Updates
September 02, 2020
SEC Modernizes Reg S-K Disclosure Rules for Business, Legal Proceedings, and Risk Factors

The U.S. Securities and Exchange Commission on August 26, 2020, approved the first significant amendments to the rules governing the description of business, legal proceedings, and risk factor disclosures in SEC filings in over 30 years. The overarching theme of the amendments is to make them less prescriptive and more principles-based, an approach that is consistent with much of the SEC's materiality-based disclosure framework. The amendments are also intended to increase readability by permitting certain information to be incorporated by reference to prior disclosures or cross-referenced to other parts of a filing and requiring summary disclosures for risk factors that extend beyond 15 pages. The amendments will be effective 30 days after publication in the Federal Register.

In his comments on the amendments, SEC Chair Jay Clayton noted that benefits of a principles-based disclosure system have been evident in recent public company disclosures made in response to COVID-19, in which companies have shifted their disclosures "to emphasize matters such as liquidity, cash needs, supply chain risks, and the health and safety of employees and customers." Chair Clayton underscored the flexibility provided by a principles-based system in discussing the rule's approach to human capital disclosures, which eschews requiring particular metrics in favor of requiring companies to disclose those metrics, if any, that are used in managing the business, to the extent material.

Commissioners Allison Herren Lee and Caroline Crenshaw both dissented from adopting the amendments, criticizing the rule changes for not requiring specific metrics related to the topic of human capital or a discussion of climate change risks.

Highlights of Rule Amendments

The most high-profile change is the addition of a broad disclosure requirement for human capital resources. As discussed in our recent update on sustainability reporting, several investor groups have petitioned the SEC for rulemaking on human capital management disclosures in recent years. As highlighted by Chair Clayton's comments mentioned above and consistent with his prior statements, the human capital resources requirement did not follow the requests to mandate particular metrics or topics, but allows companies to tailor the disclosure to their circumstances. In recent years, some companies have disclosed human capital matters in proxy statements and sustainability or similar reports posted to corporate websites, but few have included these disclosures in their annual reports on Form 10-K. The adopting release notes that:

. . . while the final amendments do not require registrants to use a disclosure standard or framework to provide human capital disclosure, as recommended by some commenters, a principles-based approach affords registrants the flexibility to tailor their disclosures to their unique circumstances, including by providing disclosure in accordance with some or all of the components of any current or future standard or framework that facilitates human capital resource disclosure that is material to an understanding of the registrant's business taken as a whole.

As companies consider what human capital management disclosures to include in their next annual report, they might look to existing frameworks for human capital management disclosures, including standards in the SASB Industry Guides and the International Organization for Standards standard ISO 30414.

The addition of a requirement for a risk factor summary where risk factor disclosures exceed 15 pages may also drive changes in disclosure practices. Some companies might take a hard look at risk factors and eliminate some that are more generically applicable to shorten the section to 15 pages (or fewer).

Another potentially helpful rule change permits a company to incorporate the description of the material development of the business by reference to a prior filing, such as the company's last Form 10-K that includes a full discussion. However, it remains to be seen whether companies will take advantage of this opportunity. The amended rule is intended to cut down on repetitive disclosures, but companies may find it easier to provide the disclosure in a single discussion rather than disclosing only material developments since the last full discussion.

Other amendments simply reflect existing market practices, including cross-referencing legal proceedings disclosures to other parts of a filing, disclosing the material effects of compliance with governmental regulations in the business description, and organizing risk factors under category headings.

For all companies, these amendments provide an opportunity for a fresh look at their business, legal proceedings, and risk factors reporting in upcoming SEC filings.

Summary of Amendments

Below we provide a brief summary of the most significant rule amendments applicable to companies, including smaller reporting companies, along with the currently applicable rule.

