

The Commission historically has focused on the importance of continuous reporting when there is a trading market, where investors have an expectation that companies will provide continuous reports under the Commission's continuous reporting system, and has found the absence of such a market support for the conclusion that small companies should be given the opportunity to avoid the cost of continuous reporting.²⁴ Today's proposal is consistent with this approach since companies with securities traded on an exchange or NASDAQ would continue to be subject to Section 12 registration and reporting, and the expectation of investors in companies traded in such markets that these companies will continue to be subject to periodic reporting would not be altered. In addition, the proposal furthers the policies of Section 3(b) of the Securities Act to allow small offerings to be conducted without subjecting the issuer to registration under Section 12 of the Exchange Act.

List of Subjects in 17 CFR Parts 230, 240, 249 and 260

Reporting and recordkeeping requirements, Securities.

Text of Proposals

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

PART 260—GENERAL RULES AND REGULATIONS, TRUST INDENTURE ACT OF 1939

1. The authority citation for Part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78l, 78m, 78n, 78o, 78w, 78ll(d), 79t, 80a-8, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

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2. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78l, 78m, 78n, 78o, 78p, 78s,

78w, 78x, 78ll(d), 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4 and 80b-11, unless otherwise noted.

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3. The authority citation for Part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a, *et seq.*, unless otherwise noted.

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4. The authority citation for Part 260 continues to read as follows:

Authority: 15 U.S.C. 77eee, 77ggg, 77nnn, 77sss, 78ll(d), 80b-3, 80b-4, and 80b-11.

Parts 230, 240, 249, and 260 [Amended]

5. 17 CFR Parts 230, 240, 249 and 260 are amended by removing the reference to "\$5 million" and adding in its place "\$10 million" in the following sections:

- (a) 17 CFR 230.157(a)
- (b) 17 CFR 240.0-10(a)
- (c) 17 CFR 240.12g-1
- (d) 17 CFR 240.12g-4(a)(1)(ii)
- (e) 17 CFR 240.12g-4(a)(2)(ii)
- (f) 17 CFR 240.12h-3(b)(1)(ii)
- (g) 17 CFR 240.12h-3(b)(2)(ii)
- (h) 17 CFR 249.323(a)
- (i) 17 CFR 260.0-7

Dated: June 27, 1995.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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17 CFR Part 230

[Release Nos. 33-7187; 34-35896; File No. S7-17-95]

RIN 3235-AG53

Revision of Holding Period Requirements in Rule 144; Section 16(a) Reporting of Equity Swaps and Other Derivative Securities

AGENCY: Securities and Exchange Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commission is proposing to amend the holding period requirements contained in Rule 144 (d) and (k) to permit resales of "restricted" securities after a one-year, rather than a two-year, holding period, if the sale complies with all of the other provisions of Rule 144. Securities held by non-affiliated shareholders could be resold without restriction after a holding period of two, rather than three years. In addition, the Commission is requesting comment on whether Rule 144 should be revised to address new trading strategies, such as equity swaps, and is reminding persons subject to reporting under Section 16 of the Securities

Exchange Act of 1934 (the "Exchange Act") that reporting of these transactions is required under the current rules.

DATES: Comments must be submitted on or before September 8, 1995.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. All comment letters should refer to File No. S7-17-95 and will be available for public inspection and copying in the Commission's Public Reference Room.

FOR FURTHER INFORMATION CONTACT: Richard K. Wulff, Office of Small Business Policy, Division of Corporation Finance at (202) 942-2950.

SUPPLEMENTARY INFORMATION: The Commission is proposing to shorten the holding periods in Securities Act of 1933 (the "Securities Act")¹ Rule 144,² the non-exclusive safe harbor for resales of "restricted" securities³ and securities held by affiliates of the issuer. Under the proposal, the holding period for resales of limited amounts of securities by any person would be reduced from two years to one year, and the holding period for resales by non-affiliates without compliance with any provisions of the rule would be reduced from three years to two years.⁴ This release also includes a discussion of whether Rule 144 should be amended to reflect new trading strategies, such as equity swaps, and a reminder to persons subject to reporting under Section 16 of the Exchange Act⁵ that reporting of these transactions is required under the current rules.

