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Legal Update
July 9, 2018

SEC Expands Definition of Smaller Reporting Company

On June 28, 2018, the US Securities and Exchange Commission (SEC) revised the definition of "smaller reporting company" in order to expand the number of registrants that will qualify as smaller reporting companies.[1] The amendments to the definition of smaller reporting company had been proposed in 2016,[2] and the amendments had been well-received by commenters. The change to the definition of smaller reporting company is intended to reduce compliance costs for those registrants, while maintaining appropriate investor protections. At the same time, the SEC amended the definitions of "accelerated filer" and "large accelerated filer" to preserve the existing qualifying thresholds in those definitions. This means that qualifying as a smaller reporting company will no longer automatically make a registrant a non-accelerated filer. These changes and related changes to the cover pages of certain forms applicable to all issuers become effective 60 days after they are published in the *Federal Register*. It is expected that the changes will become effective by the middle of September 2018.

Background

The SEC created the smaller reporting company category in 2008 to provide regulatory relief for smaller companies by allowing them to provide scaled disclosures under Regulation S-K and Regulation S-X. Prior to this most recent SEC action, smaller reporting companies generally were required to have less than $75 million in public float. Companies that did not have any outstanding public equity, or that had no market price for their public equity, had to have less than $50 million in annual revenues in order to be considered a smaller reporting company.

Revisions to Definition of Smaller Reporting Company

The SEC has revised the definition of "smaller reporting company" in Rule 405 under the Securities Act of 1933 (Securities Act); Item 10(f) of Regulation S-K; and Rule 12b-2 under the Securities Exchange Act of 1934 (Exchange Act), to mean an issuer that, as of an applicable determination date, had:

- A public float of less than $250 million or
- Annual revenues of less than $100 million and either:
  - No public float or
  - A public float of less than $700 million.

For reporting companies, the date for determining public float is the last business day of the issuer's most recently completed second fiscal quarter, while for companies filing an initial registration statement, public float is to be determined as of a date within 30 days of the date of the filing of the registration statement. In both cases, annual revenues are as of the most recently completed fiscal year for which audited financial statements are available.

As with the current definition, issuers that are investment companies, asset-backed issuers or majority-owned subsidiaries of a parent that is not a smaller reporting company cannot qualify as a smaller reporting company.

Once an issuer determines that it does not qualify as a smaller reporting company, it will remain unqualified unless when making its annual determination either it determines that:

- Its public float was less than $200 million or
- Its public float and its annual revenues meet the requirements for qualification included in the following chart:

Prior Annual Revenues	Prior Public Float	
	None or less than $700 million	**$700 million or more**
Less than $100 million	Neither threshold exceeded.	**Public float** Less than $560 million and **Revenues** Less than $100 million.
$100 million or more	**Public float** None or less than $700 million and **Revenues** Less than $80 million.	**Public float** Less than $560 million and **Revenues** Less than $80 million.

Revisions to the Definitions of Accelerated Filer and Large Accelerated Filer

The SEC has revised the definitions of "accelerated filer" and "large accelerated filer" in Rule 12b-2 under the Exchange Act to eliminate the prohibition on smaller reporting companies being able to qualify as an accelerated filer or large accelerated filer. This means that a smaller reporting company will now need to consider whether it qualifies as either an accelerated filer or a large accelerated filer as of the end of its second fiscal quarter and, if so, comply with the accelerated filing deadlines for Exchange Act reports and other applicable provisions beginning in its next fiscal year. In addition, accelerated filers and large accelerated filers that aren't emerging growth companies must comply with the auditor attestation requirements relating to internal control over financial reporting imposed by Section 404(b) of the Sarbanes-Oxley Act, while, up to this point, smaller reporting companies were exempt from this requirement as they could not be accelerated filers or large accelerated filers.[3]

In their comments on the proposed amendments, market participants, trade groups and various SEC advisory groups had noted that the threshold for triggering the Section 404(b) auditor attestation requirement ought to be reevaluated given that for many smaller reporting companies the requirement may be unduly burdensome. In the SEC's open meeting, Commissioner Piwowar and Commissioner Peirce both addressed the importance of reevaluating the threshold triggering the Section 404(b) auditor attestation requirement, with Commissioner Piwowar noting that changes to the accelerated filer definition "are inextricably linked to the [smaller reporting company] regime"[4] and Commissioner Peirce noting that "Section 404(b) of Sarbanes-Oxley" is "the most glaring burden on small issuers."[5] In the adopting release, the SEC noted that Chairman Clayton "has directed the staff to formulate recommendations to the SEC for possible additional changes to the 'accelerated filer' definition that, if adopted, would have the effect of reducing the number of registrants that qualify as accelerated filers" and, as a result, reverse, or at least lessen, the impact of the SEC's changes to the definitions of accelerated filer and large accelerated filer.

