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Changes Imminent For Exchange Act Registration

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The U.S. Securities and Exchange Commission has proposed amendments to the registration, termination of registration and suspension of reporting requirements of the Securities Exchange Act of 1934 (Exchange Act) in order to implement provisions of the Jumpstart Our Business Startups Act (Jobs Act).[1] Comments are due by March 2, 2015.

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Background

In 2012, the Jobs Act amended the thresholds for registration, termination and suspension of reporting under the Exchange Act. As a result of the Jobs Act, an issuer that is not a bank or a bank-holding company must register equity securities under the Exchange Act if it has:

- Total assets in excess of $10 million, and
- The class of equity securities is "held of record" by either
    - 2,000 persons or
    - 500 persons who are not accredited investors.

The Jobs Act requires a bank or bank-holding company to register its equity securities under the Exchange Act if it has:

- Total assets in excess of $10 million, and
- Securities are "held of record" by 2,000 or more persons (without regard to whether any persons are accredited investors).

The Jobs Act relaxed the termination and suspension of Exchange Act registration obligations for banks and bank-holding companies by increasing the record holder threshold from less than 300 to less than 1,200 persons before a bank or bank-holding can terminate its registration or suspend its reporting obligations. The threshold for other issuers to terminate or suspend their Exchange Act registration or reporting requirements for a class of equity securities remains at less than 300 record holders.

The Jobs Act also directed the SEC to modify the definition of "held of record" pursuant to Exchange Act Section 12(g)(5) so that it would exclude securities held by persons who received the securities in exempt transactions under an "employee compensation plan" and to create a safe harbor for issuers to follow when making that determination.

The related Exchange Act rules have not yet been amended, so they still refer to the thresholds that existed prior to the Jobs Act. The purpose of the SEC's proposed rule amendments is to implement these Jobs Act changes.

Discussion

Threshold Requirements. The SEC proposes to amend Rules 12g-1, 12g-2, 12g-3, 12g-4 and 12h-3 so that the provisions governing registration and termination of registration under Section 12(g) of the Exchange Act, and suspension of reporting obligations under Section 15(d) of the Exchange Act, reflect the threshold levels established by the Jobs Act.

If adopted, the proposed amendments to the thresholds for banks and bank-holding companies would expand the existing provisions of Rule 12g-4 and Rule 12h-3 to encompass the termination and suspension thresholds provided for in the Jobs Act. This would allow banks and bank-holding companies to rely on the SEC's rules to suspend reporting immediately, to avoid being deemed registered upon termination of certain exemptions or as a successor issuer, and to terminate their registration during the fiscal year, at the higher 1,200-holder threshold.

Savings and Loan-Holding Companies. Under the proposed rules, the SEC would apply the same thresholds to savings and loan-holding companies that now apply to banks and bank-holding companies for the purposes of registration, termination of registration and suspension of Exchange Act reporting requirements.

In the proposing release, the SEC stated that, because it believes that the regulatory oversight applicable to savings and loan-holding companies is substantially similar to the regulatory oversight for bank-holding companies, the SEC should treat savings and loan-holding companies consistently with other depositary institutions under the SEC rules. Therefore, the SEC has proposed amending Rule 12g-1 to establish an exemption for savings and loan-holding companies from the registration requirement that mirrors the exemption for banks and bank-holding companies established by the Jobs Act.

The SEC has also proposed amendments to Rules 12g-2, 12g-3, 12g-4 and 12h-3 to permit savings and loan-holding companies to immediately suspend current and periodic reporting in the same manner as banks and bank-holding companies (i.e., upon filing Form 15 at the less than 1,200 holder of record threshold).

Accredited Investor Definition. The Jobs Act increased the Exchange Act thresholds for registration by an issuer other than a bank or a bank-holding company to total assets exceeding $10 million and a class of nonexempted equity securities held of record by either 2,000 persons or 500 persons who are not accredited investors. In order to rely on the new, higher threshold, issuers must be able to determine which of its record holders qualify as accredited investors.

The SEC has proposed using the definition of "accredited investor" set forth in Rule 501(a) under the Securities Act of 1933 (Securities Act), which is part of the Regulation D limited offering exemption, to determine if investors are accredited investors for purposes of the registration provisions of Exchange

Act Section 12(g)(1). Under the proposed amendment to Rule 12g-1, the accredited investor determination would be made as of the last day of the fiscal year.

In addition, the SEC acknowledged in the proposing release that it can be difficult for issuers to determine whether investors are accredited because issuers are not currently required to periodically assess an investor's continued status as an accredited investor once an offering has been completed. The SEC observed that, without new guidance, issuers would likely use procedures similar to those used when relying on Securities Act Rule 506 to establish a reasonable belief that an investor is accredited. This involves due diligence based on particular facts and circumstances. The SEC is considering whether a different approach would be appropriate for determining accredited investor status under Section 12(g) of the Exchange Act and is specifically soliciting comment on the appropriate structure and criteria for such an approach.

