

# SEC Adjusts Disclosure Requirements for Public Companies

September 4, 2020

On August 26, 2020, the Securities and Exchange Commission amended its rules and forms to revise several disclosure requirements applicable to reporting companies.<sup>1</sup> The amendments address three items of Regulation S-K that had not been revised for more than 30 years:

- the description of the company’s business (Item 101),
- the description of legal proceedings (Item 103), and
- risk factors (Item 105).

The amendments will be effective 30 days after the date of publication in the Federal Register. The short timeframe makes sense, since the amendments generally remove or simplify disclosure requirements. On two points, however, they *add* requirements: most companies will now have to provide a description of human capital resources, and many companies will need to change how they present risk factors. A reporting company with a Form 10-K deadline looming will need to work quickly to address those changes. Otherwise, reporting companies can generally wait until the next 10-K to address the amendments.

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<sup>1</sup> Release No. 33-10825 (Aug. 26, 2020), available [here](#).  
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The amendments were proposed on August 8, 2019,<sup>2</sup> following up on an April 2016 concept release<sup>3</sup> that asked about the value to investors of the disclosures companies provide under the SEC’s rules. See the box at right for some background on the SEC’s program of reforming its disclosure requirements.

## What the Amendments Do

### Description of Business

Item 101 of Regulation S-K governs the general description of the company’s business in an annual report on Form 10-K or in a registration statement, for example in an IPO. Practices in addressing the existing requirement vary dramatically: a seasoned reporting company might provide just a few pages sketching the salient points about its recent developments, while in IPOs and in some industries the length and detail are significantly greater.

The amendments make the following changes, each intended to encourage more streamlined disclosure.

- Item 101(a) calls for a description of the “general development” of the business.
  - The prior rule required the discussion to cover a five-year timeframe, and that has been eliminated. For annual reports, the change is minor since Form 10-K already provides that this discussion can be limited to developments since the beginning of the fiscal year.
  - The new rule permits the discussion to be limited to an update, covering developments since the most recent full discussion. If a company takes this approach, it will need to identify a single filing containing the full discussion, incorporate that by reference and provide an active hyperlink.

### Background – The Disclosure Effectiveness Initiative

Since 2012, the SEC has undertaken a program of regulatory reform to simplify and update disclosure requirements for public companies. It has been using the term Disclosure Effectiveness Initiative for this program, which derives partly from Congressional mandates in the JOBS Act (2012) and the FAST Act (2015) and partly from the priorities of successive SEC chairs and directors of its Division of Corporation Finance.

To help follow the different workstreams, we have been maintaining a chart we call the [Disclosure Simplification Explainer](#), which maps them and provides live links to each of the underlying SEC releases.

- Item 101(c) calls for a description of the business, with a list of specific matters to be addressed to the extent they are material to the business as a whole.
  - The new rule revises and condenses the list, and it emphasizes that only material matters need to be addressed.
  - The new list adds two new items: human capital resources, as discussed further below, and effects of government regulation (where the prior rule only specifically identified environmental regulation). Most highly regulated companies already provide extensive disclosure about government regulation, but others may need to expand their disclosure beyond environmental regulation.

<sup>2</sup> Release No. 33-10668 (Aug. 8, 2019), available [here](#).

<sup>3</sup> Release No. 33-10064 (Apr. 13, 2016), available [here](#).

## Human Capital Disclosure

A new paragraph of Item 101(c) calls for:

*A description of the company's human capital resources, including the number of persons employed by the company, and any human capital measures or objectives that the company focuses on in managing the business (such as, depending on the nature of the company's business and workforce, measures or objectives that address the development, attraction and retention of personnel).*

This disclosure is required to the extent material to an understanding of the business taken as a whole, except that, if it is material to a particular segment, the company should identify the segment. Unlike the other topics identified in revised Item 101, this is essentially a new requirement. However, many companies included some discussion of human capital in their proxy statements this year, which could be a starting point for the required disclosure.

This was the most controversial element of the proposal. It responded in part to an influential July 2017 rulemaking petition from a group of major pension funds and other institutional investors, which argued that the SEC should adopt prescriptive rules and promote comparable, standardized disclosures on human capital.<sup>4</sup> The SEC's more principles-based approach attracted extensive comment similar to the petition, but the SEC decided against including more prescriptive requirements. The adopting release argues that the specific measures and objectives addressed in human capital disclosure are likely to evolve over time and may vary based on industry, geography, strategy and other factors. As discussed below, the dissenting commissioners vigorously contested this approach.

<sup>4</sup> Rulemaking petition to require issuers to disclose information about their human capital management policies,

## Regulatory Philosophy – Principles-Based versus Prescriptive

A consistent theme of the Disclosure Effectiveness Initiative has been that the SEC's rules and forms should incorporate principles-based requirements, rather than prescriptive rules. (In describing last week's amendments, the adopting release uses the expression "principles-based" 83 times.)

Principles-based rules call for a reporting company to make judgments about materiality under its specific circumstances. The merits of this approach should include concision and focus. Prescriptive rules call for each reporting company to provide the same information and apply the same test, which should promote comparability and precision. Of course, disclosure rules inevitably rely on both approaches, but the Disclosure Effectiveness Initiative has broadly favored the first.