Changes to Securities Act and Exchange Act Forms

In addition to the changes to the definitions of "smaller reporting company," "accelerated filer" and "large accelerated filer," the SEC also revised the cover pages of Forms S-1, S-3, S-4, S-8 and S-11 under the Securities Act and Forms 10, 10-K and 10-Q under the Exchange Act, in each case to eliminate the instruction informing filers to not check the "Non-accelerated filer" box if the issuer is a smaller reporting company.

Revisions to Rule 3-05(b)(2) of Regulation S-X

Rule 3-05 of Regulation S-X sets forth the requirements for when financial statements of a newly acquired business or a business to be acquired must be provided in Securities Act and Exchange Act filings.

The SEC has amended Rule 3-05(b)(2)(iv) to allow registrants to omit financial statements for the earliest of the three required fiscal years if the net revenues of the business to be acquired are less than $100 million, up from $50 million in the current rule. This rule change applies to all companies, not just smaller reporting companies.

Practical Considerations

In order to make informed decisions for the future, existing smaller reporting companies should consider the new qualification thresholds, particularly those issuers that were close to the current thresholds for losing their status or may lose their status based on the current definition and their annual determination as of the end of the second quarter (June 30, 2018, for most companies). The changes could allow these companies to benefit from the revised smaller reporting company thresholds, particularly the scaled disclosure requirements, for some time going forward.

The amendments did not modify any of the scaled disclosure accommodations for smaller reporting companies, which may continue to be complied with on an item-by-item basis. A smaller reporting company may want to consider undertaking a review regarding the accommodations that it will rely on in light of its prior disclosures, the types of disclosures made by peer companies and the types of information typically sought out by research analysts and other financial professionals.[6] As part of this review and even though there is a substantial overlap in the accommodations provided, a smaller reporting company that also qualifies as an emerging growth company should examine the accommodations provided to emerging growth companies as it determines what types of disclosure it will provide going forward.

A smaller reporting company will now need to determine whether it also qualifies as an "accelerated filer" or a "large accelerated filer." If it does, going forward, this could impact the timing of when the issuer files its quarterly reports on Form 10-Q and its annual reports on Form 10-K, as those filers have shorter filing deadlines for these reports than smaller reporting companies have. In addition, smaller reporting companies that qualify as accelerated filers or large accelerated filers and that aren't otherwise emerging growth companies need to comply with the auditor attestation requirements on the registrant's internal control over financial reporting. Now that the end of the second quarter has passed for most companies, smaller reporting companies should examine whether they will be accelerated filers or large accelerated filers and plan their future filing schedules and attestation processes accordingly, as late filings can result in the loss of eligibility to use Form S-3.

A company that does not qualify as a smaller reporting company under the existing definition should look closely at the new thresholds to determine whether it is eligible to subsequently become a smaller reporting company. If so, the smaller reporting company should take into account the accommodations made for smaller reporting companies when planning their future SEC filings.

When the SEC adopts new or revised rules, it is not unusual for the staff of the Division of Corporation Finance to issue interpretations to help issuers navigate the new provisions. Smaller reporting companies, under either the existing or the revised definitions, should monitor any developments in this area.

Finally, all issuers, whether or not smaller reporting companies, will need to revise the cover pages of various forms that they file with the SEC after the effective date of the revised rules. For most companies, this change will need to be reflected beginning with the Form 10-Q that is to be filed for the quarter ending September 30, 2018.

For more information about the topics raised in this Legal Update, please contact the author, Michael L. Hermsen, at +1 312 701 7960, any of the following lawyers or any other member of our Corporate & Securities practice.

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Endnotes

1 Amendments to Smaller Reporting Company Definition, Securities Act Release 33-10513, available at https://www.sec.gov/rules/final/2018/33-10513.pdf ("Adopting Release").

2 Amendments to Smaller Reporting Company Definition, Securities Act Release 33-10107, available at https://www.sec.gov/rules/proposed/2016/33-10107.pdf.

3 See Item 308(b) of Regulation S-K.

4 https://www.sec.gov/news/public-statement/statement-piwowar-src-062818

5 https://www.sec.gov/news/public-statement/peirce-statement-smaller-reporting-companies-062818

6 A useful chart summarizing the scaled disclosure accommodations for smaller reporting companies is provided on pages 7 though 9 of the Adopting Release.

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