


The New SEC Regulation S-K Rules

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on

October 14, 2020

Disclosure, Form 10-Q, Human capital, Regulation S-K, SEC, SEC rulemaking, Securities regulation

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The SEC's amendments to Regulation S-K will come into **effect on November 9, 2020** and apply to **10-Qs, 10-Ks and registration statements filed on or after that date as applicable**. November 9, 2020 is also the filing deadline for quarterly reports by large accelerated and accelerated filers with quarters ended on September 30, 2020. As we previously noted, the amendments alter requirements concerning the **description of business (Item 101)**, **legal proceedings (Item 103)** and **risk factors (Item 105)** by, among other things, adopting a principles-based approach to disclosure. The amendments also require new descriptions, where material to an understanding of the business, of (1) a company's "human capital resources" and (2) "any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the development, attraction and retention of personnel)."

We developed the below *Frequently Asked Questions* to provide practical guidance as companies work to revise their annual and quarterly reports in light of the new disclosure requirements.

Frequently Asked Questions

Will the amendments impact 10-Q filings for the quarter ending September 30, 2020?

Depending on the date of filing, they may. The amendments are effective on Monday, November 9, 2020, and any periodic reports filed on or after that date will need to comply with the amendments. For large accelerated and accelerated filers with December 31 year-ends, the Quarterly Report on Form 10-Q for the third quarter is due on Monday, November 9, 2020 (40 days after end of fiscal quarter). For non-accelerated filers with December 31 year-ends, the Quarterly Report on Form 10-Q for the third quarter is due on

Monday, November 16, 2020 (45 days after end of fiscal quarter). Companies may wish to consider filing their quarterly reports before the effective date of the amendments if they would prefer to postpone the implementation of the amendments until they prepare their Annual Report on Form 10-K for the year ended December 31, 2020.

What parts of the amendments will impact filings on Form 10-Q?

Item 101 (*Description of Business*) is not among the requirements of Form 10-Q, so changes addressing the description of business, including the new human capital disclosure requirements, need not be made until the filing of the Annual Report on Form 10-K for 2020.

Item 103 (*Legal Proceedings*) is included among the requirements of Form 10-Q, so disclosure of legal proceedings will need to be made in accordance with the amended text of Item 103.

With respect to risk factor disclosures, Form 10-Q requires the disclosure of “any material changes from risk factors as previously disclosed in the registrant’s Form 10-K,” but does not directly reference Item 105. Filers, therefore, may elect to postpone the inclusion of the risk factor summary, the reorganization of the risk factors and other changes required by the amendments until the filing of the Annual Report on Form 10-K for 2020. Companies, however, that routinely list their full set of risk factors in their 10-Qs (instead of only listing material changes) should consider voluntarily including the changes required by the amended Item 105.

What does it mean that the SEC is shifting to a “principles-based” disclosure regime?

The amendments are part of an incremental move away from prescriptive disclosure requirements towards a more “principles-based, registrant-specific approach to disclosure.” In practice, this means fewer line-item disclosure requirements, moving in favor of a regime that requires each registrant to tailor disclosure to its unique circumstances. Disclosure decisions in response to the amendments will require experience and judgment to evaluate the circumstances of each registrant and craft appropriate responsive disclosure.

We will monitor developments in disclosure practice in response to this shift, as we expect practice will evolve quickly over the next six months.

What changes will need to be made to the Item 101 disclosures about the general development of the business?

The amendments to Regulation S-K Item 101 include the following:

- shifting to a “principles-based” disclosure regime that permits issuers to determine, in their judgment, what developments are material to an understanding of the business;
- requiring new descriptions, where material to an understanding of the business, of (1) a company’s “human capital resources” and (2) “any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant’s business and workforce, measures or objectives that address the development, attraction and retention of personnel)”;
- requiring disclosure of material changes to a previously disclosed business strategy (without mandating that business strategies be disclosed) as a supplement to MD&A-related disclosure requirements;
- expanding regulatory compliance disclosure requirements to cover all material government regulations, not just environmental laws;
- updating the rules relating to the narrative description of a registrant’s business to refer to a nonexclusive list of disclosure topic examples, including, among other topics, revenue-generating activities, products and services, resources material to a registrant’s business (e.g., raw materials and intellectual property) and material effects of compliance with government regulations on capital expenditures, earnings and competitive position;
- eliminating the current five-year disclosure lookback; and
- permitting the business description to include only updates from previously filed information (rather than a full restatement), paired with a hyperlink to a single previously filed full discussion.

How should a company approach the elimination of the five-year disclosure window?

We recommend companies begin by reviewing their existing disclosure practices. Many registrants already include events outside of the five-year window if such events are important in understanding the development of the business.

