SEC Proposes Amendments to Exchange Act Rules Governing Registration Requirements

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On December 17, 2014, the SEC proposed **rule amendments** intended to make it easier for private companies to raise capital, by relaxing existing requirements that would otherwise force them to enter the public-company reporting system before an IPO. The proposals are the latest in the SEC's efforts to respond to the JOBS Act of 2012, which **significantly loosened** regulatory obligations imposed on pre-IPO companies and companies entering the IPO process.

The proposed amendments would provide companies with the flexibility to stay private for a longer period of time and develop a larger shareholder base before conducting an IPO. The proposals would also permit companies enhanced flexibility to offer equity compensation without triggering public-company reporting requirements. As equity-based compensation is a popular practice for pre-IPO companies, the proposed amendments will be welcome.

The SEC is seeking comment from the public through March 2, 2015.

Public-Company Reporting Thresholds

Prior to the JOBS Act, a U.S. company became subject to public-company reporting obligations (i.e., the ongoing obligation to file Form 10-Ks, 10-Qs and 8-Ks, and to solicit proxies) if, at the end of its fiscal year, a class of its equity securities (such as common stock) was "held of record" by 500 or more persons, and it had total assets of more than $1 million. The proposed amendments would implement new thresholds introduced by the JOBS Act, under which:

- the record holder threshold would be elevated from 500 persons to either (i) 2,000 persons or (ii) for companies other than banks, bank holding companies and savings and loan holding companies, 500 persons who are not "accredited investors"; and
- the asset threshold would be elevated from $1 million to $10 million.

The SEC intends to use the familiar definition of "accredited investor" from Regulation D, which allows companies to raise capital without SEC registration. Under Regulation D, an accredited investor includes, among others, corporations or partnerships with assets exceeding $5 million, and natural persons whose net worth exceeds $1 million (excluding the value of their primary residence), or who earn $200,000 or more annually. The timing of the determination would be different from Regulation D. Under Regulation D, the accredited investor determination is made when securities are sold, but for purposes of public-company reporting requirements, the determination would be made as of the last day of the company's fiscal year. Although the SEC acknowledged that companies "may have difficulty determining whether existing security holders are accredited investors," it did not provide a safe harbor or other guidance to facilitate this effort.

The favorable treatment of savings and loan holding companies is one of the few departures from the SEC's JOBS Act mandate. The SEC explained that, because regulatory oversight of savings and loan holding companies is substantially similar to that for bank holding companies, the two entities should be treated consistently under SEC rules.

Suspension and Termination of Public-Company Reporting Obligations

For most companies, suspension and termination of reporting requirements would remain unchanged: they would be triggered if the company's securities registered under the Exchange Act, on a class-by-class basis, are "held of record" by fewer than 300 persons. The SEC's proposals would amend the Exchange Act's procedural accommodations to permit banks, bank holding companies and savings and loan holding companies to immediately terminate their registration or suspend their reporting obligations if their securities are "held of record" by fewer than 1,200 persons.

Equity Compensation Awards

As directed by the JOBS Act, the SEC proposed two complementary changes to Exchange Act Rule 12g5-1 favoring equity compensation awards. First, the SEC proposed amending the definition of "held of record" to exclude securities received under certain compensatory plans in transactions exempt from Securities Act registration. And second, the SEC proposed a safe harbor for calculating the number of shareholders. The safe harbor would expressly exclude shareholders from the definition of "held of record" if they received their shares under a compensation plan in a transaction that meets the conditions of Securities Act Rule 701(c). Rule 701(c) provides a Securities Act exemption for equity compensation grants to enumerated plan participants and their family members who received such shares via gifts or domestic relations orders. However, because the proposed safe harbor is limited to holders permitted by Rule 701(c), if any such plan participants or family members transfer or sell their acquired shares, the resulting transferees would need to be included in the company's "held of record" calculation.

Definition of "Held of Record"

The SEC proposed amending the definition of "held of record" to provide that, when determining whether a company must submit to public-company reporting requirements under the record holder threshold, the company may ignore securities that are either:

- received under an employee compensation plan in a transaction exempt from Securities Act registration; or
- held by employees and other persons eligible to receive securities from the company under Securities Act Rule 701(c) who received the securities in a transaction exempt from Securities Act registration in exchange for securities excluded from the definition of "held of record."

The SEC explained that the second point is to facilitate the ability of companies to conduct restructurings, business combinations and similar transactions.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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