SEC Adopts Amendments to Accelerated and Large Accelerated Filer Definitions: First Analysis

A Lexis Practice Advisor® Article by
Ryan L. Eickel, Michael L. Hermsen, Anna T. Pinedo, and Laura D. Richman, Mayer Brown LLP

Ryan L. Eickel
Mayer Brown LLP

Michael L. Hermsen
Mayer Brown LLP

Anna T. Pinedo
Mayer Brown LLP

Laura D. Richman
Mayer Brown LLP

Introduction

This First Analysis article discusses the amendments adopted by the U.S. Securities and Exchange Commission (SEC) to the accelerated filer and large accelerated filer definitions in Rule 12b-2 under the Securities Exchange Act of 1934 (Rule 12b-2) (17 CFR 240.12b-2). The final amendments are intended to reduce the number of issuers that qualify as accelerated filers and reduce compliance costs for smaller reporting companies while maintaining investor protections.

As a result of the final amendments, certain low-revenue issuers will not be subject to the Sarbanes-Oxley Act (SOX) Section 404(b) auditor attestation requirements regarding internal control over financial reporting (ICFR). In addition, these low-revenue issuers will not need to comply with the shorter SEC reporting deadlines that apply to accelerated and large accelerated filers.

The final amendments:

- Exclude from the accelerated and large accelerated filer definitions an issuer that qualifies as a smaller reporting company (SRC) under the SRC revenue test (i.e., no revenues or annual revenues of less than $100 million in the most recent fiscal year for which audited financial statements are available), with business development companies being excluded in analogous circumstances
- Increase the transition thresholds for accelerated and large accelerated filers becoming non-accelerated filers and for exiting large accelerated filer status
- Add a revenue test to the transition thresholds for exiting both accelerated and large accelerated filer status
- Add a check box to the cover page of annual reports on Forms 10-K, 20-F and 40-F to indicate whether an ICFR auditor attestation is included in the filing

The final amendments are consistent with the SEC's historical practice of providing scaled disclosure and other

accommodations for smaller issuers and with recent actions by Congress to reduce unnecessary burdens on new and smaller issuers.

For additional information, see Public Company Periodic Reporting and Disclosure Obligations, Periodic and Current Reporting Resource Kit, Smaller Reporting Companies: Disclosure and Reporting Requirements, and Internal Control over Financial Reporting. For more information on the SEC filing deadlines for accelerated and large accelerated filers, see SEC Filing Deadlines (Large Accelerated Filers) (2020), SEC Filing Deadlines (Accelerated Filers) (2020), and SEC Filing Deadlines (Non-Accelerated Filers) (2020).

Background

An important distinction between accelerated and large accelerated filers and non-accelerated filers (such as SRCs) is the requirement that an accelerated or large accelerated filer's independent auditor must attest to, and report on, management's assessment of the effectiveness of the issuer's ICFR. The attestation requirement results in certain costs and burdens for issuers. SOX Section 404(c) exempts issuers that are neither accelerated nor large accelerated filers from the attestation requirement.

In addition, accelerated and large accelerated filers are subject to shorter filing deadlines for quarterly and annual reports than non-accelerated filers. Accelerated and large accelerated filers are also subject to certain additional disclosure requirements.

Issuers subject to the Securities Exchange Act of 1934, as amended (Exchange Act) reporting requirements are classified into various categories, including non-accelerated, accelerated and large accelerated filers, as well as SRCs and emerging growth companies. Under the existing definitions, an issuer is categorized as an accelerated filer if, at the end of its fiscal year:

- The issuer had an aggregate market value of the common equity held by its non-affiliates of $75 million or more, but less than $700 million, as of the last business day of its most recently completed second fiscal quarter.
- The issuer had been subject to the requirements of section 13(a) or 15(d) of the Exchange Act for a period of twelve calendar months.
- The issuer had filed at least one annual report pursuant to section 13(a) or 15(d) of the Exchange Act.

To be a large accelerated filer, an issuer must meet the second and third conditions but have an aggregate market value of common equity held by its non-affiliates of $700 million or more.

