

SEC Modernizes Disclosure Requirements

WRITTEN BY

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The Securities and Exchange Commission on August 26, 2020 adopted changes to the business, legal proceeding and risk factor disclosures made by public companies and companies going public. This was one of two actions taken by the SEC on that date; see our blog post describing changes to the definition of accredited investor and related changes to the qualified institutional buyer definition at [this link](#).

The changes are meant to improve the usefulness of disclosure by public companies about their business, their material pending legal proceedings, and the factors that make an investment in their securities speculative or risky. Most of these changes represent an extension of principles-based disclosure over specific line-item requirements for the particular company.

Specifically, the amendments to Item 101 (Description of Business) of Regulation S-K:

- Eliminate the existing five-year timeframe and prescriptive disclosure requirements relating to the general development of the business in favor of a principles-based mandate to describe only information material to an understanding of the general development of the business. Information about the year and form of a company's organization is no longer required.
- Permit a company to forgo a full discussion of the general development of the business in a filing other than an initial registration statement, if it provides an update since the last periodic report or registration statement that contained a full discussion of its development. Companies taking advantage of this option will need to incorporate the full discussion by reference with a hyperlink to the prior report or registration statement.
- Adopt a more principles-based requirement for a narrative discussion of the business done and intended to be done by the company, focusing on its dominant segment or each reportable segment for which financial information is presented. The specific disclosure requirements in the existing rule have been replaced by a similar but non-exhaustive list of topics that may be material.
- Include as a disclosure topic a new category covering human capital resources, to the extent a discussion of such matters would be material to investors. This covers any human capital measures or objectives that the company focuses on in managing the business. The rule lists measures or objectives that address the development, attraction and retention of personnel as a non-exclusive list of potentially relevant subjects that may be addressed, but each company will need to tailor its own disclosure in light of its workforce. Companies may, depending on their circumstance, need to address turnover, use of contractors, full- or part-time status, diversity or other factors its management considered important. The requirement to disclose the number of employees has been retained.
- Replace the disclosure topic relating to environmental enforcement matters with a general topic covering the material effects that compliance with governmental regulations may have on capital expenditures, earnings and the competitive position of the business.

The amendments to Item 103 (Legal Proceedings) of Regulation S-K:

- Expressly permit hyperlinking or cross-referencing to legal proceedings disclosure elsewhere in the document in order to avoid duplicative disclosure. This may include the MD&A, risk factors or financial statement footnotes.
- Raise the threshold for disclosure of environmental proceedings by government agencies to cover matters that the company reasonably believes will result in monetary sanctions over \$300,000 (increased from \$100,000). A company may also adopt an alternative threshold that is reasonably designed to result in disclosure of material environmental matters, so long as the threshold does not exceed the lower of \$1 million or one percent of the company's consolidated current assets. A company taking advantage of this option will need to disclose its chosen threshold (including any changes) in each annual and quarterly report.

Finally, the amendments to Item 105 (Risk Factors) of Regulation S-K:

- Require a summary of the risk factor disclosures of no more than two pages, if the full risk factor section exceeds 15 pages.
- Require the risk factor section to be organized logically with relevant headings in addition to the sub-captions currently required.
- Emphasize the principles-based approach of Item 105 by requiring disclosure of material risks. Disclosure of risks that generally apply to any company or any offering is specifically discouraged; if such risks are included, they will need to be presented at the end of the risk factor section under the caption "General Risk Factors."

The amendments represent a modernization of disclosure rules that have rarely been updated in 30 years, and should provide companies with greater flexibility to tailor their disclosure to matters material for them and avoid duplicative disclosure. The SEC's adopting release with a full text of the changes is at [this link](#). The changes take effect 30 days after publication in the Federal Register.

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If you have any questions about the rule changes or related topics, your regular Locke Lord contact or any of the authors can discuss these matters with you.

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