

August 27, 2020

SEC Meaningfully Revises Regulation S-K Periodic Disclosure Requirements: Move to Principles-Based Framework Reduces Some Public Company Disclosure Requirements While Adding and Expanding Others

The SEC has adopted a set of [amendments](#) to the periodic disclosure requirements relating to a registrant's business, legal proceedings and risk factors, which will go into effect 30 days after publication in the Federal Register. The amendments will affect a wide variety of SEC filings, including upcoming annual and quarterly reports and registration statements (including for spin-offs and IPOs). The stated purpose of the amendments, which are the most recent step in the [SEC's disclosure modernization exercise](#), is to make SEC disclosure documents more relevant to investors while reducing the burden on issuers. The changes eliminate certain prescriptive requirements in favor of a more flexible "principles-based, registrant-specific" approach, designed to elicit more tailored disclosures. The amendments also permit increased use of summaries, cross-references and hyperlinks in order to reduce repetition, among other changes seeking to discourage overly lengthy disclosure that can make it more difficult to identify important information.

While some have criticized the amendments as not going far enough or as being insufficiently prescriptive, the potential impacts may be significant. Companies will need to update their disclosure controls, practices and procedures, transition to principles-based materiality assessments that call for more judgments and consultation, plan for and draft more tailored (non-boilerplate) business, human capital, compliance and risk factor discussions germane to their industry and business models and newly consider whether certain voluntary disclosures made in other documents (*e.g.*, proxy statements, sustainability/CSR/ESG reports and human capital management reports) ought now be included, in whole or in part, in annual and quarterly reports where material.

1. Description of Business (Item 101)

The amendments to Regulation S-K Item 101 (Description of Business) include the following:

- shifting to a "principles-based" disclosure regime that permits issuers to determine, in their judgment, what developments are material to an understanding of the business;

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- requiring new descriptions, where material to an understanding of the business, of (1) a company’s “human capital resources” and (2) “any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant’s business and workforce, measures or objectives that address the development, attraction and retention of personnel)”;
- requiring disclosure of material changes to a previously disclosed business strategy (without mandating that business strategies be disclosed) as a supplement to MD&A-related disclosure requirements;
- expanding regulatory compliance disclosure requirements to cover all material government regulations, not just environmental laws;
- updating the rules relating to the narrative description of a registrant’s business to refer to a nonexclusive list of disclosure topic examples, including, among other topics, revenue-generating activities, products and services, resources material to a registrant’s business (*e.g.*, raw materials and intellectual property) and material effects of compliance with government regulations on capital expenditures, earnings and competitive position;
- eliminating the current five-year disclosure lookback; and
- permitting the business description to include only updates from previously filed information (rather than a full restatement), paired with a hyperlink to a single previously filed full discussion.

The new human capital-related disclosure requirements garnered significant attention during the regulatory comment process and was the subject of statements by several of the SEC commissioners in connection with the release of the final rules. Recognizing that private ordering in the space of human capital-related disclosures is evolving in real-time, the final rules do not adopt or endorse any specific human capital reporting framework at this time (*e.g.*, SASB, GRI, WEF/IBC, FCLT, EPIC, ISO, etc.). Instead, the amendments supplement the current requirement to disclose the number of employees with a principles-based approach reaching the human capital-related resources, measures and objectives that the company focuses on in managing and understanding the business. The rules do not prescribe a specific set of metrics or define “human capital” in this context, but stress the need for each registrant to consider how to make its disclosure specific to its industry and workforce approach and relevant to its unique facts and circumstances. By way of example, the adopting release states that “to the extent that a measure, for example, of a registrant’s part-time employees, full-time employees, independent contractors and contingent

workers, and employee turnover, in all or a portion of the registrant’s business, is material to an understanding of the registrant’s business, the registrant must disclose this information.” SEC Chairman Clayton’s public statement explicitly confirmed that he does “expect to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs” and that “[a]s is the case with non-GAAP financial measures, I would also expect companies to maintain metric definitions constant from period to period or to disclose prominently any changes to the metrics used or the definitions of those metrics.”

The SEC firmly rejected the view expressed by certain commenters that existing MD&A requirements adequately reach the matters that will be required under the updated Item 101 business disclosures and provided guidance as to the intersection between new Item 101 and MD&A. Specifically, the new Item 101 rules are designed to “elicit broader disclosure that may be material to an understanding of the registrant’s business as a whole, whereas disclosure in a registrant’s MD&A or financial statements may focus more narrowly on the specific impact on a registrant’s financial results, liquidity and capital resources or balance sheet.” Accordingly, issuers will need to assess whether, where items are discussed in the MD&A, additional disclosure related to the topic may be warranted in the business disclosures. The release provides an example in the context of MD&A discussion of a company’s supply chain financing arrangements and working capital practices, noting that while MD&A disclosure may focus on potential material impacts to periodic cash flows and financial condition, additional business disclosures related to the topic could be needed where “material to understanding the nature of [a company’s] commercial relationships.”

The SEC declined to implement an explicit safe harbor protecting against the disclosure of competitively sensitive information (concluding that the principles-based nature of the final rules should afford sufficient flexibility to provide material information without having to disclose competitively harmful information) and did affirm that PSLRA safe harbors will continue to apply to the inclusion of forward-looking statements.

2. Legal Proceedings (Item 103)

The amendments to Regulation S-K Item 103 (Legal Proceedings) increase the quantitative threshold for disclosure of environmental proceedings to which the government is a party from \$100,000 to \$300,000, unless the registrant selects a different threshold. Any alternative threshold must be reasonably designed (as determined by the registrant) to result in disclosure of material environmental

proceedings, and may not exceed the lesser of \$1 million and one percent of the current assets of the registrant and its subsidiaries on a consolidated basis.

3. Risk Factors (Item 105)

The rule includes multiple amendments to Regulation S-K Item 105 (Risk Factors), with the stated goal of minimizing “generic” or “boilerplate” risk in favor of a more tailored disclosure. If a registrant’s risk factor disclosure exceeds 15 pages, the amendments require a new summary risk factor section consisting of “concise, bulleted or numbered statements summarizing the principal factors that make an investment in the registrant or offering speculative or risky.” Risk factors must be organized under sub-headings, which are not generally mandated, except that any risk factors that “could apply generally to any company or offering of securities” must be disclosed at the end of the risk factor section under a separate “General Risk Factor” heading. The SEC noted (but was not persuaded by) the concern raised by commenters around the impact of this change on the availability of statutory safe harbor protections and signaled its preference by encouraging registrants to tailor each of their risk factors to emphasize the specific risk at issue in order to avoid having to relegate them to the “General Risk Factor” heading.

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We believe that the impact of the new rules will become evident over time as registrants grapple with revising their disclosures to implement the new requirements and as the SEC issues additional interpretive guidance elaborating on the new disclosure regime and responding to developing market practices. We also expect that the conversation around human capital disclosure is just beginning. The statements of certain SEC Commissioners expressing dissatisfaction with the absence of more prescriptive disclosures around human capital, climate change and diversity indicate that further discussion, investor pressure and private ordering around these topics will continue. The new rules, while not prescribing particular line-item disclosures on these topics, do permit registrants to make more fulsome disclosures on these topics appropriate for their circumstances.

Today’s amendments represent a significant step forward in the SEC’s modernization efforts, and we commend the SEC’s efforts to promote more readable, useful disclosure while discarding obsolete or outdated standards that arose in a different era.

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