In addition to the accelerated and large accelerated filer definitions, Rule 12b-2 currently defines an SRC as an issuer that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a non-SRC parent that:

- Has a public float of less than $250 million –or–
- Has annual revenues of less than $100 million and either no public float or a public float of less than $700 million

If an issuer qualifies as an SRC, it may choose to prepare disclosure relying on scaled disclosure requirements.

In June 2018, the SEC adopted amendments to the SRC definition. Following the adoption of the amendments, some issuers became categorized as both SRCs and accelerated or large accelerated filers. Such issuers have some benefits of scaled regulation but are still required to comply with earlier filing deadlines and the costs and burdens of the ICFR auditor attestation requirement.

In May 2019, the SEC proposed amendments to the accelerated filer and large accelerated filer definitions. Many commenters supported the portion of the proposed amendments that would exclude an issuer that is eligible to be an SRC and that meets the SRC revenue test from the accelerated and large accelerated filer definitions. Other commenters opposed the proposed amendments or suggested the need for further analysis. After considering the comments, the SEC adopted the final amendments as proposed.

Initial Guidance

Below is a summary of the SEC's amendments to the Rule 12b-2 definitions of accelerated filer and large accelerated filer.

Exclusion of Low-Revenue SRCs from Accelerated and Large Accelerated Filer Definitions

The final amendments add a new condition to the definitions of accelerated and large accelerated filer that will exclude from those definitions an issuer eligible to be an SRC under the SRC revenue test. Issuers that are eligible to be SRCs that have a public float between $75 million

and $250 million will not be considered accelerated filers if their annual revenues are $100 million or less. The final amendments also allow business development companies to qualify for this exclusion if they meet the requirements of the SRC revenue test using their annual investment income as the measure of annual revenue, although they will continue to be ineligible to be SRCs.

Under the final amendments, some, but not all, SRCs will become non-accelerated filers, thereby increasing the number of issuers that are exempt from the ICFR auditor attestation requirement. These issuers will be relieved of the costs associated with the attestation requirement, including those related to audit fees. According to the SEC, these compliance costs may be disproportionately burdensome for issuers that are SRCs under the SRC revenue test because they include fixed costs that are not scalable for smaller issuers. Additionally, the compliance costs directly divert funds otherwise available for investment or hiring due to diminished access of SRCs to internally-generated capital.

The SEC expects that the amendments will eliminate compliance costs for SRCs. Specifically, the SEC estimates that an issuer no longer subject to the ICFR auditor attestation requirement will be able to achieve substantial annual savings. These changes could be especially helpful to companies in the biopharmaceutical and technology industries.

The SEC believes that the final amendments are not likely to have a significant effect on the overall ability of investors in the affected issuers to make informed investment decisions, noting that many commenters agreed with this assessment. Issuers have a number of other obligations that the SEC believes will provide sufficient protections for investors in the affected issuers and allow investors in those issuers to make informed investment decisions. These responsibilities derive from the Foreign Corrupt Practices Act (FCPA) requirements with respect to internal accounting controls, as well as other changes to financial reporting introduced by SOX.

The SEC believes that there may be greater costs and relatively lower benefits to including low-revenue issuers, as compared to other issuers, in the accelerated and large accelerated filer definitions. In May 2019, at the open meeting on the proposed amendments, Chairman Jay Clayton noted that the amendments "are aimed at that subset of issuers where the added step of an ICFR auditor attestation is likely to add significant costs and is unlikely to enhance financial reporting or investor protection."

The benefits of the attestation requirement may be smaller for issuers with low revenues for several reasons, including:

- Lower susceptibility to the risk of misstatements, including those related to revenue recognition
- Lower risk of failure to detect and disclose material weaknesses due to less complex financial systems and controls –and–
- Lesser importance of financial statements in assessing issuer valuation

Following the effective date of the final amendments, a non-accelerated filer that meets the SRC revenue test will still be subject to many obligations with respect to the ICFR, including establishing, maintaining, and assessing the effectiveness of ICFR and for management to assess internal controls.

The SEC finds that this benefit to low-revenue SRCs is consistent with its historical practice of providing scaled disclosure and other accommodations for smaller issuers. It is also consistent with recent actions by Congress to reduce burdens on new and smaller issuers, including Title I of the JOBS Act and Section 72002 of the Fixing America's Surface Transportation Act of 2015.

