Securities Regulation Daily Wrap Up, TOP STORY—SEC commissioners highlight topics for comment on Reg S-K proposal, (Aug. 28, 2019)

Securities Regulation Daily Wrap Up

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Commissioners Jackson and Lee invite comments on the agency's shift toward principles-based disclosure and the absence of climate-risk disclosure in the recent Reg S-K proposal.

While commending the SEC's proposed revisions to Regulation S-K for adding disclosure on the topic of human capital, Commissioners Robert Jackson and Allison Herren Lee expressed concerns about the proposal's favoring of principles-based disclosure and its failure to seek comment on whether to require disclosure on climate risk. Via a statement, Lee and Jackson themselves are inviting comments on those topics "to help ensure that our rules produce the comparability and transparency that American investors deserve."

Reg S-K amendments. On August 9 the SEC proposed amendments to Items 101, 103, and 105 of Regulation S-K. According to the Commission, the proposed amendments would modernize the rule's description-of-business, legal proceedings, and risk factor disclosures to reflect changes in the markets, economy, and technology in the last several decades. The proposal stems from the JOBS Act-mandated review of Regulation S-K's disclosure requirements.

The amendments would revise Items 101(a) (general development of the business), 101(c) (narrative description of the business), and 105 (risk factors) to emphasize a more principles-based approach. The agency said that prescriptive disclosure requirements in these areas can become outdated, and the current requirements may not reflect information that is material to every business. The proposal retains a prescriptive approach to Item 103 (legal proceedings) because this disclosure requirement depends less on the specific characteristics of individual registrants.

Human capital and a balance of disclosures. Lee and Jackson said that the flexibility of principles-based disclosure has merit in some cases, but the benefits should be weighed against the costs. Principles-based disclosure gives executives discretion over what they tell investors and can hinder investors' ability to compare information and analyze potential investments. The commissioners said that the principles-based disclosures under the proposal could fail to give investors information that they need.

Specifically on the topic of human capital, the proposal takes a crucial step forward by including this topic, but the principles-based framework may give management too much discretion in describing investments in the company's workers. The Investor Advisory Committee has recommended disclosure in this area, and the Human Capital Management Coalition, which comprises institutional investors with $2.8 trillion in assets, called for a balance between specific, rules-based disclosures (for example, the amount spent on employee training) and principles-based disclosures (such as how training expenditures align with a changing business strategy). Line-item disclosures are easier for investors to extract and compare, while narrative disclosures can help put the numbers in context, HCMC said. Lee and Jackson picked up this thread by urging commenters to help the SEC get the balance right by identifying specific measures, if any, that would be useful to investors.

Climate risk disclosure. The commissioners also invited comments on whether and how the topic of climate risk should be included in a final rule. Lee and Jackson said it is clear that investors view climate risk as an important factor in making investment decisions, but that it is difficult for investors to find this information. Their statement dismisses the objection that climate risk is too difficult to quantify accurately. "Whatever one thinks about disclosure of climate risk, research shows that we are long past the point of being unable to meaningfully measure a company's sustainability profile," they write. They cite a study published last year in *The Accounting*

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Review that shows that some sustainability measures reveal material information to the market, along with the work of the Sustainability Accounting Standards Board in refining its measures through engagement with investors and issuers.

Comment period. Comments on the SEC's proposal should be received by October 22, 2019.

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