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## Striving for Simplicity: Updates to Regulation S-K Items 101 and 105

John D. Frey

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# Striving for Simplicity: Updates to Regulation S-K Items 101 and 105

*John D. Frey\**

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## INTRODUCTION

Imagine the year is 1988. The largest 500 U.S. companies in Standard & Poor's CompuStat database boasted an average market capitalization of \$4.27 billion, the largest 100 of which had an average market capitalization of \$12.25 billion.<sup>1</sup> If adjusted for inflation in 2018, these figures amount to \$9.15 billion and \$26.24 billion, respectively.<sup>2</sup> In 2018, however, the actual average market capitalization of the largest 500 companies was \$49.10 billion, and the average market capitalization of the largest 100 companies was \$141.46 billion.<sup>3</sup> Notably, many of the businesses making up the largest companies in the CompuStat database differed from 1988 to 2018.<sup>4</sup> As evidenced, business development has not been linear. Since 1988, investors have begun to form new opinions not only about what makes an asset valuable but also about what constitutes an asset.<sup>5</sup>

As businesses have grown and assets have taken new shapes, it comes as no surprise that businesses are both operating and tracking information in a different manner than in the 1980s.<sup>6</sup> Surprisingly, some of the information these businesses are required to disclose to the public has not changed in the same timeframe.<sup>7</sup> The Securities and Exchange

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1. 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. §§ 229, 239–40). Standard & Poor's is a financial services company. Its CompuStat database is a database containing information on business entities. The database provides investors with information that helps tailor investment decisions. *See Fundamental Data*, S&P GLOBAL, <https://www.spglobal.com/marketintelligence/en/solutions/fundamental-data> [<https://perma.cc/4M9G-WKNV>] (last visited Dec. 28, 2020).

2. *CPI Inflation Calculator*, BUREAU OF LAB. STAT., <https://data.bls.gov/cgi-bin/cpicalc.pl?cost1=100%2C000.00&year1=198201&year2=201908> [<https://perma.cc/8NDX-T9ZJ>] (last visited Dec. 28, 2020).

3. 84 Fed. Reg. 44,358; *see also Fundamental Data*, *supra* note 1.

4. 84 Fed. Reg. 44,358.

5. Leon Kaye, *Time to Start Valuing Human Capital as an Asset on the Balance Sheet*, GUARDIAN (Aug. 2, 2012, 12:52 PM), <https://www.theguardian.com/sustainable-business/valuing-human-capital-asset-balance-sheet> [<https://perma.cc/7MFH-CB9K>].

6. *See generally* Blair Jones, *Investors Want More Human Capital Oversight*, DIRECTORS & BOARDS (2019), <https://www.directorsandboards.com/articles/singleinvestors-want-more-human-capital-oversight> [<https://perma.cc/EAZ7-23GD>].

7. *See, e.g.*, 38 Fed. Reg. 17,202 (June 29, 1973) (to be codified at 17 C.F.R. pts. 239–40, 249); *see also* 47 Fed. Reg. 11,380 (Mar. 16, 1982) (to be codified at

Commission (SEC) adopted Regulation S-K to govern disclosure of non-financial statements.<sup>8</sup> The SEC split Regulation S-K into “Items,” and Items 101 and 105 last faced significant revision in the 1980s—an era that bears little resemblance to today’s business landscape.<sup>9</sup> Conscious of the Items’ outdatedness, the SEC proposed amendments to these Items in Proposal S7-11-19, according to its announcement on August 8, 2019.<sup>10</sup> The proposed amendments would enable Regulation S-K to serve as a better tool for both registrants and investors.<sup>11</sup> However, the issue is that even if the amendments are enacted as proposed, Items 101 and 105 would still need to undergo significant changes to be truly efficient.<sup>12</sup> The changes necessary to achieve adequacy for these Items are not particularly difficult to reach.<sup>13</sup> On August 23, 2020, the SEC announced a Final Rule on Proposal S7-11-19, and the Final Rule largely mirrored the Proposal as written.<sup>14</sup> Thus, the SEC took a small step in the right direction; however, a leap forward was just as easily achievable.<sup>15</sup>

Part I of this Comment provides background information about the SEC, Regulation S-K, and Proposal S7-11-19. The background information centers on why Congress formed the SEC, why the SEC adopted Regulation S-K, and the SEC and S-K’s impact. Additionally, Part I of this Comment sets forth the contents of the Items relevant to Proposal S7-11-19 as written prior to Proposal S7-11-19’s enactment. Part II of this Comment discusses the SEC’s past efforts to update and simplify disclosure requirements. Part II also analyzes Proposal S7-11-19’s contents and the effects and reasonings of the amendments contained within the Proposal. Further, Part II establishes the similarities and

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17 C.F.R. pts. 200–01, 229–30, 239–40, 249–50, 260, 274); 17 C.F.R. pt. 229 (2019); 84 Fed. Reg. 44,358.

8. See, e.g., 38 Fed. Reg. 17,202; see also 47 Fed. Reg. 11,380; 17 C.F.R. pt. 229 (2019); 84 Fed. Reg. 44,358.

9. See, e.g., 38 Fed. Reg. 17,202; see also 47 Fed. Reg. 11,380; 17 C.F.R. pt. 229; Gene Marks, *10 Huge Ways Running a Business Has Changed in the Past 20 Years*, ENTREPRENEUR (June 4, 2014), <https://www.entrepreneur.com/article/234396> [<https://perma.cc/7NTY-GBNC>].

10. *SEC Proposes to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K*, U.S. SEC. & EXCH. COMM’N (Aug. 8, 2019), <https://www.sec.gov/news/press-release/2019-148> [<https://perma.cc/U35V-M552>].

11. See generally 84 Fed. Reg. 44,358.

12. *Id.*

13. *Id.*

14. 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239–40).

15. 84 Fed. Reg. 44,358.

differences between Proposal S7-11-19 and its Final Rule. Part III of this Comment critiques Proposal S7-11-19 and its Final Rule and recommends supplemental changes to Items 101(a), 101(c), and 105.

## I. THE SEC AND REGULATION S-K

In 1933, Congress enacted the Securities Act, which requires companies to provide investors with information and prohibits foul play such as securities fraud.<sup>16</sup> Congress passed the Securities and Exchange Act in 1934, which created the SEC.<sup>17</sup> The Securities and Exchange Act granted the SEC authority to oversee all aspects of the securities industry.<sup>18</sup> Congress's intent in creating the SEC was to promote stability in financial markets, enforce securities laws, and instill confidence in investors.<sup>19</sup> In 1977, the SEC adopted Regulation S-K to foster uniform and integrated disclosure statements for investors.<sup>20</sup>

### A. *The SEC's Structure and Rulemaking Process*

The SEC's mission is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."<sup>21</sup> The SEC carries out this mission by requiring publicly traded companies to disclose financial information alongside other potentially meaningful information—referred to as "material" information—for investors.<sup>22</sup> The U.S. Supreme Court stated that information is material if there is a substantial likelihood that reasonable investors would consider the information important when making investment decisions.<sup>23</sup> The SEC requires the disclosure of

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16. Securities Act of 1933, 15 U.S.C. §§ 77a–aa.

17. *What We Do*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/Article/whatwedo.html> [<https://perma.cc/J3FL-R8UA>] (last modified June 10, 2013); *see also* 15 U.S.C. §§ 77a–aa.

18. 15 U.S.C. §§ 77a–aa.

19. *See id.*; *see also What We Do*, *supra* note 17.

20. Kara M. Stein, *Statement at Open Meeting on a Concept Release on the Business and Financial Disclosure Required by Regulation S-K*, U.S. SEC. & EXCH. COMM'N (Apr. 13, 2016), <https://www.sec.gov/news/statement/stein-statement-1-041316.html> [<https://perma.cc/Y2JE-YGZ5>]; *see also* 17 C.F.R. pt. 229 (2019).

21. *What We Do*, *supra* note 17.

22. *Id.*

23. *TSC Indus. v. Northway, Inc.*, 426 U.S. 438 (1976). For example, many investors sent the SEC public comments stating their desire to know the diversity of registrants' workforce because they believed the information would help make investment decisions. Therefore, this information is "material." *See, e.g.*, Louis E.

information to facilitate a common source of knowledge for investors to consider to facilitate their investment decisions.<sup>24</sup> To achieve its goal of adequate investor protection, the SEC brings civil enforcement actions against individuals and companies that do not comply with the SEC's disclosure requirements.<sup>25</sup> The SEC's leaders also have the authority to engage in rulemaking.<sup>26</sup> Five presidentially appointed commissioners run the SEC and serve staggered terms of five years.<sup>27</sup> To ensure non-partisanship, no more than three of the appointed officials can belong to the same political party.<sup>28</sup> The SEC is organized into five divisions and 24 offices, each of which plays a role in the overall governance of the securities world and assists the SEC in facilitating rulemaking decisions.<sup>29</sup>

The rulemaking process typically consists of a rule proposal, a public comment period, and a final rule adoption.<sup>30</sup> If an issue presented to the SEC is particularly unique, the SEC will publish a concept release preceding the rule proposal.<sup>31</sup> A concept release describes the issue and solicits the public's advice so the SEC can better evaluate the situation before constructing a rule proposal.<sup>32</sup> A rule proposal specifies objectives

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Matthews, Jr., Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 7, 2019), <https://www.sec.gov/comments/s7-11-19/s711119-6261126-193027.htm> [<https://perma.cc/N94T-LV8H>].

24. *What We Do*, *supra* note 17.

25. *See generally How Investigations Work*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/enforce/how-investigations-work.html> [<https://perma.cc/FZW9-DHCX>] (last modified Jan. 27, 2017).

26. *Rulemaking, How it Works*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/fast-answers/answersrulemaking.htm> [<https://perma.cc/2YQQ-2XP3>] (last modified Apr. 6, 2011).

27. *What We Do*, *supra* note 17.

28. *Id.* These characteristics are reflective of the SEC's classification as an independent agency.

29. *Id.* Divisions break the SEC down into more specific areas and include the Division of Corporation Finance, the Division of Trading and Markets, the Division of Investment Management, the Division of Enforcement, and the Division of Economic and Risk Analysis. The offices further narrow responsibility. A few examples of the offices are the Office of Women and Minority Inclusion and the Office of Credit Ratings.

30. *Rulemaking, How it Works*, *supra* note 26.

31. *SEC Concept Releases*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/rules/concept.shtml> [<https://perma.cc/L8ZL-ERLW>] (last modified Oct. 30, 2019).

