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SEC Deregistration

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The Bankers' Statement – Summer 2012

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On April 5, 2012, the Jumpstart Our Business Startups Act (JOBS Act) was signed into law. The JOBS Act increased the threshold number of record shareholders of a class of equity securities that triggers registration and reporting requirements under Section 12(g) of the Securities Exchange Act of 1934 (Exchange Act). For banks and bank holding companies (banks) with assets of more than $10 million, this threshold number is increased from 500 to 2,000.

Additionally, the JOBS Act increased the threshold number of shareholders of record below which a bank reporting to the Securities and Exchange Commission (SEC) may suspend its reporting obligations. Under the JOBS Act, a bank may now suspend its reporting obligations with the SEC (*i.e.*, "deregister" or "go dark") with regard to any class of securities that is held of record by fewer than 1,200 people.

As a result of the JOBS Act, a significant number of banks whose shares are thinly traded have already started the process (or announced their intentions) to suspend their reporting obligations under the Exchange Act, and many more are likely to do the same in the near future.[1] For those banks that are eligible to deregister, the suspension of SEC filing requirements, including the requirement to file periodic reports (*i.e.*, 10-Ks, 10-Qs and 8-Ks), proxy statements and Forms 3, 4 and 5,[2] can be very enticing. In particular, deregistration may result in a significant reduction in accounting, legal, insurance and/or compliance costs (including costs related to filing reports via EDGAR) for these banks.

However, prior to taking the steps necessary to suspend their reporting obligations under the Exchange Act, banks are well advised to carefully weigh all of the potential legal and practical implications of such deregistration.

Eligibility for Deregistration – SEC Counting Rules

In order to determine whether a bank is eligible to deregister its shares under the Exchange Act, the bank must first accurately calculate the number of holders of record of its shares. The SEC has established certain counting rules for this purpose. Under these rules, shares are considered to be "held of record" by each person who is identified as the owner of the securities on the records of the issuer.

Generally speaking, each separate "account" is considered to be one shareholder of record. However, certain exceptions and special rules apply, including the following:

- Securities identified as held of record by a corporation, a partnership, a trust (whether or not the trustees are named) or other organization are counted as being held by one person;
- Securities identified as held of record by one or more persons as trustees, executors, guardians, custodians or in other fiduciary capacities with respect to a single trust, estate or account are counted as being held of record by one person;
- Securities held by two or more persons as co-owners (such as husband and wife) are counted as being held by one person;
- Each broker that holds shares in street name for individual beneficial owners is treated as one shareholder of record, and there is no "look-through" of shares that are held in street name with a broker; *however, an institutional custodian such as CEDE & Co. is not treated as a single shareholder of record, and a bank must look through the institutional custodian and ascertain the number of brokers that hold the bank's shares in street name and have accounts with the institutional investor;*
- As a result of new rules to be established under the JOBS Act, securities granted to employees pursuant to certain employee compensation plans will be exempted for purposes of counting the number of shareholders of record;
- Securities registered in substantially similar names where the issuer has reason to believe because of the address or other indications that such names represent the same person, may be included as held of record by one person;
- In any case where a company's records of security holders have not been maintained in accordance with accepted practice, any additional person who would be identified as an owner on such records had they been maintained in accordance with accepted practice must be included as a holder of record; and
- All "beneficial owners" of a security must be counted in cases where their form of ownership is contrived for the purpose of avoiding registration.

In determining the number of shareholders of record, it is important to understand that different results may be reached *depending upon the manner in which shares are held*. This is particularly true when counting shares held by a husband and wife. If a husband and wife *jointly* own shares of a bank, they are counted as only one shareholder of record with regard to those shares. However, a different result is reached if the husband and wife each *individually* own shares. In that case, they would be counted as separate shareholders of record with respect to the shares that are individually owned. In the case where the husband and wife each own shares individually and also own shares jointly as co-owners, the husband and wife would represent *three* shareholders of record – the husband individually would be counted as one shareholder, the wife individually would be counted as one shareholder, and the husband and wife jointly would be counted as one shareholder.

Because of the technical nature of the SEC counting rules, their application can become rather complex in certain situations. As a result, banks are encouraged to consult their securities counsel when calculating their shareholders of record to ensure that the calculation is done in conformity with all applicable rules and regulations.

