

Client Update

SEC Adopts Final Rules Reflecting JOBS Act Changes to Registration Requirements

NEW YORK

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Last week, the SEC adopted final rule amendments implementing changes to the requirements for registration and termination of registration under Section 12(g) of the Exchange Act and the suspension of reporting obligations under Section 15(d) of the Exchange Act mandated by the JOBS Act and the FAST Act. Among other things, the amendments:

- reflect a higher threshold—2,000 holders of record or 500 holders of record that are not “accredited investors”—for registration, termination of registration and suspension of reporting;
- revise the definition of “held of record” for purposes of determining registration requirements under Exchange Act Section 12(g) to permit the exclusion of certain securities held by persons who received them pursuant to employee compensation plans (or in exchange for such securities);
- establish a nonexclusive safe harbor for determining securities “held of record” for purposes of Rule 12g5-1; and
- reflect revised thresholds for registration, termination of registration and suspension of reporting for banks, bank holding companies and savings and loan holding companies.

When a private company is required to register a class of equity securities under Section 12(g), it essentially goes public without the benefit of an IPO. The JOBS Act provisions are intended to provide greater flexibility to pre-IPO companies to issue equity securities, particularly under employee compensation arrangements, without triggering Exchange Act registration and reporting requirements.

The final rules generally align with the proposed rules issued by the SEC in December 2014, however there are some developments. Notably, the final rules are more favorable than the proposed rules in that securities received in an unregistered exchange for previously exempt securities continue to be entitled to

use the exemption. Companies that are considering thresholds for registration, termination of registration and suspension of reporting should consider these revised rules carefully. The SEC's adopting release is available at <http://www.sec.gov/rules/final.shtml>. The JOBS Act provisions became effective immediately; the implementing rule changes will become effective 30 days after publication in the Federal Register.

HIGHER REGISTRATION THRESHOLDS UNDER RULES 12G AND 12H

Under Exchange Act Section 12(g)(1), issuers had been required to register a class of equity securities if, at the end of the most recent fiscal year, the issuer had more than \$10 million in total assets and a class of equity securities "held of record" by 500 or more persons. The JOBS Act raised the holders threshold of Section 12(g)(1) to either 2,000 holders of record or 500 holders of record that are not "accredited investors." The threshold in Section 12(g)(4) for termination of registration and in Section 15(d)(1) for suspension of reporting remains at 300 holders of record.

To rely on the higher JOBS Act threshold, an issuer must be able to determine which of its holders are accredited investors and must make such determination as of the last day of the issuer's most recent fiscal year, as opposed to at the time of sale of the securities. As a result, issuers will need to determine annually, based on facts and circumstances, whether prior information (*i.e.*, information provided at the time of sale) provides a basis for a reasonable belief that the security holder continues to be an accredited investor. The SEC did not provide additional guidance with respect to processes and procedures for establishing a holder's accredited investor status. However, the release does indicate that reliance on determinations made in offerings within three months of year-end or on self-certifications provided more than three but less than twelve months prior to year-end, could provide a reasonable basis, depending upon the facts and circumstances. The final rules apply the definition of "accredited investor" in Rule 501(a) of the Securities Act to determinations of record holder status for purposes of Exchange Act Section 12(g)(1).

In accordance with the JOBS Act, the SEC also amended its rules to include updated reporting thresholds for banks and bank holding companies, as defined in Section 2 of the Bank Holding Company Act of 1956, and to include comparable thresholds for savings and loan holding companies, as defined in Section 10 of the Home Owners' Loan Act. Among other things, any such issuer:

- is required to register a class of equity securities pursuant to Section 12(g)(1) if, on the last day of its most recent fiscal year, it had total assets of more

than \$10 million and a class of equity securities held of record by 2,000 or more persons; and

- may terminate registration of a class of securities under Section 12(g)(4) or suspend reporting under Section 15(d)(1), if that class is held of record by less than 1,200 persons.

SHARES EXCLUDED FROM THE "HELD OF RECORD" DEFINITION

The JOBS Act instructed the SEC to revise the definition of "held of record" under Section 12(g)(5) to provide that securities held by persons who received them pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act may be excluded for the purposes of calculating the number of holders of record of a class of equity securities for purposes of registration under Section 12(g)(1).

Under amended Exchange Act Rule 12g5-1, solely for the purposes of determining whether an issuer is required to register a class of equity securities under Section 12(g)(1), the issuer may exclude securities that are:

- held by persons who received the securities pursuant to an employee compensation plan in transactions exempt from, or otherwise not subject to, the registration requirements of Section 5 of the Securities Act; or
- in certain circumstances, held by persons who received the securities in exchange for securities originally received under an employee compensation plan, as long as the persons were eligible to receive securities pursuant to Rule 701(c) at the time the excludable securities were originally issued to them.

Securities held by employees of foreign issuers must, however, be counted for purposes of determining the issuer's foreign private issuer status.

The exemption does not define employee compensation plan, but provides a nonexclusive safe harbor for securities issued to and held by persons who meet the participant requirements under an arrangement that falls within the definition of a "compensatory benefit plan" under Rule 701, as well as to their Rule 701 permitted family member transferees. Rule 701 permits companies to offer their own securities to employees, directors, general partners, trustees, officers and certain consultants pursuant to a "compensatory benefit plan," broadly defined to include "any purchase, savings, option, bonus, stock appreciation, profit sharing, thrift, incentive, deferred compensation, pension or similar plan," without having to comply with Securities Act registration requirements.

The rules also clarify and broaden the JOBS Act exclusion to apply to securities issued to employees in any other transaction that does not require registration, including so-called “no sale” issuances, as well as in offerings that are exempt from Securities Act registration requirements.

In a welcome change, the SEC has added a new provision to facilitate the ability to conduct restructurings, business combinations and similar transactions by allowing the exemption to continue to apply to securities received in substitution or exchange for previously excludable securities in a transaction exempt from, or not subject to, the registration requirements when received from the original issuer, a predecessor or an acquired company, as long as the persons receiving the securities were eligible to receive the surrendered or exchanged securities pursuant to Rule 701 at the time of the original issuance. This will allow the continued exclusion of securities held by former employees and family members following the transaction.

The SEC also established a nonexclusive safe harbor that allows an issuer, solely for the purposes of Section 12(g), to deem the securities to have been issued in a transaction exempt from, or not subject to, the registration requirements of Section 5 of the Securities Act if the issuer had a reasonable belief at the time of the issuance that the securities were issued in such a transaction. The safe harbor is available for holders of securities received in employee compensation plan transactions, such as securities issued under Section 4(a)(2), Regulation A or Regulation D, so long as they meet the compensation plan, issuer and participant conditions of Rule 701(c), regardless of whether they meet any other conditions of Rule 701. The release notes that the safe harbor is intended to provide issuers with relief from the burden of establishing that earlier issuances of securities satisfied an appropriate exemption on an annual basis as long as the issuer had a reasonable belief that it had complied with registration requirements, or an appropriate exemption, at the time of issuance.

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Please do not hesitate to contact us with any questions.