

## SEC adopts amendments to modernize disclosures under Regulation S-K



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On Aug. 26, 2020, the U.S. Securities and Exchange Commission (SEC) voted to adopt amendments to modernize the description of business, legal proceedings and risk factor disclosures that public companies are required to make pursuant to Regulation S-K.<sup>1</sup> Notably, the amendments will also require new human capital disclosures, to the extent such disclosures would be material to an understanding of the company's business.

The amendments are intended to elicit improved disclosures that are tailored to reflect a company's circumstances, improve the readability of disclosure documents for investors, and discourage repetition and the disclosure of immaterial information. The amendments will be effective 30 days after publication in the Federal Register. Accordingly, companies should consider whether these amendments may be in effect at the time they file their Form 10-Q for the third quarter. However, these amendments are more likely to have a greater impact on a company's Form 10-K for fiscal year 2020.

### Items 101(a) and 101(c): Description of business

Item 101(a) of Regulation S-K currently requires a description of the general development of the company's business during the past five years, or such shorter period as the company may have been engaged in business. In order to provide companies more flexibility to tailor disclosures to their unique circumstances, the amendments eliminate the prescribed five-year disclosure timeframe and instead require disclosure of information material to an understanding of the development of the business, regardless of a specific timeframe. A corresponding change was made to the smaller reporting companies' three-year lookback period.

Item 101(a) has also been amended to include a non-exclusive list of four topics, and disclosure on these topics will only be required to the extent the disclosure is material to an understanding of the general development of the business. Information not included under one of the four listed topics would continue to be required if material to an understanding of the general development of the company's business. The four topics are:

1. Any material changes to a previously disclosed business strategy;
2. The nature and effects of any material bankruptcy, receivership or any similar proceeding with respect to the company or any of its significant subsidiaries;
3. The nature and effects of any material reclassification, merger or consolidation of the company or any of its significant subsidiaries; and
4. The acquisition or disposition of any material amount of assets otherwise than in the ordinary course of business.

<sup>1</sup> Please see the Regulation S-K Modernization Summary at the end for a brief overview of the existing requirements as well as a summary of the final amendments.

*The information contained herein is based on a summary of legal principles. It is not to be construed as legal advice and does not create an attorney-client relationship. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.*

Additionally, disclosure of both the year and form of organization is also no longer specifically required under Item 101(a).

For filings after its initial registration statement, a company may provide an update of the general development of its business, disclosing any material developments that have occurred since the most recently filed full discussion of the general development of its business. Companies that take this approach must incorporate by reference the most recent filing that contains that full discussion.

Item 101(c), which requires a narrative description of a company's business, was also amended. Specifically, the amendments:

1. Provide a non-exclusive list of disclosure topic examples that is drawn, in part from the current topics listed in Item 101(c);<sup>2</sup>
2. Include as a disclosure topic, a description of the company's human capital resources to the extent material to an understanding of the company's business, including any human capital measures or objectives that the company focuses on in managing the business; and
3. Refocus the regulatory compliance disclosure requirement by including all material government regulations as a topic, not just environmental laws as was previously required.

With respect to human capital, the final amendments identify various human capital measures and objectives that address the attraction, development and retention of personnel as non-exclusive examples of subjects that may be material, depending on the nature of the company's business and workforce. The SEC emphasizes that a company's disclosure must be "tailored to its unique business, workforce, and facts and circumstances." Companies will still need to disclose, to the extent material to understanding a company's business, the number of employees they have.

### **Item 103: Legal proceedings**

Under Item 103 of Regulation S-K, companies are currently required to disclose any proceeding under environmental laws to which a governmental authority is a party unless the company reasonably believes it will not result in sanctions of \$100,000 or more. The final amendments increase the quantitative threshold for disclosure of those proceedings to \$300,000. However, the amendments also afford a company some flexibility by allowing the company, at its election, to select a different threshold that it determines is reasonably designed to result in disclosure of material environmental proceedings, provided that the threshold does not exceed the lesser of \$1 million or one percent of the current assets of the company.

The final rules also clarify that companies are permitted to provide disclosure responses to Item 103 by hyperlink or cross-reference to legal proceedings disclosures elsewhere in the document, such as in the MD&A, risk factors or a note to the financial statements.

### **Item 105: Risk factors**

Item 105 of Regulation S-K requires disclosure of the most significant factors that make an investment in the company or offering speculative or risky and specifies that the discussion should be concise and organized logically. Under the final amendments, if a company's risk factor disclosure exceeds 15 pages, it must include a concise, bulleted or numbered statement, which is no more than two pages, summarizing the principal risk factors that make an investment in the company or offering speculative or risky.