¹ 15 U.S.C. 77a *et seq.*

² 17 CFR 230.144.

³ "Restricted securities" are defined in Rule 144(a)(3). See *infra* Note 7.

⁴ The Commission has established the Advisory Committee on the Capital Formation and Regulatory Processes (the "Advisory Committee"), chaired by Commissioner Steven M.H. Wallman. The Advisory Committee is considering fundamental issues relating to the regulatory framework governing the capital formation process, including whether the current system of registering securities offerings should be replaced with a company registration system. The recommendations of the Advisory Committee may result in rule proposals or legislative recommendations that, if endorsed by the Commission, ultimately may address the matters discussed in this release. Under some of the company registration models now being considered by the Advisory Committee, many of the legal distinctions between publicly offered and privately placed securities would be eliminated, including the concept of restricted securities. Securities issued by a company registered with the Commission would be freely tradeable, regardless of the public or private character of the transaction.

⁵ 15 U.S.C. 78p.

²⁴ See Release 33-6605 (September 30, 1985) [50 FR 41162].

I. Background and Proposal

The Commission adopted Rule 144 in 1972⁶ to provide an objectively determinable safe harbor for resales of "restricted" securities and "control" securities. "Restricted" securities generally are securities issued in private placements;⁷ "control" securities are securities owned by affiliates of the issuer. The rule provides that a person that complies with its terms and conditions will not be engaged in a distribution of securities and, thus, not be an underwriter⁸ for purposes of the Section 4(1) exemption from Securities Act registration for ordinary trading transactions.⁹

The rule includes holding periods for "restricted" securities to establish that the holder did not purchase with a view to an unregistered public distribution. Under the rule, all "restricted" securities must be held at least two years before any can be resold, measured from the time the securities were purchased from the issuer or an affiliate. For "restricted" securities held between two and three years, other provisions of the rule require that the issuer be providing certain current information about itself, that limited amounts of securities are resold, that the resales are effected in ordinary brokerage transactions or directly with a market-maker, and that a notification of the resale is filed with the Commission. After a three-year holding period, "restricted" securities may be resold by non-affiliates without compliance with any of these provisions.

The length of the holding period for "restricted" securities significantly impacts the costs of raising capital in private placements since investors require that the price of the securities be discounted commensurate with the market risk during the holding period. In each of the past four years, the small business community has asked the Commission through the annual Government-Business Forums on Small Business Capital Formation to consider shortening the Rule 144 holding

period.¹⁰ The two-year holding period has been in place since the rule was adopted in 1972; the concept of "free" resales for non-affiliates after three years was adopted in 1981.¹¹ In 1990, the rule was revised¹² to permit the holding period to be measured from the time that the securities were purchased from the issuer or an affiliate, so that holders may tack each other's holding periods, rather than requiring the entire holding period for each holder.

Based on the Commission's experience with Rule 144 in the 20 years since adoption, the Commission believes that it is appropriate to enhance the utility of the safe harbor, and reduce costs for private capital formation, by shortening the holding periods. Consequently, the Commission is proposing that the holding period applicable to limited Rule 144 resales be reduced from two years to one¹³ and the holding period for "free" resales by non-affiliates reduced from three years to two. The Commission believes that these proposed holding periods are sufficiently long to establish that the securities were not purchased with a view to a public unregistered distribution.

Comment is requested as to whether the proposed revisions to the holding period are appropriate. Are these periods sufficient to assure that persons relying upon Rule 144 are not engaged in a public distribution of securities inconsistent with the Section 4(1) ordinary trading transaction exemption? Should the periods be retained, or should the proposed periods be changed to be shorter or longer? If other holding periods are suggested, the basis for the selected holding period should be indicated.