32. *Id.*

to combat certain issues and plans to achieve those objectives.<sup>33</sup> Similar to a concept release, the SEC seeks the public's opinion on rule proposals through a public comment period with a length of 30 to 90 days.<sup>34</sup> The public comment period is open to the public, but typically potentially affected entities, interested accountants, and scholars that specialize in the area in question submit the comments.<sup>35</sup> The final step in the rulemaking process is rule adoption.<sup>36</sup> The SEC considers the public comments, and it either agrees upon the specifics of a final rule or rejects the proposed rule.<sup>37</sup> If a rule is adopted out of the proposal, the SEC can adopt the proposal in full, enact only portions of the proposal, or adopt a slightly modified version of the original proposal.<sup>38</sup> If the SEC adopts any part of the proposal as a final rule, it becomes an official rule governing publicly traded companies.<sup>39</sup>

Throughout the rulemaking process, the SEC considers whether the rules it crafts should take a principles-based approach, a prescriptive-based approach, or a mix of both approaches.<sup>40</sup> A principles-based structure relies upon a registrant's ability to determine the significance of information in relation to the registrant's business and financial situation.<sup>41</sup> In other words, a registrant must determine both whether certain information is material and how to disclose the information deemed to be material.<sup>42</sup> Principles-based systems provide a disclosure "concept" rather

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33. *Rulemaking, How it Works*, *supra* note 26; *see also SEC Proposed Rules*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/rules/proposed.shtml> [<https://perma.cc/E6KM-W4S3>] (last modified July 31, 2020).

34. *Rulemaking, How it Works*, *supra* note 26; *see also SEC Proposed Rules*, *supra* note 33.

35. *See generally Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/comments/s7-11-19/s71119.htm> [<https://perma.cc/UFN9-AH74>] (last modified July 30, 2020). *See also How to Submit Comments*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/rules/submitcomments.htm> [<https://perma.cc/CB-B3-CGAR>] (last modified Sept. 10, 2019).

36. *What We Do*, *supra* note 17; *see also SEC Final Rules*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/rules/final.shtml> [<https://perma.cc/VPG3-WE3W>] (last modified July 31, 2020).

37. *What We Do*, *supra* note 17; *see also SEC Final Rules*, *supra* note 36.

38. *See generally SEC Final Rules*, *supra* note 36.

39. *What We Do*, *supra* note 17; *see also SEC Final Rules*, *supra* note 36.

40. *See generally SEC Proposed Rules*, *supra* note 33.

41. 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239-40).

42. *Id.*

than a specific, inflexible requirement.<sup>43</sup> Additionally, this approach can decrease the potential for a regulation to become outdated.<sup>44</sup> Due to its adaptive nature, a principles-based approach can be reactive rather than stagnant; however, there is the risk that registrants will underreport when allowed to use their own discretion in determining what should and should not be reported.<sup>45</sup>

Contrarily, a prescriptive-based approach calls for uniform and consistent disclosure across all registrants without reliance on a particular registrant's judgment.<sup>46</sup> A prescriptive approach is attractive for disclosure areas that do not necessarily depend on specific characteristics of individual registrants.<sup>47</sup> Academic studies considering the choice between prescriptive-based approaches and principles-based approaches express a preference for a principles-based system because of its core focus on materiality standards.<sup>48</sup> Studies also note, however, the value of the comparability that a prescriptive-based approach provides.<sup>49</sup> Both approaches carry positives and negatives, which the SEC must weigh carefully to determine the best solution for shaping Regulation S-K's future.

### *B. Regulation S-K*

Originally, Regulation S-K set out the reporting requirements for registration statements but did not significantly reach outside the small

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43. Executive Compensation and Related Person Disclosure, Exchange Act Release No. 33-8732A, 88 SEC Docket 2353 (Aug. 29, 2006).

44. 84 Fed. Reg. 44,358.

45. *Id.*

46. Business and Financial Disclosure Required by Regulation S-K, Exchange Act Release No. 33-10064, 113 SEC Docket 4731 (Apr. 13, 2016).

47. 84 Fed. Reg. 44,358.

48. Eugene A. Imhoff Jr. & Jacob K. Thomas, *Economic Consequences of Accounting Standards: The Lease Disclosure Rule Change*, 10.4 J. ACCT. & ECON. 277 (1988); Cheri L. Reither, *What Are the Best and Worst Accounting Standards?*, 12.3 ACCT. HORIZONS 283 (1998); Christopher P. Agoglia, Timothy S. Doupnik & George T. Tsakumis, *Principles-Based versus Rules-Based Accounting Standards: The Influence of Standard Precision and Audit Committee Strength on Financial Reporting Decisions*, 86.3 ACCT. REV. 747–767 (2011); Usha Rodrigues & Mike Stegemoller, *An Inconsistency in SEC Disclosure Requirements? The Case of the “Insignificant” Private Target*, 13.2–.3 J. CORP. FIN. 251, 251–69 (2007).

49. Andrew A. Acito, Jeffrey J. Burks & W. Bruce Johnson, *The Materiality of Accounting Errors: Evidence from SEC Comment Letters*, 36.2 CONTEMP. ACCT. RES. 839 (2018).



scope of registration.<sup>50</sup> However, in 1982, the SEC expanded Regulation S-K to become the governing regulation for the disclosure requirements of all non-financial statements.<sup>51</sup> The SEC sought the further expansion of Regulation S-K to simplify registrants' disclosure processes and to lessen the burden of locating the disclosure information for investors.<sup>52</sup> Today, Regulation S-K's primary function remains the overall governance of the disclosure of non-financial statements.<sup>53</sup> Particularly, each Item of Regulation S-K governs a certain area of disclosure.<sup>54</sup> The SEC proposed amendments to the contents of Items 101, specifically Items 101(a), 101(c), and 105 of Regulation S-K through Proposal S7-11-19, and these proposals were enacted substantially as written through a Final Rule, effective November 9, 2020.<sup>55</sup>

*1. Item 101(a) as Written before Proposal S7-11-19*

Item 101(a) governs the description of the registrant's general business development.<sup>56</sup> Notably, Item 101(a) took a prescriptive-based approach to disclosure.<sup>57</sup> The registrant had to explain its general development of business over the past five years.<sup>58</sup> Due to the prescriptive nature of this Item, registrants must have disclosed the year of the registrant's organization and its form of organization; information about bankruptcy; information about any reclassification, merger, or consolidation; acquisition or disposition of assets outside of the ordinary course of business; and material changes to the mode of conducting business.<sup>59</sup>

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50. Adoption of Integrated Disclosure System, 47 Fed. Reg. 11,380 (Mar. 16, 1982) (to be codified at 17 C.F.R. pts. 200, 201, 229, 230, 239, 240, 249, 250, 260, 274).

51. *Id.*

52. *Id.*

53. 17 C.F.R. pt. 229 (2019).

54. *Id.*

55. 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239-40); 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239-40).

56. 17 C.F.R. § 229.101(a) (2019).

57. *Id.*

58. *Id.*

59. *Id.*

## 2. Item 101(c) as Written before Proposal S7-11-19

Item 101(c) governs the disclosure requirement of a registrant's current and future business activities.<sup>60</sup> Under Item 101(c), some disclosure requirements referenced each of the registrant's segments, while other requirements reference the registrant as a whole.<sup>61</sup> A "segment" is a component of a business that generates its own revenues and facilitates its own products and services.<sup>62</sup> The registrant had to disclose a description of the products and services that each of its segments renders, as well as the markets and methods of distribution of those products and services.<sup>63</sup> If a segment was designing a new product or service, and the product or service's existence is public information, the registrant must provide an update on the status of the product or service if a material amount of investment is involved in the designing process.<sup>64</sup> A number of other segment-specific requirements are listed within Item 101(c).<sup>65</sup> Matters that the registrant could have disclosed with respect to its business in general—as opposed to the particular segments—include a description of the compliance with regulations intended to protect the environment, any capital expenditures for environmental control facilities, and the number of persons the registrant employs.<sup>66</sup>

Importantly, Item 101(c) was riddled with outdated disclosure requirements. The SEC adopted many of the disclosure requirements

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60. 17 C.F.R. § 229.101(c) (2019).

61. *Id.*

62. *Segment*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/segment.asp> [<https://perma.cc/V9XF-ESA5>] (last updated Jan. 5, 2020).

63. 17 C.F.R. § 229.101(c).

64. *Id.*

65. Item 101(c) requires disclosure specific to each of a registrant's segments for the following topics: the sources and availability of materials a segment uses; the effect of held patents, trademarks, and the like; whether the business of the segment is or may be seasonal; the common practices of the registrant and the industry as a whole relating to working capital items; whether the segment depends significantly on one or a few customers; information on backlog orders; if any material portion of the business is subject to renegotiation or termination at the election of the government; and competitive conditions, such as identity of markets, methods of competition, and positive or negative factors pertaining to the competitive position of the registrant all must be disclosed in a segment-specific manner. *Id.*

66. *Id.*

found in Item 101(c) in 1973.<sup>67</sup> Likewise, the SEC added the requirement to disclose information relating to compliance with environmental regulations in 1973,<sup>68</sup> pursuant to a mandate from the National Environmental Policy Act of 1969.<sup>69</sup> Item 101(c) introduced capital expenditures relating to environmental control facilities not long after in 1976.<sup>70</sup> Consequently, Item 101(c) consists of disclosure requirements that are reflective of the business world as it existed in the 1970s.<sup>71</sup>

Proposal S7-11-19 is not the first time Item 101 has faced potential restructuring.<sup>72</sup> In 1996, the Task Force on Disclosure Simplification, a group consisting of SEC staff created for the purpose of reviewing rules that may be subject to simplification, delivered a report to the Commission containing suggestions for changes to Item 101.<sup>73</sup> The Task Force believed that Item 101's requirements led to duplication of quantitative information that could be found in a registrant's financial statements.<sup>74</sup> Accordingly, it recommended that the SEC get rid of the disclosure requirements found in Item 101 that could be handled under another area of disclosure.<sup>75</sup> Ultimately, the SEC enacted rule changes in response to many of the Task Force's recommendations, but the SEC did not follow its

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67. 38 Fed. Reg. 17,202 (June 29, 1973) (to be codified at 17 C.F.R. pts. 230–31, 239, 241, 249, 276); 38 Fed. Reg. 12,100 (May 9, 1973) (to be codified at 17 C.F.R. pts. 239–40, 249).

68. 38 Fed. Reg. 12,100 (May 9, 1973) (to be codified at 17 C.F.R. pts. 239–40, 249).

69. National Environmental Policy Act of 1969, Pub. L. No. 91-190, 83 Stat. 852 (1970) (codified as amended at 42 U.S.C. § 4321–47).

70. 41 Fed. Reg. 21,632 (May 27, 1976) (to be codified at 17 C.F.R. pts. 239, 249).

