

## Insights

# DIVIDED SEC AMENDS REGULATION S-K RULES TO MODERNIZE DESCRIPTIONS OF BUSINESS, LEGAL PROCEEDINGS AND RISK FACTORS

Aug 26, 2020

On August 26, 2020, by a 3-2 party-line vote, the SEC adopted amendments to Regulation S-K that aim to modernize the descriptions of business and legal proceedings, and risk factor disclosure requirements. The amendments reflect a principles-based approach in which disclosure objectives are set and management is permitted to exercise judgment on how to satisfy those objectives – tailored to the particular registrant – to the extent such information is material to an understanding of the topic.

Two of the Commissioners ([Lee](#) and [Crenshaw](#)) issued dissents expressing strong concern that the amendments did not address ESG issues. In particular, they criticized the adopting release for, among other things, remaining silent on the topics of diversity and climate risk, despite significant interest among a broad range of investors, and expressing the view that the principles-based approach does not ensure that companies have considered the materiality of those issues.

The amendments will be effective 30 days after publication in the Federal Register.

## AMENDMENTS TO REGULATION S-K

The amendments revise disclosure requirements for registrants under Items 101(a) (description of the general development of the business), 101(c) (narrative description of the business), 103 (legal proceedings) and 105 (risk factors) of Regulation S-K. According to the SEC:

“The [amended] rules are designed for this information to be presented on a basis consistent with the lens that management and the board of directors use to manage and assess the registrant's performance. The modernization of Items 101, 103, and 105 is intended to elicit improved disclosures, tailored to reflect registrants' particular circumstances, which are designed will improve disclosures for investors and add efficiencies to the compliance efforts of registrants. The amendments are also intended to improve the readability of disclosure documents, as well as discourage repetition and reduce the disclosure of information that is not material.”

The amendments to Items 101 and 103 will affect only domestic registrants and “foreign private issuers” that have elected to file on domestic forms subject to Regulation S-K disclosure requirements. Regulation S-K does not apply to foreign private issuers unless a form reserved for foreign private issuers (such as Securities Act Form F-1, F-3, or F-4) specifically refers to Regulation S-K.

Certain conforming amendments were made to Form S-4 and Schedule 14A.

## **Description of Business (Items 101(a) and (c))**

The amendments provide a nonexclusive list of the types of information that a company may need to disclose, based on a principles-based approach. For example, a company would describe its dependence on key products and services that are material instead of focusing on products and services that meet the quantitative thresholds based on revenue currently prescribed in Item 101(c)(1)(i).

The revised list of disclosure topics relating to the general development of a company’s business and accompanying business description:

- Eliminates the look-back in Item 101(a) – generally five years, or three years for smaller reporting companies – to focus on material developments of a company’s business, regardless of a specific time frame.
- Permits inclusion of only updated disclosures in subsequent filings of material developments in the reporting period, along with a hyperlink to the most recent filing that, together with the update, provides a full discussion of the general development of the business. Otherwise, the registrant must provide a complete discussion, including any material updates.
  - Eliminates the requirement to disclose transactions and events that affect or may affect operations, as they would be required in MD&A.
  - Adds a reference to material changes to any previously disclosed business strategy (without mandating disclosure of such strategy if not previously provided, consistent with the principles-based approach).
- Revises and expands the list of disclosure topics in Item 101(c) with a principles-based, non-exclusive list of topics, including:
  - 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 market demand, and competitive conditions (with the SEC noting that the principles-based approach permits sufficiently

flexibility to allow omission of proprietary or other sensitive information)

- Resources material to a registrant's business, such as (i) sources and availability of raw materials and (ii) the duration and effect of all patents, trademarks, licenses, franchises, and concessions (with no reference to copyright and trade secret protections due to cost and other concerns)
- 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
- The extent to which the business is or may be seasonal

The discussion should focus on the dominant segment or each reportable segment, provided that only information material to an understanding of the business taken as a whole is required.

- Require, to the extent material, new disclosures regarding "human capital resources," which includes any human capital measures or objectives that management focuses on in managing the business. Depending on the nature of the company's business and workforce, this would require disclosure of measures or objectives that address the attraction, development and retention of personnel.
  - The SEC decided not to define the term "human capital" as it may evolve and be used differently by industry.
  - In contrast to the proposal, the SEC decide to require disclosure, to the extent material, of the number of employees, as currently required. It believes that figure can help investors assess the size and scale of operations as well as changes over time, and provide context to any discussion of human capital management.
- Expands the current requirement to disclose the impact of environmental regulations to cover all material government regulations.
  - Information regarding human capital resources and government regulations is required to be discussed for the registrant's business in general and, when material, the segments to which these matters are significant also must be identified.
- Eliminates references to working capital practices, new segments and the dollar amount of backlog, although the SEC noted they should still be disclosed if material.

## **Legal Proceedings (Item 103)**

The amendments, among other changes:

- Clarify that hyperlinks or cross-references to legal proceedings disclosure elsewhere in the same document (e.g., MD&A, risk factors or a note to the financial statements) are permitted to avoid duplication.
- Establish alternative disclosure thresholds, where disclosure would be required for environmental proceedings to which a governmental authority is a party if such proceeding involves potential monetary sanctions, unless the registrant reasonably believes such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than:
  - \$300,000 or more – tripled from the current \$100,000 level; or
  - At the election of the registrant, such other amount that the registrant determines is reasonably designed to result in disclosure of any such proceeding that is material to its business or financial condition; however, the threshold may not exceed the lesser of \$1 million or 1% of the current assets of the registrant on a consolidated basis. (If elected, the alternative threshold must be disclosed in each periodic report, including any changes).

## **Risk Factors (Item 105)**

The amendments, among other changes:

- Require a summary – that does not exceed two pages – if the risk factors section exceeds 15 pages, in the form of a series of concise, bulleted or numbered statements.
  - The SEC estimates the 15-page threshold will affect approximately 40% of filers.
- Replace the disclosure standard from “most significant” to “material” risk factors to focus on factors that make an investment in the registrant or offering speculative or risky.
  - The SEC hopes the change will result in more tailored disclosure and reduce the inclusion of generic risk factors and potentially shorten the discussion.
- Require risk factors to be organized under relevant headings in addition to the sub-captions currently required, with any risk factors that may generally apply to an investment in securities disclosed at the end of the risk factor section under a separate caption (“General Risk Factors”), to help investors better understand lengthy risk factor disclosures.
  - The SEC believes that inclusion of risk factors under the “General Risk Factor” caption should not, by itself, affect the availability of the PSLRA safe harbor. Nevertheless, it encourages registrants to tailor their risk factor disclosures to emphasize the specific relationship of the risk to the registrant or the offering and therefore avoid the need to include the risk under the general risk heading.

- The amendments do not require companies to prioritize risk factors, as they are intended to provide flexibility to determine the order to most effectively present them.

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For further information on this topic, please contact [Randy Wang](#), [Vicki Westerhaus](#) or any other BCLP Securities and Corporate Governance lawyer. Additional resources are available on our Website for the [BCLP Securities and Corporate Governance Practice](#). Bryan Cave Leighton Paisner LLP makes available the information and materials in its Website for informational purposes only. The information is general in nature and does not constitute legal advice. Further, the use of this site, and the sending or receipt of any information, does not create any attorney-client relationship between us. Therefore, your communication with us through this Website will not be considered as privileged or confidential.

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- Securities & Corporate Governance

## MEET THE TEAM



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