II. Equity Swaps and Other Like Investment Strategies

A. Treatment Under Rule 144

In 1990 when the Commission amended Rule 144 to allow tacking of the holding period between investors,

the Commission also deleted the provision that previously tolled the holding period if the holder engaged in short sales, puts or other options to sell securities.¹⁴ The intervening 5-year period since implementation of the holding period revisions has evidenced the growth of a variety of investment strategies associated with separating the bundle of rights that make up a security: strategies that are used in both the private and public securities markets. Through the use of equity swaps, forward contracts, derivatives and other financial tools, holders of restricted and control shares are selling interests in such shares while retaining legal title to the "underlying" security. Today, record or beneficial ownership does not necessarily reflect who holds the voting, investment or income interests of a security.¹⁵

The Commission is examining whether it may be appropriate to revise Rule 144 to reflect the economic realities of these transactions. For example, is it appropriate to treat securities as "held" in the private markets if the economic risk of the investment has been shifted to the public markets? If not, should this be addressed through reintroducing holding period tolling concepts for periods when the holder is not at risk, or should the rule be revised to require compliance with the rule when the risk shifting transaction to the public markets occurs? If Rule 144 were to be revised to address these questions, what changes would best ensure that the economic benefits and risks of investment are not shifted during the prescribed holding period? Also, should any possible revisions distinguish between companies that are and are not widely followed in the market and, if so, why? In addressing the question generally, commenters should provide their views as to the need to have a fungibility doctrine underlie Rule 144 to assure that the safe harbor in fact protects resales that are not part of the distribution and that are consistent with investment intent.

B. Reminder of Requirement To File Section 16 Reports

Questions are being raised as to the adequacy of information to the markets about the securities transactions effected through equity swaps and similar

⁶Release No. 33-5223 (January 11, 1972) [37 FR 591].

⁷"Restricted" securities include those acquired from the issuer or an affiliate in a transaction or chain of transactions not involving a public offering; those acquired from the issuer and subject to resale limitations under Regulation D, 17 CFR 230.501-508 or Rule 701, 17 CFR 230.701; those subject to the Regulation D resale limitations and acquired in a transaction or chain of transactions not involving a public offering; and those acquired in a transaction or chain of transactions meeting the requirements of Rule 144A, 17 CFR 230.144A.

⁸See Section 2(11) of the Securities Act.

⁹Section 4(1) exempts transactions by persons that are not issuers, underwriters or dealers.

¹⁰Final Reports of the SEC Government-Business Forum On Small Business Capital Formation (June 1992) (June 1993) (June 1994) (February 1995). The Small Business Investment Incentive Act of 1980 directs the Commission to host this annual meeting for the purpose of reviewing "the current status of problems and programs relating to small business capital formation." Pub. L. No. 96-477, Section 503, 94 Stat. 2275, 2292-93 (1980).

¹¹Release No. 33-6286 (February 6, 1981) [46 FR 12195].

¹²Release No. 33-6862 (April 23, 1990) [55 FR 17933].

¹³Conforming changes also are proposed to be made in paragraph (e)(3) relating to determining the limitations on the amounts resalable by pledgees, donees and trusts, reducing the period from two years after the event of pledge default, donation or trust acquisition, to one year.

¹⁴In 1990, the Commission rescinded former subdivision (d)(3) of Rule 144, which generally tolled the holding period while a holder had a short position in or an option to sell securities of the same class as the restricted securities.

