

Client Alert

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

August 9, 2019

On August 8, 2019, the Securities and Exchange Commission (the “SEC”) voted to propose [rule amendments](#) to modernize the description of business (Item 101), legal proceedings (Item 103) and risk factor disclosures (Item 105) that registrants are required to make pursuant to Regulation S-K. The SEC acknowledged that the disclosure items have not undergone significant revision in over 30 years.

The proposed amendments are part of the ongoing effort by the SEC to evaluate and improve the disclosure regime for both investors and registrants as mandated by Section 108 of the Jumpstart Our Business Startups Act (“JOBS Act”). The proposed amendments are a mix of a “principles” based approach whereby registrants will have the flexibility to evaluate the significance of information in the context of their overall business and financial circumstances and determine whether disclosure is necessary, and a “prescriptive” based approach whereby bright-line, quantitative thresholds specify when disclosure is required or requires all registrants to disclose the same type of information. The proposed amendments to Item 101 (Business) and Item 105 (Risk Factors) emphasize a principles-based approach in order to recognize that as businesses differ, so will the items which are material to them. In contrast, the proposed amendments to Item 103 (Legal Proceedings) would continue to use a prescriptive approach as such disclosure is less specific to the nature of a registrant.

The SEC is soliciting public comment on its proposed amendments through mid-October.

Summary of Proposed Amendments

Item 101(a); General Development of Business. [Item 101\(a\)](#) currently requires a description of the general development of the business of the registrant during the past five years or such shorter period as the registrant may have been engaged in business and in doing so requires disclosure of certain categories of information including, among others, the acquisition or disposition of material amount of assets other than in the ordinary course of business, material changes in the mode of conducting business or the nature of any material reclassification, merger or consolidation.

The proposed amendments would:

- eliminate the prescribed five year time frame for this disclosure and instead require registrants to focus on information material to an understanding of the development of their business irrespective of a specific time frame;
- allow registrants in filings *after* their initial registration statement to provide only an update of the general development of the business that focuses on material developments in the reporting period, and with an active hyperlink to the registrant’s most recent filing that, together with the update, would contain the full discussion of the general development of the registrant’s business;
- make disclosure more principles-based and include a non-exclusive list of types of information that a registrant may need to disclose to the extent such disclosure is material to an understanding of the general development of the registrant’s business; and
- include as a new listed disclosure topic, to the extent material to an understanding of the registrant’s business, transactions and events that affect or may affect the company’s operations, including material changes to a registrant’s previously disclosed business strategy.

Item 101(c); Narrative Business Description. [Item 101\(c\)](#) currently requires a narrative description of the business done and intended to be done by the registrant and its subsidiaries, focusing upon the registrant's dominant segment or each reportable segment about which financial information is presented in their financial statements. To the extent material to an understanding of a registrant's business, Item 101(c) includes two items that every registrant must discuss and to the extent material to an understanding of the registrant's business, any description of a segment must include ten specific items currently listed in Item 101(c).

The proposed amendments would:

- include a revised list of disclosure topics, principally drawn from the existing list in Item 101(c), thereby providing registrants flexibility to tailor disclosure to the specific circumstances of such registrant such that disclosure would be required only to the extent a topic is material to the understanding of a registrant's business;
- update the compliance disclosure topic and require disclosure on compliance with material government regulations, not just environmental laws; and
- replace the current requirement to disclose the number of employees with a requirement to include a description of the registrant's human capital resources, including any human capital measures or objectives that management focuses on in managing the business to the extent it would be material to an understanding of the registrant's business, such as measures or objectives that address the attraction, development and retention of personnel.

Item 101(h); Smaller Reporting Companies. [Item 101\(c\)](#) currently permits smaller reporting company to fulfill its disclosure obligations under Item 101, including with respect to its business development, by providing the disclosure specified under that paragraph. The proposed amendments would eliminate the prescribed three-year time frame for this disclosure; however, the amendments propose to retain the requirement that a smaller reporting company must provide the same information for its predecessors, if any, if it has not been in business for three years.

Item 103; Legal Proceedings. [Item 103](#) currently requires disclosure of any material pending legal proceedings (other than ordinary routine litigation incidental to the business) to which the registrant or any of its subsidiaries is a party or of which their property is the subject. It also requires the disclosure of the name of the court or agency, the date institute, the principal parties and a description of the underlying facts alleged and the relief sought.

The proposed amendments would:

- expressly provide for the use of hyperlinks or cross-references to legal proceedings disclosure elsewhere in the document. This is intended to reduce duplicative disclosure as, although Item 103 and US GAAP differ, registrants commonly repeat some or all of the disclosure provided elsewhere in the document, such as notes to the financial statements in order to comply with US GAAP; and
- update the disclosure threshold for environmental proceedings from the current \$100,000 threshold to \$300,000 to adjust for inflation.

Item 105; Risk Factors. [Item 105](#) currently requires disclosure of the most significant factors that make an investment in the registrant or offering speculative or risky and directs the registrant to describe how each risk affects the registrant or the securities offered and discourages the disclosure of risks that are generic. The SEC has proposed the below amendments in light of the lengthy and generic nature of risk factor disclosure presented by many registrants.

The proposed amendments would:

- require summary risk factor disclosure, if the risk factor section exceeds 15 pages, in the forepart of the prospectus or annual report, as applicable, under an appropriately captioned heading. The summary would consist of short, concise bulleted or numbered statements summarizing the principal factors that make an investment in the registrant or offering speculative or risky. The SEC estimates that this would affect approximately 40% of current filers;

- replace the requirement to disclose the “most significant” factors with “material” factors in order to focus registrants on disclosing risks to which reasonable investors would attach importance in making investment decisions; and
- require registrants to organize risk factors under relevant headings in order to help readers comprehend lengthy risk factor disclosures.

Proposed Amendments and Foreign Private Issuers

The proposed amendments to Items 101 and 103 would affect only domestic registrants and “foreign private issuers” that have elected to file on domestic forms because Regulation S-K does not apply to foreign private issuers unless a form reserved for them (i.e. Form F-1, F-3, or F-4) specifically refers to Regulation S-K. In contrast, the proposed amendment to Item 105 would affect both domestic and foreign registrants because Forms F-1, F-3 and F-4 all refer to that Item.

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