

# To the Point

SEC – final guidance

## SEC streamlines some Regulation S-K disclosures and requires human capital disclosures

The rules are intended to improve the readability of disclosures and discourage the inclusion of redundant or immaterial information.

### What you need to know

- ▶ The SEC amended its requirements for disclosures about a registrant's business, legal proceedings and risk factors.
- ▶ The SEC added new requirements for disclosures about human capital resources and the measures or objectives on which management focuses, if they are material.
- ▶ The amendments take a principles-based approach that gives registrants flexibility to tailor disclosures to their circumstances.
- ▶ The amendments will be effective 30 days after publication in the Federal Register.

### Overview

The Securities and Exchange Commission (SEC) adopted **final amendments** to its rules in Regulation S-K to streamline the disclosures registrants are required to make about business, legal proceedings and risk factors and to add new requirements for disclosures about human capital resources

The amendments are intended to reduce the burden of preparing disclosures and provide investors with more meaningful information. The rulemaking is part of the SEC's broader disclosure effectiveness initiative. As part of that initiative, the SEC has also **proposed** but not yet finalized modernizing the financial disclosure requirements in Regulation S-K.

Chairman Jay Clayton said the latest amendments update rules that have not changed in more than 30 years, despite changes to the US and world economies. He added that, while the old rules were well suited for the 1970s and 1980s, they "simply have not kept up."

The SEC also said the amendments reflect its long-standing commitment to principles-based requirements. In the adopting release, the SEC noted that these types of requirements “generally elicited detailed discussions of the impact of COVID-19 on registrants’ liquidity position, operational constraints, funding sources, supply chain and distribution challenges, the health and safety of workers and customers, and other registrant- and sector-specific matters.”

## Key considerations

### Description of business

The amendments eliminate the requirement to disclose general business developments over the past five years and allow registrants to tailor the disclosures to contain information that is material to an understanding of the development of their business. In filings after an initial registration statement, registrants will be permitted to provide only material updates along with a hyperlink to the most recently filed full discussion of developments that, together with the update, would present a complete discussion. The amendments also require companies to disclose any material changes to a previously disclosed business strategy.

The amendments also provide a list of topics that require disclosures only if they are material to an understanding of the registrant’s business taken as a whole. The list is nonexclusive, which the SEC said is intended to make the requirements more clearly principles-based and less likely to elicit disclosure that is not material.

While the list is based on existing rules, the SEC expanded the topic related to compliance with environmental laws to include compliance with all material government regulations. Other changes included eliminating specific references to backlog and working capital and combining related items like products and services provided and dependence on certain customers. The amended rules eliminate the requirement to name any customers that account for 10% or more of revenue, but registrants will need to consider whether the name of such a customer is a material fact that needs to be disclosed under the new requirement.

### Human capital resources

The amendments also require enhanced disclosures about a registrant’s human capital resources. In addition to continuing to disclose the number of people they employ, registrants will be required to include a description of human capital resources and any measures or objectives on which management focuses, if they are material to an understanding of the business. The final rule includes examples of human capital measures and objectives that may be material (e.g., measures on personnel attraction, development and/or retention) and does not prescribe specific measures to be disclosed by all registrants. The SEC emphasized such measures are examples of potentially relevant subjects, not mandates.

In adopting the final rules, the SEC rejected recommendations from numerous commenters to adopt more prescriptive requirements for human capital resource disclosure and to require separate disclosures about diversity and the risk of climate change.

The SEC said in its adopting release that its principles-based requirement will allow the human capital disclosures to evolve over time in response to factors such as the industry, the various regions or jurisdictions in which the registrant operates, strategy (e.g., vertically integrated) and macroeconomic and other conditions that affect human capital resources, such as national or global health matters. Two of the SEC’s five commissioners voted against the amendments, citing calls for more robust requirements about human capital, diversity and climate change.

### How we see it

This is the first time the SEC has mandated disclosure about a matter that many believe drives the long-term value created by a company. We believe this change in course by the SEC may cause some companies to consider making additional disclosures about other drivers of long-term value in their SEC filings to offer a balanced presentation.

The amendments to Item 105 aim to address the lengthy and generic nature of the risk factor disclosures presented by many registrants.

### Legal proceedings

While the amendments do not change the requirement in Item 103 of Regulation S-K to disclose details about material pending legal proceedings involving the registrant, they permit registrants to provide hyperlinks or cross-references to other disclosures elsewhere in the same filing (e.g., financial statement footnotes).

The amendments also modify the threshold for disclosing environmental proceedings to which a governmental authority is a party. Registrants will now be required to disclose matters that they believe will result in sanctions of \$300,000 or more (up from \$100,000 or more). But registrants will also be able to elect to use a higher threshold that is reasonably designed to result in disclosure of any material proceeding, as long as the threshold does not exceed the lesser of \$1 million or 1% of the registrant's current assets.

### How we see it

In a change from the proposal, the SEC will allow registrants to use a threshold higher than the inflation-adjusted bright line of \$300,000. However, in setting a limit of the lesser of \$1 million or 1% of current assets on thresholds registrants can elect to use, the SEC is indicating that it believes these matters are important to investors, even when the potential financial impact is relatively small.

### Risk factors

The changes to the Item 105 disclosures of risk factors require companies to report "material" risk factors, rather than the "most significant" ones. In addition, if a filing's risk factors section exceeds 15 pages, the registrant will have to provide a summary of no more than two pages. The SEC estimates this change will affect 40% of current filers. These changes are intended to address the lengthy and generic nature of the existing risk factors presented by some registrants.

Risk factors will also be required to be organized under relevant headings in addition to the subcaptions currently required. Risks that could apply generically to any registrant will have to be presented at the end of the Item 105 disclosure in a general risk factors section. The SEC believes these changes will focus registrants on disclosing the risks unique to them that investors would consider important in making investment decisions.

### How we see it

For many years, the SEC staff has encouraged registrants to provide more focused and readable disclosures about risks. Requiring better organization of the disclosures, and a summary for investors when the disclosures are lengthy, may balance the needs of investors and with those of registrants that also use the disclosures to protect them from liability under the federal securities laws. Registrants that are not required to provide the summary because their disclosures do not exceed 15 pages may also consider providing the short summary if they believe it will help investors better understand the risks they are facing.

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