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SEC Proposes Modernizing Certain Regulation S-K Disclosure Requirements

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Introduction

On August 8, 2019, the SEC issued a [proposed rule](#)¹ that would modernize the disclosure requirements in Regulation S-K, Item 101, "Description of Business"; Item 103, "Legal Proceedings"; and Item 105, "Risk Factors."

The main provisions of Regulation S-K, which is the central repository for disclosure requirements for public companies (other than financial statement requirements), were established more than 30 years ago. The SEC states in the proposed rule that the changes are intended to improve the readability of disclosures, reduce repetition, and eliminate nonmaterial information, thereby simplifying compliance for registrants and making disclosures more meaningful for investors. The proposal is part of a comprehensive SEC review of its disclosure requirements (the [disclosure effectiveness](#) initiative) and reflects input from the SEC staff's 2016 [Report on Modernization and Simplification of Regulation S-K](#)² and comments on the SEC's 2016 Concept Release [Business and Financial Disclosure Required by Regulation S-K](#).³

¹ SEC Proposed Rule No. 33-10668, "Modernization of Regulation S-K Items 101, 103, and 105."

² The SEC staff's report was issued under a mandate in the Fixing America's Surface Transportation Act (commonly referred to as the "FAST Act").

³ See Deloitte's April 18, 2016, [Heads Up](#) on the concept release.

Key Proposed Amendments to Regulation S-K

The proposed changes to the disclosure requirements related to a registrant's description of its business and risk factors are intended to expand the use of a principles-based approach that would give registrants more flexibility to tailor disclosures. The proposed changes to disclosures of legal proceedings would continue to apply the current, more prescriptive approach because those requirements are less dependent on a registrant's specific characteristics.

General Development of the Business

The proposed amendments to the requirements in Regulation S-K, Item 101(a), "General Development of Business," include the following:

- *Eliminate the prescribed timeline* — Item 101(a) currently requires registrants to disclose a description of the general developments of the business for the past five years (or since inception if that period is shorter). The proposed rule would eliminate that timeframe and instead require registrants "to focus on the information material to an understanding of the development of their business, irrespective of a specific timeframe." A similar change would be made to Regulation S-K, Item 101(h), "Smaller Reporting Companies," which currently requires a three-year timeline for disclosure.
- *Update the non-exclusive list of disclosure topics* — The proposed amendments contain a "non-exclusive list of the types of information that a registrant may need to disclose" if such information is material to the understanding of the general development of the registrant's business. The proposed rule would add "material changes to a registrant's previously disclosed business strategy" to the list of disclosure topics currently in Item 101(a). If a registrant has not previously disclosed its business strategy, however, the SEC is not proposing to require such disclosure, lest it force disclosure of proprietary information that could cause competitive harm.
- *Allow current-period updates with cross-references to disclosures in prior filings* — Registrants currently must provide a complete description of the general development of the business even if they have disclosed this information previously. The proposed rule would permit a registrant to provide (1) an update of Item 101(a) that includes only material developments in the current reporting period and (2) an active hyperlink to the registrant's "most recently filed disclosure that, together with the update, would present a full discussion of the general development of its business."

Narrative Description of the Business

Under Regulation S-K, Item 101(c), "Narrative Description of Business," a registrant's description of the business must focus on its reportable segments. Item 101(c) currently lists 12 items that, if material, must be included in the registrant's disclosures. The SEC notes, however, that many registrants "interpret Item 101(c) as requiring disclosure of each enumerated item, even if it is not material," and that the proposed amendments are intended to reinforce the principles-based approach and update the list of potential disclosure topics. Accordingly, the proposed rule provides a revised non-exclusive list of topics about which disclosure would be required if the topics are "material to an understanding of the registrant's business taken as a whole." Notably, the new list expands the human capital topic to include any "human capital measures or objectives that management focuses on in managing the business." The SEC indicates in the proposed rule that "the exact measures or objectives included in a registrant's human capital resource disclosure may change over time and may depend on the industry."

Current and proposed disclosure topics, as listed in the proposal, are as follows:

Current Item 101(c) Disclosure Topics

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|--|---|
| 1. Principal products produced and services rendered | 8. Dollar amount of backlog orders believed to be firm |
| 2. New products or segments | 9. Business subject to renegotiation or termination of government contracts |
| 3. Sources and availability of raw materials | 10. Competitive conditions |
| 4. Intellectual property | 11. The material effects of compliance with environmental laws |
| 5. Seasonality of the business | 12. Number of employees |
| 6. Working capital practices | |
| 7. Dependence on certain customers | |
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Proposed Item 101(c) Disclosure Topics

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|---|--|
| 1. Revenue-generating activities, products and/or services, and any dependence on key products, services, product families or customers, including governmental customers | 4. Description of any material portion of the business that may be subject to renegotiation of profits or termination of contracts or subcontracts at the election of the Government |
| 2. Status of development efforts for new or enhanced products, trends in market demand and competitive conditions | 5. Extent to which business is or may be seasonal |
| 3. Resources material to a registrant's business (including raw materials and effect of all patents, trademarks, licenses, franchises, and concessions) | 6. Compliance with material government regulations, including environmental regulations |
| | 7. Description of the registrant's human capital resources |
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Legal Proceedings

The proposed amendments to the requirements in Item 103 related to legal proceedings include the following:

- *Allow the use of hyperlinks or cross-references* — To help registrants avoid duplicative disclosure, the proposed rule would allow the use of hyperlinks or cross-references to disclosures about legal proceedings that were included elsewhere in the document.
- *Update the disclosure threshold for environmental proceedings for inflation* — For environmental proceedings to which the government is a party, Instruction 5.C. to Item 103 currently requires disclosure if such a proceeding is expected to result in sanctions of \$100,000 or more. To adjust for inflation, the proposed amendments would revise the disclosure threshold to \$300,000.

Risk Factors

As noted in the proposed rule, the amendments are intended to address the historically “lengthy and generic nature” of disclosures currently provided by many registrants under Item 105 related to risk factors. To this end, the proposed rule would:

- Require summary risk factor disclosure for registrants with more than 15 pages of disclosures in the risk factors section.
- Replace the requirement for registrants to disclose the “most significant” risk factors with one to disclose the “material” risk factors.
- Require risk factors to be organized under relevant headings, and require any risk factors that generally apply to an investment in securities to be disclosed at the end of the risk factor section under a separate caption.

Next Steps

The SEC is interested in feedback from market participants on this matter and does not require a specific format for the submission of comments. Some commenters may choose to present their views in a narrative format without any reference to specific questions posed by the SEC, and others may choose to answer all, or only some, of the specific requests for comment. Any format is acceptable, and the SEC encourages all types of feedback.

Comments on the proposed rule are due 60 days after its publication in the *Federal Register*.

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