



Legislative Action on Exchange Act Registration Thresholds

On June 14, 2011, Representative David Schweikert (R-AZ) introduced a bill in the U.S. House of Representatives that would raise the threshold for mandatory registration under the Securities Exchange Act of 1934 (the “Exchange Act”) from 500 persons holding equity securities of record to 1,000 persons for all companies.¹ This bill would also exclude accredited investors and securities held by persons who received such securities pursuant to employee compensation plans from counting against the 1,000-record holder threshold.

Representative Jim Himes (D-Conn.) and Steve Womack (R-Ark.) introduced a related bill in the House on May 24, 2011.² The Himes-Womack bill is nearly identical to a bill introduced in the Senate on March 10, 2011 by Senators Kay Bailey Hutchinson (R-Texas) and Mark Pryor (D-Ark.).³ These bills seek to amend Section 12(g) of the Exchange Act by raising the threshold that triggers registration from 500 to 2,000 record holders if the issuer is a bank or a bank holding company. The bill would also modify the threshold for deregistration under Sections 12(g) and 15(d) of the Exchange Act in the case of a bank or a bank holding company from 300 to less than 1,200 shareholders.

Background

Section 12(g) of the Exchange Act requires issuers to register a class of equity securities with the Securities Exchange Commission (“SEC”) if, on the last day of the issuer’s fiscal year, such class of securities is held of record by 500 or more record holders and the company has total assets of more than \$10 million.⁴ After a company has registered under Section 12(g), all of the reporting requirements under the Exchange Act apply; therefore, a company would need to file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements on Schedule 14A, and certain persons would be required to report transactions on Forms 3, 4 and 5 and Schedules 13D and 13G.⁵ A company can deregister a class of equity securities under Section 12(g), when such class of equity securities is held of record by less than 300 persons, or by less than 500 persons and the total assets of the issuer has not exceeded \$10 million on the last day of each of the issuer’s three most recent fiscal years.

¹ H.R. 2167. See <http://www.gpo.gov/fdsys/pkg/BILLS-112hr2167ih/pdf/BILLS-112hr2167ih.pdf>.

² H.R. 1965. See <http://www.gpo.gov/fdsys/pkg/BILLS-112hr1965ih/pdf/BILLS-112hr1965ih.pdf>.

³ S. 556. See <http://www.gpo.gov/fdsys/pkg/BILLS-112s556is/pdf/BILLS-112s556is.pdf>.

⁴ While section 12(g) provides for a \$1 million threshold, Rule 12g-1 provides an exemption from the mandatory registration provisions of Section 12(g) for companies with assets of \$10 million or less.

⁵ Foreign private issuers are subject to less burdensome disclosure requirements. A foreign private issuer is required to file annual reports on Form 20-F, and quarterly and current reports on Form 6-K if such information is required to be made public in its home jurisdiction. A foreign private issuer is also exempt from the proxy solicitation requirements and its insiders are not required to report transactions on Forms 3, 4 and 5.

Prior to 1964, only listed companies were required to comply with the Exchange Act registration, reporting, proxy solicitation and other requirements. Section 12(g) of the Exchange Act was added in amendments to the Exchange Act in 1964.⁶ The purpose of the amendments, as stated in the preamble, was “to extend disclosure requirements to the issuers of additional publicly traded securities.”⁷ The legislative history indicates that the purpose of adding this section was to extend the registration and disclosure requirements to issuers whose securities trade in the over-the-counter market were comparable to the registration and disclosure requirements of listed issuers. The amendments had the effect of increasing investor confidence in issuers whose securities trade in the over-the-counter market and allowed such companies to access the capital markets with greater ease.

In the 1980s, the SEC raised the asset threshold incrementally to \$5 million and then, in 1996, it was raised to the current level of \$10 million.⁸ There have been no subsequent changes to the Section 12(g) registration and deregistration threshold. Consistent with congressional intent, the SEC stated that the numerical thresholds that mandate registration under Section 12(g) were directed toward issuers that had active trading markets and public interest of a level sufficient to warrant mandatory disclosure to ensure the protection of investors.⁹

The Proposed Legislation

The Schweikert bill seeks to amend Section 12(g) of the Exchange Act by raising the registration threshold to 1,000 holders of record of a class of equity securities. The bill would also exclude accredited investors and securities held by persons who received such securities pursuant to employee compensation plans from counting against the 1,000-record holder threshold.

The Himes-Womack bill would amend Section 12(g) by modifying the threshold that triggers Section 12(g) registration to 2,000 holders of record of a class of equity securities if the issuer is a bank or a bank holding company. The bill preserves the 500 holders of record threshold for all other companies, and raises the deregistration threshold for a bank or a bank holding company from 300 to 1,200 holders of record.

