



SEC ADVISORY
COMMITTEE ON SMALL
AND EMERGING BUSINESSES



OCTOBER 31, 2011
MULTIPURPOSE ROOM
9:00 AM-5:00 PM

Overview of Issues



- These slides have been prepared by the SEC Staff as background for the Advisory Committee. Statements do not necessarily reflect the views of the Commission.

Triggers for Public Reporting



- **Section 12(g) of the Exchange Act requires a company to register its securities with the SEC if its securities are “held of record” by 500 or more persons and the company has “total assets” exceeding \$10 million.**

Triggers for Public Reporting



- Section 12(g) was adopted in 1964 following a rigorous special study of the securities markets in the early 1960s, commissioned by Congress and conducted by the SEC.

Triggers for Public Reporting



- Following adoption of Section 12(g), the Commission adopted a rule defining the term “held of record.”
- The definition of “held of record” counts as holders of record only persons identified as owners on records of security holders maintained by the company, or on its behalf, in accordance with accepted practice.

Triggers for Public Reporting



- Securities markets have changed significantly since the 1960s.
- Today, most securities of publicly-traded companies are held in nominee or “street name” rather than directly by the owner.
- This means that for most publicly-traded companies, much of their individual shareholder base is not counted under the current definition of “held of record.”

Triggers for Public Reporting



- All shareholders of most private companies, who generally hold their shares directly, are counted as “holders of record” under the definition.
- This has required private companies that have more than \$10 million in total assets and that cross the 500 record holder threshold – where the number of record holders is actually representative of the number of shareholders – to register and commence reporting.

Triggers for Public Reporting



- At the same time, it has allowed a number of companies, many of whom likely have substantially more than 500 shareholders, to stop reporting, or “go dark,” because there are fewer than 500 “holders of record” due to the fact that the companies’ shares are held in street name.
- In light of these issues, some have called for changes to the definition and threshold adopted pursuant to Section 12(g).
- There are four currently pending bills in the House and Senate relating to the Section 12(g) thresholds.

Triggers for Public Reporting



- To facilitate the Commission's review of the issues related to the thresholds for public reporting (and those for leaving the reporting system), the Chairman has asked the staff to undertake a robust study like the one conducted when Section 12(g) was enacted.
- The rapid growth of organized markets for pre-IPO company common stock, and the participation in those markets of single stock funds as investors, also raises interesting policy questions impacting our Section 12(g) study and analysis.

Scaling of Regulations



- The SEC first adopted an integrated scaled disclosure system for small business in 1992.
- In 2007, the SEC adopted a number of regulatory changes intended to simplify and ease the burdens of regulations that affect smaller companies.
- This included establishing category of “smaller reporting companies” – companies that have less than \$75 million in public float (or if the company cannot calculate public float, less than \$50 million in revenue) – eligible to provide scaled disclosure.

Scaling of Regulations



- There are other scaled or phased-in requirements in SEC rules that apply to newly-public companies, such as phase-in of Sarbanes-Oxley 404(a) and 404(b) requirements.
- For the most part, the general disclosure requirements for newly-public companies are the same as for all public companies.

Capital Raising Strategies



- **Crowdfunding:**
 - Generally, a form of capital raising whereby groups of people pool money, typically comprised of very small individual contributions, to support an effort by others to accomplish a specific goal.
- **Interest in crowdfunding as a capital raising strategy that could offer investors an ownership interest in a developing business is growing.**

Capital Raising Strategies



- Proponents of crowdfunding note that current technology could allow small business owners to easily access a large number of possible investors as a source of funding to help grow and develop their businesses or ideas.
- The proponents are advocating for exemptions from the Securities Act registration requirements for crowdfunding transactions.
- However, an exemption from registration -- and the investor protections provided by registration -- may present opportunities for fraud.

Capital Raising Strategies



- A House bill to permit certain crowdfunding, has passed the House Financial Services Committee.

Capital Raising Strategies



- **Regulation A:**
 - Provides an exemption from registration for transactions by non-reporting companies of up to \$5 million per year.
 - Requires an offering document to be filed with the SEC.
 - Allows companies to “test the waters” for interest in their offerings.
 - Permits a public offering.
 - Securities purchased are not restricted securities.
 - Companies that complete Regulation A offerings do not automatically become subject to ongoing reporting under the Exchange Act.
 - No state preemption.

Capital Raising Strategies



- **Regulation A is not widely used.**
 - In Fiscal 2010, there were 25 initial Regulation A filings with the SEC and seven Regulation A offerings were qualified.
- **Bills have been introduced in both the Senate and the House that would require the Commission to create a new exemption, which would be similar to Regulation A, but with certain additional conditions and a higher offering limit.**

Restrictions on General Solicitation



- One of the most commonly-used exemptions from the registration requirements of the Securities Act is Section 4(2), which exempts transactions by an issuer “not involving any public offering.”
- Rule 506 is a safe harbor under Section 4(2).
- Currently, an issuer seeking to rely on Section 4(2) or Rule 506 is generally subject to a restriction on the use of general solicitation or advertising to attract investors for its offering.
- The restriction was designed to protect those who would benefit from the safeguards of registration from being solicited in connection with a private offering.

Restrictions on General Solicitation



- Some believe that these restrictions are unnecessary because offerees who might be located through a general solicitation but who do not purchase the security -- either because they do not qualify under the terms of the exemption or because they choose not to purchase -- would not be harmed by the solicitation.
- Others support the restriction on general solicitation because it makes it more difficult for fraudsters to find potential victims or for unscrupulous issuers to condition the market for their securities.

Restrictions on General Solicitation



- The Chairman asked the staff to review the restrictions our rules impose on general solicitation in private offerings.
- A bill has been passed by the House Committee on Financial Services that would permit general solicitation in offerings under Rule 506 of Regulation D, so long as all of the purchasers are accredited investors.