71. *See generally* 38 Fed. Reg. 17,202; 38 Fed. Reg. 12,100; 41 Fed. Reg. 21,632. The SEC did amend Item 101(c) in 2018 to eliminate Item 101(c)(1)(xi), which overlapped with a broader disclosure requirement. 83 Fed. Reg. 50,148 (Oct. 4, 2018) (to be codified at 17 C.F.R. pts. 210, 229, 230, 239–40, 249, 274).

72. *See generally* U.S. SEC. & EXCH. COMM'N, REPORT OF THE TASK FORCE ON DISCLOSURE SIMPLIFICATION (Mar. 1996), <https://www.sec.gov/news/studies/smpl.htm> [<https://perma.cc/3DPP-5CRJ>]; 61 Fed. Reg. 30,397 (May 31, 1996) (to be codified at 17 C.F.R. pts. 210, 228, 229, 230, 232, 239–40, 249); 62 Fed. Reg. 43,581 (July 18, 1997) (to be codified at 17 C.F.R. pts. 228, 228, 230, 232, 239–40, 249).

73. U.S. SEC. & EXCH. COMM'N, *supra* note 72.

74. *Id.*

75. *Id.*

recommendations for Item 101, leaving in place outdated parts of Item 101.<sup>76</sup>

### 3. *Item 105 as Written before Proposal S7-11-19*

Finally, Item 105 mandates the disclosure of risk factors that investors may find material when making investment decisions.<sup>77</sup> This Item required a registrant to warn potential investors of the most significant factors that make a potential investment in its business risky.<sup>78</sup> Item 105 instructed registrants to leave out risk factors that could be applicable to any entity; the risks should be specific to the registrant.<sup>79</sup> The SEC found that reporting entities seem to face trouble excluding generic risk factors.<sup>80</sup> Prior to Proposal S7-11-19, registrants had the option—but were not required—to include a summary of the risk-factor disclosure that Item 105 mandates.<sup>81</sup> Item 503(c) originally governed the disclosure of risk factors.<sup>82</sup> The SEC rescinded Item 503(c) and replaced it with Item 105 in March of 2019.<sup>83</sup>

## II. CHANGES AND UPDATES

In an effort to produce more effective disclosure policies, the SEC undertook an ongoing “Disclosure Effectiveness Initiative.”<sup>84</sup> The initiative responded to congressional mandates found in the Jumpstart Our Business Startups Act (JOBS Act) and the Fixing America’s Surface

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76. *See generally* 61 Fed. Reg. 30,397; 62 Fed. Reg. 43,581. Since then, the SEC twice considered deleting subsections of Item 101(c), but the subsections were retained. 81 Fed. Reg. 51,607 (Aug. 4, 2016) (to be codified at 17 C.F.R. pts. 210, 229, 230, 239–40, 249, 274); 83 Fed. Reg. 50,148 (Oct. 4, 2018) (to be codified at 17 C.F.R. pts. 210, 229, 230, 239–40, 249, 274); 64 Fed. Reg. 1,728 (Jan. 12, 1999) (to be codified at 17 C.F.R. pts. 210, 229, 240, 249).

77. 17 C.F.R. § 229.105 (2019).

78. *Id.* An example of such a risk factor is a registrant’s success depending heavily on the current management team.

79. *Id.*

80. 63 Fed. Reg. 6,730 (Feb. 6, 1998); 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239–40).

81. 17 C.F.R. § 229.105.

82. FAST Act Modernization and Simplification of Regulation S-K, Exchange Act Release No. 5206, 2019 WL 1314887 (Mar. 20, 2019).

83. *Id.*

84. *Spotlight on Disclosure Effectiveness*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/spotlight/disclosure-effectiveness.shtml> [<https://perma.cc/DWP7-DFLC>] (last modified Dec. 13, 2016).

Transportation Act (FAST Act).<sup>85</sup> President Barack Obama signed the JOBS Act into law on April 5, 2012.<sup>86</sup> By design, the JOBS Act relaxes securities regulations for smaller businesses, and its changes include loosening restrictions on raising capital.<sup>87</sup> Importantly, the JOBS Act required the SEC to conduct a review of Regulation S-K and to submit a report upon completion.<sup>88</sup> The review aimed to identify outdated and unclear areas of Regulation S-K that the SEC should revise.<sup>89</sup> As the SEC values the public's opinion, it received public comments on the issue while conducting the study.<sup>90</sup>

In accordance with the JOBS Act's mandate, the SEC issued the report in December of 2013.<sup>91</sup> In the report, which did not itself change anything within Regulation S-K, the SEC stated that it planned to continue to investigate Regulation S-K, along with other regulations, to develop a plan to effectively modernize and simplify Regulation S-K.<sup>92</sup> Although the SEC clearly showed its desire to update Regulation S-K, it did not specifically detail how updates would occur in the report.<sup>93</sup> However, the SEC did emphasize potential tactics for review and overarching principles to consider. The SEC discussed two particular tactics of review: (1) a compressive approach, which involves reviewing and updating requirements on a wholesale basis, and (2) a targeted approach, which

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85. Rick A. Fleming, *Moving Forward with the Commission's Disclosure Effectiveness Initiative*, U.S. SEC. & EXCH. COMM'N (Nov. 19, 2016), [https://www.sec.gov/news/speech/moving-forward-with-the-disclosure-effectiveness-initiative.html#\\_ednref5](https://www.sec.gov/news/speech/moving-forward-with-the-disclosure-effectiveness-initiative.html#_ednref5) [<https://perma.cc/CZ92-TWWL>]; see also Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012); Fixing America's Surface Transportation Act, Pub. L. No. 114-94, 192 Stat. 1312 (2015).

86. *Spotlight on Jumpstart Our Business Startups (JOBS) Act*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/spotlight/jobs-act.shtml> [<https://perma.cc/F3N6-D6KK>] (last modified Dec. 9, 2016); see also Pub. L. No. 112-106, 126 Stat. 306.

87. Pub. L. No. 112-106, 126 Stat. 306.

88. *Id.*

89. U.S. SEC. & EXCH. COMM'N, REPORT ON REVIEW OF DISCLOSURE REQUIREMENTS IN REGULATION S-K (Dec. 2013), <https://www.sec.gov/files/reg-sk-disclosure-requirements-review.pdf> [<https://perma.cc/GS44-FWSN>]; see also Pub. L. No. 112-106, 126 Stat. 306.

90. *Comments on SEC Regulatory Initiatives Under the JOBS Act: Title I – Review of Regulation SK*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/comments/jobs-title-i/reviewreg-sk/reviewreg-sk.shtml> [<https://perma.cc/R96D-Y86W>] (last modified June 3, 2013).

91. U.S. SEC. & EXCH. COMM'N, *supra* note 89.

92. *Id.*

93. *Id.*

requires reviewing and updating requirements on a topic-by-topic basis.<sup>94</sup> A comprehensive approach allows the SEC to view the interplay between all areas of disclosure, which fosters a clearer understanding of overlapping and unnecessary disclosure requirements.<sup>95</sup> The SEC noted in its report that a comprehensive approach would take a significantly longer time to implement changes, as it would require an abundance of resources to analyze disclosure requirements as a whole.<sup>96</sup> Alternatively, a targeted approach allows for a deeper analysis of each topic and allows for changes to be made on a rolling basis, as opposed to requiring one massive change.<sup>97</sup> Yet, a targeted approach carries the risk of updates losing sight of the overall cooperation of disclosure requirements because the focus is specific to one area at a time.<sup>98</sup> The SEC ultimately recommended a comprehensive approach.<sup>99</sup>

Further, the SEC highlighted four overarching principles to address when considering additional updates to Regulation S-K.<sup>100</sup> First, the SEC believed any recommended revisions should, at least as a general trend, emphasize a principles-based approach.<sup>101</sup> Second, the SEC urged an evaluation of the appropriateness of current scaled disclosure requirements and of whether having thresholds for required disclosure is beneficial or harmful for emerging business entities.<sup>102</sup> Third, the SEC noted that it should give particular consideration to the methods of information delivery and presentation.<sup>103</sup> Finally, the SEC evinced a desire to keep readability of disclosures a top priority.<sup>104</sup>

The Disclosure Effectiveness Initiative also responded to the FAST Act.<sup>105</sup> President Obama signed the FAST Act into law on December 4, 2015.<sup>106</sup> The FAST Act required the SEC to revise Regulation S-K and file

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94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. Fixing America's Surface Transportation Act, Pub. L. No. 114-94, 192 Stat. 1312 (2015).

106. *Fixing America's Surface Transportation Act or "FAST Act,"* U.S. DEP'T OF TRANSP., FED. HIGHWAY ADMIN., <https://www.fhwa.dot.gov/fastact/> [<https://perma.cc/9AL5-TBJH>] (last modified Feb. 14, 2017); *see also* Pub. L. No. 114-94, 192 Stat. 1312. The Act provided funding for surface transportation

a report on its plans for Regulation S-K's revision.<sup>107</sup> Following the FAST Act's mandate, the SEC issued the report on November 23, 2016.<sup>108</sup> The report itself did not contain much information relevant to Item 101, but it did kickstart the relocation of risk disclosure to Item 105.<sup>109</sup> On March 20, 2019, the SEC adopted amendments to Regulation S-K in response to the FAST Act's mandate.<sup>110</sup>

Working alongside the JOBS Act and the FAST Act's mandates, the Disclosure Effectiveness Initiative strove to modernize and simplify reporting requirements for both Regulation S-K and Regulation S-X.<sup>111</sup> For years, particularly between 2014 and 2016, the SEC received public comments to facilitate input on the Disclosure Effectiveness Initiative.<sup>112</sup> In 2016, the SEC issued a concept release aimed at revisiting Regulation S-K's business and financial disclosure requirements.<sup>113</sup> Through the concept release, the SEC requested more public comments specifically concerned with whether investors believed they had adequate information to make informed investments and voting decisions.<sup>114</sup> The comments also sought input on whether investors believed the SEC's rules were outdated or unnecessary and whether disclosure requirements should be principles-

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infrastructure planning and investment. The Act as a whole is mostly irrelevant to the world of securities regulation.

107. Pub. L. No. 114-94, 192 Stat. 1312.

108. U.S. SEC. & EXCH. COMM'N, REPORT ON MODERNIZATION AND SIMPLIFICATION OF REGULATION S-K (Nov. 23, 2016), <https://www.sec.gov/files/sec-fast-act-report-2016.pdf> [<https://perma.cc/FTQ6-RG2T>].

109. *Id.* Risk factor was originally located in Item 503(c).

110. *SEC Adopts Rules to Implement FAST Act Mandate to Modernize and Simplify Disclosure*, U.S. SEC. & EXCH. COMM'N (Mar. 20, 2019), <https://www.sec.gov/news/press-release/2019-38> [<https://perma.cc/Y9YL-W364>]. These amendments are explored further in Part II of this Comment.