In addition, the amendments can provide an opportunity for companies to take a step back and do some high-level thinking about the most material developments in the business and what is material to investors today.

How should a company approach the disclosure of business strategy?

We recommend that companies first review their prior disclosures to determine what disclosures, if any, regarding business strategy have previously been made. Each company should also review strategic planning materials that have been reviewed by its board of directors to determine if existing disclosures require updates for any material developments.

With respect to companies that do not have express disclosures with respect to business strategy, each company must weigh the potential benefits to shareholders from offering business strategy disclosure against the requirement that this disclosure be regularly updated in the future to reflect material changes.

We will review market practices with respect to business strategy disclosure as they evolve, but we expect that many companies may take the amendments as an opportunity to overhaul their disclosure significantly, including the potential inclusion of a business strategy section where one has not previously been disclosed.

What is the new requirement concerning human capital disclosures?

The amendment requires new descriptions, where material to an understanding of the business, of (1) a company's "human capital resources" and (2) "any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the development, attraction and retention of personnel)."

How should a company begin thinking about what kind of human capital disclosures it should make?

Under the new amendment, a company should disclose the key human capital measures and objectives, if any, that it focuses on in managing the business, which may include, if applicable, measures and objectives that underlie performance goals for incentive compensation. We suggest that companies:

- start with the human capital factors that are already publicly disclosed and that are reported to the board / board committee(s) on a regular basis, if any, and confirm that such factors are consistent with disclosed corporate goals;
- engage in a "bottom up" review of these factors, starting the discussion with business unit leaders and filtering their feedback through senior management; and
- evaluate whether reporting of factors to the board / board committee(s) should be commenced or expanded, considering (1) which board committee(s) would be most suited to provide oversight and (2) the frequency and detail of information to be reported, including in light of anticipated public disclosure of factors.

We have also found that, in evaluating potential disclosure changes, close coordination with the human resources / human capital management function of the company is often critical to better understand how the company itself manages talent and evaluates human capital matters in general for internal purposes.

Does a company need to change its current practices or are there any specific measures or objectives a company is required to include in the new human capital disclosure?

No. The amendments require companies to describe “any human capital measures or objectives” currently employed by a company in managing the business; there is no independent requirement to begin employing new human capital measures and objectives or to disclose any particular measures or objectives. The SEC explicitly declined to include more prescriptive requirements because they recognize that the exact measures and objectives included in human capital management disclosure may evolve over time and may vary significantly based on factors such as the industry, region and other circumstances.

What are some potential human capital measures or objectives companies have been disclosing?

Although each company will need to focus on the human capital measures and objectives it actually uses in managing the business, many companies have disclosed information in the following broad categories:

- **Workforce Diversity:** percentage of women and / or people of color across the global or U.S. workforce, at the management level, in leadership positions or across incoming hires
- **Workforce Compensation:** pay ratio for female to male employees; pay ratio for diverse to non-diverse employees; change in starting wages
- **Cultural Initiatives:** diversity hires, employee engagement, turnover and issues escalation resolution
- **Workforce Health and Safety:** recordable injury rates (e.g., consolidated total recordable incident rate; consolidated lost time injury rate); number of employees participating in certain health and wellness programs
- **Workforce Skills and Capabilities:** aggregate amount of money or employee hours invested in training programs; number of employees participating in internal training or career planning programs
- **Workforce Stability:** employee engagement scores and certain turnover rates (e.g., turnover rate for high-performing personnel)

What are some factors a company can consider in preparing the description of its human capital resources?

Each company will need to consider its industry and particular circumstances in determining what its human capital resources are and how to describe how those resources are material to an understanding of its business taken as a whole. The following is a non-exclusive list of factors that may be material to certain companies:

- **Demographic Information**

- number of full-time, part-time, and seasonal workers
- number and category of employees by jurisdiction or region
- race / ethnicity and gender diversity data of employees
- percentage of active workforce covered by collective bargaining agreements / works council arrangements, broken down by U.S. and non-U.S. employees
- education and experience of the company's workforce

- **Recruitment, Promotion, Retention, and Succession**

- description of talent recruitment and retention efforts
- rates of hiring and promotion (which could be presented by level of employee)
- voluntary and involuntary employee turnover rate (which could be presented by level of employee)
- training and other opportunities for emerging talent in the organization
- status of relations with labor unions and / or works councils
- succession planning for senior leadership and business unit lead roles

- **Worker Safety and Training**

- safety of the workforce, including frequency and severity of, and lost-time due to injuries and fatalities
- health of the workforce, including frequency of lost-time due to illnesses and workplace-specific issues (e.g., pandemic impact on supply chain)
- employee training information, including expenditures for training in job duties, safety and health, industry / professional qualification, and education, and measures regarding average hours of training

- **General**

- the organizational structure through which the company manages its human capital resources
- information regarding the trend of any of the human capital factors noted above
- material elements of company policies (e.g., paid sick leave) relating to any of the human capital factors noted above

What changes have been made to Item 103 (Legal Proceedings)?

