

SEC Disclosure Requirement Amendments to Regulation S-K: Description of Business, Legal Proceedings, and Risk Factors

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Effective Nov. 9, 2020, the Securities and Exchange Commission's (SEC) amendments to "modernize the description of business, legal proceedings, and risk factor disclosures" required under Regulation S-K take effect. These amendments largely follow the proposed amendments, dated Aug. 8, 2019,^[1] with some clarifications. The intent of the amendments is to improve the disclosure regime, which has not had a major overhaul in over thirty years. Below is a summary of the changes to the disclosure requirements regarding description of business, legal proceedings, and risk factors, as well as some considerations to keep in mind for the filing of a Q3 Form 10-Q.

Description of Business

Item 101(a) no longer requires a registrant to provide a description of the business development for the previous five years (or three years for smaller reporting companies). The amendments require the disclosure of material information to the understanding of the business development, without the specific lookback. Subsequent to any initial filing, which includes a Description of Business, a registrant is now able to simply provide an update to the material developments of the business that have taken place since the most recent full discussion disclosure. This can be accomplished by including a hyperlink to the most recent full discussion disclosure.

Item 101(c) is revised to expand upon the principles-based approach to disclosure by removing the current list of specific items and replacing it with a non-exclusive list of disclosure topic examples, some of which were already included in the former list. The elimination of the prescribed disclosure topics list and suggested non-exclusive list is designed to remove disclosure not material to a particular registrant. Now, a registrant is required to disclose only the information, which taken as a whole, is material to the understanding of the business. This less prescriptive approach is intended to force registrants to think more holistically about their business and tailor the disclosures appropriately to what is material to the understanding of the business.

To the extent it would be material to the business understanding, the amendments require a description of human capital resources. The SEC decided not to define "human capital," given the term is potentially malleable and also may take on different meanings across various industries.

These disclosures must be tailored to the registrant's unique business and shall include any human capital objectives the registrant utilizes in managing the business.

Although registrants are not required to disclose their business strategy, registrants must now disclose material changes to a previously disclosed business strategy. Similar to human capital, "business strategy" is intentionally undefined, providing registrants with flexibility to tailor these disclosures to their specific set of facts and circumstances.

The regulatory compliance disclosure has been shifted from being applicable to environmental laws only to all material government regulations. The SEC opted not to include climate change or diversity disclosures in the amendments.

Legal Proceedings

While it was common practice to cross-reference to legal proceedings disclosed elsewhere, Item 103 is revised to expressly allow registrants to internally hyperlink to legal proceedings disclosure located elsewhere in the document, which will help avoid duplicative disclosure.

For disclosure of environmental proceedings where the government is a party, the amendments provide a modified disclosure that raises the existing threshold from \$100,000 to \$300,000, while also providing the registrant flexibility to use another threshold amount reasonably designed to result in disclosure of any such proceeding material to its business or financial condition. Provided, however, that disclosure will be required in all cases where the potential monetary sanctions exceed the lesser of: (1) \$1 million or (2) 1 percent of the current assets of the registrant and its subsidiaries on a consolidated basis.

Risk Factors Disclosure

Similar to the changes in Items 101 and 103, Item 105 is refined to implement a principles-based approach by requiring a registrant to disclose risk factors that are material instead of most significant. The intent of the amendment is to tailor the risk factor disclosure to the registrant and reduce the inclusion of generic risk factors, while potentially shortening the length of the risk factor disclosure, benefitting both the investors and registrants.

If a registrant's risk factor disclosure is more than 15 pages, the registrant will be required to also provide a bulleted or numbered summary, which is limited to no more than two pages, detailing why an investment in the registrant or an offering by the registrant is speculative or risky. Therefore, this forces registrants to make some choices about the relative materiality of the risk factors relating to their business when selecting which to include in the summary.

In addition to the sub-captions currently required, registrants must now organize risk factor disclosure under relevant headings. The amendments do not require the prioritization of the order of the risk factors. However, the SEC did note such prioritization could be beneficial to users of the disclosure, but the registrant will have the flexibility in selecting the order that most effectively presents the risk factors. The amendments require the registrant to include a separate heading for risk factors generally applicable to investments in securities at the end of the risk factor section.

What You Should Be Doing Now

In addition to the effective date of these amendments, Nov. 9, 2020 is also the deadline for calendar fiscal year-end large accelerated filers and accelerated filers to file their Q3 Form 10-Q.[2] The most likely amended rule to have a potential impact on a registrant's Q3 Form 10-Q filing is Item 103. A registrant is able to utilize the new Item 103's modified disclosure for government environmental proceedings by complying with the higher threshold (\$300,000) or a registrant's chosen threshold, subject to the restrictions placed in Item 103. Additionally, it is possible for amended Item 105 to impact a registrant's Q3 Form 10-Q. Item 1A to Part II of Form 10-Q requires registrants, "Set forth any material changes from risk factors as previously disclosed in the registrant's Form 10-K in response to Item 1A to Part 1 of Form 10-K." Therefore, if there are significant modifications to the risk factors previously disclosed in a registrant's Form 10-K, the registrant should comply with the amended rules of Item 105. Because Form 10-Q does not require disclosure under Item 101, the Item 101 amendments will have no impact with the upcoming 10-Q filing.

[1] See *Modernization of Regulation S-K Items 101, 103, and 105*, Release No. 33-10668 (Aug. 8, 2019) [84 FR 44358 (Aug. 23, 2019)]

[2] The Q3 Form 10-Q deadline for calendar year-end non-accelerated filers is November 16, 2020.

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