At a glance

The SEC has amended its disclosure requirements relating to the description of business, legal proceedings, and risk factors, which are required in many SEC filings, including Form 10-K and many registration statements. Key changes include:

- permitting a company to provide (in a filing other than an initial registration statement) an update of the general development of its business if it incorporates by reference a full discussion from a single previously-filed registration statement or report;
- requiring, if material, a description of the company’s human capital resources, including any human capital measures/objectives that the company focuses on in managing its business (e.g., those that address the development, attraction, and retention of personnel);
- increasing the quantitative threshold for disclosing certain governmental environmental proceedings and allowing legal proceedings disclosures to be hyperlinked or cross-referenced to other sections in the document; and
- requiring a risk factor summary if the risk factor section is longer than 15 pages.

Many of the amended requirements reflect a principles-based, registrant-specific approach to disclosure, intended to facilitate an understanding of the company through the eyes of management. The changes are a result of the SEC’s on-going disclosure effectiveness initiative.

The changes become effective 30 days after they are published in the Federal Register.

Certain of the amendments may require management to develop new or modify existing controls and processes designed to ensure compliance with the SEC’s disclosure requirements.
Changes to the description of the business

Human capital disclosures

Perhaps the most notable amendment to Regulation S-K 101 relates to the expansion of human capital disclosures. The amended rules require a registrant to provide a description of its human capital resources (including the number of employees), if material to an understanding of the registrant’s business taken as a whole. And if material to a particular segment, that segment should be identified.

Registrants are also required to disclose, if material, any human capital measures or objectives that the registrant focuses on in managing its business, such as those related to the development, attraction, and retention of employees. A registrant should tailor its disclosures to its business and workforce.

In response to these amendments, SEC Chair Jay Clayton stated that he “expect[s] to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs.” He further noted that they should be constant from period to period, and if not, registrants should disclose any changes to the metrics used or how the metrics are calculated.

General development disclosure

The amendments to Regulation S-K 101(a) replace the previous requirement for information about the general development of the business over the last five years (three years for small reporting companies) with a requirement to disclose only information that is material to an understanding of the general development of the business. Additionally, registrants are permitted, in filings made after a registrant’s initial registration statement, to provide only an update to the general development of the business rather than a full discussion as long as they incorporate by reference and hyperlink to the full description in a prior report or registration statement. A registrant should focus its disclosures on material developments since its most recent full discussion of the general development of the business.

Principles-based approach

When describing the registrant’s current and intended business, the amendments to Regulation S-K 101(c) replace the current prescriptive list of 12 items required to be addressed with a more principles-based approach. Under the amended rules, when describing each segment of its business, a registrant is required to provide information material to an understanding of the entire business. The amendments list examples of items to consider, including some which were previously among the prescribed disclosures:

- Revenue-generating activities, products, and/or services, and any dependence on such activities, key products, services, product families, or customers
- The status of development efforts for new or enhanced products, trends in market demand, and competitive conditions
• Resources material to the business
• A description of any material portion of the business that may be subject to renegotiation or termination by the government
• The extent to which the business is seasonal

Compliance with government regulations

The amendments require disclosures regarding the material effects that compliance with all government regulations, not just environmental laws, may have upon the capital expenditures, earnings, and competitive position of the registrant, including the estimated capital expenditures for costs expected to be incurred related to environmental control facilities.

Streamlining the legal proceedings disclosure

Cross-referencing to disclosures elsewhere in the filing

Regulation S-K 103 currently requires that a registrant disclose any material pending legal proceedings, including the name of the court/agency where the proceedings are pending, the date the proceedings were instituted, the principal parties, and a description of the proceeding. While there were no significant changes to these specific disclosures, the amendments provide an option for registrants to include a hyperlink or cross reference to legal proceedings disclosures provided elsewhere in a filing. For example, a registrant may provide a cross reference to its MD&A, risk factors, or notes to the financial statements.

Increase to environmental proceedings disclosure threshold

The amendments increase the disclosure threshold for environmental proceedings to which the government is a party from $100,000 to $300,000, with flexibility for the registrant to select a different threshold, if certain conditions are met, as long as it does not exceed the lesser of $1 million or 1% of a registrant’s current assets.

Changes to risk factors disclosure

Under existing Regulation S-K 105, registrants are required to include a discussion of the “most significant” factors that make an investment in the registrant or the offering speculative or risky. The amended rules update the disclosure threshold to refer to “material factors.” The amended rules also direct registrants to present any generic risk factors at the end of the risk factor section under the caption “General Risk Factors.”

The amendments provide that the risk factor section be organized under relevant headings that adequately describe the risk. If the discussion exceeds 15 pages, the registrant must provide a series of concise bulleted or
numbered statements that is no more than two pages summarizing the principal factors.

Controls and procedures

Certain elements of the amendments will require management to disclose new information or change the manner in which existing information is presented. With regard to filings under the Securities Exchange Act of 1934, management will need to make sure disclosure controls and procedures are designed to ensure that the information required is recorded, processed, summarized, and reported on a timely basis. Controls will also need to ensure that information in registration statements and other public disclosures is accurate, complete, and presented fairly. Among the controls that may need to be re-evaluated are those designed to:

- identify and calculate human capital measures and objectives considered in managing the business,
- evaluate when information about the development of the business is material to an understanding of the business,
- determine the material effects that compliance with government regulations may have on capital expenditures, earnings, and competitive position,
- estimate capital expenditures expected to be incurred related to environmental control facilities, and
- determine an appropriate environmental disclosure threshold.

The new rules related to the human capital disclosures have received perhaps the most attention. Management may already have included certain human capital measures in prior SEC filings or other public disclosures (e.g., sustainability report, website, investor calls). It may also, however, consider other human capital-related metrics in managing its business that are not currently publicly disclosed. In preparation for compliance with the amendments, management may want to inventory the metrics and objectives that will need to be disclosed and ensure adequate controls and procedures are in place to identify and calculate them on a consistent basis.