The Himes-Womack bill also directs the Chief Economist and the Director of the Division of Corporation Finance of the SEC to jointly conduct a study, including a cost-benefit analysis, of shareholder registration thresholds. The cost-benefit analysis must weigh the benefits to investors of the increased disclosure relative to the costs to issuers as a result of registration and examine the administrative costs to the SEC that are associated with different thresholds. In conducting the study, the Chief Economist and the Director of the Division of Corporation Finance must evaluate whether to increase the asset threshold, index the asset threshold to inflation, increase the shareholder threshold, change the shareholder threshold to be based on beneficial ownership or to create thresholds based on other criteria. The Chief Economist and the Director of the Division of Corporation Finance are required to submit a report and a recommendation to Congress within two years.

Time for Reform?

The proposed bills come at a time when there have been other attempts at amending Section 12(g). For example, the impact of regulations, including the 500 holder of record threshold in Section 12(g) of the Exchange Act, was recently put in the spotlight by correspondence between Congressman Darrell Issa (R-CA), Chairman of the House Committee on Oversight and Government Reform, and Mary Schapiro, Chairman of the SEC.¹⁰ Subsequently, Chairman Schapiro also testified on May 10, 2011, before the U.S. House of Representatives Committee on Oversight and Government Reform on the impact of regulations, including the shareholder

⁶ Securities Acts Amendments of 1964, Pub. L. 88-467; 78 Stat. 565 (referencing Section (3), which added Exchange Act Section 12(g)).

⁷ See *id.*

⁸ Release No. 34-37157 (May 1, 1996).

⁹ Release No. 34-23407 (July 8, 1986).

¹⁰ Our client memorandum on this topic is available at <http://www.mofo.com/files/Uploads/Images/110420-US-Capital-Raising-in-the-Spotlight.pdf>.

thresholds under Section 12(g), on the future of capital formation in the U.S.¹¹ Chairman Schapiro also recently instructed her staff to review the impact of regulations on capital formation for small businesses, focusing on a number of areas, including the number of shareholders that trigger public reporting. Chairman Schapiro indicated that this review will include an evaluation of the recommendations of the annual SEC Government-Business Forum on Small Business Capital Formation. The SEC has also created an email box for suggestions for reform on their website located at <http://www.sec.gov/spotlight/regulatoryreviewcomments.shtml>. Chairman Schapiro indicated that the SEC will also consider recommendations from a new Advisory Committee on Small and Emerging Companies.

Securities markets have changed significantly since the enactment of the 1964 amendments to Section 12(g), and while the Commission has increased the asset thresholds, it has not made any corresponding changes to the holder of record thresholds under this section. Privately held companies may have less than 500 record holders but can still have actively traded securities on the secondary markets. In the case of public companies, the vast majority of securities are held in street name. Brokers, who typically own large positions in companies, are counted as one record holder. In contrast, in smaller private companies, shares are held directly and all holders are counted for purposes of Section 12(g).

Raising the registration threshold would benefit private companies and secondary trading markets. Private companies would more easily avoid the reporting requirements that come with mandatory SEC registration under Section 12(g), and some companies would stay private longer if they were not subject to the registration provisions of the Exchange Act as a result of the number of holders of record of their equity securities. The existence of more, growing private companies could potentially invigorate secondary trading markets, which provide shareholders of private companies with access to liquidity prior to going public through an IPO or due to the mandatory registration provisions of Section 12(g).

The Senate Bill was referred to the Senate Committee on Banking, Housing, and Urban Affairs on March 10, 2011, but the Committee has not scheduled hearings on the bill.¹² The House bills were likewise referred to the House Committee on Financial Services. Similar bills amending the registration thresholds were also proposed in 2007, and the relevant committees took no action on either bill.¹³ An amendment identical to the Himes-Womack Bill was introduced to the 2010 Dodd-Frank bill, but was not considered nor adopted as part of that legislation.¹⁴ Without concerted effort by the bills' sponsors and advocates, the current bills may meet the same fate as earlier legislative attempts at addressing the Exchange Act registration threshold.

Contact

Anna T. Pinedo
(212) 468-8179
apinedo@mof.com

¹¹ SEC Chairman Mary Schapiro's Testimony before the U.S. House of Representatives Committee on Oversight and Government Reform on the Future of Capital Formation. See <http://sec.gov/news/testimony/2011/ts051011mls.htm>.

¹² Nor has further action yet been taken on H.R. 1965, which was referred to the House Financial Services Committee on May 26, 2011, or H.R. 2167, which was referred to the same committee on June 14, 2011.

¹³ The 2007 reform attempts were S. 1405 and H.R. 1869 (109th Congress).

¹⁴ Sen. Hutchison introduced the amendment. See S. Res. 3833 (110th Congress), 156 Cong. Rec. 3262.

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