

## **SEC Adopts Final Rules Amending Regulation S-K Disclosure Requirements for Business, Legal Proceedings, and Risk Factors**

### **I. Overview**

On August 26, 2020, the Securities and Exchange Commission (the “SEC”) adopted final rules (the “Final Rules”) to update certain disclosure items required by Regulation S-K for the first time in over 30 years.<sup>1</sup> Specifically, the Final Rules amend Items 101 (Business), 103 (Legal Proceedings), and 105 (Risk Factors). These amendments reflect the SEC’s “long-standing commitment to a principles-based, registrant-specific approach to disclosure” and continue its shift away from the previous regime of prescriptive disclosure requirements. An SEC-prepared summary of the differences between the rules as currently in effect and as adopted is attached hereto as Appendix A. For a thorough discussion of the current rules and the amendments when they were proposed last year, please see our memorandum found [here](#). In the below summary of the Final Rules, we discuss the principal areas where the Final Rules diverge from the proposed amendments.

### **II. Description of Business**

The most significant substantive changes to the disclosure rules relate to the Description of Business section. Previously, Item 101 was more prescriptive in nature, requiring specific disclosures often without regard to a filer’s industry or materiality to its business. The SEC observed that this sometimes led to burdensome or irrelevant disclosure that did not necessarily provide investors with improved insight into a company’s business. The SEC stated that the Final Rules are intended to decrease certain administrative burdens on filers, while ensuring that investors continue to have access to relevant and material business updates. Significantly, Item 101(c) adds a new requirement for a discussion of human capital resources, to the extent material to a company’s business. SEC Chairman Jay Clayton drew attention to his support for this change in his remarks on the Final Rules, stating that “today, human capital accounts for and drives long-term business value in many companies much more so than it did 30 years ago” and that “to the extent those [human capital] efforts have a material impact on [a company’s] performance, I believe investors benefit from understanding the drivers of that performance.”<sup>2</sup> Two SEC Commissioners dissented from approving the Final Rules, saying that the amendments did not go far enough and mentioning in particular the lack of requirements regarding specific commonly kept metrics and diversity.<sup>3</sup>

#### **A. General Description (Item 101(a))**

Prior to the Final Rules, Regulation S-K required a detailed description of the general development of a company’s business during the past five years (or three years for smaller reporting companies). Specifically, a filer had to disclose (i) the year and form of organization; (ii) any bankruptcy matter involving the company or its significant subsidiaries; (iii) any material reclassification, merger, consolidation of company of significant subsidiaries; (iv) any acquisition or disposition of a material amount of assets not in ordinary course of business;

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<sup>1</sup>Securities and Exchange Commission, Modernization of Regulation S-K Items 101, 103 and 105, Nos. 33-10825; 34-89670, available at <https://www.sec.gov/rules/final/2020/33-10825.pdf>. (August 26, 2020). Unless otherwise specified, all quoted statements in this memorandum are taken from this release.

<sup>2</sup>Jay Clayton, Public Statement on Modernizing the Framework for Business, Legal Proceedings and Risk Factor Disclosures, available at <https://www.sec.gov/news/public-statement/clayton-regulation-s-k-2020-08-26> (August 26, 2020).

<sup>3</sup>The full text of Commissioner Crenshaw’s and Commissioner Lee’s statements are available at: <https://www.sec.gov/news/public-statement/crenshaw-statement-modernization-regulation-s-k> and <https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26>, respectively.

and (v) material changes in mode of conducting business. The Final Rules eliminate the five year (and three year) lookback period and the specific disclosure requirements, replacing them with a requirement to disclose “information material to an understanding of the general development of the business.” The suggested disclosure topics include: (i) material changes to previously disclosed business strategies; (ii) material bankruptcies or any similar proceedings; (iii) material reclassifications, mergers, or consolidations; and (iv) material acquisitions or dispositions outside of the ordinary course of business.

The Final Rules amending Item 101(a) were adopted substantially as proposed, with some clarifying comments. The Final Rules were modified to clarify that smaller reporting companies will also be directed to look back only to “the period of time that is material to and understanding of the general development of the business.” The suggested disclosure topics under the Final Rules were also modified from the proposed rules, eliminating a duplicative requirement to disclose “transactions and events that affect a company’s operations” and instead replacing this with the disclosure of changes to previously disclosed business strategy. The Final Rules allow filers to incorporate by reference to a single previous filing (as opposed to multiple filings) that includes a discussion of the general development of the business and, if the filer so elects, the filer would only be required to include any material developments since that filing. The Final Rules were also modified from the proposed rules to clarify that only one filing may be incorporated by reference and, if a filer opts not to incorporate by reference, they must include the general description in full.

## **B. Narrative Description (Item 101(c))**

### **Item 101(c)(1)**

Prior to the amendments, Item 101(c) reflected a prescriptive approach to disclosure, specifying extensive line item disclosure requirements without providing a filer with any flexibility to take into account its industry or specific circumstances. The Final Rules, which were adopted as proposed as related to Item 101(c)(1) disclosure, eliminate the specific line items, instead urging disclosure regarding the “business done and intended to be done” in the following areas, to the extent material to the business as a whole: (i) revenue generating activities/products/services; (ii) product development, market trends and competitive atmosphere; (iii) availability of material resources (including the duration and effect of patents, trademarks, licenses, franchises and concessions); (iv) government contracts; and (v) seasonality.