Although the SEC did not propose a requirement that issuers report whether they have obtained an ICFR auditor attestation, the SEC requested comment on whether it should do so. After reviewing comments, the SEC decided to add a check box to the cover page of Forms 10-K, 20-F and 40-F to indicate whether an ICFR auditor attestation is included in the filing. The SEC believes that more prominent and easily accessible disclosure of this information will be useful to investors and market participants while imposing only minimal burdens on issuers. Under the new rule, all issuers will be required to include the check box on their cover pages in any annual report filed on or after the final amendments' effective date.

Increase in Transition Thresholds for Becoming Non-Accelerated Filers and Exiting Large Accelerated Filer Status

The final amendments revise the transition thresholds for issuers exiting accelerated and large accelerated filer status. Currently, once an issuer is an accelerated or a large accelerated filer, it cannot transition to non-accelerated filer status until its public float falls below a threshold that is lower than the public float threshold for initially becoming an accelerated or large accelerated filer. As discussed above, in order to be categorized as an accelerated filer, an issuer must have a public float of $75 million or more,

but less than $700 million, as of the last business day of its most recently completed second fiscal quarter. A large accelerated filer must have a public float greater than $700 million.

In order for an accelerated filer to become a non-accelerated filer, its public float as of the last business day of its most recently completed second fiscal quarter must fall below $50 million, a determination made at the end of the fiscal year. Similarly, a large accelerated filer will become an accelerated filer if its public float falls below $500 million as of the last business day of its most recently completed second fiscal quarter determined at the end of the fiscal year, or it will become a non-accelerated filer if its public float falls below $50 million applying that same test.

The final amendments:

- Increase the public float transition threshold for accelerated and large accelerated filers to become a non-accelerated filer from $50 million to $60 million –and–
- Increase the large accelerated filer public float transition provision from $500 million to $560 million

The SEC expects that these increases in the transition thresholds will limit the number of cases in which an issuer would qualify as both an SRC and either an accelerated filer or large accelerated filer. Additionally, by increasing the transition thresholds, the public float transition thresholds will be 80% of the initial thresholds, which is consistent with the recent amendments to the SRC transition thresholds. Thus, the transition thresholds across the SRC, accelerated filer, and large accelerated filer definitions will be in alignment. The SEC believes this approach appropriately balances the risk of frequent reclassifications resulting from a higher percentage threshold against the risk of delaying appropriate transitions due to a lower threshold.

Addition of Revenue Test to Transition Thresholds for Exiting Accelerated and Large Accelerated Filer Status

The final amendments add the SRC revenue test to the public float transition thresholds for accelerated and large accelerated filers. Following the effective date of the amendments, an issuer will exit large accelerated filer status and become an accelerated filer if its public float falls to less than $560 million but more than $60 million. It will become a non-accelerated filer if its public float falls below $60 million or if its annual revenues fall below the applicable revenue threshold to become eligible to use the SRC accommodations.

Similarly, an issuer will exit accelerated filer status and become a non-accelerated filer if its public float falls below $60 million or it meets the revenue test of the SRC definition.

If the SRC revenue test were not added to the accelerated filer and large accelerated filer transition thresholds, then an issuer's revenues would not be considered in determining:

- Whether an accelerated filer could become a non-accelerated filer –or–
- Whether an issuer could exit its large accelerated filer status

In response to a comment received, the SEC noted that providing transition thresholds will mitigate any concerns as to whether the manner in which issuers recognize revenue will cause them to frequently lose and gain non-accelerated filer status.

Looking Ahead

The effective date of the final amendments is April 27, 2020, and the final amendments will apply to an annual report filing due on or after the effective date. The public float test for accelerated filer and large accelerated filer status is determined as of the last day of the issuer's most recently completed second fiscal quarter. For calendar year end SRC's, eligibility will be determined as of June 30, 2020. SRC's that will no longer be accelerated filers or large accelerated filers, should be able to immediately revise their audit plans for the remainder of the year and be in a position to redeploy assets that would have been used on an ICFR audit for other operating purposes.

