SEC Proposes Welcome Expansion of "Smaller Reporting Company" Definition

Written by Melanie Figueroa and Gabrielle Napolitano ***July 5, 2016***

To the delight of many who have been lobbying the Securities and Exchange Commission (the "SEC") over recent years to increase the pool of public companies that can qualify for the scaled disclosure requirements available to smaller registrants, the SEC is seeking comments for proposed amendments that will expand the definition of a "smaller reporting company." The proposals described in a release issued by the SEC on June 26, 2016, begin to address the SEC's mandate under the 2015 FAST Act to revise Regulation S-K to further scale disclosure for smaller registrants and provide for amendments to Rule 405 under the Securities Act of 1933, Rule 12b-23 under the Securities Exchange Act of 1934 and Item 10(f)5 of Regulation S-K. In each case the definition of a "smaller reporting company" issuer eligible for scaled disclosure is expanded from less than $75 million in public float as of the last business day of such issuer's most recently completed second fiscal quarter to less than $250 million in public float or for those issuers without a public float and annual revenues of less than $50 million during the most recently completed fiscal year to annual revenues of less than $100 million in the prior fiscal year.

With these proposed amendments, the SEC expressed the sentiment that an expansion of the "smaller reporting company" definition would not "significantly alter the total mix of information available about these registrants." The sentiment expressed by the SEC is shared by industry leaders who have been calling for the changes on the premise that even the scaled disclosure currently required from smaller registrants provides more than adequate information to allow both existing and potential investors to make educated decisions about their investment strategies in such companies going forward. The truth of the matter is that compliance costs for smaller public companies including those that are able to take advantage of the scaled disclosure requirements remain a real burden. Many smaller reporting companies are consistently faced with the challenge of meeting the costs associated with being a public company which the SEC has estimated to be approximately $2.5 million with respect to initial regulatory compliance costs in the case of an initial public offering and $1.5 million annually for ongoing compliance of a public company. For

Q: How is public float calculated for purposes of assessing qualification as a "smaller reporting company"?

A: Public float is calculated by multiplying the price at which the common equity was last sold, or the average of the bid and asked prices, in the principal market for the common equity by the aggregate worldwide number of shares of voting and non-voting common equity held by non-affiliates.

Q: As of what date is public float calculated?

A: For SEC reporting issuers, public float is calculated as of the last business day of the most recently completed fiscal quarter. For issuers completing an IPO or initial Exchange Act registration, public float is calculated within 30 days of filing the registration statement.

smaller issuers, those compliance costs represent real numbers that detract from a company's ability to otherwise conduct its operations and seek continued growth.

> **Q: What are the scaled disclosure accommodations applicable to smaller reporting companies?**
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> **A:** Some of the scaled disclosure accommodations for smaller reporting companies, among others, include, 3 years of business development disclosure rather than 5, 2 years of audited financial statements and MD&A disclosure rather than 3, and 2 years of summary compensation disclosure rather than 3.

While the proposed amendments are clearly a win for smaller registrants, the SEC failed to go the full mile by not similarly proposing an alteration to the $75 million public float threshold applicable to "accelerated filers." As such, an issuer with a public float of $100 million, for example, would be allowed to issue scaled disclosure as a "smaller reporting company" while still being subject to the accelerated timeline required by an "accelerated filer," as well as the requirement to provide a SOX 404(b) auditor's internal control attestation. On this point, the SEC commented that there is no specific evidence that any potential savings from exempting registrants with public floats between $75 million and $250 million from the auditor attestation provisions of Section 404(b) of the Sarbanes –Oxley Act would justify the loss of investor protections and registrant benefits that are received with such requirements, citing the fact that those issuers that were subject to the Section 404(b) auditor attestation requirements generally had lower restatement rates than registrants that were not subject to the requirements. It is worth noting, however, that emerging growth companies (an issuer with "total annual gross revenues" of less than $1 billion during its most recently completed fiscal year) are exempt from the auditor attestation requirements and in addition, the discussion draft of the Financial Choice Act prepared by the House Financial Services Committee includes a proposal to exempt from the requirements of SOX 404(b) any issuer with a total market cap (rather than public float) of less than $250 million. Together, these acts may help to bridge the gap that the SEC appears to be leaving open at this time.

Overall, the sum impact of the proposed re-evaluation of the 2007 definition of "smaller reporting company" reflects real support from the SEC of the stated goal of promoting capital formation and the expansion of the qualification requirements for those issuers classifying as "smaller reporting companies" is an important step toward better aligning the regulatory landscape with the entrepreneurial lens through which our economy is increasingly filtered.

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