

August 21, 2019

SEC Proposes to Modernize Descriptions of Business and Legal Proceedings, and Risk Factor Disclosures, Under Regulation S-K

On August 8, 2019, the Securities and Exchange Commission [proposed amendments](#) to Regulation S-K that aim to modernize the descriptions of business and legal proceedings, and risk factor disclosure requirements. The proposed amendments are designed to improve the readability of disclosure documents, as well as discourage repetition and disclosure of non-material information.

Background

In 2013, the SEC prepared the *Report on Review of Disclosure Requirements in Regulation S-K* (the “S-K Study”) pursuant to Section 108 of the Jumpstart Our Business Startups Act. The S-K Study recommended that the SEC perform a comprehensive evaluation of the information that registrants are required to disclose, how and where such information is disclosed, and technology’s potential to improve disclosure, an effort that has become known as the SEC’s “Disclosure Effectiveness Initiative.” In 2016, the SEC requested public comment on the business and financial disclosure requirements in Regulation S-K in a [concept release](#).

Proposed Amendments to Regulation S-K

The proposed amendments would revise disclosure requirements for registrants under Items 101(a) (description of the general development of the business), 101(c) (narrative description of the business), 103 (legal proceedings) and 105 (risk factors) of Regulation S-K. The SEC proposal reflects a desire for more principles-based disclosure requirements where disclosure objectives are set and management can exercise judgment on how to satisfy those objectives.

Item 101(a) – General Development of Business

Current Disclosure Requirement

Item 101(a) of Regulation S-K requires a registrant to describe the general development of its business during the past five years, including:

- the year in which the registrant was organized and its form of organization;
- any bankruptcy or similar proceeding with respect to the registrant or a significant subsidiary;

- any merger or consolidation of the registrant or a significant subsidiary;
- any material acquisition or disposition outside the ordinary course of business; and
- any material change in the mode of conducting the business.

Proposed Amendments

Elimination of Prescribed Timeframe. The SEC proposes to eliminate the five-year disclosure timeframe for the registrant's description of general business development. Disclosure would instead focus on the information material to understanding the development of a registrant's business, irrespective of a specific timeframe.

Shifting to a Principles-Based Approach. The SEC proposed amendments would eliminate the prescriptive list of disclosure items and allow registrants instead to satisfy their obligation by providing material information on the general development of their business. The proposed amendments provide suggested topics for identifying material information, which largely match the items currently in Item 101(a)'s prescriptive list, and introduce a new potential discussion item for registrants—describing any material change to a previously disclosed business strategy. The proposed amendments are designed to provide investors with material information and registrants with flexibility in tailoring disclosure to reflect the circumstances of their business.

Require Only Updated Disclosure in Subsequent Filings. For filings made after a registrant's initial registration statement, the proposed amendments only would require the registrant to provide an update on general business development for any material developments in the reporting period. A registrant would include a hyperlink to the most recent filing that, together with the update, would contain the full discussion of the general development of the registrant's business. The SEC believes that this amendment would help investors focus on recent material developments, while removing repetitive information that can obscure important developments.

Item 101(c) – Narrative Development of Business

Current Disclosure Requirement

Item 101(c) of Regulation S-K requires a narrative description of the registrant's dominant business segment or each reportable segment about which financial information is presented in the financial statements. A registrant's narrative description of any segment must cover items (1)-(10) below to the extent material to understanding the registrant's business. The registrant must discuss items (11) and (12) below with regard to its business in general.

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- 1 Principal products produced and services rendered
 - 2 New products or segments
 - 3 Sources and availability of raw materials
 - 4 Intellectual property
 - 5 Seasonality of the business
 - 6 Working capital practices
 - 7 Dependence on certain customers
 - 8 Dollar amount of backlog orders believed to be firm
 - 9 Business subject to renegotiation or termination of government contracts
 - 10 Competitive conditions
 - 11 The material effects of compliance with environmental laws
 - 12 Number of employees

While the current rule only requires a registrant to disclose items (1)-(10) above to the extent material to the registrant's business, many registrants interpret Item 101(c) as requiring disclosure of each enumerated item.

Proposed Amendments

The proposed amendments would clarify that a registrant only has to discuss the enumerated items for a segment when material to its business. By reaffirming the principles-based approach of Item 101(c), the amendments are designed to encourage registrants to exercise judgment in evaluating what disclosure to provide, which will result in disclosure better suited to a registrant's specific circumstances.

