

SEC Adopts Amendments to Disclosures of Business Issues (Item 101), Legal Proceedings (Item 103), and Risk Factors (Item 105) Under Regulation S-K

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On August 26, 2020, the United States Securities and Exchange Commission (“SEC”) adopted revisions to the disclosure requirements under Item 101 – Description of the Business, Item 103 – Legal Proceedings, and Item 105 – Risk Factors of Regulation S-K to “modernize” disclosure requirements in order to provide investors with more meaningful information regarding the registrant’s securities, reduce the burden on registrants to disclose matters that might be immaterial to their business, and enable registrants to tailor disclosures to more accurately match their particular circumstances. These regulations had not been substantially revised for over 30 years and, due to changes in the economy, technology, availability of information, inflation, and other areas, some disclosures made pursuant to these items had become generic, repetitive, or nonmaterial and therefore of limited use to investors and onerous for registrants to navigate.

The changes will become effective 30 days after the final rule is published in the *Federal Register*.

Item 101 – Description of the Business

Item 101(a)

Item 101(a) of Regulation S-K has historically required disclosure of the general development of a registrant’s business, its subsidiaries, and any predecessors during the past five years, or such shorter period as the registrant may have been engaged in business, and prescribed certain categories of disclosures.

The amendments to Item 101(a) eliminate the five-year timeframe in order to permit registrants to make disclosures as frequently as appropriate and provide for principles-based disclosure of information material to an investor’s understanding of the general development of the registrant’s business. Under the amended item, disclosure may include, but should not be limited to, the following topics:

- any material changes to a previously disclosed business strategy;

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- the nature and effects of any material bankruptcy, receivership, or any similar proceeding with respect to the registrant or any of its significant subsidiaries;
 - the nature and effects of any material reclassification, merger, or consolidation of the registrant or any of its significant subsidiaries; and
 - the acquisition or disposition of any material amount of assets other than in the ordinary course of business.

The amendments to Item 101(a) provide additional flexibility for registrants to disclose only information that aids in the understanding of the business as opposed to having to provide irrelevant disclosures to ensure compliance with the item. With the five-year timeframe eliminated from Item 101(a), registrants may now provide disclosure from beyond the five-year period or for a shorter period if all material aspects of their business are described. Further, principles-based disclosures permit registrants to provide disclosure only to the extent required for an understanding of the business without potentially requiring disclosure of confidential or sensitive information.

The amendments to Item 101(a) also permit a registrant to incorporate by reference, by use of a hyperlink, the most recent full discussion of the general development of the business from a prior filing and provide only an update to the discussion focused on any material changes in the applicable reporting period. Note, however, that the amended item only permits reference to a single prior document for the full discussion of the business. If there have been material changes disclosed in prior filings that did not contain the full discussion of the development of the business and are still relevant, these updated disclosures must be included in the current filing again. The registrant may, in the alternative, provide a full discussion of the development of the business in any subsequent filing without linking back to previous disclosures.

Item 101(c)

Item 101(c) of Regulation S-K has historically required a narrative description of a registrant's business, including, to the extent material, a list of items explicitly set forth in the item. The amendments to Item 101(c) instead provide for a principles-based approach to disclosures with the following non-exclusive list of disclosure topics drawn in part from the existing list of topics in Item 101(c), to provide for more informative and relevant disclosures:

- revenue-generating activities, products, and/or services, and any dependence on revenue-generating activities, key products, services, product families, or customers, including governmental customers;
- status of development efforts for new or enhanced products, trends in market demand, and competitive conditions (with the caveat that disclosure of proprietary information is not required);
- resources material to a registrant's business; including both sources and availability of raw materials and the duration and effect of all patents, trademarks, licenses, franchises, and concessions held;
- a description of any material portion of the business that may be subject to renegotiation of profits or termination of contracts or subcontracts at the election of the government;

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- seasonality of the business;
 - material effects that compliance with government regulations, including environmental regulations, may have upon the capital expenditures, earnings, and competitive position of the registrant and its subsidiaries, including the estimated capital expenditures for environmental control facilities for the current fiscal year and any other material subsequent period; and
 - a description of the registrant's human capital resources, including the number of persons employed by the registrant, and 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).

The amendments to Item 101(c) add as a disclosure topic the description of the registrant's human capital resources and refocuses the regulatory compliance disclosures to include all material government regulations, not just environmental laws.

Item 101(h)

The final rule also includes corresponding amendments to the disclosure requirements for smaller reporting companies in Item 101(h) of Regulation S-K by eliminating the three-year disclosure timeframe as previously provided in the item and permitting the use of hyperlinks to prior disclosures in subsequent filings.

Item 103 – Legal Proceedings

Item 103 of Regulation S-K generally requires disclosure of any material pending legal proceedings, excluding routine litigation incidental to the business, and disclosure of certain details of the proceeding (court or agency, date, parties, facts all alleged, relief sought). In addition, Item 103 currently requires disclosure of proceedings under environmental laws unless the registrant believes the monetary sanctions under such proceeding would not exceed \$100,000.

In order to minimize repetitive or duplicative disclosure under this item, the amendments to Item 103 permit a registrant to use hyperlinks or cross-references to other sections of a filing where these same details are provided, such as management's discussion & analysis (MD&A), risk factors, or notes to financial statements. In addition, the SEC determined that the one-size-fits-all threshold of \$100,000 of monetary sanctions for disclosure of certain environmental proceedings is ineffective in soliciting meaningful disclosure of these proceedings. As a result, the amendments to Item 103 require disclosure for certain environmental proceedings that involve potential monetary sanctions of \$300,000 or more, or such other amount that the registrant determines, in its discretion, will result in the disclosure of all material proceedings. If the registrant elects to use a threshold other than \$300,000, it must also disclose that threshold in each annual and quarterly report. Note, however, that disclosure will be required, regardless of the registrant's determination of its threshold, for any proceeding that could result in sanctions over the lesser of one million dollars or 1% of the current assets of the registrant and its subsidiaries.

Item 105 – Risk Factors

Item 105 of Regulation S-K requires disclosure of the material factors that make an investment in the registrant speculative or risky. The amendments to Item 105 are tailored to make disclosures under this item concise, logical, and less generic so as to provide more meaningful and useful information to investors. Specifically, the amendments to Item 105 (1) require a concise, bulleted, or numbered summary of the risk factors, no longer than two pages in length, if the risk factors section exceeds 15 pages, (2) refine the principles-based approach to disclosure of only the “material” risk factors opposed to the “most significant” risk factors, and (3) require disclosure of risk factors to be organized under relevant headings in addition to the subcaptions currently required, with any risk factors that may generally apply to an investment in the registrant’s securities disclosed at the end of the risk factor section under a separate caption.

The amendments to Item 105 are intended to help investors get a quick understanding of the most important risks in longer disclosures, to reduce the disclosure of generic risks applicable to all businesses, to help registrants tailor risk factor disclosures to include only those risks that are of particular importance, and to help investors quickly find and focus on the risks they deem most important and understand the general types of risks facing the registrant that may be material to their investment.

Conclusion

The amendments to Regulation S-K are designed to make disclosures under these items easier to comply with and more informative for investors. Prior to the amendments, disclosures under these items could provide many pages of nonmaterial information, included only to comply with outdated requirements. Under the amendments, registrants should be able to more easily prepare their disclosures by referencing only information applicable and material to their specific business and eliminating duplicative disclosures by the use of hyperlinks and cross-references.

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