Ryan L. Eickel, Associate, Mayer Brown LLP

Ryan Eickel is an associate in Mayer Brown's New York office and a member of the Corporate & Securities practice. He advises issuers, investment banks, sponsors and investors in both public and private placements of equity and debt securities, including initial public offerings, follow-on offerings, tender and exchange offers, at-the-market offerings, medium and senior term note programs, investment-grade debt offerings and other capital markets transactions.

Prior to joining Mayer Brown, Ryan was a lawyer at another international law firm and a consultant in the financial services risk and regulatory practice of a major international accounting firm. While attending The George Washington University Law School, Ryan was an associate on The George Washington Law Review and a judicial intern for Judge William W. Nooter of the Superior Court of the District of Columbia.

Michael L. Hermsen, Partner, Mayer Brown LLP

Mike Hermsen is a partner in Mayer Brown's Corporate & Securities Group. Mike has an extensive practice that focuses on securities matters, including the representation of issuers in securities offerings and liability management transactions, corporate clients in connection with compliance, reporting and stock exchange matters and companies, boards of directors and management on, among other things, corporate governance matters and executive compensation disclosures and reporting. Mike has been included in The Best Lawyers in America in the practice areas of Securities/Capital Markets Law and Securities Regulation for over a decade and Legal 500 recommends Mike in "Capital Markets – Equity Offerings" noting Mike has "unsurpassed knowledge of SEC rules." In addition, Mike is frequently cited in the media regarding new regulatory initiatives.

Anna T. Pinedo, Partner, Mayer Brown LLP

Anna Pinedo is a partner in Mayer Brown's New York office and a member of the Corporate & Securities practice. She concentrates her practice on securities and derivatives. Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products.

She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including technology, telecommunications, healthcare, financial institutions, REITs and consumer finance. Anna has worked closely with foreign private issuers in their securities offerings in the United States and in the Euro markets. She also works with financial institutions in connection with international offerings of equity and debt securities, equity- and credit-linked notes, and hybrid and structured products, as well as medium term note and other continuous offering programs.

In the derivatives area, Anna counsels a number of major financial institutions acting as dealers and participants in the commodities and derivatives markets. She advises on structuring issues as well as on regulatory issues, including those arising under the Dodd-Frank Act. Her work focuses on foreign exchange, equity and credit derivatives products, and structured derivatives transactions. Anna has experience with a wide range of transactions and structures, including collars, swaps, forward and accelerated repurchases, forward sales, hybrid preferred stock and off-balance sheet structures. She also has advised derivatives dealers regarding their Internet sites and other Internet and electronic signature/delivery issues, as well as on compliance matters.

Laura D. Richman, Counsel, Mayer Brown LLP

Laura Richman's wide-ranging corporate and securities practice has a strong focus on corporate governance issues and public disclosure obligations. Laura's practice includes Securities and Exchange Commission reports, such as proxy statements and annual, quarterly and current reports. She advises on executive compensation disclosure, insider trading regulation and Dodd-Frank and Sarbanes-Oxley compliance. Laura represents listed company clients with respect to stock exchange compliance matters. She advises clients on governance policies and other board and shareholder matters. In addition, her practice includes representing clients on transactions such as securities offerings and mergers and acquisitions, as well as providing general securities, corporate, limited liability company and contract advice. Laura has practiced with Mayer Brown since 1981.

With regard to securities transactions, Laura represents issuers and underwriters in public and private offerings of debt and equity securities (both initial public offerings and offerings of seasoned, public companies), including guidance on federal and state securities law compliance. She also advises issuers in connection with the securities law aspects of employee benefit plans and dividend reinvestment plans.

Other transactional matters in which Laura represents corporate clients include acquisitions and dispositions of assets or stock, restructurings (such as holding company formation) and going-private transactions. She also advises investors in leveraged buyout transactions, and represents financial institutions that take equity positions in companies. Laura advises clients on shareholder rights plans and anti-takeover protection provisions.

In addition to her governance and transactional practice, Laura counsels clients on day-to-day corporate questions. She drafts and reviews contracts and other corporate documentation, prepares terms and conditions of sale, provides guidance on limited liability company and other limited liability entity issues, and assists clients with various regulatory issues. Laura was named an Illinois Super Lawyer for Business/Corporate in 2006 and 2008.