111. 81 Fed. Reg. 23,915 (Apr. 22, 2016) (to be codified at 17 C.F.R. pts. 210, 229–30, 232, 239–40, 249). Regulation S-X states the disclosure requirements for public companies' financial statements. 17 C.F.R. pt. 210 (2019).

112. *See generally Comments on Disclosure Effectiveness*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/comments/disclosureeffectiveness/disclosureeffectiveness.shtml> [<https://perma.cc/B9LB-S73L>] (last visited Dec. 17, 2020).

113. Business and Financial Disclosure Required by Regulation S-K, *supra* note 46.

114. *See generally Comments on Concept Release: Business and Financial Disclosure Required by Regulations S-K*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/comments/s7-06-16/s70616.htm> [<https://perma.cc/QLQ6-8VFY>] (last modified July 29, 2019).

based, prescriptive-based, or a mix of both.<sup>115</sup> In response to these federal mandates, and equipped with the public's opinions, the SEC began taking action to update Regulation S-K.

### A. S-K Updates

To reach the goals of the Disclosure Effectiveness Initiative, the SEC amended parts of Regulation S-K twice within the year prior to the announcement of Proposal S7-11-19.<sup>116</sup> These amendments only affected one Item relevant to Proposal S7-11-19, but the updates shed light on why Regulation S-K as a whole needs modernizing.<sup>117</sup> On October 4, 2018, the SEC adopted final rules containing amendments to various sections of Regulation S-K, partly in compliance with the FAST Act's mandate.<sup>118</sup> This adoption was a result of the SEC proposing amendments on July 13, 2016.<sup>119</sup> The final rules adopted most of the proposed amendments; however, the SEC made modifications to some of the proposed amendments based on input from commenters, and, in other cases, the SEC abandoned the proposed amendments altogether.<sup>120</sup> The SEC believed the amendments would facilitate the disclosure of information to investors and simplify compliance without significantly altering the total mix of information provided to investors.<sup>121</sup> The SEC reasoned that certain requirements have become outdated as a result of changes in the regulatory, business, and technological environments.<sup>122</sup> For example, Item 201(a)(1) required disclosure of market prices for securities, but this information is readily available to the public on the internet.<sup>123</sup> As a

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115. Business and Financial Disclosure Required by Regulation S-K, *supra* note 46.

116. 83 Fed. Reg. 50,148 (Oct. 4, 2018) (to be codified at 17 C.F.R. pts. 210, 229–30, 239–40, 249, 274); 84 Fed. Reg. 12,674 (Apr. 2, 2019) (to be codified at 17 C.F.R. pts. 229–30, 232, 239–40, 249, 270, 274–75).

117. 83 Fed. Reg. 50,148; 84 Fed. Reg. 12,674. Updating any outdated segment of Regulation S-K causes the remaining outdated disclosure requirements to seem even more out of place.

118. 83 Fed. Reg. 50,148.

119. 81 Fed. Reg. 51,607 (Aug. 4, 2016) (to be codified at 17 C.F.R. pts. 210, 229–30, 239–40, 249, 274).

120. 83 Fed. Reg. 50,148.

121. *Id.*

122. *Id.*

123. See, for example, NASDAQ, [www.nasdaq.com](https://perma.cc/J24X-8F5B) [https://perma.cc/J24X-8F5B] (last visited Dec. 17, 2020); NYSE, [www.nyse.com](https://perma.cc/S3SY-V6SR) [https://perma.cc/S3SY-V6SR] (last visited Dec. 17, 2020); YAHOO! FINANCE, [www.finance.yahoo.com](https://perma.cc/8X44-6HXG) [https://perma.cc/8X44-6HXG] (last visited Dec. 17,



consequence, the SEC amended Item 201(a)(1) to remove this requirement.<sup>124</sup>

The amendments paid particular attention to eliminating redundant disclosure requirements found throughout all SEC regulations, and public commenters helped identify overlapping disclosures that the SEC overlooked.<sup>125</sup> For example, the SEC originally only proposed one reduction involving Regulation S-K: retracting a subsection because its disclosure requirements were substantially the same as a related subsection.<sup>126</sup> However, in the final rule adoption, the SEC included a second retraction to Regulation S-K, eliminating an unnecessary instruction that public comments helped identify.<sup>127</sup> This adoption of the final rule also deleted Item 101(c)(1)(xi), which referred to customer-sponsored research activities, because the requirement overlapped with a broader disclosure requirement.<sup>128</sup> Similarly, four subsections of other Items were deleted because of overlap.<sup>129</sup> The SEC deleted Item 201(c)(1) because of a redundancy within Regulation S-X requirements, Item 601(b)(26) because of obsolescence, and it consolidated Item 101(d)(4) into Item 303.<sup>130</sup> These deletions helped Regulation S-K to read more efficiently.<sup>131</sup>

On April 2, 2019, the SEC again amended parts of Regulation S-K through a final rule adoption as a direct response to a federal mandate contained with the FAST Act.<sup>132</sup> Following the directive of the Disclosure Effective Initiative, the SEC believed these amendments would improve the readability and navigability of disclosure, avoid repetition, and avoid disclosure of immaterial information.<sup>133</sup> The final rule adoption stemmed from a rule proposal announced on October 11, 2017.<sup>134</sup> Similar to the final

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2020); GOOGLE FINANCE, [www.google.com/finance](https://www.google.com/finance) [https://perma.cc/43MW-6QUB] (last visited Dec. 17, 2020), among many others.

124. 83 Fed. Reg. 50,148.

125. *Id.*; 81 Fed. Reg. 51,607 (Aug. 4, 2016) (to be codified at 17 C.F.R. pts. 210, 229–30, 239–40, 249, 274).

126. 81 Fed. Reg. 51,607; 83 Fed. Reg. 50,148.

127. 83 Fed. Reg. 50,148.

128. *Id.*

129. *Id.*

130. *Id.*

131. *See generally id.*

132. 82 Fed. Reg. 50,998 (Nov. 2, 2017) (to be codified at 17 C.F.R. pts. 229–30, 232, 239–40, 249, 270, 274–75); 84 Fed. Reg. 12,674 (Apr. 2, 2019) (to be codified at 17 C.F.R. pts. 229–30, 232, 239–40, 249, 270, 274–75); Fixing America's Surface Transportation Act, Pub. L. No. 114-94, 192 Stat. 1312 (2015).

133. 84 Fed. Reg. 12,674.

134. 82 Fed. Reg. 50,998.

rule adoption on October 4, 2018, the SEC enacted some of the proposed amendments exactly as proposed, some with minor modifications, and purposefully excluded others.<sup>135</sup> Certain amendments focused solely on clarifying rules without making a legitimate substantive change.<sup>136</sup> For example, the SEC intended Item 303(a) to allow for a principles-based approach regarding its year-threshold requirement.<sup>137</sup> However, the SEC believed that registrants tended to include excessive information on earlier years, making disclosure under the Item immaterial.<sup>138</sup> As a result, the SEC amended Item 303(a) to clarify that disclosure on early years is not necessary if it leads to immaterial disclosure.<sup>139</sup> This amendment technically did not change any requirement because this was always the SEC's intention with Item 303(a).<sup>140</sup>

In the April 2019 final rule adoption, the SEC also enacted an amendment to Item 601(b)(10).<sup>141</sup> The substance of the amendment is not of particular importance; however, the SEC's decision to enact the proposed amendments is noteworthy.<sup>142</sup> Typically, the SEC gives heavy weight to the public's opinion on the rule proposals that it produces.<sup>143</sup> Uncharacteristically, the SEC enacted the proposed amendments to Item 601(b)(10) after receiving skepticism from public commenters.<sup>144</sup> Commenters expressed concern that the amendments would lead to too little disclosure.<sup>145</sup> The SEC carried out the amendments as proposed even in light of these public concerns, which showed its serious commitment to lessening the overall amount of requisite disclosure.<sup>146</sup> This decision is comparable to the SEC's decision to avoid amendment to Item 601(b)(21)(i).<sup>147</sup> The SEC proposed adding additional disclosure

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135. 84 Fed. Reg. 12,674; *see also* 83 Fed. Reg. 50,148.

136. 84 Fed. Reg. 12,674.

137. *Id.* Item 303(a) contained language prompting disclosure for a certain amount of years, but the prompt was not designed as a necessity, but rather as an example.

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*; 17 C.F.R. § 229.601(b)(10) (1982). Item 601(b)(10) requires disclosure of material contracts not made in the ordinary course of business.

142. 84 Fed. Reg. 12,674.

143. *See generally* SEC Final Rules, *supra* note 36.

144. 84 Fed. Reg. 12,674.

145. *Id.*

146. *Id.*

147. 82 Fed. Reg. 50,998 (Nov. 2, 2017) (to be codified at 17 C.F.R. pts. 229–30, 232, 239–40, 249, 270, 274–75); 84 Fed. Reg. 12,674. Item 601(b)(21)(i)

requirements to Item 601(b)(21)(i), and public commenters expressed concern that the burden on registrants from following the extra requirements would severely outweigh the benefit to investors.<sup>148</sup> To respect the public commenters' wishes, the SEC chose to reject the proposed amendment.<sup>149</sup> The final adoption also relocated disclosure of risk factors from Item 503(c) to a new Item, Item 105.<sup>150</sup>

### *B. Proposal S7-11-19 and Its Final Rule*

On August 8, 2019, the SEC announced Proposal S7-11-19.<sup>151</sup> Proposal S7-11-19 recommended amendments to Items 101(a), 101(c), and 105 of Regulation S-K.<sup>152</sup> With the exception of Item 105, the SEC has not significantly updated these Items in over 30 years.<sup>153</sup> The proposals would not alter the purposes of the current Items; however, they would change the manner in which Regulation S-K accomplishes these purposes.<sup>154</sup> This Proposal, in its totality, sought to improve the readability of disclosure documents and to avoid unnecessary repetition of disclosure information, ultimately making it easier for registrants to report and allowing for smoother reading of the reported information.<sup>155</sup> The SEC considered public comments in response to past disclosure modernization efforts when forming Proposal S7-11-19.<sup>156</sup> The Proposal was subject to a 60-day public comment period that began on August 23, 2019 and ended

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requires disclosure of the names and locations of each of the registrant's subsidiaries. 17 C.F.R. § 229.601(b)(21)(i) (2019).

148. 82 Fed. Reg. 50,998; 84 Fed. Reg. 12,674.

149. 84 Fed. Reg. 12,674.

150. *Id.*; 17 C.F.R. § 229.105 (2019). This change is the only amendment to an Item addressed in Proposal S7-11-19. 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229–30, 239–40).

