



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

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Reading Time : **5 min**

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### **Background**

The proposed amendments are part of a comprehensive evaluation of the SEC's disclosure requirements that was recommended in the SEC staff's Report on Review of Disclosure Requirements in Regulation S-K ("S-K Study"), which was mandated by Section 108 of the Jumpstart Our Business Startups Act (JOBS Act). Based on recommendations in the S-K Study, the SEC staff launched the Disclosure Effectiveness Initiative. As part of the Disclosure Effectiveness Initiative, which seeks to improve the SEC's disclosure regime for both investors and registrants, the SEC staff has been evaluating the information registrants are required to disclose, how this information is presented, where this information is disclosed and how the SEC can better leverage technology in furtherance of its stated goal.

In developing the proposed amendments, the SEC considered input from comment letters received in response to its disclosure modernization efforts. It also took into account the SEC staff's experience with Regulation S-K arising from the Division of Corporation Finance's disclosure review program and changes in the regulatory and business landscape since the adoption of Regulation S-K.

### **Proposed Amendments to Regulation S-K**

#### **Item 101(a) – General Development of Business**

The proposed amendment of Item 101(a) would:

- Eliminate the prescribed five year timeframe.

- Make the rule largely principles-based, requiring disclosure of a topic only to the extent such information is material to an understanding of the general development of a registrant's business.
- Provide the following nonexclusive list of the types of information that a registrant may need to disclose (to the extent material to an understanding of the registrant's business):
  1. Material bankruptcy, receivership or any similar proceeding (currently covered in Item 101(a)(1)).
  2. The nature and effects of any material reclassification, merger or consolidation of the registrant or any of its significant subsidiaries (currently covered in Item 101(a)(1)).
  3. The acquisition or disposition of any material amount of assets otherwise than in the ordinary course of business (currently covered in Item 101(a)(1)).
  4. Transactions and events that affect or may affect the company's operations, including material changes to a registrant's previously disclosed business strategy (new).
- Permit a registrant, in filings made after a registrant's initial filing, 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.

### **Item 101(c) – Narrative Description of Business**

The proposed amendment of Item 101(c) would:

- Clarify and expand the principles-based approach of the rule, by providing the following nonexclusive list of disclosure topics that a registrant may need to disclose (to the extent material to an understanding of the registrant's business):
  1. Revenue-generating activities, products and/or services, and any dependence on key products, services, product families or customers, including governmental customers (currently covered in Item 101(c)(1)(i) and (vii)).
  2. Status of development efforts for new or enhanced products, trends in market demand and competitive conditions (currently covered in Item 101(c)(1)(ii) and (x)).
  3. Sources and availability of raw materials (currently covered in Item 101(c)(1)(iii)).

4. The duration and effect of all patents, trademarks, licenses, franchises and concessions held (currently covered in Item 101(c)(1)(iv)).
5. A 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 (currently covered in Item 101(c)(1)(ix)).
6. The extent to which the business is or may be seasonal (currently covered in Item 101(c)(1)(v)).
7. Compliance with material government regulations, including environmental regulations (modifies Item 101(c)(1)(xii), refocuses the regulatory compliance requirement by including material government regulations, not just environmental provisions).
8. Human capital disclosure (modifies Item 101(c)(1)(xiii), rather than number of persons employed, now includes any human capital measures or objectives that management focuses on in managing the business, such as those that address the attraction, development and retention of personnel).

### **Item 103 – Legal Proceedings**

The proposed amendment of Item 103 would:

- Expressly state that the required information about material legal proceedings may be provided by including hyperlinks or cross-references to legal proceedings disclosure located elsewhere in the document.
- Raise the threshold for disclosure of environmental proceedings to which the government is a party from \$100,000 (which was set in 1982) to \$300,000.

### **Item 105 – Risk Factors**

The proposed amendment of Item 105 would:

- Require summary risk factor disclosure (consisting of a series of short, concise, bulleted or numbered statements summarizing the principal factors that make an investment in the registrant or offering speculative or risky) if the risk factor section exceeds 15 pages.
- Refine the principles-based approach of the rule by changing the disclosure standard from the “most significant” factors to the “material” factors required to be disclosed.
- Require risk factors to be organized under relevant headings, 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.

## **Analysis**

With the exception of the proposed amendments to legal proceedings disclosure (which retains, but increases, the prescriptive threshold for environmental proceedings to which the government is a party), there are two underlying themes in the SEC's proposing release. The first underlying theme is that disclosure of the subject information is only required to the extent such information is material to an understanding of the registrant's business. As noted in the footnotes to the proposing release, information is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision. The second underlying theme is that the subject disclosure requirements are based on a principles, rather than prescriptive, approach. A principles-based approach, according to the proposing release, relies on a company's management to evaluate the significance of information in the context of the company's overall business and financial circumstances, which provides flexibility that may elicit more relevant disclosures about these items than having prescriptive requirements. Both of these themes are consistent with findings from studies the SEC staff has conducted over the past several years as part of the SEC's Disclosure Effectiveness Initiative.

These proposed amendments have the potential to reduce existing disclosure in a registrant's filing that may be repetitive, not applicable or not material. In the case of changes to a previously disclosed business strategy or strategies regarding human capital, the proposed amendments also have the potential to add disclosure to a registrant's filing. Although the 60-day public comment period has not been set, as the proposed amendments have not yet been published in the Federal Register, registrants should be on the lookout for any SEC rule changes that may be adopted in light of the proposing release.

## **Categories**

Compliance
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