

SEC Proposes Changes to Rule 144

December 23, 2020

This week, the SEC **proposed** to amend Rule 144 to revise the holding period determination for securities acquired upon conversion or exchange of market adjustable securities of unlisted companies so that it begins upon the conversion or exchange. The SEC's proposal would make a number of other changes, including, among other things, mandating electronic filing of Form 144, adding a check box on Forms 4 and 5 to indicate transactions made pursuant to a Rule 10b5-1 plan, and eliminating the requirement for affiliates of unlisted companies to file Form 144 for resales of securities.

Change to Holding Period for Some Convertible Securities

Current Rule 144(d)(3)(ii) provides that securities acquired solely in exchange for other securities of the same company are deemed to have been acquired at the same time as the securities surrendered for conversion or exchange. The SEC's proposal would amend the rule to provide that, for securities acquired upon conversion or exchange of market adjustable securities issued by unlisted companies where the conversion formula is not fixed at the time of the initial transaction, the holding period determination would not begin until the conversion or exchange of those market adjustable securities.

The proposed amendment would not affect the use of Rule 144 for most convertible securities. The proposed amendment would apply only to convertible securities where:

- the securities acquired upon conversion or exchange were acquired from a company that, at the time of the conversion or exchange, did not have a class of securities listed, or approved for listing, on a national securities exchange; and
- the convertible or exchangeable security contains terms, such as conversion rate or price adjustments, that offset declines in the market value of the underlying securities occurring prior to conversion or exchange.

In making this proposed change, the SEC noted that the conversion price for market adjustable securities is often at a substantial discount to the market price of the underlying securities at the time of conversion or exchange. Therefore, a quick sale into the public markets of the underlying securities upon conversion or exchange following the satisfaction of the holding period with respect to the market adjustable securities would be likely. Accordingly, this proposed change is intended to mitigate the risk of unregistered distributions of the underlying security.

The proposed rule would be applicable, in some instances, to the preferred stock of pre-IPO companies, which is often issued at a conversion ratio equal to liquidation preference rather than a fixed ratio. Should the proposed rule apply in such instances, holders of the preferred stock would be more likely to request registration rights.

Other Proposed Changes

In addition to the changes to the holding period, the proposal would, among other things:

- require that all Form 144 filings be made electronically;
- eliminate the requirement that an affiliate send one copy of the Form 144 to the exchange on which the securities trade;
- eliminate certain information currently required on Form 144, including home addresses;
- change the Form 144 filing deadline to coincide with the Form 4 filing deadline;

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- add a check box to Forms 4 and 5 to provide filers the option of disclosing their sales or purchases were made pursuant to a Rule 10b5-1 plan; and
- eliminate the Form 144 filing requirement for resales of securities by affiliates of unlisted companies.

While the requirement to file a Form 144 electronically would not significantly affect U.S. companies, it would lead to more transparency of sales of securities by insiders of foreign private issuers who do not currently file forms required by Section 16 electronically.

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

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