### **Item 101(c)(2)**

The Final Rules include two new disclosure requirements: (i) a discussion of the material effects of compliance with government regulations, including environmental regulations and associated costs and (ii) the aforementioned description of human capital resources. In response to certain comments that opposed the new requirement to disclose material effects of government regulations, the SEC explained that while not currently required, when material, it is already common practice for registrants to include this disclosure. In addition, if only a particular segment of a registrant’s business is materially affected, then the registrant should identify that segment and still make the disclosure. With regard to the human capital requirement, which includes a specific list of considerations that appear to be prescriptive, the SEC explained that the listed items are merely examples of potentially relevant subjects to be assessed by each registrant using the principles based approach.

Each of these requirements was slightly modified in the Final Rules from the initial proposals. In revising the proposed rules on disclosure of the material effects of government regulations, the SEC removed a duplicative reference to the word “material” in describing the government regulations themselves. Instead, the Final Rules require disclosure of the “material effects of government regulations.” Regarding the disclosure of human capital

metrics, the Final Rule also added a requirement to disclose, to the extent material, a registrant’s total number of employees.

### III. Legal Proceedings (Item 103)

The Final Rules make two changes to Item 103 disclosure, each designed to reduce the administrative burden on registrants. Filers can now incorporate by reference, whether through hyperlink or internal cross-reference, legal proceedings disclosed elsewhere in the filing (such as management’s discussion & analysis, risk factors or notes to the financial statements). Additionally, the threshold for disclosure of environmental proceedings is adjusted for inflation and raised from \$100,000 to \$300,000. While maintaining the new threshold contained in the proposed rules, in response to comments the Final Rules adopt a hybrid approach to environmental disclosure. They create a flexible standard for disclosing environmental liability, allowing companies to elect one of two disclosure standards: (1) the bright-line \$300,000 cut off or (2) a more flexible approach, whereby the registrant sets a threshold that “(A) [it] determines is reasonably designed to result in disclosure of any such proceeding that is material to the business or financial condition is disclosed, (B) the registrant discloses (including any change thereto) in each annual and quarterly report, and (C) does not exceed the lesser of \$1 million or one percent of the current assets of the registrant and its subsidiaries on a consolidated basis.” Although these revisions were widely regarded as positive, two Commissioners dissented, explaining that, as amended, Item 103 does not include a requirement that registrants disclose the effects of climate change on their business.<sup>4</sup>

### IV. Risk Factors (Item 105)

In modifying the risk factor disclosure requirements, the SEC sought to minimize the use of “lengthy and generic [or]...boilerplate” risk factors, hoping to increase investor readability and make the disclosure more meaningful. Registrants whose risk factors are over 15 pages long will now be required to include in the forepart of the document, in the form of “concise, bulleted or numbered statements,” a summary of the “principal” factors that make an investment speculative or risky. In a modification from the proposed rules, the Final Rules state that this summary cannot exceed two pages. The SEC estimates approximately 40% of filers will be effected by this new requirement. The standard for disclosing risk factors has also been revised, from “most significant” to “material” as defined in Rule 12b-2 of the Securities Exchange Act of 1934 and Rule 405 of the Securities Act of 1933 (i.e., “those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered”).<sup>5</sup> Finally, risk factors will need to be reorganized under relevant headings (in addition to the currently required subcaptions). The Final Rules do not go so far as to prescribe any specific headings other than to require that all the risk factors that apply generally to any company or offering be grouped together at the end of risk factors section, under the subheading “General Risk Factors.” The Final Rules make clear, however, that risk factors need not be ordered by priority or materiality.

### V. Conclusion

Registrants should review the Final Rules thoroughly and consult with securities counsel when preparing disclosure statements going forward.

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<sup>4</sup> See footnote 3 above.

<sup>5</sup> 17 CFR 240.12b-2

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or [hbanks@cahill.com](mailto:hbanks@cahill.com); Geoffrey E. Liebmann at 212.701.3313 or [gliebmann@cahill.com](mailto:gliebmann@cahill.com); or Emma O'Hara at 212.701.3150 or [ehara@cahill.com](mailto:ehara@cahill.com); or [publications@cahill.com](mailto:publications@cahill.com).

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## Appendix A

### SEC-Prepared Summary of Existing Rules and Amendments

Regulation S-K Item	Summary of Existing Item Requirements	Summary of the Final Amendments
Item 101(a)	Requires a description of the general development of the business of the registrant during the past five years, or such shorter period as the registrant may have been engaged in business.	<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>• Registrants, in filings made after a registrant'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 registrant's most recent filing containing</li> </ul>

		a full discussion of the general development of its business, and incorporate by reference that prior discussion.
Item 101(c)	Requires a narrative description of the business done and intended to be done by the registrant and its subsidiaries, focusing upon the registrant’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 registrant’s business taken as a whole, the description of each such segment must include disclosure of several specific matters.	Revises Item 101(c) to: <ul style="list-style-type: none"> <li>• Clarify and expand the principles-based approach of Item 101(c), with a non-exclusive 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 registrant’s human capital resources to the extent such disclosures would be material to an understanding of the registrant’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>
Item 103	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	Revises Item 103 to: <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> </ul>

	<p>be contemplated by governmental authorities.</p> <p>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>	<ul style="list-style-type: none"> <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 registrant 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 registrant and its subsidiaries on a consolidated basis.</li> </ul>
Item 105	<p>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, organized logically, and furnished in plain English. The Item also states that registrants should set forth each risk factor under a subcaption that adequately describes the risk. Additionally, Item 105 directs registrants to explain how each risk affects the registrant or the securities being offered and discourages disclosure of risks that could apply to any registrant.</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 subcaptions currently required, with any risk</li> </ul>

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		factors that may generally apply to an investment in securities disclosed at the end of the risk factor section under a separate caption.
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