Advantages and Disadvantages of Deregistration

The advantages of a bank suspending its reporting obligations under the Exchange Act are rather clear and easy to quantify. These advantages include:

- Reduced accounting, legal and compliance costs and decreased burden on management and staff related to Exchange Act and Sarbanes-Oxley requirements and public disclosure obligations;
- Greater flexibility in determining what information will be publicly disclosed (*e.g.*, executive compensation and competitive business information);
- Certain corporate governance requirements (*e.g.*, the requirement to have a majority of independent directors) may be simplified or eliminated;
- Potentially lower ongoing securities law liability risks (*e.g.*, short-swing profit rules would no longer apply and CEO and CFO certifications would no longer be required); and
- D&O insurance premiums may decrease.

However, there are also a number of potential disadvantages that should be carefully considered. These disadvantages include:

- Reduced visibility of the bank to public shareholders, which may result in reduced share liquidity and/or a decrease in the trading price of its shares;
- Additional efforts must be taken to make information about the bank available to the public;
- After deregistration, the bank would no longer be eligible for listing on Nasdaq and, therefore, would be required to delist;[3]
- Additional efforts may be required to ensure compliance with insider trading rules and restrictions; and
- Shares acquired by insiders pursuant to equity plans generally will be subject to a holding period before they can be sold to any non-insider.

It is important to note that certain provisions of the securities laws will continue to apply even after deregistration is effective. In particular, insiders of the bank will continue to be subject to the insider trading prohibitions under state and federal securities laws, and the anti-fraud standards of SEC Rule 10b-5 would still impose liability -- civil and criminal -- if someone with material, nonpublic information about the bank purchases or sells the bank's securities without first fully disclosing such information (or provides (*i.e.*, "tips") the material, non-public information to someone else who buys or sells the bank's securities).

In addition to the foregoing, a bank should carefully consider its future capital needs when evaluating whether to deregister. Once a bank has deregistered, it may become more difficult and/or costly to later raise capital through an offering of shares or to issue shares as consideration in an acquisition of another bank or bank holding company.

In the event that a bank deregisters and later decides to conduct a public offering of shares (whether to raise additional capital or as consideration in an acquisition), the bank would be required to prepare and file offering documents with the SEC at that time. These offering documents would need to include all of the types of information that would have been required if the bank had been filing Forms 10-K, 10-Q and 8-K. In addition, the bank may be required to prepare and file proxy materials that comply with SEC requirements. While any such offering is in progress and through the end of the year in which the offering is completed, the bank would also be required to make filings under the Exchange Act, including Forms 10-K, 10-Q and 8-K.

Conclusions

The JOBS Act significantly increases the threshold number of shareholders of record below which a public reporting company may suspend its reporting obligations under the Exchange Act. For banks, this threshold number is now 1,200.

For many banks with thinly traded stock, the decision to deregister may appear, at first glance, to be a "no brainer." However, banks should carefully consider all of the potential advantages and disadvantages prior to deregistering with the SEC. While the cost savings may initially appear to be significant, it is important for banks to go through the exercise of quantifying the cost savings. Because banks are already highly regulated by state and federal banking regulators and subject to significant reporting obligations, the actual cost savings may prove to be less than anticipated.

In addition, banks should carefully consider the impact of deregistration on the bank's ability to raise additional capital in the future. If it is likely that the bank may be raising capital in the near future, whether through a public offering of securities or as consideration in an acquisition of another financial institution, the cost savings and other benefits associated with deregistration may be outweighed by the increased effort and expense required in connection with the capital raise.

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[1] According to the *American Banker*, data provided by the OTC Markets indicates that 46% of the 413 banks currently trading on Nasdaq have fewer than 1,200 shareholders. Alan Kline, *Small Banks Rush to Leave SEC*, AMERICAN BANKER, May 21, 2012, Vol. 177, Issue 78.

[2] For a period of six months after deregistration becomes effective, an insider subject to Section 16 reporting obligations must continue to report transactions which occur within six months after a non-exempt opposite way transaction which occurred prior to the effective date of deregistration. For example, if a director purchases shares of the bank 30 days prior to the effective date of deregistration, the director must report any sale of shares of the bank which occur within 60 days following the purchase even if the sale occurs after deregistration. After deregistration, the shares of the bank will likely be quoted on the OTC Bulletin Board or another over-the-counter quotation system. As a result, the bank would still likely be deemed to be "publicly traded" and, therefore, subject to the notice requirements of FINRA. Thus, for example, the bank would be required to provide a notice to FINRA at least 10 days before the record date for any dividend in order to comply with the requirements of SEC Rule 10b-17.

[3] After deregistration, the shares of the bank will likely be quoted on the OTC Bulletin Board or another over-the-counter quotation system. As a result, the bank would still likely be deemed to be "publicly traded" and, therefore, subject to the notice requirements of FINRA. Thus, for example, the bank would be required to provide a notice to FINRA at least 10 days before the record date for any dividend in order to comply with the requirements of SEC Rule 10b-17.

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