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Alert
SEC Disclosure and Corporate Governance

SEC Proposes Rule Amendments to Implement JOBS Act Mandate for Exchange Act Registration

Last week, the Securities and Exchange Commission (SEC) proposed rules to implement Title V and Title VI of the Jumpstart Our Business Startups Act (the JOBS Act).[1] Specifically, the SEC proposed to revise the rules governing registration, termination of registration and suspension of reporting under the Securities Exchange Act of 1934 (the Exchange Act) to reflect the new thresholds set forth in the JOBS Act.[2]

Background: Title V and Title VI of the JOBS Act

The JOBS Act amended Sections 12(g) and 15(d) of the Exchange Act to adjust the thresholds for registration, termination of registration and suspension of reporting. Specifically, Title V of the JOBS Act increased the registration threshold by amending Section 12(g)(1) of the Exchange Act to require an issuer, other than a bank or bank holding company, to register a class of equity securities within 120 days after its fiscal year end if, on the last day of its fiscal year, the issuer had total assets of more than $10 million and the class of equity securities was "held of record" by at least either (i) 2,000 persons, or (ii) 500 persons who are not accredited investors.

For banks and bank holding companies, Title VI of the Act increased the record holder threshold to 2,000 without regard to the number of non-accredited investors. Title VI of the JOBS Act also relaxed the "exit" requirements of both Section 12(g)(4) (termination) and Section 15(d) (suspension) of the Exchange Act for banks and bank holding companies by permitting these companies to exit the Exchange Act reporting system if the number of record holders dropped below 1,200 (up from the pre-JOBS Act threshold of 300).

The JOBS Act also amended the definition of "held of record" to exclude securities held by persons who received them pursuant to an "employee compensation plan" in transactions exempted from registration, and instructed the SEC to create a safe harbor for issuers when making that determination.

Overview of the Proposed Rule Amendments

The proposed amendments would implement the mandate of the JOBS Act by:

- Amending the Exchange Act rules that govern the mechanics relating to registration, termination of registration under Section 12(g) and suspension of reporting obligations under Section 15(d) to reflect the new holder of record thresholds set forth in the JOBS Act.
- Revising the rules to apply the same increased registration, termination of registration and suspension of reporting thresholds for banks and bank holding companies to savings and loan holding companies.
- Applying the definition of "accredited investor" in Rule 501(a) of the Securities Act of 1933 (the Securities Act) to determinations as to which record holders are accredited investors for purposes of Exchange Act Section 12(g)(1).
- Amending the definition of "held of record," in determining whether an issuer is required to register a class of equity securities pursuant to Exchange Act Section 12(g)(1), to exclude securities that are either:
  - Held by persons who received them under an employee compensation plan in transactions exempt from Securities Act registration or that did not involve a "sale"; or
  - In certain circumstances, held by persons who received them in exchange for securities received under an employee compensation plan.
- Proposing a non-exclusive safe harbor under which a person will be deemed to have received the securities pursuant to an "employee compensation plan" that relies on the current definition of "compensatory benefit plan" in Securities Act Rule 701 and the conditions of Rule 701(c).

"Accredited Investor" Determination – familiar definition but new timing with respect to testing

As noted above, the JOBS Act provides an increased threshold for the purposes of Exchange Act Section 12(g)(1) registration for holders of record that are accredited investors. The SEC did not propose to establish a new definition of "accredited investor," but instead proposed that the existing definition of accredited investor in Securities Act Rule 501(a) apply in making determinations under Exchange Act Section 12(g)(1). However, the "accredited investor" determination under 12(g)(1) would be made as of the last day of the fiscal year rather than at the time of the sale of the securities.

After an issuer completes its offering and has sold securities to purchasers who have been determined to be accredited investors, the issuer is not otherwise required to periodically assess an investor's continued status as an accredited investor. However, under the proposed rule amendments, the issuer will be required to update its information as to status of its investors as of the end of the fiscal year for purposes of determining whether a class of securities must be registered under Exchange Act Section 12(g)(1). While recognizing that issuers may have difficulty determining whether existing security holders are accredited investors for purposes of the Section 12(g)(1) threshold, the SEC rejected the suggestion of permitting issuers to rely on information previously provided by these security holders in connection with the purchase or transfer of securities, concerned that such reliance could result in the use of outdated information.

"Held of Record" Amendments – extend beyond the mandate of the JOBS Act

The proposed rules would amend the definition of "held of record" to provide that when determining whether an issuer is required to register a class of equity securities pursuant to Exchange Act Section 12(g)(1), the issuer may exclude securities that are either:

- Held by persons who received them under 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;[3] or

- Held by persons eligible to receive securities from the issuer pursuant to Securities Act Rule 701(c) who acquired the securities in exchange for securities excludable under the proposed definition.