This contrast played a central role in the August 26 meeting, because the SEC relied on the principles-based philosophy – over the objections of two dissenting commissioners – to decline to adopt more specific disclosure requirements on human capital, diversity and climate change.

## Risk Factors

Item 105 of Regulation S-K governs risk factor disclosure. The amendments clarify that risk factors must be "material" (where the old rule said "the most significant") and expressly require that they be "concise."

practices and performance, File No. 4-711 (July 6, 2017), available [here](#).

The amendments also make the following important changes in the organization of the risk factor discussion.

- If the risk factor section exceeds 15 pages, the company must include a summary no longer than two pages, consisting of “concise, bulleted or numbered statements.” The adopting release estimates that this will affect 40% of companies.
- The discussion must be “organized logically with relevant headings,” an approach many companies already take but some do not.
- If there are generic risk factors (which the rule expressly discourages), they must be disclosed at the end under the caption “General Risk Factors.”
- In a registration statement, risk factors must be placed immediately following the summary section or, if there is no summary, after the cover page and pricing information.

Many companies may take the opportunity afforded by the amended rules to revise their risk factors and reduce them to 15 or fewer pages (thus avoiding the need for the summary). Where a summary is required, it is likely to take the form already often required by the SEC staff in an IPO prospectus – a bulleted list of the top few risk factors, often with a very brief description of each one.

However, the amended rules may lead to a more significant revision of risk factor disclosure, as many European companies have done in response to the European Union Prospectus Regulation.

### Legal Proceedings

Item 103 of Regulation S-K governs disclosure of legal proceedings. The amendments reorganize the Item but leave its substance largely intact, on the grounds that a prescriptive approach is more appropriate for this topic. The amendments streamline this disclosure in two ways:

- The new rules expressly permit required information to be provided by means of hyperlinks or cross-references to disclosure elsewhere in the document (*e.g.*, MD&A or the contingencies note to the financial statements). As the adopting release notes, many companies already take the cross-reference approach. However, to the extent existing legal proceedings disclosure contains forward-looking information (beyond that required by ASC 450), companies may prefer not to move that disclosure to the financial statement notes, where they are not covered by the PSLRA safe harbor for forward-looking statements.
- The amendments raise the threshold for disclosure of environmental proceedings to which the government is a party. The old rule had a \$100,000 threshold, and the new rule raises that to \$300,000 but gives the company flexibility to select a different threshold that it determines is reasonably designed to result in disclosure of material environmental proceedings, so long as it does not exceed the lesser of \$1,000,000 or 1% of the company’s current assets.

### The Dissenters

The SEC was divided on whether to adopt the amendments, as it has been in most of its significant recent rulemaking. The two Democratic commissioners dissented, delivering statements at the August 26 meeting that focused on two topics the amendments do not address: diversity and climate change. Commissioner Lee noted that the SEC received thousands of comments advocating disclosure requirements on diversity and climate risk, and she alluded to recent events that “have provided a real-time case study on the need for many of these disclosures.”<sup>5</sup> Commissioner Crenshaw, on the job for only a few weeks, focused on the failure to adopt specific, prescriptive rules requiring comparable disclosures about human capital.<sup>6</sup>

<sup>5</sup> Regulation S-K and ESG Disclosures: An Unsustainable Silence (Aug. 26, 2020), available [here](#).

<sup>6</sup> Statement on the “Modernization” of Regulation S-K Items 101, 103 and 105 (Aug. 26, 2020), available [here](#). At several points, the adopting release notes that commenters

## Looking Forward

*The Task at Hand.* The August 26 amendments provide companies with an opportunity to improve their disclosures on business description and risk factors, but they also provide two significant new assignments: reorganize (and maybe streamline) risk factors and develop some form of human capital disclosure.

*The MD&A Proposal.* One major piece of the Disclosure Effectiveness Initiative, closely related to last week's amendments, is the January 30, 2020 proposal to rewrite the MD&A requirement in Item 303 of Regulation S-K.<sup>7</sup> Will the MD&A proposal get done before the Commission sees significant changes in composition?

*The Democratic Agenda.* The statements of the dissenting commissioners also provide food for thought about disclosure changes that might be anticipated if there is a majority of Democratic commissioners in the future. The agenda seems likely to include mandatory disclosures – possibly using specific prescribed measures – on human capital, diversity practices, climate risk and sustainability generally.

*Will Disclosure Improve?* These amendments, like other elements of the Disclosure Effectiveness Initiative, highlight the question of how effective rule changes can be in reducing the complexity, density and prolixity that characterize much corporate disclosure. Disclosures are not just a product of rules. They also reflect, in part, the widely-held attitude that making disclosures longer and more complicated has little incremental cost and may have some benefits in managing risks concerning civil liability, enforcement activity and other regulatory entanglements of the company, its management and gatekeepers. To take the example of risk factors, it will be interesting to see if the amendments will result in shorter or more focused disclosure.

*Foreign Private Issuers.* The general inattention to FPIs has been a curious feature of several major pieces in the Disclosure Effectiveness Initiative. The amendments do not address Form 20-F, so they will not directly affect FPIs except for risk factors in Securities Act registration statements. It will be interesting to see whether foreign private issuers adjust their SEC disclosure practices to reflect the amendments.

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suggested addressing climate risk but that doing so would be inconsistent with the principles-based approach.

<sup>7</sup> Release No. 33-10750 (Jan. 30, 2020), available [here](#).