

CLIENT ALERT

SEC Proposes Changes to Modernize Business, Legal Proceedings and Risk Factor Disclosures

August 16, 2019

AUTHOR

Jeffrey S. Hochman

The Securities and Exchange Commission recently proposed amendments to modernize and simplify the business, legal proceedings and risk factor disclosure requirements under Regulation S-K.¹ The proposed amendments 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relevant disclosure, while not mandating specific information that may not be material in many cases and may become outdated.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 SEC proposals that are part of its ongoing disclosure effectiveness initiative,² the proposed 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 have not undergone significant revision in over 30 years.

Below is a summary of the proposed amendments:

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). As proposed,

¹ See SEC Release No. 33-10668, *Modernization of Regulation S-K Items 101, 103, and 105*, available [here](#).

² 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 Proposes Simplifying Financial Disclosures Relating to Acquisitions and Dispositions (May 13, 2019)*, available [here](#).

SEC Proposes Changes to Modernize Business, Legal Proceedings and Risk Factor Disclosures

these fixed timelines would be eliminated; instead, registrants would be 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 would only be required to update this disclosure, focusing on material developments (such as a change in business strategy) during the reporting period, while incorporating by reference with an active hyperlink the most recently filed disclosure that, together with the updated disclosure, would present the full discussion of the development of their business. The proposed rules would 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.

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 proposed rules would better clarify that the items are required to be described only to the extent material to an understanding of the registrant's business. The proposed rules would reduce the list of items to be disclosed if material 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.

At the same time, while eliminating the requirement to disclose the number of employees, the rules would 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. Disclosure regarding compliance with environmental laws would be expanded to cover compliance with all material regulations, as most reporting companies currently do.

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 would expressly state that some or all of the required information may be provided by including hyperlinks or cross-references to legal proceedings disclosure located elsewhere in the document. Amended Item 103 would update the current \$100,000 threshold for disclosure of environmental proceedings to \$300,000, retaining in this case a specific requirement rather than a principles-based standard of materiality.

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

SEC Proposes Changes to Modernize Business, Legal Proceedings and Risk Factor Disclosures

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 proposed rules would make three improvements:

- To improve the readability of the frequently lengthy risk factor disclosure of many registrants, the proposed rules would require 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 an investment in the registrant or offering speculative or risky.
- To better focus registrants on disclosing the risks that investors would consider important in making investment decisions, the rule would require 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 would be 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, would need to group them at the end of the risk factor section under the caption “General Risk Factors.”

As currently proposed, the changes to Items 101 and 103 would impact only domestic reporting companies. The changes to risk factor disclosure in Item 105 would also affect foreign private issuers.

The SEC release includes 47 questions, many with various subparts, soliciting feedback on the proposed amendments. Comments on the proposal are due 60 days after publication in the Federal Register.

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

Jeffrey S. Hochman

212 728 8592

jhochman@willkie.com

Copyright © 2019 Willkie Farr & Gallagher LLP.

This alert is provided by Willkie Farr & Gallagher LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This alert may be considered advertising under applicable state laws.

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Palo Alto, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000, and our fax number is (212) 728-8111. Our website is located at www.willkie.com.