The SEC Amends the Smaller Reporting Company Thresholds

June 29, 2018

Yesterday, the Securities and Exchange Commission (SEC) adopted amendments to the "smaller reporting company" (SRC) definitions to expand the number of companies that qualify for certain existing reduced or scaled disclosure accommodations. The amendments are intended to enable qualifying registrants to reduce compliance costs. The Commission believes that this amendment will promote capital formation while maintaining appropriate investor protections. Specifically, the definition of SRC includes registrants with a public float of less than $250 million, as well as registrants with annual revenues of less than $100 million for the previous year and either no public float or a public float of less than $700 million.

The Commission's announcement is at www.sec.gov/news/press-release/2018-116 and the release itself is at www.sec.gov/rules/final/2018/33-10513.pdf. The rules will become effective 60 days after publication in the Federal Register.

The Revised SRC Thresholds

The Commission established the SRC category of companies in 2008 in an effort to provide general regulatory relief. As a result, SRCs are permitted to provide scaled disclosures under Regulations S-K and S-X. In issuing these amendments, the SEC's focus is to foster more capital formation by reducing the costs of compliance. In doing so, SEC Chairman Jay Clayton indicated he wanted investors to have more access to investing options where the Commission's public company disclosure rules and protections apply. Mr. Clayton stated:

> These amendments to the existing SRC compliance structure bring that structure more in line with the size and scope of smaller companies while maintaining our longstanding approach to investor protection in our public capital markets. Both smaller companies — where the option to join our public markets will be more attractive — and Main Street investors — who will have more investment options — should benefit.

The new SRC definition enables a company with less than $250 million of public float to provide reduced disclosures, as compared to the $75 million threshold under the prior definition. As noted above, companies with less than $100 million in annual revenues in their prior fiscal year also qualify if they also have either no public float or a public float that is less than $700 million. This reflects a change from the revenue test per the prior definition, which allowed companies to provide scaled disclosure only if they had no public float and less than $50 million in annual revenues. The public float test is applied as of the end of the most recently completed second fiscal quarter. The following table summarizes the amendments:

Criteria	Previous SRC Definition	Revised SRC Definition
Public Float	Public float of less than $75 million	Public float of less than $250 million
Revenues	Less than $50 million of annual revenues and no public float	Less than $100 million of annual revenues and • no public float, or • public float of less than $700 million

Consistent with the previous definition, under the amendments, a company that determines that it does not qualify as a SRC under the above thresholds will remain unqualified until it determines that it meets one or more lower qualification thresholds. The subsequent qualification thresholds, set forth in the table below, are set at 80 percent of the initial qualification thresholds.

Criteria	Previous SRC Definition	Revised SRC Definition
Public Float	Public float of less than $50 million	Public float of less than $200 million, if it previously had $250 million or more of public float
Revenues	Less than $40 million of annual revenues and no public float	Less than $80 million of annual revenues, if it previously had $100 million or more of annual revenues; and Less than $560 million of public float, if it previously had $700 million or more of public float.

The SEC staff estimates that nearly 1,000 additional companies will be eligible for SRC status in the first year under the new definition. These include: 779 companies with a public float of $75 million or more and less than $250 million; 161 companies with a public float of

$250 million or more and less than $700 million and revenues of less than $100 million; and 26 companies with no public float and revenues of $50 million or more and less than $100 million.

Accelerated Filer and Large Accelerated Filer Definitions

It is very important to point out that the final amendments to the SRC thresholds do not affect the application of the current thresholds contained in the SEC's "accelerated filer" and "large accelerated filer" definitions. Accordingly, companies with $75 million or more of public float that qualify as SRCs will remain subject to requirements applicable to accelerated filers. These requirements include the timing of the filing of periodic reports and providing an annual auditor's attestation of management's assessment of internal control over financial reporting as required by Section 404(b) of the Sarbanes-Oxley Act of 2002.

However, Chairman Clayton has directed the SEC staff to formulate recommendations for changes to the "accelerated filer" definitions that, if adopted, would have the effect of reducing the number of companies that qualify as accelerated filers in order to further reduce compliance costs for those companies. Due to this added complexity of the overlap between the SRC thresholds and accelerated filer thresholds, the SEC staff was asked to consider the historical and current relationship between these two definitions. In effect, once the new SRC rule goes into effect, qualifying as a SRC will no longer automatically make a registrant a non-accelerated filer. We expect further developments in this area.

This direction by Chairman Clayton is not a new point of focus for the SEC. Debate regarding the accelerated filer thresholds has raged on for many years as it relates to compliance with SOX Section 404(b). The question is around where to draw the line between raising the threshold to provide regulatory relief and the need to protect investors.

Fueling that debate is the decline in "reissuance" restatements filed by SEC registrants for the eleventh year in a row. Such restatements require the issuer to file an Item 4.02 disclosure in an 8-K stating that past financials may no longer be relied upon, of which this notification remains in effect until the filed financial statements are correct and current. In addition, total restatements – inclusive of "revision" restatements, which typically involve immaterial misstatements or adjustments made in the normal course of business – have declined for three consecutive years to reach a 17-year low. Furthermore, 56 percent of all restatements were by non-accelerated filers, suggesting that those issuers not subject to the discipline of Section 404(b) appear to have more difficulty with restating financial statements. Thus, the trending in restatements has been directionally positive, which has been and will likely continue to be considered by the SEC staff relative to the objective of reducing compliance costs.[1]

We really don't know where the SEC staff is likely to end up with respect to the recommendations they may make to the Commissioners or when they will present those recommendations to trigger the rulemaking process. Given that "appropriate investor protections" has been a longstanding factor in the debate as to where the appropriate threshold should be, the amendment, if any, and timing are anyone's guess. Accordingly, companies meeting the current accelerated filer definition should continue with their plans to comply with the various requirements pursuant to how they are classified under those definitions.

Summary

The change in the SRC threshold has created relief in the form of reduced or scaled disclosure accommodations for over nearly 1,000 issuers. The change results in an overlap with the existing accelerated filer thresholds. The SEC staff has been directed to make recommendations on whether to adjust the accelerated filer thresholds.

Our Beltway insiders have informed us that "SOX relief" is indeed a target, on the Hill as well as at the SEC. The Senate Committee on Banking, Housing and Urban Affairs recently discussed exemption from Section 404(b) as it relates to emerging growth companies. Lately, the trend has been if the Hill "suggests" a change or an easing of regulation, the regulators respond before legislation is passed. Committee Chair Mike Crapo announced at the end of the so-called "discussion" hearings this week that he and his staff are working on a package of bills with the House, which he referred to as corporate governance reforms. Jeb Hensarling, Chairman of the House Financial Services Committee refers to the package as "capital markets growth bills." The point is, if this package is worked out with the Senate's blessing, there will likely be significant regulatory relief provisions that are passed. Given the election year politics in 2018, it remains to be seen how quickly this will happen.

That all said, we would not recommend that issuers tap the brakes on their 404(b) compliance in hopes they will get relief before the end of the year. With 2018 half over for calendar-year companies, that could be a risky strategy. Most importantly for calendar-year companies: If the Commission were to amend the accelerated filer thresholds, the question

[1] 2017 Financial Restatements Review, AuditAnalytics®, June 7, 2018, available at www.auditanalytics.com/blog/2017-financial-restatements-review/.

arises as to whether the amendment would be effective for 2018 as the second quarter ends today for purposes of applying the public float test. Therefore, our suggestion is to stay the course for 2018 compliance.

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