The proposed amendments also revise the discussion topics in Item 101(c) to reflect a more principles-based approach. A registrant's description of a business segment would cover items (1)-(5) below to the extent material to the registrant's business. A registrant's description of its business in general would discuss items (6) and (7) to the extent material.

- 1 Revenue-generating activities, products and/or services, and any dependence on key products, services, product families, or customers, including governmental customers
- 2 Status of development efforts for new or enhanced products, trends in market demand and competitive conditions
- 3 Resources material to a registrant's business, such as raw materials, patents, trademarks, licenses, franchises and concessions
- 4 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
- 5 The extent to which the business is or may be seasonal
- 6 Compliance with material government regulations, including environmental regulations
- 7 Human capital disclosure

The proposed amendments replace “number of employees” with “human capital disclosure” as a discussion topic because the SEC believes that a description of the registrant's human capital resources beyond employee headcount may be material to investors, including a description of human capital measures or objectives that management focuses on in managing the business.

Item 103 – Legal Proceedings

Current Disclosure Requirement

Item 103 of Regulation S-K requires a registrant to disclose any material pending legal proceedings, other than ordinary routine litigation, to which the registrant or any of its subsidiaries is a party or to which its property is the subject. A registrant must also disclose any environmental legal proceeding to which a governmental authority is a party, unless the registrant reasonably believes it will result in sanctions of less than \$100,000.

Proposed Amendments

The SEC has observed that information required under Item 103 is often already provided in the notes to the financial statements, the MD&A and the risk factors. In an effort to avoid duplicative disclosure, the proposed amendments permit registrants to provide some or all of the required information under Item 103 by using cross-references to disclosure elsewhere in the document. The SEC also proposes increasing the disclosure threshold for environmental proceedings from \$100,000 to \$300,000 to adjust for inflation since the rule's promulgation.

Item 105 – Risk Factors**Current Disclosure Requirement**

Item 105 of Regulation S-K requires a registrant to disclose the most significant factors that make an investment in the registrant or offering speculative or risky. Risk factors must be organized logically and their disclosure must be concise. Registrants should not include generic risk factors that apply to any company or offering.

Proposed Amendments

The SEC expressed concern over lengthy risk factor disclosure in public filings. The SEC has commented on the increasing use of generic risk factors that add to the complexity of disclosure documents, without providing additional material information to investors. The proposed amendments listed below are intended to make risk disclosure under Item 105 more concise and effective for investors.

- A registrant would be required to provide summary risk factor disclosure if the risk factor section exceeds 15 pages. The summary would consist of a series of short, concise, bulleted or numbered statements summarizing the principal factors that make the investment speculative or risky.
- The disclosure standard would be changed from the “most significant” factors to the “material” factors, which make an investment speculative or risky. The SEC believes this change would result in registrants disclosing only risks that reasonable investors would find material, which will shorten risk disclosure to the benefit of investors and registrants.
- Registrants would be required to organize risk factors under relevant headings in order to help investors comprehend lengthy risk disclosures. In addition, generic risk factors that apply to other companies or offerings would be placed at the end of the risk factor section under the caption “General Risk Factors.”

The proposed amendments have a 60-day public comment period following publication in the Federal Register.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Mark S. Bergman
+44-20-7367-1601
mbergman@paulweiss.com

Christopher J. Cummings
+1-416-504-0522
ccummings@paulweiss.com

Gregory A. Ezring
+1-212-373-3458
gezring@paulweiss.com

Andrew J. Foley
+1-212-373-3078
afoley@paulweiss.com

Catherine L. Goodall
+1-212-373-3919
cgoodall@paulweiss.com

David S. Huntington
+1-212-373-3124
dhuntington@paulweiss.com

Brian M. Janson
+1-212-373-3588
bjanson@paulweiss.com

John C. Kennedy
+1-212-373-3025
jkennedy@paulweiss.com

Raphael M. Russo
+1-212-373-3309
rrusso@paulweiss.com

Monica K. Thurmond
+1-212-373-3055
mthurmond@paulweiss.com

Lawrence G. Wee
+1-212-373-3052
lwee@paulweiss.com

Tracey A. Zaccone
+1-212-373-3085
tzaccone@paulweiss.com

Hank Michael
+1-212-373-3892
hmichael@paulweiss.com

Associate Michael N. Bendetson contributed to this Client Alert.