151. *SEC Proposes to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K*, *supra* note 10.

152. 84 Fed. Reg. 44,358.

153. *Id.*

154. *SEC Proposes to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K*, *supra* note 10.

155. 84 Fed. Reg. 44,358.

156. *Id.*

on October 22, 2019.<sup>157</sup> On August 26, 2020, the SEC enacted a Final Rule on Proposal S7-11-19's contents.<sup>158</sup>

*1. Item 101(a) as Proposed and as Enacted*

The proposed Item 101(a) calls for a principles-based approach regarding the registrant's general development of business description.<sup>159</sup> The SEC found that disclosure regarding general business development was often repetitive and believed that repetitive information was burdensome to investors.<sup>160</sup> As such, the proposed changes to Item 101(a) attempt to combat the repetitive nature of disclosure of general business development.<sup>161</sup> The proposed Item 101(a) provides a non-exclusive list of the information that a registrant must disclose.<sup>162</sup> Disclosure would only be necessary to the extent that the disclosed information is material to understanding the registrant's general business development.<sup>163</sup> Based on public comments, the SEC believes that the more effective goal for Item 101(a) is to maintain the principles-based approach, as opposed to switching to a prescriptive-based approach, which would allow only for disclosure of material information.<sup>164</sup> The proposed Item requires disclosure of transactions and events that affect or may affect the company's operations, such as changes to the registrant's previously disclosed business strategy, which is a newly listed disclosure topic.<sup>165</sup> Under the proposed Item, registrants are not required to disclose their business strategy; however, for registrants that have willingly disclosed business strategy in the past, there is a requirement of an update containing material changes to that business strategy.<sup>166</sup> The SEC believes that requiring all entities to disclose their business strategies may be harmful

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157. *Id.* See generally *Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105*, *supra* note 35. See also *How to Submit Public Comments*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/rules/submitcomments.htm> [<https://perma.cc/6NPZ-LJBH>] (last modified Sept. 10, 2019).

158. 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239–40).

159. 84 Fed. Reg. 44,358.

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

164. *Comments on Concept Release: Business and Financial Disclosure Required by Regulations S-K*, *supra* note 114; see also 84 Fed. Reg. 44,358.

165. 84 Fed. Reg. 44,358; see also 17 C.F.R. § 229.101(a) (2019).

166. 84 Fed. Reg. 44,358.

to some businesses.<sup>167</sup> For example, for a business whose strategy is proprietary, the business may potentially lose value due to competitors mimicking the strategy if the registrant's strategy became public knowledge.<sup>168</sup>

Additionally, the proposed Item 101(a) eliminates the five-year prescribed timeframe for business development disclosure.<sup>169</sup> Through a reference to the initial registration statement, the proposed Item allows a registrant to provide an update of its general development of business that focuses specifically on the current reporting period for all filings subsequent to a registrant's initial registration statement.<sup>170</sup> Pursuant to Securities Act Rule 411 and Exchange Act Rule 12b-23, registrants are currently permitted to provide Item 101(a) disclosure through reference to a previous filing; thus, this proposed change clarifies an existing system rather than creating a new rule.<sup>171</sup> The proposed Item requires the registrant to incorporate an active hyperlink referencing the registrant's most recent filing that, in conjunction with the update, provides a full explanation of the registrant's general business development.<sup>172</sup> This regime not only enables readers to have access to a complete discussion of the registrant's general business development but also provides focus on recent, material development rather than a registrant's entire history.<sup>173</sup>

Through the Final Rule, the SEC enacted the proposed amendments to Item 101(a) mostly as proposed.<sup>174</sup> The only noteworthy difference is that the Final Rule eliminates the disclosure topic that refers to general transactions and events that affect or may affect a registrant's operations.<sup>175</sup>

## 2. *Item 101(c) as Proposed and as Enacted*

Proposed Item 101(c) expands upon its existing principles-based approach to disclosure of a description of the registrant's past and future business dealings.<sup>176</sup> The SEC is concerned that registrants consider the

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167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. 17 C.F.R. § 230.411 (1995); 17 C.F.R. § 240.12b-23 (1995).

172. 84 Fed. Reg. 44,358.

173. *Id.*

174. 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239-40).

175. *Id.*

176. 84 Fed. Reg. 44,358.

enumerated requirements in Item 101(c) to be prescriptive-based requirements, warranting disclosure of each listed topic even when the disclosure of the listed topic is immaterial.<sup>177</sup> The new language of Item 101(c) seeks to clarify the principles-based idea that disclosure is only necessary when material.<sup>178</sup> The proposed Item 101(c) provides a non-exclusive list of disclosure topics.<sup>179</sup>

The proposed Item 101(c) no longer explicitly refers to working capital practices, new segments, and dollar-amount potential of backlog orders.<sup>180</sup> In the spirit of the principles-based approach, disclosure would be necessary if any of these topics were material to an understanding of a registrant's business.<sup>181</sup> Studies reflect that information pertaining to new segments and backlog orders are significant to firm productivity; however, if a registrant has material information regarding either of these areas, the registrant will still be required to disclose the information.<sup>182</sup> The proposed Item specifically mentions material effects of compliance with general material governmental regulations, as well as material environmental regulations, whereas the current Item 101(c) only refers to material environmental regulations, with no reference to general material governmental regulations.<sup>183</sup> Moreover, the proposed Item 101(c) also modifies the language governing the disclosure of capital expenditures for

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177. *Id.*; see also 17 C.F.R. § 229.101(c) (2018).

178. 84 Fed. Reg. 44,358.

179. *Id.* These topics include: (1) revenue-generating activities, products, and services, and any dependence on key products, services, product families, or customers, including governmental customers; (2) status of development efforts for new or enhanced products, trends in market demand, and competitive conditions; (3) resources material to a registrant's business, including subsections (a) for raw materials and (b) for the duration and effect of all patents, trademarks, licenses, franchises, and concessions held; (4) 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; (5) the extent to which the business is or may be seasonal; (6) compliance with material government regulations, including environmental regulations; and (7) human capital disclosure.

180. *Id.*

181. *Id.*

182. Antionette Schoar, *Effects of Corporate Diversification on Productivity*, 57 J. FIN. 2379, 2379–2403 (2002); Siva Rajgopal, Terry Shevlin & Mohan Venkatachalam, *Does the Market Fully Appreciate the Implications of Leading Indicators for Future Earnings? Evidence from Order Backlog*, 8 REV. ACCT. STUD. 461, 461–92 (2003).

183. 84 Fed. Reg. 44,358.

environmental control facilities.<sup>184</sup> Currently, the requirement demands disclosure for the current fiscal year, the succeeding fiscal year, and for other material periods.<sup>185</sup> The Proposal changes this language to require disclosure for the current year and any further material periods, with no mention of a succeeding fiscal year.<sup>186</sup> The current Item 101(c) requires disclosure of the number of the registrant's employees but neglects general human capital disclosure.<sup>187</sup> Human capital disclosure has become a particular area of interest to investors over the years because investors realize how important human capital is to the success of a business, and, consequently, the proposed Item 101(c) directly mentions human capital.<sup>188</sup>

Like Item 101(a), the Final Rule enacted these proposed amendments to Item 101(c) substantially as proposed.<sup>189</sup> As a noteworthy difference, the Final Rule requires registrants to disclose their total number of employees.<sup>190</sup> While this requirement is prescriptive, it is the only prescriptive requirement found under Item 101(c) in the Final Rule.<sup>191</sup>

### 3. *Item 105 as Proposed and as Enacted*

The proposed Item 105 builds upon its existing principles-based approach and demands more organization and summarization of the required information.<sup>192</sup> The proposed Item 105 includes an additional requirement of a summary section if risk factor disclosure exceeds 15 pages.<sup>193</sup> The SEC believes that this requirement will incentivize registrants to limit the length of their risk factor disclosures.<sup>194</sup> Further, the SEC believes that readers will have an easier time understanding a registrant's risk factor disclosure if the registrant chooses to exceed the 15-page limit due to the reader's ability to view a summary.<sup>195</sup> To refine

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184. *Id.*; 17 C.F.R. § 229.101(c) (2018).

185. 17 C.F.R. § 229.101(c).

186. 84 Fed. Reg. 44,358.

187. 17 C.F.R. § 229.101(c).

188. Kaye, *supra* note 5.

189. 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239–40).

190. *Id.* Another small difference can be found within the exact wording of Item 101(c), as a sentence was restructured for clarity.

191. *Id.*

192. 84 Fed. Reg. 44,358.

193. *Id.*

194. *Id.*

195. *Id.*

its principles-based approach, the new Item changes the language setting the standard for disclosable information from “most significant” factors to “material” factors.”<sup>196</sup> The SEC has used the language “most significant” regarding risk factor disclosure since 1964, making that language both outdated and counter-intuitive.<sup>197</sup> In addition, the proposed Item requires registrants to organize risk factors under relevant headings, including a section entitled “General Risk Factors.”<sup>198</sup> This system acts as a safeguard of coherent investor readability of risk factor disclosure if a registrant’s risk factor disclosure is still lengthy.<sup>199</sup>

Item 503(c) governed the contents currently located in Item 105 until March of 2019.<sup>200</sup> The decision to relocate risk factor disclosure to Item 105 stemmed from the report that the SEC issued in response to the FAST Act mandate.<sup>201</sup> When deciding to relocate risk factor disclosure from Item 503(c) to Item 105, the SEC also implemented certain changes to the contents of the Item.<sup>202</sup> Item 503(c) mentioned specific examples of risk factors, including: a registrant’s lack of an operating history; lack of profitable operations in recent periods; financial position; business or proposed business; and lack of a market for a registrant’s common equity securities or securities convertible into or exercisable for common equity securities.<sup>203</sup> The SEC implemented these examples in 1964, and the examples existed until Item 503(c)’s relocation.<sup>204</sup> The SEC, along with public commenters, believed that these listed risk factors were skewing risk factor disclosure towards disclosure for the listed areas, which ignored the principles-based spirit of reporting material information.<sup>205</sup> The drift away from principles-based risk factor disclosure also led to a concern over the psychological phenomenon known as “anchoring.”<sup>206</sup> There is evidence that individuals rely on the first piece of information they read,

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196. *Id.*

197. 29 Fed. Reg. 2,490 (Feb. 15, 1964) (to be codified at 17 C.F.R. pt. 231).

198. 84 Fed. Reg. 44,358.

199. *Id.*

200. FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

201. U.S. SEC. & EXCH. COMM’N, *supra* note 110.

202. FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

203. *Id.*

204. *See generally* 29 Fed. Reg. 2,490 (Feb. 15, 1964) (to be codified at 17 C.F.R. pt. 231).

205. FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

206. 84 Fed. Reg. 12,674 (Apr. 2, 2019) (to be codified at 17 C.F.R. pts. 229–30, 232, 239–40, 249, 270, 274–75).



referred to as the “anchor.”<sup>207</sup> A registrant ignoring the order of the risk factor information it discloses may, in turn, compromise the purpose of risk factor disclosure because investors may believe that the earliest listed information is the most important information.<sup>208</sup> As a result, Item 105 abandoned the specifically listed risk factors upon the transition from Item 503(c) to Item 105.<sup>209</sup>

The SEC received public feedback on potential approaches to risk factor disclosure.<sup>210</sup> The SEC considered approaches such as requiring registrants to explain how they are addressing potential risks, ensuring registrants discuss the probability of risk occurrence and the risk factor’s likely effect on registrants’ performance, and instructing registrants to describe their risk assessments.<sup>211</sup> The SEC believes there is a problem surrounding the length and generic flavor of risk factor disclosure.<sup>212</sup> Studies show that, while the length of individual registrants’ risk factor disclosure varies, such length as a whole increased in recent years.<sup>213</sup> One study shows a 50% increase in the word count of risk factor disclosures from 2006 to 2014. During the same time period, other disclosures only experienced a 10% word count increase.<sup>214</sup> Item 105 currently instructs

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207. See Amos Tversky & Daniel Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1124–31 (1974).

208. *Id.*

209. Tversky & Kahneman, *supra* note 207; see also 17 C.F.R. § 229.105 (2019).

210. 81 Fed. Reg. 23,915 (Apr. 22, 2016) (to be codified at 17 C.F.R. pts. 210, 229–30, 232, 239–40, 249).

211. *Id.*

212. 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239–40).

213. See PRICEWATERHOUSECOOPERS LLP, 2012 FINANCIAL REPORTING SURVEY: ENERGY INDUSTRY CURRENT TREND IN SEC REPORTING (Feb. 2013), <https://www.pwc.com/gx/en/oil-gas-energy/publications/pdfs/pwc-sec-financial-reporting-energy.pdf> [<https://perma.cc/KMG6-ZHMB>]; see also PRICEWATERHOUSECOOPERS LLP, 2014 TECHNOLOGY FINANCIAL REPORTING TRENDS (Aug. 2014), [www.pwc.com/en\\_US/us/technology/publications/assets/pwc-2014-technology-financial-reporting-trends.pdf](http://www.pwc.com/en_US/us/technology/publications/assets/pwc-2014-technology-financial-reporting-trends.pdf) [<https://perma.cc/9Z2K-X68M>]; Travis Dyer, Mark Lang & Lorien Stice-Lawrence, *The Ever-Expanding 10-K: Why Are 10-Ks Getting So Much Longer (and Does It Matter)?*, THE CLS BLUE SKY BLOG (May 5, 2016), <http://clsbluesky.law.columbia.edu/2016/05/05/the-ever-expanding-10-k-why-are-10-ks-getting-so-much-longer-and-does-it-matter/> [<https://perma.cc/TFE7-SAZB>].

214. Anne Beatty et al., *Are Risk Factor Disclosures Still Relevant? Evidence from Market Reactions to Risk Factor Disclosures Before and After the Financial Crisis* (Dec. 19, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2186589](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2186589) [<https://perma.cc/YN2U-R6W8>].

registrants not to present generic risks applicable to any entity,<sup>215</sup> and the SEC made attempts to guide businesses in a direction away from generic risk disclosure.<sup>216</sup> However, the SEC recognizes that these attempts have been unsuccessful.<sup>217</sup>

The Final Rule on Proposal S7-11-19 enacted the proposed amendments to Item 105 as written.<sup>218</sup>

### *C. Desired Impact*

Section 2(b) of the Securities Act and Section 3(f) of the Exchange Act require the SEC to consider whether any potential action will promote efficiency, competition, and capital formation when engaging in rulemaking.<sup>219</sup> Section 23(a)(2) of the Exchange Act requires the SEC to consider the rule's impact on competition and prohibits the SEC from adopting any rule that would impose an unnecessary burden on competition.<sup>220</sup> The amendments will guide Items 101 and 105 towards a reactive, registrant-specific disclosure model.<sup>221</sup> If the amendments are successful in eliminating unnecessary immaterial disclosure, the amendments may save issuers money on the cost of disclosure and incentivize investors to invest more in firms with clear and concise financial disclosures.<sup>222</sup> Although a principles-based approach grants registrants discretion when reporting material information, the SEC believes that other controls, such as the accounting controls and antifraud provisions of securities laws, will reduce the ability for registrants to misjudge what constitutes material information.<sup>223</sup>

Mary Jo White, former SEC chair, noted in a 2013 speech that when disclosure becomes overwhelming, or strays from its core purpose, it can lead to “disclosure overload”—a phenomenon that makes it difficult for investors to sift through mass amounts of disclosure information and make

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215. 17 C.F.R. § 229.105 (2019).

216. 63 Fed. Reg. 6,730 (Feb. 6, 1998); 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239–40).

217. 63 Fed. Reg. 6,730; 84 Fed. Reg. 44,358.

218. 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239–40).

219. 15 U.S.C. § 77b(b) (2010); 17 U.S.C. § 78c(f) (2010).

220. 17 U.S.C. § 78w(a)(2) (2010).

221. 84 Fed. Reg. 44,358.

222. Alastair Lawrence, *Individual Investors and Financial Disclosure*, 56 J. ACCT. & ECON., 130 (2013). It should be noted that this study was based on data from the 1990s and may not be immediately reproducible today.

223. 17 C.F.R. § 240.10b-5(b) (1951); *see also* 84 Fed. Reg. 44,358.

a decision as to what information, if any, is the most relevant to their needs.<sup>224</sup> Increased quantity and complexity of disclosure threatens investors' ability and desire to process information.<sup>225</sup> Registrants want to adhere to disclosure requirements, but research shows that the quality of disclosed information is significantly more important than the pure quantity of disclosed information.<sup>226</sup> Further, registrants tend to disclose the same immaterial information.<sup>227</sup> This type of boilerplate disclosure makes it difficult for investors to analyze a specific registrant's disclosure and inhibits investors' ability to distinguish between entities.<sup>228</sup>

#### D. Public Comments

The public comments to Proposal S7-11-19 provided valuable insight into investors' and registrants' opinions on the proposed amendments to Items 101(a), 101(c), and 105.<sup>229</sup> The SEC received comments from a diverse group consisting of individual investors, investment firms, CEOs, vice presidents, attorneys, healthcare groups, and accounting firms.<sup>230</sup>

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224. Mary Jo White, *The Path Forward on Disclosure*, U.S. SEC. & EXCH. COMM'N (Oct. 15, 2013), <https://www.sec.gov/news/speech/spch101513mjw> [<https://perma.cc/K966-XVGN>].

225. Joost Impink, Mari Paananen & Annelies Renders, *Regulation-Induced Disclosures: Is 'More' Actually 'Less'?* (Mar. 4, 2016), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2742059](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2742059) [<https://perma.cc/4ZMA-26VL>].

226. Santhosh Abraham & Philip J. Shrivies, *Improving the Relevance of Risk Factor Disclosure in Corporate Annual Reports*, 46 BRIT. ACCT. REV. 91 (2014).

227. Ole-Kristian Hope, Danqi Hu & Hai Lu, *The Benefits of Specific Risk-Factor Disclosures*, 21 REV. ACCT. STUD. 1005 (2016).

228. *Id.*

229. See generally *Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105*, *supra* note 35. It is also worth noting that public comments are not always useful. See, for example, a comment from Ron Zimmermann, apparent SEC conspiracy theorist, stating, "What the SEC is trying to do smells. Mega investors will continue to know corporate strategy, but the small investor will continue to be kept in the dark. That's discrimination. Who and what is behind this current SEC agenda?" Ron Zimmermann, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 11, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-193350.htm> [<https://perma.cc/7Q3B-EWLR>].

230. See generally *Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105*, *supra* note 35.

Comments generally supported the proposed amendments and primarily focused on diversity and human capital.<sup>231</sup>

A number of commenters urged the SEC to expand reporting requirements to include information on the diversity of a registrant's workforce.<sup>232</sup> Commenters believed hiring and retaining diverse employees ultimately leads a business to outpace competitors failing to do the same.<sup>233</sup> Further, commenters cited studies finding that hiring diverse employees and maintaining a diverse board of directors leads to better financial performance.<sup>234</sup> Particularly, commenters stated that businesses employing larger amounts of women naturally face less harassment within the workplace, which is a metric investors should find worthy of disclosure.<sup>235</sup> Likewise, commenters stated that companies with racially diverse employees would likely attract investors because the companies

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231. *See, e.g.*, Dennis E. Nixon, President, International Bancshares Corporation, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 8, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6282633-193308.pdf> [<https://perma.cc/ZWX5-2K66>].

232. *See, e.g.*, Matthews, *supra* note 23; Maxim Finskiy, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 7, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6261127-193047.pdf> [<https://perma.cc/J8WU-9RH2>]; Corey Bates, CEO of Auto Connection Manassas, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 4, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6252498-192812.pdf> [<https://perma.cc/256G-HR7R>]; Bec Brideson, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 17, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6309988-193494.pdf> [<https://perma.cc/99US-3PVV>]; Zoe Bray-Cotton, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 16, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6308786-193488.pdf> [<https://perma.cc/LQ4C-4WU9>].

233. *See, e.g.*, Matthews, *supra* note 23; Finskiy, *supra* note 232; Bates, *supra* note 232; Brideson, *supra* note 249; Bray-Cotton, *supra* note 232.

234. *See, e.g.*, Karen Cross, CEO of The Hashimoto's Solution, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 2, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6245351-192768.pdf> [<https://perma.cc/4WU2-LJQE>]; Brideson, *supra* note 232; Bray-Cotton, *supra* note 232.

235. *See, e.g.*, Bates, *supra* note 232; Trevor Lambert, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 2, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6236362-192712.pdf> [<https://perma.cc/F5AW-7EWG>]; Susan Baker, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Sept. 4, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6067407-191464.pdf> [<https://perma.cc/EDR3-BG63>].

valued diversity, and a more inclusive environment would be less likely to lead to discrimination lawsuits.<sup>236</sup> Thus, the commenters noted the value of an investor being able to comprehend a registrant's information on diversity through disclosure.<sup>237</sup>

Commenters to Proposal S7-11-19 primarily focused on general human capital disclosure.<sup>238</sup> Generally, commenters noted that human capital is an important asset, and a registrant's management of human capital is relevant for investment decisions.<sup>239</sup> Many commenters lobbied for very broad human capital disclosure because of human capital's perceived importance for a business's success.<sup>240</sup> One commenter proposed that a specific section in risk factor disclosure, Item 105, should be devoted to the risks involved with a registrant's human capital.<sup>241</sup>

Not all public commenters favored the overarching principles-based direction of Proposal S7-11-19.<sup>242</sup> Some commenters feared that allowing corporations to make judgment calls for disclosure, as opposed to forcing corporations to follow bright-line rules, will lead to corporations engaging in as little disclosure as possible to keep investors in the dark.<sup>243</sup> These

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236. See, e.g., Bates, *supra* note 232; Lambert, *supra* note 235; Baker, *supra* note 235.

