

SEC proposes modernizing certain disclosures

By Julius J. Brecht

Recently, the Securities and Exchange Commission proposed in a release (Release)¹ to revise certain of its disclosure rules to which registrants of securities offerings and other registrants required to file certain reports with the SEC are subject (Proposed Changes). The proposed changes relate to portions of Regulation S-K adopted by the SEC.

Scope of proposed changes

Three Items. The three items of Regulation S-K constituting the scope of the Proposed Changes are as follows (collectively, Items):

- **Description of business**— Item 101 of Regulation S-K (Item 101).
- **Legal proceedings**— Item 103 of Regulation S-K (Item 103).
- **Risk factors**— Item 105 of Regulation S-K (Item 105).

Public comment period has ended. The Release, over 100 pages in length, announced a solicitation of public comment on the Proposed Changes for the period ending Oct. 24, 2019. It noted the items had not undergone significant revision for over 30 years. The release further stated that the proposed changes were intended to update the items, thus improving disclosure for investors and simplifying compliance by registrants.

The SEC received numerous comments on the proposed changes. Formal adoption of the proposed changes (or some variation on them as a result of public comment) may ensue with the end of the public comment period.

Focus of release. A focus of the release is on disclosure by registrants who are issuers in public securities offerings under, and subject to registration of those offerings under, the Securities Act of 1933, as amended. However, the release also pertains to registrants under the Securities Exchange Act of 1934 who are, under that act, required to make periodic and current reports to the SEC.

The nature of the proposed changes may also apply to non-registrants under the Securities Act who nevertheless seek to offer securities pursuant to an exemption from registration under that act. So, the proposed changes may apply to, or otherwise have an impact on, disclosure requirements provided elsewhere in, and which must be followed by offerors in private offerings in reliance upon exemptions provided elsewhere under, the Securities Act.

For example, Rule 502 of Regulation D (a registration exemption format adopted by the SEC under the Securities Act, in part, for private securities offerings) sets forth non-financial disclosure requirements. Those requirements include, as a default, provisions of various disclosure formats that the issuer might seek to use. Some of those formats rely, in part, upon required disclosures expressly referencing the Items. In the future, other formats not requiring disclosures by expressly referencing the items may, nevertheless, require disclosure based upon the items.

Bi-level securities regulation Federal and state levels. Se-

curities regulation in the United States is not only at the federal level as administered by the SEC. It also takes place on the state level by each state through the state's securities law as administered by the securities regulator in that state. For Alaska, the securities regulator is the Administrator of Securities. However, the securities law, which had been in place since Alaska became a state in 1959, was repealed and replaced (effective Jan. 1, 2019) with a new and revised Alaska Securities Act (AS 45.56, Alaska Securities Act).²

Registration or exemption. While state and federal securities laws are, for the most part, independent of one another, they each, in the context of securities offerings, focus on a requirement of registration of the offering, with limited exception. The exception occurs when there is an exemption from registration available and the issuer satisfies the terms of that exemption.

Impact on state regulation. So, the proposed changes, while limited to interpretation of federal securities law, could influence how the disclosure requirements of the securities laws of the various states, including the new Alaska Securities Act, are interpreted by the corresponding state securities regulator. Furthermore, the proposed changes could then influence how courts in the states, including Alaska courts, interpret those corresponding state securities laws.

Primary purpose of the items
Integrated disclosure of material information. Regulation S-K provides an integrated disclosure for registration statements under the Securities Act and for registrants subject to reporting requirements under the Exchange Act. As stated in the release, a primary purpose of the items has been to seek disclosure of information material to an investment decision.

Addresses many changes in the marketplace and economy. The release states that the proposed changes are set forth to address the many changes that have occurred in capital markets and the domestic and global economy in the time frame since the initial adoption of Regulation S-K. It states that these changes include the mix of businesses, the way they operate and the technology used by them.

Nature of, and some examples of, the proposed changes

This article is not intended to be a detailed analysis of the proposed changes. However, a brief outline of the approach taken by the SEC on the nature of required disclosure under, and a few examples of the extent of, the proposed changes are as follows.

Nature. Generally, the proposed changes apply two approaches to required disclosure:

- **Principles-based approach** — Registrant decides whether disclosure is material.

- **Prescriptive-based approach** — Registrant must disclose.

The principles-based approach allows the registrant flexibility in determining the disclosure that is material to an investment decision. The release proffers that the principles-based approach articulates a disclosure concept rather than specifying a line-item requirement.

It relies upon management to evaluate and determine whether the disclosure is necessary.

In contrast, the prescriptive-based approach provides a bright-line, quantitative threshold specifying when disclosure is required. It also sets forth that all registrants are required to disclose the same type of information. The prescriptive-based approach does not rely upon management's judgment as to whether disclosure is required.

Examples. As an example of the proposed changes under Item 101 and applying the principles-based approach, the required business description must provide information material to an understanding of the general business development of the registrant. This approach also eliminates, in that disclosure, the prescribed and arbitrary five-year time frame for disclosure in the current Item 101. As a further adjustment to Item 101 and using the principles-based approach, the proposed changes require inclusion in the disclosure a description of human capital resources and measures or objectives that management focuses on in managing the business.

As an example of proposed changes to Item 103 and applying the principles-based approach, information on legal proceedings may as an alternative be provided by hyperlink or cross-reference to legal proceedings disclosure located elsewhere in the document. The release states that this approach averts duplicative disclosure in the document. Furthermore, as a prescriptive-based approach, the proposed changes dealing with Item 103 include raising the threshold for disclosure of environmental proceedings to which the government is a party from the current amount of \$100,000 to \$300,000.

As an example of proposed changes to Item 105 and applying the prescriptive-based approach, the registrant must provide a summary risk factor disclosure when the risk factors section of the disclosure exceeds 15 pages. The proposed changes also change, as a prescriptive-based approach, the disclosure standard from "most significant" factors to "material" factors. It further requires organization of the risk factors under relevant headings.

Possible consequences of the proposed changes

While the proposed changes, in part, relate to interpretation of the Securities Act disclosure requirements for a registered offering, they may also have an impact on non-registered offerings, i.e., private securities offerings under that act. Furthermore, the proposed changes may indicate a trend in disclosure requirements seeping into those under state securities law as well.

A careful read of the entire release will provide the full impact of the proposed changes disclosure requirements on offerings under the Securities Act and on reports to the SEC under the Exchange Act. This caution is especially important for the prudent practitioner who may advise a client on such an offering or report.

A careful read of the release may, in addition, provide insight as to how the disclosure requirements of the proposed changes may seep

into future state regulation of securities offerings.

Footnotes:

¹"Modernization of Regulation S-K Items 101, 103, and 105," SEC Release Nos. 33-10668, 34-86614; File No. S7-11-19, RIN 3235-AL78; August 8, 2019.

²Brecht, Julius J. "Revised Alaska Securities Act— learning some new ropes." The Alaska Bar Rag April-June 2019: Page 22.

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Julius J. Brecht is an attorney in private practice and Of Counsel with the law firm of Bankston Gronning Brecht, P.C. with offices in Anchorage. His concentration of practice is in state and federal securities law and corporate and business law. He may be reached at jbrecht@bgbalaska.com.

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