

Clients & Friends Memo

SEC Adopts Amendments to Modernize Risk Factor Disclosure Requirements

August 28, 2020

On August 26, 2020,¹ the Securities and Exchange Commission (the “SEC”) announced the adoption of amendments to modernize the description of business, legal proceedings, and risk factor disclosures that registrants are required to make pursuant to Regulation S-K. For purposes of SEC-registered securitizations, the most significant changes are:

- to discourage lengthy risk factor disclosures (especially generic risk factors that could apply to any issuer or any offering) that do not concisely address the material risks of the specific offered security;
- to require that risk factors be organized under appropriate headings and sub-captions; and
- to require a summary (no more than 2 pages) of risk factors in the forepart of the prospectus if the risk factor section exceeds 15 pages.

These changes become effective 30 days after publication in the Federal Register.

Prior to adoption of these amendments, Item 105 of Regulation S-K (“**Item 105**”) required the disclosure of the “most significant” factors that make an investment in the offering speculative or risky. The SEC cites recent studies that “have indicated that risk factor disclosures have increased over time”² and notes that the inclusion of “generic, boilerplate risks that could apply to any offering”³ contributes to the length of risk factor disclosure. In adopting amendments to Item 105, the SEC aims to address the “lengthy and generic nature”⁴ of risk factor disclosure presented in offering materials.

¹ Modernization of Regulation S-K Items 101, 103, and 105, Release Nos. 33-10825; 34-89670 (Aug. 26, 2020), available at <https://www.sec.gov/rules/final/2020/33-10825.pdf> (the “Release”).

² See Release at pp. 65-66.

³ See Release at p. 66.

⁴ See Release at p. 65.

In addition, the SEC has reiterated its commitment to a principles-based, registrant-specific approach to disclosure. The amendments refine the “principles-based” approach of Item 105 by replacing the “most significant” risk factors standard with a “material” risk factors standard. This change is intended to focus the registrant on “disclosing the risks to which reasonable investors would attach importance in making investment...decisions”.⁵

The SEC believes that these amendments “will result in risk factor disclosure that is more tailored to the particular facts and circumstances of each registrant, which should reduce the disclosure of generic risk factors and potentially shorten the length of the risk factor discussion, to the benefit of both investors and registrants”.⁶

Below is the full text of Item 105 as amended:⁷

§ 229.105 (Item 105) Risk factors.

(a) Where appropriate, provide under the caption “Risk Factors” a discussion of the material factors that make an investment in the registrant or offering speculative or risky. This discussion must be organized logically with relevant headings and each risk factor should be set forth under a subcaption that adequately describes the risk. The presentation of risks that could apply generically to any registrant or any offering is discouraged, but to the extent generic risk factors are presented, disclose them at the end of the risk factor section under the caption “General Risk Factors.”

(b) Concisely explain how each risk affects the registrant or the securities being offered. If the discussion is longer than 15 pages, include in the forepart of the prospectus or annual report, as applicable, a series of concise, bulleted or numbered statements that is no more than two pages summarizing the principal factors that make an investment in the registrant or offering speculative or risky. If the risk factor discussion is included in a registration statement, it must immediately follow the summary section required by § 229.503 (Item 503 of Regulation S-K). If you do not include a summary section, the risk factor section must immediately follow the cover page of the prospectus or the pricing information section that immediately follows the cover page. Pricing information means price and price-related information that you may omit from the prospectus in an effective registration statement based on Rule 430A (§ 230.430A of this chapter). The registrant must furnish this information in plain English. See § 230.421(d) of Regulation C of this chapter.

⁵ See Release at p. 72.

⁶ See Release at pp. 73-74.

⁷ See Release at pp.128-129.

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If you have any questions, please feel free to contact any of the following attorneys or your Cadwalader contact.

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