The amendments to Regulation S-K Item 103 increase the quantitative threshold for disclosure of environmental proceedings to which the government is a party from \$100,000 to \$300,000, unless the registrant selects a different threshold. Any alternative threshold must be reasonably designed (as determined by the registrant) to result in disclosure of material environmental proceedings, and may not exceed the lesser of \$1 million and one percent of the current assets of the registrant and its subsidiaries on a consolidated basis.

Should a company consider implementing a higher disclosure threshold?

Each company will need to evaluate its particular circumstances and the types of litigation in which it tends to become involved, and weigh the advantages of mitigated disclosure obligations against the potential risks of selecting a higher threshold.

Companies should consider and evaluate the risks that:

- setting a threshold between \$300,000 and \$1 million could potentially give rise to arguments by the SEC or plaintiffs' lawyers that the company considers risks in excess of such dollar amount to be material generally, and potential claims as to why other potential risks in excess of such dollar amount were not disclosed; and
- damages from an environmental proceeding are not always accurately estimable, so setting a threshold between \$300,000 and \$1 million could give rise to under-disclosure of environmental proceedings that later prove to exceed the threshold.

These risks, and other similar risks, should be weighed against the benefits of potentially reducing litigation disclosure requirements.

What changes have been made to Item 105 (Risk Factors)?

The amendments to Regulation S-K Item 105 include the following:

- if a registrant's risk factor disclosure exceeds 15 pages, the amendments require a new summary risk factor section consisting of "concise, bulleted or numbered statements summarizing the principal factors that make an investment in the registrant or offering speculative or risky";
- replaces the requirement to disclose the "most significant" risk factors with the "material" risk factors; and
- risk factors must be organized under sub-headings, which are not generally mandated, except that any risk factors that "could apply generally to any company or offering of securities" must be disclosed at the end of the risk factor section under a separate "General Risk Factors" heading.

What are some models for the required summary risk factor disclosure?

The summary risk factor disclosure must take the form of concise, bulleted or numbered statements. We suggest taking a look at the cautionary notes regarding forward-looking statements sections that accompany annual and quarterly reports, many of which already contain summaries of risk factors in bulleted form.

What are some examples of subcaptions companies can use to organize their risk factors?

The following are some examples of how a number of companies have organized their risk factors. Each company should consider its particular circumstances when determining a logical and intelligible way to organize its risk factors.

- Strategic Risks; Operational Risks; Legal and Compliance Risks; Financial Risks
- Risks Related to the COVID-19 Pandemic; Risks Associated with Our Industry; Risks Related to Our Business Model and Capital Structure; General Commercial, Operational, Financial and Regulatory Risks
- Litigation and Regulatory Risks; Company and Operational Risks; Industry and Economic Risks; Other Risks
- Strategic Risks; Operational Risks; Financial Risks; Legal, Tax, Regulatory, Compliance, Reputational and Other Risks
- Credit Risks; Liquidity Risks; Operational Risks; Regulatory Compliance Risks; Market Risks; Legal Risks; Strategic Risks; General Business Risks
- Risks Related to the Economy and Other External Factors, Including Regulation; Risks Related to the Use of Technology; Risks Related to the Business of Banking; Risks Related to Estimates and Assumptions; Risks Related to Our Need for Customers; Risks Related to Other Operational Issues; Other Key Risks
- Market and Competition Risks; Risks Related to Investment Performance; Technology and Operational Risks; Risks Related to Human Capital; Risks Related to Key Third-Party Relationships; Legal and Regulatory Risks

Should a company try to shrink its risk factors to stay under the 15-page limit?

Companies will need to weigh the advantage of not including a summary against the potential increase of litigation risk from dropping, combining or streamlining risk factors to meet the page limit. Before eliminating or truncating a risk factor, a company should ask itself whether there is any concrete reason it can point to why something was a risk factor in the prior year but not this year.

What are some examples of “generic” risk factors?

The amendments require registrants to present risks that could apply generally to any company or offering of securities at the end of the risk factor section under the caption “General Risk Factors.” Some examples of such general risk factors include:

- Risks related to investment in our securities
- Risks related to shifts in the broader economy or market
- Risks associated with a particular industry
- General business risks

