

SEC Reporting & Compliance Alert

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SEC Modernizes Business Description, Legal Proceedings and Risk Factors Disclosure Requirements

On August 26, 2020, the Securities and Exchange Commission (SEC) voted 3-2 to modernize Regulation S-K rules requiring business description, legal proceedings and risk factor disclosures. The amendments are intended to update the rules in line with more recent market developments, improve the readability of disclosures for investors and simplify compliance requirements for companies. Notably, the amendments will require new human capital disclosures, if material to understanding the company's business as a whole, but do not specifically address other "ESG" (environmental, social and governance) topics, such as diversity and climate change, prompting dissent from two commissioners.¹

The changes do not impact or benefit foreign private issuers that do not use forms that reference the relevant Regulation S-K disclosure requirements (*e.g.*, companies that file annual reports on Form 20-F). The amendments to Item 105 regarding risk factors, however, will apply to foreign private issuers filing registration statements on Form F-1, F-3 or F-4.

The final rules will become effective 30 days after publication in the Federal Register. Below is a summary of the noteworthy changes reflected in the final rules. A copy of a summary chart from the SEC's adopting release comparing the existing item requirements with the amendments is [available here](#).

General Development of Business (Item 101(a))

Look-Back Period Eliminated. Companies will continue to be required to describe the general development of their business. The amendments, however, eliminate the look-back period² to focus on material developments of a company's business, regardless of a specific time frame.

Hyperlinks to Prior Discussion Permitted. Companies will be allowed to hyperlink to a prior filing for the most recent discussion of the general development of the company's

¹ Commissioners [Allison Herren Lee](#) and [Caroline A. Crenshaw](#) dissented, primarily on the grounds that the final rules either failed to address or inadequately addressed the issues of diversity, climate risk and human capital.

² Currently, smaller reporting companies are subject to a three-year look back and all other companies are subject to a five-year look back under Items 101(h) and (a), respectively. For annual reports on Form 10-K, however, companies remain subject to only a one-year look back for disclosure regarding business developments.

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business, rather than repeating the same discussion in subsequent filings, and provide only an update of material developments since the prior filing to which the company has hyperlinked.

Prescribed Topics Replaced With Examples. The amendments make clear that companies need to disclose only information material to an understanding of the general development of the business. In other words, a company will no longer need to address all topics listed in Item 101(a) if it determines that one or more of those topics are not material to understanding the general development of the company's business. The amendments add business strategy as a new topic and reflect minor updates to many of the existing topics. The updated list of disclosure topic examples a company may need to address in its discussion of business development consists of the following:

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

Business Description (Item 101(c))

New Human Capital Disclosure. Companies will be required to provide human capital disclosures to the extent material to an understanding of the company's business. Specifically, a company will be required to describe (i) the company's human capital resources, including the number of employees (as currently prescribed), and (ii) any human capital measures or objectives that the company focuses on in managing the business, such as measures or objectives that address the development, attraction and retention of personnel, depending on the nature of the company's business and workforce. The SEC declined to define "human capital" or mandate a specific set of metrics, noting that the meaning of human capital and measures and objectives in this context vary significantly and may evolve over time. In this regard, the SEC emphasized in the adopting release that each company's disclosure "must be tailored to its unique business, workforce, and facts and circumstances."

Government Regulations. The final rules require disclosure of the material impact of compliance with all government regulations, expanding the existing requirement, which applies to only environmental regulations.

Other Disclosure Topic Examples. The existing list of prescriptive disclosure items will be replaced by disclosure topic examples and the flexible requirement that companies need to disclose only information material to an understanding of the business taken as a whole.³ For example, a company would need to describe its dependence on key products and services that are material, instead of describing products and services that meet quantitative thresholds as currently prescribed. The amendments also reflect updates for business, market and technology developments and remove quantitative thresholds and certain topics that are typically addressed in the Management's Discussion and Analysis (MD&A). The updated list of disclosure topic examples consists of the following:

- 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 products, trends in market demand and competitive conditions;
- Resources material to a company's business, such as (i) sources and availability of raw materials and/or (ii) the duration and effect of all patents, trademarks, licenses, franchises and concessions held;
- 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
- The extent to which the business is or may be seasonal.

Legal Proceedings (Item 103)

Increased Dollar Threshold for Environmental Sanctions. Companies will remain obligated to disclose legal proceedings to which a governmental authority is a party and that seek monetary sanctions under certain environmental laws, unless the company reasonably believes those monetary sanctions will not exceed a

³ The SEC declined to amend the list of topics for smaller reporting companies, noting that retaining the existing list in Items 101(h)(1) through (6) "will continue to permit smaller reporting companies to provide a less detailed description of their business, consistent with the current scaled disclosure requirements for these companies."

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specified dollar threshold. The amendments increase the specified dollar threshold to \$300,000 (from \$100,000) to adjust for inflation. The amendments also allow companies to choose their own dollar threshold, so long as such threshold:

- is reasonably designed, as the company determines, to result in disclosure of any material proceeding;
- does not exceed the lesser of \$1 million or 1% of the current assets of the company and its subsidiaries on a consolidated basis; and
- is disclosed (including any changes to the threshold) in each annual and quarterly report.

Hyperlinks or Cross-References Permitted. The final rules will explicitly permit hyperlinks or cross-references to legal proceedings disclosure elsewhere in the document (such as in the MD&A, risk factors or notes to the financial statements) to avoid duplication, consistent with common practice today.

Risk Factors (Item 105)

Updated Materiality Standard. Item 105 will be updated to require “material” risk factors (replacing the existing “most significant” standard) to focus on risks that are important to investors in making an investment decision.

Summary of Risk Factors May Be Required. If a company’s risk factors exceed 15 pages, those risk factors will be required to be preceded by a new summary of the principal factors that cause an investment in the company or offering to be speculative or risky. The summary must consist of concise, bulleted or numbered statements on no more than two pages.

Headings Now Required. The amendments specifically require risk factors to be organized under relevant headings (along with the currently required subcaptions for each risk factor), codifying the approach that many companies have already adopted. In addition, although the amended rule continues to explicitly discourage disclosing risks that could apply generically to any company or offering, such risks may be presented at the end of the risk factor section under a separate caption, “General Risk Factors.”

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Additional information is available in the SEC’s [adopting release](#) and accompanying [press release](#).

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