Finally, the amended rules will require companies to organize their risk factors under relevant headings in addition to the sub-captions that are currently required. Companies will be required to present risks that could apply generally to any company or offering of securities at the end of the risk factor section under the caption "General Risk Factors."

<sup>2</sup> The updated list of disclosure topics include the following: "(i) Revenue-generating activities, products and/or services, and any dependence on revenue-generating activities, key products, services, product families or customers, including governmental customers; (ii) Status of development efforts for new or enhanced products, trends in market demand and competitive conditions; (iii) Resources material to a company's business, such as: (A) Sources and availability of raw materials; and (B) The duration and effect of all patents, trademarks, licenses, franchises, and concessions held; (iv) 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; and (v) The extent to which the business is or may be seasonal."

**Regulation S-K modernization summary**

Regulation S-K item	Summary of existing item requirements	Summary of the final amendments
<p><b>Item 101(a)</b></p>	<p>Requires a description of the general development of the business of the company during the past five years, or such shorter period as the company may have been engaged in business.</p>	<p>Revises Item 101(a) to:</p> <ul style="list-style-type: none"> <li>▪ Be largely principles-based, requiring disclosure of information material to an understanding of the general development of the business, and eliminating the previously prescribed five-year timeframe.</li> </ul> <p>Revises Item 101(h) to:</p> <ul style="list-style-type: none"> <li>▪ Eliminate the three-year timeframe with respect to smaller reporting companies.</li> </ul> <p>Revises Items 101(a) and (h) to clarify that:</p> <ul style="list-style-type: none"> <li>▪ Companies, in filings made after a company's initial filing, may provide an update of the general development of the business rather than a full discussion. The update must disclose all of the material developments that have occurred since the company's most recent filing containing a full discussion of the general development of its business, and incorporate by reference that prior discussion</li> </ul>
<p><b>Item 101(c)</b></p>	<p>Requires a narrative description of the business done and intended to be done by the company and its subsidiaries, focusing upon the company's dominant segment or each reportable segment about which financial information is presented in its financial statements. To the extent material to an understanding of the company's business taken as a whole, the description of each such segment must include disclosure of several specific matters.</p>	<p>Revises Item 101(c) to:</p> <ul style="list-style-type: none"> <li>▪ Clarify and expand the principles-based approach of Item 101(c), with a nonexclusive list of disclosure topic examples (drawn in part from the topics currently contained in Item 101(c));</li> <li>▪ Include, as a disclosure topic, a description of the company's human capital resources to the extent such disclosures would be material to an understanding of the company's business; and</li> <li>▪ Refocus the regulatory compliance disclosure requirement by including as a topic all material government regulations, not just environmental laws.</li> </ul>

<p><b>Item 103</b></p>	<p>Requires disclosure of any material pending legal proceedings including the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Similar information is to be included for any such proceedings known to be contemplated by governmental authorities. Contains a threshold for disclosure based on a specified dollar amount (\$100,000) for proceedings related to Federal, State, or local environmental protection laws.</p>	<p>Revises Item 103 to:</p> <ul style="list-style-type: none"> <li>▪ Expressly state that the required information may be provided by hyperlink or cross-reference to legal proceedings disclosure located elsewhere in the document to avoid duplicative disclosure; and</li> <li>▪ Implements a modified disclosure threshold that increases the existing quantitative threshold for disclosure of environmental proceedings to which the government is a party from \$100,000 to \$300,000, but that also affords a company the flexibility to select a different threshold that it determines is reasonably designed to result in disclosure of material environmental proceedings, provided that the threshold does not exceed the lesser of \$1 million or one percent of the current assets of the company and its subsidiaries on a consolidated basis.</li> </ul>
<p><b>Item 105</b></p>	<p>Requires disclosure of the most significant factors that make an investment in the company or offering speculative or risky and specifies that the discussion should be concise, organized logically and furnished in plain English. The Item also states that companies should set forth each risk factor under a sub-caption that adequately describes the risk. Additionally, Item 105 directs companies to explain how each risk affects the company or the securities being offered and discourages disclosure of risks that could apply to any company.</p>	<p>Revises Item 105 to:</p> <ul style="list-style-type: none"> <li>▪ Require summary risk factor disclosure of no more than two pages if the risk factor section exceeds 15 pages;</li> <li>▪ Refine the principles-based approach of Item 105 by requiring disclosure of “material” risk factors; and</li> <li>▪ 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.</li> </ul>