Impact on restructurings and business combinations

By proposing to exclude from the "held of record" definition securities held by persons who received them in exchange for securities received under an employee compensation plan, the SEC intended to facilitate the ability of an issuer to conduct restructurings, business combinations and similar transactions that are exempt from Securities Act registration. Thus, if the securities being surrendered in such a transaction would not have been counted under the proposed definition of "held of record," the securities issued in the exchange also would not be counted under this definition. The securities issued in the exchange would be deemed to have a compensatory purpose because they would replace other securities previously issued pursuant to an employee compensation plan.

Non-Exclusive Safe Harbor and "Employee Compensation Plan" Definition

The JOBS Act amended Exchange Act Section 12(g)(5) to exclude from the definition of "held of record" 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, and instructed the SEC to create a safe harbor for issuers when making that determination. However, the Act did not include a definition of "employee compensation plan." Without further guidance after the enactment of the JOBS Act, some practioners took to including language in Rule 701 compensatory benefit plans specifically stating that such plans are intended to qualify as an "employee compensation plan" within the meaning of Section 12(g)(5) of the Exchange Act. However, the proposed rule amendments include a non-exclusive safe harbor under proposed Rule 12g5-1(a)(7) that would provide that a person will be deemed to have received the 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).

An issuer would be able to rely on the safe harbor for determining the holders of securities issued in reliance on Securities Act Rule 701, as well as holders of securities issued in transactions otherwise exempted from, or not subject to, the registration requirements of the Securities Act that satisfy the conditions of Rule 701(c), even if all the other conditions of Rule 701 (such as issuer eligibility in Rule 701(b)(1), the volume limitations in Rule 701(d) or the disclosure delivery provisions in Rule 701(e)) were not met. Thus, the safe harbor would be available for holders of securities received in other employee compensation plan transactions exempted from, or not subject to, the registration requirements of Section 5 of the Securities Act – e.g., securities issued in reliance on Securities Act Section 4(a)(2), Regulation D of the Securities Act, or Regulation S of the Securities Act, that meet the conditions of Rule 701(c).

Those eligible to rely on the safe harbor

The safe harbor would be available for the plan participants enumerated in Rule 701(c), including employees, directors, general partners, trustees, officers and certain consultants and advisors. The safe harbor also would be available for permitted family member transferees with respect to securities acquired by gift or domestic relations order, or securities acquired by them in connection with options transferred to them by the plan participant through gifts or domestic relations orders.

However, because the safe harbor would be limited to holders who are persons specified in Rule 701(c) who received the securities under specified circumstances, once these persons subsequently transfer the securities, whether or not for value, the securities would need to be counted as held of record by the transferee for purposes of determining whether the issuer is subject to the registration and reporting requirements of Exchange Act Section 12(g)(1).

Foreign private issuers

Foreign private issuers would also be able to rely on the safe harbor when making their determination of the number of U.S. resident holders under Exchange Act Rule 12g3-2(a).[4]

The SEC will seek public comment on the proposed rule amendments for a period of 60 days following their publication in the Federal Register.

ENDNOTES

1. H.R. 3606, *available at* http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.
2. The proposing release is available at: http://www.sec.gov/rules/proposed/2014/33-9693.pdf.
3. The SEC noted that although the JOBS Act specifically refers to "transactions exempted" from the Securities Act Section 5 registration requirements, many issuers issue securities to employees without Securities Act registration on the basis that the issuance is not a "sale" under Section 2(a)(3) of the Securities Act and therefore do not trigger the registration requirement of Securities Act Section 5. While not technically "transactions exempted from the registration requirements of Section 5," the SEC believes that such "no sale "issuances are similar to other compensatory issuances to employees in exempt transactions in that the issuer provides the awards to employees for a compensatory purpose, and, as such, should be similarly excluded from the "held of record" determination.
4. Under Rule 12g3-2(a), foreign private issuers that meet the asset and shareholder threshold of Section 12(g) are exempt from registering any class of securities under that section if the class of securities is held by fewer than 300 holders resident in the United States. For purposes of determining whether this threshold is met, Rule 12g3-2(a)(1) specifies that the method shall be as provided in Exchange Act Rule 12g5-1, subject to specific provisions relating to brokers, dealers, banks and nominees. Because the rule directs issuers to the definition of "held of record" in Rule 12g5-1, the SEC determined that statutory changes to Section12(g)(5) and the proposed changes to Rule 12g5-1 would apply to a foreign private issuer's Rule 12g3-2(a) analysis.

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If you have any questions on these matters, please do not hesitate to speak to your regular contact at Weil, Gotshal & Manges LLP or to any member of Weil's Public Company Advisory Group:

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