237. See, e.g., Matthews, *supra* note 23; Finskiy, *supra* note 232; Bates, *supra* note 232; Brideson, *supra* note 232; Bray-Cotton, *supra* note 232.

238. See generally *Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105*, *supra* note 35.

239. See, e.g., Daniel H. Kolber, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 5, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-6255642-192908.htm> [<https://perma.cc/GHF6-9N93>]; Bruce Bolger, Dr. Ron B. McKinley & Lee S. Webster, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Aug. 20, 2019), <https://www.sec.gov/comments/s7-11-19/s71119.htm> [<https://perma.cc/8DEV-GKLP>].

240. See, e.g., Kolber, *supra* note 239; Bolger, McKinley & Webster, *supra* note 239.

241. Kolber, *supra* note 239.

242. See, e.g., Terry Travers-Davin, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 11, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-193332.htm> [<https://perma.cc/45PG-99GS>]; Lynn Jamison, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 11, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-193368.htm> [<https://perma.cc/JHS4-PBRF>]; Larry McFall, Comment Letter on Proposed Rule to Modernize Regulation S-K Items 101, 103, and 105 (Oct. 12, 2019), <https://www.sec.gov/comments/s7-11-19/s71119-193370.htm> [<https://perma.cc/2MR5-U97C>].

243. See, e.g., Travers-Davin, *supra* note 242; Jamison, *supra* note 242; McFall, *supra* note 242.

commenters favor lengthy and detailed disclosure, which is uncommon for the current trend of regulatory disclosure.<sup>244</sup> These commenters assume that principles-based disclosure automatically leads to less disclosure when compared to prescriptive disclosure, which is not necessarily the case.<sup>245</sup> The SEC believes in the success of previous updates, and the SEC's trend toward principles-based disclosure in general evidences that principles-based disclosure has benefits that outweigh the risks involved.<sup>246</sup>

### III. OUTLOOK ON PROPOSAL S7-11-19 AND ITS FINAL RULE

Through Proposal S7-11-19, the SEC showed a commitment to modernize Regulation S-K.<sup>247</sup> The amendments to Items 101(a), 101(c), and 105 fall in line with the SEC's desire to obtain more efficient disclosure, but the amendments leave the Items in an underwhelming state compared to additional changes that could be implemented.<sup>248</sup> This sections offers alterations to the proposed and enacted amendments that would sufficiently result in better disclosure requirements.

#### A. Suggestions for Item 101(a)

Proposal S7-11-19 contained both ideal and off-based solutions to Item 101(a).<sup>249</sup> These changes aimed to shift disclosure from a stagnant, prescriptive model to a dynamic, principles-based approach.<sup>250</sup> The SEC and investors are following a trend toward principles-based disclosure; thus, changes to Item 101(a) are likely to lead to an efficient, investor-friendly disclosure process that is representative of investors' interests.<sup>251</sup> For example, the proposed Item 101(a) eliminated a five-year prescribed timeframe for business development disclosure, allowing registrants the

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244. See, e.g., Travers-Davin, *supra* note 242; Jamison, *supra* note 242; McFall, *supra* note 242.

245. See, e.g., Travers-Davin, *supra* note 242; Jamison, *supra* note 242; McFall, *supra* note 242. See generally Imhoff & Thomas, *supra* note 48, at 277–310; Reither, *supra* note 48; Agoglia, Douppnik & Tsakumis, *supra* note 48, at 747–67; Rodrigues & Stegemoller, *supra* note 48, at 251–69.

246. U.S. SEC. & EXCH. COMM'N, *supra* note 110.

247. See generally 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239–40).

248. *Id.*

249. *Id.*

250. *Id.*

251. See generally U.S. SEC. & EXCH. COMM'N, *supra* note 110.

flexibility to disclose what investors may find truly material without burdening investors with immaterial information solely because the SEC required too long of a timeframe.<sup>252</sup>

The non-exhaustive list in proposed and ultimately enacted Item 101(a) should, theoretically, act as a starting point for registrants, making disclosure of the proper types of information easier; however, the list may cause unintended consequences.<sup>253</sup> For example, the SEC recently eliminated a non-exclusive list from the principles-based risk factor disclosure contained in Item 503(c).<sup>254</sup> Registrants tended to use the list—a list the SEC intended to serve as a “helping hand”—as a necessary guideline for risk disclosure, checking each item off and ignoring the materiality of the disclosed information.<sup>255</sup> This type of disclosure led registrants to disclose information in the same order, which caused investors to fall victim to anchoring.<sup>256</sup> For these reasons, the list contained in Item 503(c) did not survive the move to Item 105.<sup>257</sup> Thus, providing a list within the amended Item 101(a) may lead to the same prescriptive-based results that the current Item 101(a) produces.<sup>258</sup>

The SEC should stray away from a list of examples and instead provide clear instruction as to what satisfies the materiality standard.<sup>259</sup> The SEC’s actions regarding the transition from Item 503(c) to Item 105, however, would not be a mirror image of a decision to eliminate listed factors in Item 101(a).<sup>260</sup> Item 503(c) already contained a principles-based philosophy, and Item 105 carried on the principles-based philosophy more efficiently.<sup>261</sup> Here, the SEC is attempting to move Item 101(a) from a prescriptive-based approach to a principles-based approach.<sup>262</sup> Thus, as

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252. 84 Fed. Reg. 44,358.

253. *See, e.g.*, FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

254. *Id.*

255. *Id.*

256. Tversky & Kahneman, *supra* note 207, at 1124–31; FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

257. 17 C.F.R. § 229.105 (2019).

258. *See generally* discussion *supra* Part II. *See also* FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

259. *See generally* discussion *supra* Part II concerning Item 105.

260. 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239–40); FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

261. FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82; 17 C.F.R. § 229.105.

262. 84 Fed. Reg. 44,358.

registrants are accustomed to prescriptive disclosure for Item 101(a), there is value in providing the registrants with some sort of starting point, and, here, the non-exclusive list would suffice.<sup>263</sup> This step-by-step approach loses merit when the true issue involving Item 503(c) is fleshed out and properly appreciated.<sup>264</sup> Item 503(c) resulted in prescriptive-like disclosure even when the SEC intended for the disclosure to be principles-based.<sup>265</sup> Thus, relabeling Item 101(a)'s disclosure requirements as principles-based may not be enough to achieve the goal of principles-based disclosure.<sup>266</sup> The SEC would have better served its mission by restricting Item 101(a) without implementing a list.<sup>267</sup>

### *B. Suggestions for Item 101(c)*

Item 101(c) faces an intriguing change in the form of the addition of human capital to its listed requirements.<sup>268</sup> A business's human capital and human capital management are material to its overall success.<sup>269</sup> Scott Stringer, comptroller of New York, emphasized the importance of human capital disclosure in a comment he made to the SEC, stating, "While many companies declare that their workforce is their 'most valuable asset,' . . . companies provide very little information about how they are managing that most valuable of assets."<sup>270</sup> Public comments favored adopting and expanding human capital disclosure, and many public commenters listed specific topics they believe are necessary for investors, including worker recruitment; employment practices; hiring practices; employee benefits and grievance mechanisms; investment in employee training; workplace health and safety; strategies and goals related to

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263. See generally discussion *supra* Part II concerning Item 105; FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

264. FAST Act Modernization and Simplification of Regulation S-K, *supra* note 82.

265. *Id.*

266. See generally *id.*

267. See generally discussion *supra* Part II concerning Item 105.

268. 84 Fed. Reg. 44,358.

269. See, e.g., AARON BERNSTEIN & LARRY BEEFERMAN, IIRC INST. & HARVARD L. SCH. LAB. & WORKLIFE PROGRAM, THE MATERIALITY OF HUMAN CAPITAL TO CORPORATE FINANCIAL PERFORMANCE (2015), [https://lwp.law.harvard.edu/files/lwp/files/final\\_human\\_capital\\_materiality\\_april\\_23\\_2015.pdf](https://lwp.law.harvard.edu/files/lwp/files/final_human_capital_materiality_april_23_2015.pdf) [<https://perma.cc/2CVC-X6TH>].

270. LETTER FROM SCOTT M. STRINGER, NEW YORK CITY COMPTROLLER, COMMENT LETTER ON CONCEPT RELEASE: BUSINESS AND FINANCIAL DISCLOSURE REQUIRED BY REGULATION S-K (July 21, 2016) <https://www.sec.gov/comments/s7-06-16/s70616-239.pdf> [<https://perma.cc/765W-GLAY>].



human capital management; legal or regulatory proceedings related to employee management; whether collective bargaining agreements cover employees; and employee compensation or incentive structures.<sup>271</sup> Commenters believe disclosure of these areas will prove beneficial to investors and will not unduly burden registrants.<sup>272</sup> These beliefs are based in part on studies that show businesses are already collecting human capital information similar to the above-listed topics; therefore, it would not be difficult to disclose information that is already being collected.<sup>273</sup> Further, commenters noted that investors would have the ability to obtain a stronger understanding of the core values of a registrant by comparing registrants' human capital disclosure.<sup>274</sup>

Public involvement pertaining to human capital disclosure proved so substantial that the SEC received a rulemaking petition from the Human Capital Management Coalition.<sup>275</sup> The rulemaking petition asked the SEC to adopt rules that would require the disclosure of human capital information.<sup>276</sup> The rulemaking petition focused on workforce demographics; workforce stability; workforce composition; workforce skills and capabilities; workforce culture and empowerment; workforce health and safety; workforce productivity; human rights commitments and their implementation; and workforce compensation and incentives.<sup>277</sup> The

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271. *Comments on Concept Release: Business and Financial Disclosure Required by Regulations S-K*, *supra* note 114.

272. *See, e.g.*, SENATOR MARK R. WARNER, COMMENT LETTER ON CONCEPT RELEASE: BUSINESS AND FINANCIAL DISCLOSURE REQUIRED BY REGULATION S-K (July 19, 2018), <https://www.sec.gov/comments/s7-06-16/s70616-4186935-172772.pdf> [<https://perma.cc/K872-V8W9>].