Applicable Rules	Current Rule	Amendments
Business Section: Regulation S-K Item 1.01		

Regulation S-K Item 101(a) and Item 101(h)	**Description of Development of Business During Prescribed Timeframe**. A description of the development of the company's business during the past *five years*. Although the rule provides a list of topics as examples for the types of developments to disclose, in practice companies treat the listed topics as mandatory. For smaller reporting companies, the description of the development of the business must cover the past *three years*.	**Description of Material Developments**. Only developments material to an understanding of the general development of the business are required to be disclosed. **Updates to List of Development Topics**. The list of development topics was retained but clarified to confirm that disclosure of a topic is required only to the extent the information is material. Material changes to previously disclosed business strategy was added to the list of topics. The year and form of organization were removed from the list. **Timeframe Material to Understanding the Business**. Rather than a prescribed timeframe of five years (three for smaller reporting companies), disclosure need only cover a timeframe that the company determines is material to understanding the business. **Incorporation by Reference**. In filings submitted after a company's initial registration statement, a company may disclose only those material developments in the business since the most recent full discussion of its business (for most public companies, this will be the company's last annual report on Form 10-K), and incorporate such full discussion by reference through a hyperlink.

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<td>Regulation S-K Item 101(c)</td>
<td>Prescriptive Categories for Disclosure. The narrative description of the business done and intended to be done by the company must include information in specific categories listed in the regulation, to the extent they are material to an understanding of the company's business, focusing on the company's dominant segment or each segment about which financial information is presented in the financial statements.</td>
<td>Nonexclusive Categories for Disclosure. The revised rule clarifies and makes the nonexclusive list of disclosure topic examples more principles-based. Substantive revisions to the list include:
Combining the topics of raw materials and the duration and effect of intellectual property rights into a single topic of resources material to the business
Updating the topic of the material effects of compliance with environmental laws to cover compliance with all government regulations, consistent with existing market practice
Significantly expanding the requirement to provide the number of persons employed by the company by including it within a broader requirement to describe the company's human capital resources, including any human capital measures or objectives that management focuses on in managing the business
Human Capital Disclosure. Although human capital was added as a potential disclosure topic, the amendments do not provide for specific reporting frameworks for human capital disclosures and instead allow companies to tailor their disclosures to their specific businesses and industries.</td>
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Legal Proceedings: Regulation S-K Item 103

Regulation S-K Item 103	**Material Legal Proceedings**. Information relating to material legal proceedings must be disclosed. **Threshold for Environmental Proceedings Disclosure**. Any environmental proceeding in which the government is a party must be disclosed unless the company reasonably believes it will result in less than $100,000 of sanctions.	**Hyperlinks and Cross-References**. Clarifies that disclosures located elsewhere in the document may be cross-referenced and hyperlinked to reduce repetition and the overall length of filings. This rule change validates an existing practice by many companies of cross-referencing to the contingencies note to the financial statements. **Increased Quantitative Threshold for Environmental Proceedings**. The threshold for disclosures relating to environmental proceedings has been increased to $300,000. The amended rule also provides companies flexibility to adopt a higher threshold. A company may opt to use an alternative threshold that it determines is reasonably designed to result in the disclosure of material environmental proceedings, so long as the threshold does not exceed the lesser of $1 million or one percent of the current assets of the company. A company opting to use an alternative threshold must disclose that threshold in each quarterly and annual report.
Risk Factors: Regulation S-K Item 105		

Regulation S-K Item 105	**Most Significant Factors**. The *most significant factors* that make an investment speculative or risky must be included. **Subcaptions**. Each risk factor must be listed under a subcaption that adequately describes the risk.	**Material Factors**. Rather than the *most significant factors*, the *material* risks making an investment speculative or risky must be disclosed. **Headings**. Risk factors must be organized under headings in addition to the subcaptions. Many companies already organize their risk factors in this way, with varying approaches taken in different industries. Groupings of risk factors might include risks related to the company's business or industry, risks related to government regulation or intellectual property, risks related to indebtedness, and risks related to ownership of the company's securities. All risk factors that "could apply generically to any registrant or any offering" must be listed under a "General Risk Factor" heading and located at the end of the section. Although the amended rule does not further define what is a general risk factor, the adopting release notes that "we encourage 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." This guidance indicates that companies can avoid including such a section by ensuring that all risk factors are tailored to the company specifically. **Summary Section**. Any Risk Factor section that exceeds 15 pages must be accompanied by a bulleted or numbered summary that is no longer than two pages. The amendments to this item are intended to reduce redundant, generic, and immaterial disclosures, while allowing companies to tailor disclosures to their specific businesses and industries

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