update option must include disclosure of all the material developments that have occurred since the most recent full discussion of the general development of its business.
 - A filing that provides only updates to the full discussion and incorporates the full discussion by reference cannot be incorporated by reference into a subsequent filing, such as a registration statement on Form S-3 or S-4, which will limit the usefulness of the update option.

Narrative Description of Business — Item 101(c) of Regulation S-K

The amendments revise Item 101(c) primarily to:

- Implement a principles-based approach, requiring disclosure of the registrant's business done and intended to be done, focusing on each reportable segment, but requiring only information material to an understanding of the business as a whole.
- Present a streamlined, non-exhaustive list of topics to be considered for disclosure, if material.
- Expand the regulatory compliance disclosure topic to include disclosure of the material effects of compliance with all government regulations, rather than just environmental laws.
 - Although there is currently no separate line item requiring disclosure of government regulations material to a registrant's business, it is already common practice for registrants to provide this information.
- Add the following topic to the list of topics to be considered for disclosure, if material: "A description of the registrant's human capital resources, including the number of persons employed by the registrant, any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the development, attraction and retention of personnel)."
 - As an example, the SEC noted that a registrant will be required to disclose its part-time employees, full-time employees, independent contractors, and contingent workers, and employee turnover, to the extent such information is material to

understanding the registrant's business.

In his public statement regarding the amendments (available [here](#)), SEC Chairman Jay Clayton highlighted the topic of human capital resources disclosure, stating, "I fully support the requirement in today's rules that companies must describe their human capital resources, including any human capital measures or objectives they focus on in managing the business, to the extent material to an understanding of the company's business as a whole. From a modernization standpoint, today, human capital accounts for and drives long-term business value in many companies much more so than it did 30 years ago. Today's rules reflect that important and multifaceted shift in our domestic and global economy." Chairman Clayton noted that the rules require that, in crafting this disclosure, companies must incorporate metrics, if any, that the company focuses on in managing the business, to the extent material to an understanding of the company's business as a whole. He stated that while the SEC did not adopt a requirement to disclose any particular metric, he does "expect to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs."

Smaller Reporting Companies — Description of Business — Item 101(h) of Regulation S-K

The amendments revise Item 101(h) primarily to:

- Eliminate the three-year time frame for this disclosure in favor of the materiality framework.
- Add a new provision allowing registrants to provide an update focusing on material business developments since the last full discussion, rather than a full discussion of the development of the registrant's business, similar to the provision in Item 101(a) discussed above.

Legal Proceedings — Item 103 of Regulation S-K

The amendments revise Item 103 primarily to:

- Expressly permit required information to be provided by hyperlink or cross-reference to disclosure of legal proceedings elsewhere within the document (e.g., Management's Discussion and Analysis, Risk Factors, or notes to financial statements).
- Increase the quantitative threshold for disclosure of environmental proceedings involving potential monetary sanctions to which the government is a party, from \$100,000 to \$300,000, or, at the election of the registrant, its own disclosure threshold that meets the following parameters:
 - Does not exceed the lesser of \$1 million or 1% of the current assets of the registrant and its subsidiaries on a consolidated basis.
 - Is reasonably designed to result in disclosure of any such proceedings material to the business or financial condition of the registrant.
 - Is disclosed (including any change thereto) in each annual and quarterly report.

Risk Factors — Item 105 of Regulation S-K

The amendments revise Item 105 primarily to:

- Require the registrant, if its risk factor disclosure exceeds 15 pages, to include a risk factor summary limited to two pages. The risk factor summary must consist of concise bulleted or numbered statements summarizing the principal risk factors.
- Require organization of risk factors under headings, in addition to the subcaptions currently required. The SEC noted that many registrants already organize their risk factors disclosure through groupings of related risk factors and the use of headings.
 - Although the SEC declined to require prioritization of risk factors, doing so is considered a best practice.
- Require risk factors that could apply to any company or offering of securities to be disclosed under a separate heading “General Risk Factors,” located at the end of the Risk Factors section.
 - The SEC noted that despite the fact that the current rule instructs registrants not to present generic risks, it is not uncommon for companies to include them. As amended, the rule provides that the “presentation of risks that could apply generically to any registrant or any offering is discouraged...” In the release adopting the amendments, the SEC encourages registrants to tailor their risk factors to emphasize the specific relationship of the risk to the registrant or the offering, thereby avoiding the need to include the risk under the General Risk Factors heading.
- Refine the principles-based approach of the rule by changing the rule’s language to require disclosure of “material” factors instead of the “most significant” factors.

The [amendments go into effect](#) 30 days after publication in the Federal Register.

The full text of the final amendments can be found [here](#).