¹⁵See Release No. 33-7190, which addresses other issues relating to equity swaps and similar transactions.

strategies.¹⁶ In August 1994, the Commission's release proposing revisions to rules under Section 16 of the Exchange Act¹⁷ included a discussion of reporting obligations arising from equity swaps and similar risk-shifting transactions. In that release, the Commission stated that Section 16 insiders must report equity swaps and similar transactions in equity securities of the issuer,¹⁸ unless the swap relates solely to interests in securities comprising part of specified market baskets or indices of stocks.¹⁹

The release provided the following example of an equity swap required to be reported. An insider agrees to pay to the counterparty for a period of three years the value of dividend payments on 100,000 shares of issuer common stock, in exchange for payment of a fixed interest rate based on the market value of the 100,000 shares of stock at the commencement of the swap term. The parties also agree that at the end of the swap term, the insider will pay to the counterparty the cash value of any appreciation on the shares during the term, or, conversely, the counterparty will pay to the insider the cash value of any depreciation. The insider retains title to and any voting rights in the securities.

The release suggested a method of reporting entering into and closing out the swap using stock appreciation and depreciation rights and deemed acquisitions and dispositions of the underlying securities. In setting forth this analysis, the Commission specially noted in the release that it was not suggesting that previously filed forms reporting swap transactions in another manner needed to be revised, or that swap transactions reported differently would be subject to disclosure pursuant to Item 405 of Regulations S-B or S-K.²⁰ The release solicited comment on whether the Commission's approach reflects economic reality and whether a

separate reporting code for equity swaps is needed. The Commission wishes to remind Section 16 insiders that reporting at the time these transactions are entered into and when they are closed out is required.²¹

III. Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an initial regulatory flexibility analysis in accordance with the Regulatory Flexibility Act.²² The analysis notes that the amendments to Rule 144 are being proposed as a result of recommendations developed at the SEC Government-Business Forums on Small Business Capital Formation. The purpose of the revisions is to remove unnecessary restrictions in the resale of securities while maintaining important protections to the investing public.

A copy of the initial regulatory flexibility analysis may be obtained from Twanna M. Young, Office of Small Business Policy, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Stop 7-8, Washington, DC 20549, (202) 942-2950.

IV. Statutory Basis, Text of Proposal and Authority

The amendment to the Commission's rule is being proposed pursuant to sections 2(11), 4(1), 4(4) and 19(a) of the Securities Act.

List of Subjects in 17 CFR Part 230

Reporting and recordkeeping, Securities.

For the reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read in part, as follows:

Authority: 15 U.S.C. 77b, 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78l, 78m, 78n, 78o, 78w, 78ll(d), 79t, 80a-8, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

2. Section 230.144 is amended by revising paragraphs (d)(1), (e)(3)(ii), (e)(3)(iii), (e)(3)(iv) and (k) to read as follows:

²¹ To the extent settlement of the parties obligations occurs on an interim basis during the term of the swap, such as quarterly, the insider's Section 16 obligations would arise with respect to each settlement.

²² 5 U.S.C. 603.

§ 230.144 Persons deemed not to be engaged in a distribution and therefore not underwriters.

* * * * *

(d) *Holding period for restricted securities. * * **

(1) *General rule.* A minimum of one year must elapse between the later of the date of the acquisition of the securities from the issuer or from an affiliate of the issuer, and any resale of such securities in reliance on this section for the account of either the acquiror or any subsequent holder of those securities, and if the acquiror takes the securities by purchase, the one-year period shall not begin until the full purchase price or other consideration is paid or given by the person acquiring the securities from the issuer or from an affiliate of the issuer.

* * * * *

(e) *Limitation on amount of securities sold. * * **

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(3) *Determination of amount. * * **

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(ii) The amount of securities sold for the account of a pledgee thereof, or for the account of a purchaser of the pledged securities, during any period of three months within one year after a default in the obligation secured by the pledge, and the amount of securities sold during the same three-month period for the account of the pledgor shall not exceed, in the aggregate, the amount specified in paragraph (e)(1) or (2) of this section, whichever is applicable;

(iii) The amount of securities sold for the account of a donee thereof during any period of three months within one year after the donation, and the amount of securities sold during the same three-month period for the account of the donor, shall not exceed, in the aggregate, the amount specified in paragraph (e)(1) or (2) of this section, whichever is applicable;

