

Memorandum

SEC Revises Disclosure Requirements With Respect to Description of Business, Legal Proceedings and Risk Factors

September 14, 2020

On August 26, 2020, the SEC adopted rule amendments modernizing the description of business, legal proceedings and risk factor disclosures that public companies are required to make in their SEC filings. The amendments largely track the SEC's rule proposal from August 2019 following the SEC's mandated Regulation S-K study and related disclosure effectiveness initiative. Companies should be aware that, in their upcoming Forms 10-K, they will be required to evaluate whether to include discussion of human capital resources and material government regulation, to the extent not already provided. In addition, companies will need to assess whether a risk factor summary is necessary or otherwise modify their risk factor disclosure in response to the new rules.

The final rules will become effective 30 days after publication in the Federal Register.¹

Amendments to Description of Business

- Companies are now permitted to focus on information material to an understanding of the development of their business, irrespective of a specific timeframe (five years or, for smaller reporting companies, three years). Form 10-K already requires only an update for developments since the beginning of the fiscal year for which the report is filed, so this change will have minimal effect on annual reports.
- After their initial filings made in connection with becoming a public company, companies may provide an update covering material developments to the most recent disclosure, rather than a full discussion, and incorporate by reference via hyperlink to a single prior filing that prior discussion. The final rule release makes clear, however, that a filing that includes an update to the description of business along with a hyperlink to an earlier filing containing a more fulsome description of business section could not be incorporated by reference into a subsequent filing, such as a Form S-3 or Form S-4. Accordingly, we suspect that this change will not be particularly useful to companies often accessing the capital markets through registered offerings of securities.
- The new rules are principles-based and provide an updated non-exclusive list of disclosure topics (some of which already exist under current rules). Among the relevant changes, a description of human capital

¹ All the amendments apply to domestic issuers. The amendments to the description of business and legal proceedings disclosures will not apply to foreign private issuers unless they have elected to file on domestic forms subject to Items 101 and 103 of Regulation S-K. However, the amendments to the risk factors disclosure will apply to foreign private issuers as Forms F-1, F-3 and F-4 specifically refer to Item 105 of Regulation S-K.

resources must be provided to the extent such disclosures would be material to an understanding of the company's business. The rules also identify certain measures and objectives that address the attraction, development and retention of personnel. In addition, in a change from the proposed rules, companies will continue to be required to disclose the number of persons employed by the company if material to an understanding of the company's business. In a controversial move, a divided SEC decided against adopting more prescriptive human capital disclosure requirements. In addition, diversity and climate change disclosures were not included in the final rule.

- The new rules explicitly require that companies describe all material government regulations, and not only environmental laws.

Amendments to Legal Proceedings Disclosure

- The new rules explicitly permit companies to cross-reference or hyperlink to legal proceedings disclosure located elsewhere in the filing to avoid duplicative disclosure. This change codifies widespread existing practice as many companies already cross-reference the financial statement footnotes for legal proceedings disclosure.
- The new rules also implement a modified disclosure threshold that increases the existing quantitative threshold for disclosure of governmental environmental proceedings from \$100,000 to \$300,000 but that also affords companies the flexibility to select a different threshold that they determine is reasonably designed to result in disclosure of material environmental proceedings, provided that the threshold does not exceed the lesser of \$1 million or one percent of current assets on a consolidated basis and the alternative threshold is disclosed in each annual and quarterly report.

Amendments to Risk Factors Disclosure

- The new rules refine the principles-based approach of existing rules by requiring disclosure of "material," as opposed to "significant," risk factors.
- If a company's risk factor section exceeds 15 pages, the new rules require a risk factor summary of no more than two pages, consisting of numbered or bulleted statements summarizing the principal risk factors that make an investment in the company or offering speculative or risky. The adopting release notes that this format is currently required in the Form S-11 context, which serves as an appropriate model for the summary risk factor presentation required under the final amendments. Accordingly, the risk summary can prioritize certain risks and omit others. For companies whose risk factor disclosure marginally exceeds 15 pages, it may be worth considering condensing the existing risk factor disclosure to avoid triggering the requirement to provide a risk factor summary.
- The new rules require a company's risk factors to be organized under relevant headings in addition to the subcaptions currently required, with any risk factors that may generally apply to an investment in securities disclosed at the end of the risk factor section under a separate caption. The new rules will not require

companies to prioritize the order in which they discuss their risk factors. However, the SEC noted that such prioritization could be useful to investors and companies will continue to be permitted to prepare and organize their risk factor disclosures in a way that emphasizes the relative importance of certain risks.

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