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SEC Adopts Amendments to Modernize Portions of Regulation S-K

On August 26, 2020, the Securities and Exchange Commission adopted modest amendments to Item 101 (business description), Item 103 (legal proceedings) and Item 105 (risk factors) of Regulation S-K. The amendments reflect efforts under the SEC's ongoing Disclosure Effectiveness Initiative and continue the theme of "principles-based" disclosure, rejecting prescriptive disclosure requirements, in most instances.

These amendments were approved by the SEC by a vote of 3-2 after much debate. In his public statement, Chairman Clayton emphasized that "[o]ur rules also are designed to elicit disclosure tailored to each company's particular industry and business model, while being flexible enough to continue to allow for fulsome disclosure as businesses evolve in the future." Two Commissioners dissented and critiqued the amendments for not sufficiently modernizing the SEC's disclosure rules. Commissioner Lee criticized the amendments for their failure to include "a discussion of climate risk" and failure "to go beyond merely introducing the topic of human capital generally, despite investors' views that this is not nearly enough." Commissioner Crenshaw echoed some of Commissioner Lee's concerns stating, "the rule before us today fails to deal adequately with two significant modern issues affecting financial performance: climate change risk and human capital . . . [and] the final rule is also silent on diversity, an issue that is extremely important to investors and to the national conversation."

Near-Term Implications

These amendments will go into effect 30 days after their publication in the Federal Register. For a calendar-year company, most of the new rules will not apply to its periodic reports until the next Annual Report on Form 10-K. However, as these amendments will likely be in effect as early as the deadline for Quarterly Reports on Form 10-Q for the period ending September 30, 2020, companies should be aware that the legal proceedings disclosure threshold with respect to environmental



proceedings has been changed from \$100,000 to \$300,000 (or a different reasonable threshold that does not exceed the lesser of \$1 million or one percent of the current assets of the company). The rule change also expressly allows for legal proceeding disclosure to be incorporated into Part II, Item 1 of Form 10-Q to avoid repetitive disclosure.

A reporting company with a non-calendar fiscal year and a Form 10-K deadline in the near term will need to work quickly to provide a description of human capital resources. Further, many companies will need to rethink how they organize and present risk factors.

Summary of Amendments to Regulation S-K

The table below summarizes the amendments to Regulation S-K and provides key takeaways.

	<u>Existing Requirements</u>	<u>New Requirements</u>
<p>Item 101(a) <i>Description of the General Development of the Business</i></p>	<ul style="list-style-type: none"> Requires a description of the general development of the business during the past five years, or such shorter period as the registrant may have been engaged in business. 	<ul style="list-style-type: none"> Eliminates prescriptive five-year timeline for disclosures; and Requires full business description only in initial filing; subsequent filings may provide updates. When providing updates, companies must identify a single SEC filing containing the full discussion, incorporate such by reference and provide an active hyperlink.
	<p>Takeaway: The amendments make the requirements principles-based, eliminating prescriptive requirements and reducing redundancy.</p>	
<p>Item 101(c) <i>Narrative Description of the Business</i></p>	<ul style="list-style-type: none"> Requires a narrative description of the business done and intended to be done by the registrant and its subsidiaries, focusing upon the registrant’s dominant segment or each reportable segment about which financial information is presented in its financial statements. To the extent material, the description of each such segment must include disclosure of several specified disclosure topics. 	<ul style="list-style-type: none"> Clarifies and expands the principles-based approach of Item 101(c), with a nonexclusive list of disclosure topic examples (emphasizes only material matters need to be addressed); Includes, as a disclosure topic, a description of the registrant’s human capital resources to the extent such disclosures would be material to an understanding of the registrant’s business; and



		<ul style="list-style-type: none"> • Refocuses the regulatory compliance disclosure requirement by including as a topic all material government regulations, not just environmental laws.
	<p>Takeaway: The amendments require disclosure of a company’s human capital resources to the extent material to an understanding of the company’s business, but companies have latitude to determine the content and specificity of the human capital information they report. Companies who discuss human capital management in their proxy statements may reconsider such existing disclosures together with the new Form 10-K disclosure requirement.</p> <p>Companies should evaluate whether disclosure about government regulation needs to be expanded beyond environmental regulation.</p>	
<p>Item 103 <i>Legal Proceedings</i></p>	<ul style="list-style-type: none"> • Requires disclosure of any material pending legal proceedings including the name of the court or agency, the date instituted, the parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. • Similar information is required for proceedings known to be contemplated by governmental authorities. • Requires disclosure based on a \$100,000 threshold for proceedings related to federal, state or local environmental protection laws. 	<ul style="list-style-type: none"> • States that the required information may be provided by hyperlink or cross-reference to legal proceedings disclosure located elsewhere in the document (e.g., the contingencies note to the financial statements); and • Increases the disclosure threshold for environmental proceedings to which the government is a party from \$100,000 to \$300,000 (also provides flexibility to select a different reasonable threshold that does not exceed the lesser of \$1 million or one percent of current assets).
	<p>Takeaway: The amendments provide increased flexibility to eliminate some previously required disclosures relating to environmental proceedings that may be perceived as immaterial to the company as a whole.</p>	
<p>Item 105</p>	<ul style="list-style-type: none"> • Requires disclosure of the most significant factors that 	<ul style="list-style-type: none"> • Requires summary risk factor disclosure of no more than two



<i>Risk Factors</i>	<p>make an investment in the registrant or offering speculative or risky and specifies that the discussion should be concise, organized logically, and furnished in plain English. The Item also states that registrants should set forth each risk factor under a subcaption that adequately describes the risk.</p>	<p>pages if the risk factor section exceeds 15 pages;</p> <ul style="list-style-type: none"> Refines the principles-based approach of Item 105 with a focus on disclosure of “material” risk factors (as opposed to “most significant”); and Requires risk factors to be “organized logically with relevant headings.”
	<p>Takeaway: Companies should use this as an opportunity to reevaluate their risk factor discussion and eliminate risk factors that are applicable generally to all companies and which are not “material”. We expect many companies will try to reduce risk factor disclosure to less than 15 pages to avoid the required risk factor summary requirement.</p>	

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