273. BERNSTEIN & BEEFERMAN, *supra* note 269.

274. *See, e.g.*, TIM GOODMAN, DIRECTOR OF HERMES INVESTMENT MANAGEMENT, COMMENT LETTER ON CONCEPT RELEASE: BUSINESS AND FINANCIAL DISCLOSURE REQUIRED BY REGULATION S-K (July 21, 2016), <https://www.sec.gov/comments/s7-06-16/s70616-230.pdf> [<https://perma.cc/E2HA-DCA6>].

275. HUMAN CAPITAL MANAGEMENT COALITION, PETITION FOR RULEMAKING ON REQUIRING REGISTRANTS TO DISCLOSE INFORMATION ABOUT THEIR HUMAN CAPITAL MANAGEMENT POLICIES (July 6, 2017), <https://www.sec.gov/rules/petitions/2017/petn4-711.pdf> [<https://perma.cc/JB6D-Y7Z7>]. The Human Capital Management Coalition is a group of institutional investors. A rulemaking petition is a request from the public that the SEC issue, amend, or repeal a rule. *See Petitions for Rulemaking Submitted to the SEC*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/rules/petitions.shtml> [<https://perma.cc/Z9CC-74V5>] (last modified Aug. 15, 2019).

276. HUMAN CAPITAL MANAGEMENT COALITION, *supra* note 275.

277. *Id.*

Investor Advisory Committee, a committee designed to advise the SEC on regulatory matters,<sup>278</sup> also provided the SEC with input, suggesting that human capital disclosure be reflective of the varied circumstances of different businesses rather than constructed with a one-size-fits-all approach.<sup>279</sup>

Currently, Item 101(c)'s only human capital disclosure requirement is that a registrant must disclose the total number of its employees.<sup>280</sup> Authors of a meta-analysis reviewing 66 studies found that human capital characteristics aside from number of employees, such as education, experience, and training, have positive effects on firm performance.<sup>281</sup> Another study found that human resource management practices are reflective of turnover rates.<sup>282</sup> Thus, many areas of human capital disclosure are pertinent to investors and should require disclosure.<sup>283</sup>

Businesses speak of human capital with great importance, and investors clearly value disclosure of human capital information.<sup>284</sup> Accordingly, the SEC is taking a step in the right direction with its inclusion of human capital in Item 101(c); however, human capital's inclusion in Item 101(c) may not be enough.<sup>285</sup> Public comments called for wide-scale human capital disclosure and pinpointing of specific issues.<sup>286</sup> For example, multiple commenters demanded that the SEC require disclosure relating to the diversity of the registrant's workforce.<sup>287</sup> Merely

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278. *Spotlight on Investor Advisory Committee*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/spotlight/investor-advisory-committee.shtml> [<https://perma.cc/W4WF-3LFX>] (last modified Feb. 14, 2017).

279. INVESTOR ADVISORY COMMITTEE, RECOMMENDATION OF THE INVESTOR ADVISORY COMMITTEE: HUMAN CAPITAL MANAGEMENT DISCLOSURE (Mar. 28, 2019), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/human-capital-disclosure-recommendation.pdf> [<https://perma.cc/U725-RU9Z>].

280. 17 C.F.R. § 229.101(c) (2018).

281. T. Russell Crook et al., *Does Human Capital Matter? A Meta-Analysis of the Relationship Between Human Capital and Firm Performance*, 96 J. APPL. PSYCHOL. 443 (2011).

282. Mark A. Huselid, *The Impact of Human Resource Management Practices on Turnover, Productivity, and Corporate Financial Performance*, 38 ACAD. MANAG. J. 635 (1995).

283. *See generally id.*; Crook et al., *supra* note 281.

284. *See, e.g.*, LETTER FROM SCOTT M. STRINGER, *supra* note 270.

285. *See generally Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105, supra* note 35.

286. *See, e.g.*, Kolber, *supra* note 239; Bolger, McKinley & Webster, *supra* note 239.

287. *See, e.g.*, Matthews, *supra* note 232; Finskiy, *supra* note 232; Bates, *supra* note 232; Brideson, *supra* note 232; Bray-Cotton, *supra* note 232.

including an unorganized mess of human capital disclosure within Item 101(c) will not allow for coherent disclosure given the amount and complexity of human capital disclosure that investors are seeking.<sup>288</sup> Thus, considering the massive support surrounding human capital disclosure, the SEC should create a new subsection of Item 101 dedicated entirely to human capital disclosure.<sup>289</sup> A dedicated subsection would allow investors to easily locate human capital disclosure and provide a means to compare human capital disclosure across registrants without having to sift through disclosures unrelated to human capital.<sup>290</sup> In addition, a dedicated subsection would allow the SEC to cleanly break down human capital disclosure into more specific areas of disclosure, such as the disclosure of workplace diversity that commenters rally behind.<sup>291</sup>

### *C. Suggestions for Item 105*

The SEC's ongoing battle with generic risk factor disclosure reaches another chapter with Proposal S7-11-19's proposed amendments to Item 105.<sup>292</sup> The SEC previously made a huge stride toward cleaning up risk factor disclosure when it eliminated the listed examples of risk factor disclosure.<sup>293</sup> The SEC aims to take one step further with its amendments to Item 105; however, the amendments to Item 105 contain a problem that may cause registrants to continue a free-for-all of unnecessary generic risk factor disclosure.<sup>294</sup>

The SEC amended Item 105(c) to have registrants organize risk factors under relevant headings.<sup>295</sup> This structure would coerce a registrant to consider the relevance of the information it is disclosing and allow readers of the disclosure to easily navigate and make sense of different areas of potential risk.<sup>296</sup> The problem is that the proposed amendments prompt

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288. See generally *Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105*, *supra* note 35.

289. *Id.*

290. See generally 17 C.F.R. § 229.101 and its current subsections for an idea of how subsections are organized.

291. See generally *Comments on Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105*, *supra* note 35.

292. 84 Fed. Reg. 44,358 (Aug. 23, 2019) (to be codified at 17 C.F.R. pts. 229, 239-40).

293. See generally *FAST Act Modernization and Simplification of Regulation S-K*, *supra* note 82 (discussing Item 503(c)).

294. 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239-40).

295. *Id.*

296. *Id.*

registrants to include a section entitled “General Risk Factors.”<sup>297</sup> Generic disclosure existing under a title indicating its presence will allow investors to avoid reading the section if they so choose.<sup>298</sup> But, Item 105 does not require generic risk disclosure, and registrants will not understand as much given the prompt to label a section of disclosure as “General Risk Factors.”<sup>299</sup> Further, investors may still read the general risk factor section solely because it is provided, and it will be highly unlikely for investors to find anything of value within the section.<sup>300</sup> Thus, the amendment will not adequately fix the problems with risk factor disclosure.<sup>301</sup> Requiring labeled sections for risk factor disclosure is an effective way to force a registrant to consider the information it chooses to disclose, but the SEC should not have included the prompt for a section of general risk factors.<sup>302</sup>

#### *D. Summary of Proposals*

The state of Regulation S-K prior to Proposal S7-11-19’s announcement, the Final Rule of Proposal S7-11-19’s contents, and this Comment’s recommendations for Items 101(a), 101(c), and 105 are summarized in the chart below.

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297. *Id.*

298. *See generally id.*

299. *See generally* 63 Fed. Reg. 6,730 (Feb. 6, 1998); 84 Fed. Reg. 44,358.

300. *See generally* Dyer, Lang & Stice-Lawrence, *supra* note 213; 84 Fed. Reg. 44,358.

301. 85 Fed. Reg. 63,726.

302. *Id.*

	<b>Regulation S-K before Proposal S7-11-19</b>	<b>Final Rule Enactment of Proposal S7-11-19</b>	<b>Recommendations</b>
<b>Item 101(a)</b>	<ul style="list-style-type: none"> <li>- prescriptive-based</li> <li>- listed requirements</li> </ul>	<ul style="list-style-type: none"> <li>- switch to principles-based approach</li> <li>- still contains listed requirements</li> </ul>	<ul style="list-style-type: none"> <li>- abandon listed requirements</li> <li>- adopt pure materiality standard</li> </ul>
<b>Item 101(c)</b>	<ul style="list-style-type: none"> <li>- principles-based</li> <li>- no human capital requirement</li> </ul>	<ul style="list-style-type: none"> <li>- “more” principles-based</li> <li>- direct reference to human capital</li> </ul>	<ul style="list-style-type: none"> <li>- move human capital disclosure to its own sub-Item</li> <li>- allow human capital disclosure to be further broken down</li> </ul>
<b>Item 105</b>	<ul style="list-style-type: none"> <li>- principles-based</li> <li>- optional summarization of disclosure</li> </ul>	<ul style="list-style-type: none"> <li>- “more” principles-based</li> <li>- requires summary section if disclosure exceeds 15 pages</li> <li>- requires organization of disclosure under labeled headings</li> <li>- prompts a heading to be labeled “risk factor disclosure”</li> </ul>	<ul style="list-style-type: none"> <li>- keep the heading requirement but delete the prompt for a disclosure heading labeled “risk factor disclosure”</li> </ul>

### CONCLUSION

Governing reporting requirements for business development, general business endeavors, and risk factors, Items 101(a), 101(c), and 105 are

important contents of Regulation S-K, and the Items carry significant consequences for both registrants and investors.<sup>303</sup> These Items are outdated, and there is an unambiguous need for amendments.<sup>304</sup> Proposal S7-11-19 and its subsequent enactment are the SEC's attempt to combat the inefficient disclosure requirements provided within these Items.<sup>305</sup> The proposed amendments within Proposal S7-11-19 and the amendments that were actually enacted by the SEC's Final Rule on Proposal S7-11-19 would partially achieve the SEC's goal of modernizing Regulation S-K; however, the amendments still leave Items 101(a), 101(c), and 105 with much room for improvement.<sup>306</sup> If the changes to the amendments that this Comment suggests are implemented, Regulation S-K will reach a properly efficient and modern state that benefits both registrants and investors.

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303. 17 C.F.R. § 229.101(a) (2018); 17 C.F.R. § 229.101(c); 17 C.F.R. § 229.103 (2019); 17 C.F.R. § 229.105 (2019).

304. *See, e.g.*, 38 Fed. Reg. 17,202 (June 29, 1973) (to be codified at 17 C.F.R. pts. 230–31, 239, 241, 249, 276); *see also* 47 Fed. Reg. 11,380 (Mar. 16, 1982) (to be codified at 17 C.F.R. pts. 155, 200, 201, 211, 229–30, 231, 239–40, 249–50, 260, 274); 17 C.F.R. § 229; 84 Fed. Reg. 44,358.

305. 84 Fed. Reg. 44,358; 85 Fed. Reg. 63,726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239–40).

306. 84 Fed. Reg. 44,358; 85 Fed. Reg. 63,726.