(iv) Where securities were acquired by a trust from the settlor of the trust, the amount of such securities sold for the account of the trust during any period of three months within one year after the acquisition of the securities by the trust, and the amount of securities sold during the same three-month period for the account of the settlor, shall not exceed, in the aggregate, the amount specified in paragraph (e)(1) or (2) of this section, whichever is applicable;

* * * * *

(k) *Termination of certain restrictions on sales of restricted securities by persons other than affiliates.* The requirements of paragraphs (c), (e), (f) and (h) of this section shall not apply to

¹⁶ See Rucker, "Short Interest: No More Bullish Bellow," Barron's, May 1, 1995.

¹⁷ Release No. 34-34514 (August 10, 1994) [59 FR 42449].

¹⁸ The term "insider" as used in this release refers to officers, directors and holders of more than ten percent of a class of equity securities who are subject to Section 16.

¹⁹ 59 FR 42449, 42457, footnote 101 and accompanying text. No Section 16 consequences would flow from a swap transaction to the extent the swap relates solely to interests in securities comprising part of a broad-based, publicly traded market basket or index of stocks, approved for trading by the appropriate federal governmental authority, that are deemed not to confer beneficial ownership for purposes of Section 16 pursuant to Rule 16a-1(a)(5)(iii) [17 CFR 240.16a-1(a)(5)(iii)] and/or are excluded from the definition of "derivative securities" pursuant to Rule 16a-1(c)(4) [17 CFR 240.16a-1(c)(4)].

²⁰ 17 CFR 228.405 and 229.405.

restricted securities sold for the account of a person who is not an affiliate of the issuer at the time of the sale and has not been an affiliate during the preceding three months, provided a period of at least two years has elapsed since the later of the date the securities were acquired from the issuer or from an affiliate of the issuer. In computing the two-year period for purposes of this provision, reference should be made to paragraph (d) of this section.

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Dated: June 27, 1995.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 95-16390 Filed 7-7-95; 8:45 am]

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17 CFR Parts 230 and 232

[Release No. 33-7188; File No. S7-18-95]

RIN 3235-AG52

Solicitations of Interest Prior to an Initial Public Offering

AGENCY: Securities and Exchange Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Securities and Exchange Commission ("Commission") is publishing for comment a proposed rule that would allow issuers contemplating initial public offerings to solicit indications of investor interest in their companies prior to the filing of a registration statement under the Securities Act of 1933. The proposed rule would allow an issuer to assess potential investor interest in the company before incurring possibly significant costs associated with the preparation of offering disclosure documents. The proposals are intended to reduce the regulatory impediments and cost of accessing public markets consistent with investor protection interests.

DATES: Comments must be submitted on or before September 8, 1995.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comment letters should refer to File No. S7-18-95. All comments received will be available for public inspection and copying in the Commission's public reference room, 450 Fifth Street, N.W., Washington, D.C., 20549.

FOR FURTHER INFORMATION CONTACT: Richard K. Wulff, Office of Small Business Policy, Division of Corporation

Finance, at (202) 942-2950 or James R. Budge, Office of Disclosure Policy, Division of Corporation Finance, at (202) 942-2910.

SUPPLEMENTARY INFORMATION: The Commission is publishing for comment a rule¹ that would permit an issuer prior to its initial public offering ("IPO") to solicit indications of interest in the company's securities before filing a registration statement under the Securities Act of 1933 (the "Securities Act").² The Commission also is proposing to amend the "test the waters" provision³ under Regulation A⁴ to permit issuers that "test the waters" under Regulation A and decide to have a registered offering instead to do so without a 30 day waiting period, as well as permitting issuers to use Regulation A if, after "testing the waters" under the proposed new rule, they determine to go forward with a Regulation A offering instead of a registered offering.⁵ In addition, Securities Act Rule 100⁶ would be amended to add a definition of direct participation investment program for purposes of the new rule, and Regulation S-T⁷ would be amended to provide that the "test the waters" document for registered offerings may be submitted to the Commission in electronic format via the EDGAR system, at the option of the issuer.

