

CLIENT ALERT

# SEC Modernizes Business, Legal Proceedings and Risk Factor Disclosures

August 31, 2020

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The Securities and Exchange Commission recently adopted amendments to modernize and simplify the business, legal proceedings and risk factor disclosure requirements under Regulation S-K, including providing new human capital disclosure requirements.<sup>1</sup> The amendments, which were adopted “substantially” as proposed,<sup>2</sup> generally follow a more flexible “principles-based approach,” designed to elicit the most relevant disclosure, while not mandating specific information that may not be material in many cases and may become outdated.

As with other amendments that are part of the SEC’s ongoing disclosure effectiveness initiative,<sup>3</sup> these amendments are intended to improve the quality and readability of disclosure documents, discouraging repetition and disclosure of information that is not material, while simplifying compliance for public companies. The SEC notes that the disclosure items being updated had not undergone significant revision in over 30 years.

The amendments, which are summarized below, become effective 30 days following publication in the Federal Register.

<sup>1</sup> See SEC Release No. 33-10825, *Modernization of Regulation S-K Items 101, 103, and 105*, available [here](#).

<sup>2</sup> See SEC Release No. 33-10668, *Modernization of Regulation S-K Items 101, 103, and 105*, available [here](#), and our related client memorandum *SEC Proposes Changes to Modernize Business, Legal Proceedings and Risk Factor Disclosures* (August 16, 2019), available [here](#).

<sup>3</sup> See, for example, our client memoranda *SEC Adopts Disclosure Simplifications* (August 27, 2018), available [here](#), *SEC Adopts Additional Amendments to Modernize and Simplify Disclosure* (March 29, 2019), available [here](#), and *SEC Simplifies Financial Disclosures Relating to Acquisitions and Dispositions* (May 28, 2020), available [here](#).

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### General Development of Business (Items 101(a) and 101(h))

Under Items 101(a) and 101(h) of Regulation S-K, registrants are required to provide a description of the general development of their business during the past five years (three years for smaller reporting companies). The amended rules eliminate these fixed timelines; instead, consistent with the principles-based approach, registrants are required to disclose the relevant information material to an understanding of the development of their business without regard to a specific uniform period.

Following the initial filing containing this description, registrants are required to update this disclosure, focusing on material developments (such as a change in business strategy) during the periods since such previous disclosure, while incorporating by reference with a single hyperlink such previous disclosure. Alternatively, registrants can include the full updated discussion of their material business development in the filing.

The amendments also modify the list of types of information to be disclosed contained in Item 101(a)(1) to be non-exclusive, with such information required to be disclosed only to the extent material to an understanding of the general development of the registrant's business. The amendments retain the existing disclosure topics regarding any bankruptcy, receivership or similar proceedings; any material reclassification, merger or consolidation of the registrant or any of its significant subsidiaries; and the acquisition or disposition of any material assets other than in the ordinary course of business.

### Narrative Description of Business (Item 101(c))

Item 101(c) requires a narrative description of the registrant's current and intended business, mandating disclosure of a litany of enumerated items, such as principal and new products (with specific quantitative thresholds), raw materials, intellectual property, seasonality, working capital practices, dependence on certain customers and other items. The amended rules clarify that the items are required to be described only to the extent material to an understanding of the registrant's business. The amended rules further reduce the list of material items to be disclosed to a shorter list of revenue-generating and other items that the business may depend on, while emphasizing the principles-based approach requiring disclosure of *any* item material to an understanding of the business.

The amendments also require, to the extent material, a description of the registrant's human capital resources, including any human capital measures or objectives that management focuses on in managing the business. The rules retain the requirement that registrants disclose the number of their employees, which the proposing release had sought to eliminate. Required disclosure regarding compliance with environmental laws is expanded to cover compliance with all material governmental regulations, as most reporting companies currently do.

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### Legal Proceedings (Item 103)

Item 103 requires reporting companies to disclose any material pending legal proceedings, other than ordinary routine litigation incidental to the business, and certain related details. To minimize overlap with similar disclosure in the financial statements, the amended rule expressly states that required information may be provided by including hyperlinks or cross-references to legal proceedings disclosure located elsewhere in the document.

Amended Item 103 updates the current \$100,000 threshold for disclosure of environmental proceedings to \$300,000, but also provides flexibility for a registrant to select a higher threshold that it determines is reasonably designed to result in disclosure of material environmental proceeds, provided that this threshold does not exceed the lesser of \$1 million or one percent of the registrant's current assets on a consolidated basis. Any such selected threshold must be disclosed.

### Risk Factors (Item 105)

Item 105 requires disclosure of the most significant factors that make an investment in the registrant or offering speculative or risky and specifies that the discussion should be concise and organized logically. Item 105 directs registrants to explain how each risk affects the company or the securities being offered, discourages disclosure of risks that could apply generically to any registrant or offering and requires registrants to set forth each risk factor under a sub-caption that adequately describes the risk. The amended rules make three improvements:

- To improve the readability of the frequently lengthy risk factor disclosure of many registrants, the rules require summary risk factor disclosure not to exceed two pages if the risk factor section exceeds 15 pages. The summary should consist of a series of short, concise, bulleted or numbered statements summarizing the principal factors that make an investment in the registrant or offering speculative or risky.
- To better focus registrants on disclosing the risks that investors consider important in making investment decisions, the rule requires disclosure of all "material" risks that make a registrant's securities speculative or risky, rather than the current standard of the "most significant" factors.
- To further improve readability, registrants are required to organize their risk factor disclosure under relevant headings (in addition to the current individual risk factor sub-captions) and, to further discourage generic risk factors common to many companies or offerings, must group any such generic risk factors at the end of the risk factor section under the caption "General Risk Factors."

As adopted, the changes to Items 101 and 103 affect domestic reporting companies and foreign private issuers that have elected to file on domestic forms subject to Regulation S-K. The changes to risk factor disclosure in Item 105 affect both domestic and foreign registrants.

Two Commissioners (Allison Herren Lee and new Commissioner Caroline Crenshaw) voted against the amendments, citing the lack of specific disclosure mandates regarding climate change and diversity, and insufficient disclosure

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regarding human capital. We expect the SEC and investors to continue to focus on these important subjects, and encourage registrants to provide appropriate disclosure under the principles-based system, even if disclosure may not be specifically required under the current rules.

If you have any questions regarding this client alert, please contact the following attorney or the Willkie attorney with whom you regularly work.

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