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Proposed Amendments to “Smaller Reporting Company” Definition

SEC’s Proposal Would Substantially Expand the Number of Registrants That Qualify as Smaller Reporting Companies

SUMMARY

The SEC has proposed amendments to the definition of “smaller reporting company” (SRC) as used in the SEC’s rules and regulations. These amendments would substantially expand the number of registrants qualifying as SRCs by increasing the financial thresholds that registrants must meet to obtain SRC status. Under the proposed rules, registrants with less than \$250 million in public float (increased from \$75 million) would qualify as SRCs, as would registrants with zero public float if their revenues were below \$100 million in the previous year.

The proposed amendments to the definition of SRC are available on the SEC’s website at <https://www.sec.gov/rules/proposed/2016/33-10107.pdf>. Comments on the proposed rules are due no later than August 30, 2016.

BACKGROUND

The SEC established the SRC category of registrants in 2007 to provide general regulatory relief for smaller registrants. The relief was designed to promote capital formation and to reduce compliance costs for smaller registrants while maintaining investor protections. Currently, SRCs are registrants with:

- less than \$75 million in public float as of the last business day of their most recently completed second fiscal quarter; or
- zero public float and annual revenues of less than \$100 million in their most recent fiscal year.

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SRCs may comply with certain scaled disclosures provided to them in Regulation S-K and Regulation S-X. For example, SRCs are:

- required to include only two years (instead of three years) of income, cash flow and changes in stockholders' equity statements;
- required to provide only a two-year (instead of a three-year) comparison of management's discussion and analysis of financial condition and results of operations;
- required to provide only two years (instead of three years) of summary compensation table information;
- not required to provide a compensation discussion and analysis (CD&A) or pay ratio disclosure; and
- not required to include risk factors in Exchange Act filings.

PROPOSED AMENDMENTS

A. KEY FEATURES OF THE PROPOSED AMENDMENTS

Under the proposed amendments, SRCs would be registrants with:

- less than \$250 million in public float as of the last business day of their most recently completed second fiscal quarter; or
- zero public float and annual revenues of less than \$100 million in their most recent fiscal year.

Consistent with the current definition of SRC, a registrant filing its initial registration statement under the Securities Act or the Exchange Act would calculate its public float as of a date within 30 days of publicly filing the registration statement. A company filing an initial Securities Act registration statement would calculate its public float by multiplying the estimated public offering price per share at the time of filing by the sum of the number of shares included in the registration statement and the number of shares held by non-affiliates before the offering. As an Exchange Act registration statement does not affect an issuer's public float, if an issuer files only an initial Exchange Act registration statement and does not have a public float or cannot calculate the value of its float, then the issuer's eligibility for SRC status would be based on its annual revenues.

A registrant that determines that it does not qualify as an SRC would remain unqualified unless and until it determines that:

- its public float is less than \$200 million as of the last business day of its most recently completed second fiscal quarter; or
- if such registrant's public float were zero, its annual revenues were less than \$80 million during its previous fiscal year.

These thresholds represent significant increases from those in the current SRC rules, which require a non-SRC seeking to qualify as an SRC to have a public float of less than \$50 million or, if the non-SRC's public float is zero, annual revenues of less than \$40 million.

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B. THE PROPOSED AMENDMENTS WOULD PRESERVE THE THRESHOLD CURRENTLY CONTAINED IN THE “ACCELERATED FILER” DEFINITION

While the SEC is proposing to increase the public float threshold for SRC qualification, the proposed amendments would not affect the public float threshold for qualification as an accelerated filer, which is \$75 million. Thus, under the proposed amendments, SRCs with a public float between \$75 million and \$250 million would remain subject to the accelerated filer disclosure requirements and filing deadlines.

IMPLICATIONS

Under the proposed amendments, a large group of post-IPO, but not fully distributed, companies would qualify as SRCs despite total equity values well in excess of \$250 million. Assuming market acceptance of the reduced disclosure—which could foreseeably be an issue, particularly as to financial disclosures—these newly eligible SRCs could enjoy cost savings in the form of reduced compliance costs, including not being required to prepare a CD&A and not being required to determine and disclose the pay ratio.

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