Held of Record Requirements. Section 12(g)(5) of the Exchange Act, as amended by the Jobs Act, provides that the definition of "held of record" does not include securities held by persons who received them pursuant to "an employee compensation plan" in transactions exempt from registration under Section 5 of the Securities Act. To implement this provision, the SEC has proposed amending Exchange Act Rule 12g5-1 so that, when determining whether an issuer is required to register a class of equity securities with the commission, the issuer may exclude securities that are held by persons who received the securities pursuant to an employee compensation plan in transactions exempt from the registration requirements of Section 5 of the Securities Act or that did not involve a sale within the meaning of Section 2(a)(3) of the Securities Act.

The proposed rules would also permit the issuer to exclude securities held by persons eligible to receive securities from the issuer pursuant to Securities Act Rule 701(c), described in more detail below, who received the securities in a transaction exempt from the registration requirements of Section 5 of the Securities Act in exchange for compensatory securities received under a plan that are excludable from the determination of securities held of record under the above-described amendment to the definition of "held of record." This exclusion for securities obtained in such exchanges is intended to facilitate the issuer's ability to engage in restructurings, business combinations and similar transactions that are exempt from regulation under the Securities Act.

Safe Harbor for Securities Issued Pursuant to Employee Compensation Plans. The SEC has proposed Rule 12g5- 1(a)(7)(ii) as a nonexclusive safe harbor, providing that a person will be deemed to have received securities pursuant to an employee compensation plan if such person received them pursuant to a compensatory benefit plan in transactions that met the conditions of Securities Act Rule 701(c). The safe harbor would apply as long as the conditions of Rule 701(c) are met, even if any conditions set forth in other portions of Rule 701, such as issuer eligibility, volume limitations or disclosure delivery provisions, are not met. Because the proposed safe harbor is nonexclusive, failure to satisfy all of the conditions of Rule 701(c) would not preclude reliance on Section 12(g)(5) of the Exchange Act or other provisions of proposed Rule 12g5-1(a)(7).

The proposed safe harbor would be available for securities issued to employees, directors, general partners, trustees, officers, and certain consultants and advisers pursuant to an employee compensation plan. In addition, the safe harbor would apply to permitted family member-transferees with respect to securities acquired by gift or domestic relations order, or securities that they acquired in connection with options transferred to them by plan participants through gifts or domestic relations orders.

The proposed safe harbor is limited to holders who are persons specified in Rule 701(c). Therefore, if

such a person subsequently transfers the securities, whether or not for value, the securities would need to be counted as held of record for purposes of determining whether the issuer is subject to the Exchange Act's registration and reporting requirements.

Rule 701. Existing Securities Act Rule 701(c) plays a role in the proposed amendment to the definition of "held of record" and to the safe harbor for compensatory securities. Briefly, Rule 701(c) requires that the compensatory benefit plan be:

- Written and delivered to employees;
- Established by the issuer, its parents, its majority-owned subsidiaries or the majority-owned subsidiaries of the issuer's parent, for the participation of their employees;
- Applicable only to specified family members; and
- Compliant with special requirements for consultants and advisers.

Foreign Private Issuers. Foreign private issuers would be able to rely on the proposed safe harbor for securities issued pursuant to employee compensation plans when making their determinations of the number of U.S.-resident holders for the purpose of Rule 12g3- 2(a). Rule 12g3-2(a) exempts foreign private issuers from registering any class of securities if such class is held by fewer than 300 holders resident in the United States.

Practical Considerations

To a large degree, the proposed amendments adjust SEC rules to reflect existing Jobs Act changes to the Exchange Act. However, companies that believe they may be impacted by the proposed amendments should review the proposing release carefully to determine if they wish to make any comments on these proposals.

As a result of the proposed rules, companies may need to adopt new due diligence procedures to the extent they are close to triggering registration, deregistration or suspension thresholds because of the number of their shareholders who are not accredited investors. These companies should consider putting such procedures in place as early as possible to provide better tracking and planning. It may be helpful for such companies to submit comments to the SEC concerning any issues or anticipated problems that they may have in determining the accredited investor status of their shareholders, as well as suggesting any refinements or identifying open questions that they would like the SEC to consider in the final rules on this subject.

Private companies not currently subject to Exchange Act reporting requirements may want to consider adopting provisions in their articles of incorporation and/or bylaws that require investors to respond to inquiries of accredited investor status, possibly providing for the mandatory buyout of persons who do not provide such certification, or who are not accredited investors if the company determines it is necessary or advisable to avoid triggering the Exchange Act registration requirements.

If the proposed rules are adopted, companies should consider whether employee compensation plans that permit transfers of securities received under such plans could cause them to exceed thresholds and thereby require registration under the Exchange Act. If there are issues, companies should consider what, if any, revisions they want to make to such plans.

In any event, companies in this situation should implement due diligence procedures to track ownership

of securities issued pursuant to employee compensation plans and consider whether buyback or right of first refusal provisions should be added to the plan documents if the company determines it is necessary or advisable to avoid triggering the Exchange Act registration requirements.

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[1] See Release No. 33-9693;34-73876, available at http://www.sec.gov/rules/proposed/2014/33-9693.pdf.