I. Background

In 1992, as part of its Small Business Initiatives, the Commission introduced new procedures into Regulation A that allow issuers considering whether to undertake a public offering to "test the waters" for potential investor interest before undertaking a full-scale offering that requires the preparation, Commission filing and delivery to investors of the mandated offering documentation.⁸ The initiative was intended to provide a cost-effective means for an issuer, with no established market for its securities, to determine whether there is any investor interest in its securities before undertaking an offering and incurring the full costs of compliance with the applicable disclosure requirements. If, after the solicitation, the issuer concludes there is insufficient or no investor interest, it

can avoid significant, unnecessary compliance costs. If the issuer determines to proceed with the offering, it is required to provide potential investors with the full mandated disclosure documents. Since adoption of the "test the waters" procedures, 61 issuers have submitted solicitations to the Commission, 26 of which have proceeded to file Regulation A or registered offerings.

In 1993, the North American Securities Administrators Association, Inc. ("NASAA")⁹ undertook a two-year pilot program to consider and evaluate "test the waters" approach under state securities laws.¹⁰ Nine states¹¹ have been participating in the pilot. The NASAA pilot procedures differ from those adopted under Regulation A in several respects, the most significant of which are: (a) a pre-use filing requirement; (b) more mandated information in the solicitation document;¹² (c) a requirement that the written solicitation document be delivered to those directly contacted; and (d) delivery of the prospectus at least seven days prior to sale. Several classes of issuers are disqualified from using the NASAA pilot "test the waters" procedures.

Various commenters have suggested that the Commission explore extending the benefits of the "test the waters" process beyond Regulation A.¹³ Most recently, the Subcouncil on Capital Allocation of the Competitiveness

⁹NASAA is an association of securities commissioners from each of the 50 states, the District of Columbia, Puerto Rico, Mexico and several of the Canadian provinces.

¹⁰ See NASAA's Proposed Statement of Policy on Solicitation of Interest (Test the Waters) ("NASAA's Statement") which is set forth in an Appendix to this release.

¹¹ Colorado, Kansas, Massachusetts, Oklahoma, Oregon, Pennsylvania, Vermont, Virginia, and Washington.

¹² The NASAA Statement requires, in addition to the information set forth in Rule 254, (1) the date of the issuer's organization as well as a statement of its stage of development; (2) a more specific description of the issuer's business, products and services and the manner in which the issuer intends to carry out its activities; (3) a general indication of the manner of using proposed proceeds from the offering; and (4) a complete listing of the issuer's officers and directors, their locations, employment history and educational background. See Solicitation of Interest Form in the NASAA Statement in the Appendix to this release.

¹³ The comment letter prepared by members of the Committee on Federal Regulation of Securities, the Committee on State Regulation of Securities and the Small Business Committee of the Section of Business Law of the American Bar Association on the Small Business Initiatives suggested in 1992 that the Commission explore extending use of "test the waters" beyond the Regulation A context to other offerings. See letter dated July 8, 1992 in response to request for comment on the Small Business Initiatives (Release No. 33-6924 (March 12, 1992) [57 FR 9768]).

¹ Proposed Rule 135d.

² 15 U.S.C. 77a et seq.

³ Securities Act Rule 254 [17 CFR 230.254].

⁴ 17 CFR 230.251-230.263.

⁵ Proposed amendments to Rule 254(d) [17 CFR 230.254(d)] and Rule 254(b)(4) [17 CFR 230.254(b)(4)].

⁶ 17 CFR 230.100.

⁷ 17 CFR Part 232.

⁸ Release No. 33-6949 (July 30, 1992) [57 FR 36442]; Release No. 33-6996 (April 28, 1993) [58 FR 26509].