



## Securities Law ADVISORY ■

**AUGUST 22, 2019**

### SEC Proposes to Modernize Disclosure Requirements Under Regulation S-K

The Securities and Exchange Commission (SEC) proposed amendments to its disclosure requirements for description of business, legal proceedings, and risk factors in Regulation S-K. These proposals are part of the SEC's initiative to improve disclosure for investors and registrants.

This is a follow-on to the SEC staff's 2013 "Report on Review of Disclosure Requirements in Regulation S-K" delivered pursuant to Section 108 of the Jumpstart Our Business and Startups (JOBS) Act. The report recommended that the SEC conduct a comprehensive evaluation of its disclosure requirements. The SEC revisited the business and financial disclosure requirements of Regulation S-K in 2016 with a concept release that requested public comments. The SEC reviewed the comment letters it received from both the report and the concept release in developing the proposed amendments.

#### **Proposed Amendments**

The SEC [proposed amendments](#) to the following topics and items:

- General Development of Business (Item 101(a) of Reg S-K)
- Narrative Description of Business (Item 101(c) of Reg S-K)
- Legal Proceedings (Item 103 of Reg S-K)
- Risk Factors (Item 105 of Reg S-K)

#### **General Development of Business (Item 101(a))**

The SEC proposed certain amendments to the description of business requirement to establish a more principles-based approach.

##### *Eliminate prescribed five-year timeframe*

In order to provide more flexibility to each registrant in tailoring disclosures to its business, the SEC proposed to amend Item 101(a) to eliminate the five-year disclosure requirement. Instead, registrants would be instructed to focus on information that is material to an understanding of their businesses' development. A parallel proposed amendment to Item 101(h) would eliminate the requirement for smaller reporting companies to describe business development during the last three years.

This advisory is published by Alston & Bird LLP to provide a summary of significant developments to our clients and friends. It is intended to be informational and does not constitute legal advice regarding any specific situation. This material may also be considered attorney advertising under court rules of certain jurisdictions.

### Updates to business description with hyperlinks to previous descriptions

The SEC proposed to amend Item 101(a)(1) to only require an update of the general development of business that focuses on any material developments during the reporting period following the description of the business in the initial registration statement. The proposal also requires registrants to include a hyperlink to the most recently filed disclosure that, together with the update, would present a full discussion of the general development of business.

### Additional requirement to include material changes to business strategy as potential disclosure

The SEC also proposed an amendment to Item 101(a) that would add a non-exclusive list of the types of information that a registrant should address in its description of business. The disclosure of a listed topic would only be required if it would be material to an understanding of the general development of the registrant's business. In addition, a newly proposed item would require disclosure about material changes to a registrant's previously disclosed business strategy.

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

### Non-exclusive list of disclosure topics

Item 101(c) currently requires a narrative description of the business and includes a list of 12 mandatory disclosure items. The SEC recognizes that the items on the current list are not relevant to all registrants and elicit disclosure that is not material to some registrants.

To elicit more relevant disclosure, the SEC proposed to amend Item 101(c) to include a non-exclusive list of disclosure topics that would not require disclosures unless the topic is material to an understanding of the registrant's business. Among others, the following topics are proposed to be added or retained as a disclosure topic in Item 101(c):

- Availability of raw materials.
- The importance, duration, and effect of patents, trademarks, licenses, franchises, and concessions held as non-exclusive types of property that may be material to the registrant's business (no proposal to add copyrights and trade secrets).
- Renegotiation or termination of a government contract.
- Extent to which the business is or may be seasonal.
- Material effects of compliance with material government regulations (not just environmental regulation).

### Human capital

Notably, the SEC has proposed a new requirement to address a registrant's human-capital management in addition to the number of people registrants employ. The SEC believes intangible assets like human capital represent an essential resource for registrants and would be more useful to investors than prescriptive requirements that are not as effective at eliciting material information. To that end, the SEC's proposal requires disclosure of any human-capital measures or objectives that management focuses on in managing the business if such measures or objectives are material to an understanding of the registrant's business. The SEC acknowledges in the proposal that the human-capital disclosure will vary by industry and company, and rather than prescribe line-item disclosures, registrants should describe where management focuses its attention on material human-capital matters.

## **Legal Proceedings (Item 103)**

Item 103 currently requires disclosure of any material pending legal proceeding that is not routine litigation incidental to the registrant's business. Because Item 103 and U.S. GAAP have overlapping requirements, the disclosures made in

Item 103 are sometimes repeated in financial statements or other sections. To prevent repeat disclosures, the SEC proposed to revise Item 103 to explicitly state that the disclosure may be made via hyperlink to another section in the document.

In addition, Item 103 currently requires disclosure of any proceeding under environmental law that the registrant reasonably believes will result in sanctions of \$100,000 or more and to which a governmental authority is a party. The \$100,000 threshold was first mentioned in the 1981 proposing release and was based in part on actual fines assessed in environmental proceedings at the time. The SEC proposed to increase the threshold to \$300,000 to adjust for inflation.

## **Risk Factors (Item 105)**

Item 105 requires disclosure of the most significant risk factors that make investing in the registrant or offering risky and specifies that the disclosure should be concise and organized logically. The SEC seeks to address lengthy and generic risk factor disclosures that have become commonplace by proposing three amendments to Item 105.

### Summary risk factor disclosure

First, the SEC proposed to amend Item 105 to require summary risk factor disclosure if the risk factor section exceeds 15 pages. The summary section would consist of short, concise bulleted or numbered statements that summarize the principal risk factors. The proposal calls for an appropriately titled summary section to be included in the forepart of the prospectus or annual report.

### Replace “most significant” factors with “material” factors

The second proposed amendment seeks to focus registrants on disclosing the risks that reasonable investors would find important in making investment decisions. Since guidance on risk factor disclosure was first published in 1964, the SEC has emphasized the disclosure of “most significant” or “principal” risk factors. Yet the length of risk factors has continued to increase over the years. In response, the SEC proposed to update Item 105 by revising the standard for disclosure to “material” risk instead of “most significant” risk.

### Organize risk factors / general risk factors

The last proposed amendment to Item 105 codifies a common practice of organizing risk factors and improves the clarity of risk factors. Although many registrants already organize risk factor disclosures under headings, the proposal seeks to codify that practice and require all registrants to do so. The SEC’s review also found that many registrants include generic risk factors that are similar to disclosures made by other registrants in their industry, without adding value to investors. To remedy that issue, the SEC also proposed to require registrants to disclose general, boilerplate risk factors at the end of the risk factors section under the caption “General Risk Factors.”

## **Next Steps**

Once the proposed amendments are published in the *Federal Register*, a 60-day comment period will commence. Comments can be submitted through the SEC’s Internet Comment Form, by email, or by mail.

You can subscribe to future *Securities* advisories and other Alston & Bird publications by completing our [publications subscription form](#).

If you would like more information, please feel free to contact one of the attorneys in our [Securities Group](#).

# ALSTON & BIRD

WWW.ALSTON.COM

© ALSTON & BIRD LLP 2019

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777

BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500

BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719

CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111

DALLAS: Chase Tower ■ 2200 Ross Ave. ■ Suite 2300 ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899

LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100

NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444

RALEIGH: 555 Fayetteville Street ■ Suite 600 ■ Raleigh, North Carolina, USA, 27601-3034 ■ 919.862.2200 ■ Fax: 919.862.2260

SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001

SILICON VALLEY: 950 Page Mill Road ■ Palo Alto, California, USA, 94304-1012 ■ 650-838-2000 ■ Fax: 650.838.2001

WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333