

Deregistration decision: Look before you leap

Going private comes with its own issues

Bankers tired of red tape may look eagerly forward to deregistering their companies' shares. But know up front that you will face some tradeoffs along the way. This article describes the challenges bank boards will confront in considering the JOBS Act's new rules on deregistration.

By Steve Cocheo, executive editor and digital content manager

For years, ABA and other banking interests worked to change the rules concerning the number of shareholders that triggered a bank's obligation to become a "reporting company"--one that must file public reports with the Securities and Exchange Commission, and, as a result, also fulfill other governance and securities compliance duties.

The JOBS Act, signed by the President, has at last made the long-pursued changes into law. In brief, the new law raised the threshold for becoming an SEC reporter to 2,000 shareholders of record, from 500. At the same time, the threshold below which a public bank or bank holding company could file to "deregister," taking itself out from under SEC registration and reporting, was raised to 1,200 shareholders of record, from 300. Other changes of potential interest to community banks have also been made by the new law.

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This article originally appeared in different form in the May 2012 ABA Bank Directors Briefing, our monthly board service. Download that issue as a sample with an order form [here](#).

Now that the legislative work is over, the management and boards of public banking companies, as well as those companies that were nearing the threshold of becoming public companies, have the final law and pending SEC regulations, to consider. (The new registration and deregistration thresholds became effective immediately, and SEC has one year to revise its rules. However, some other aspects of the JOBS Act involving capital instruments and capital raising cannot be exercised until SEC finalizes implementing regulations. And some aspects of deregistration also hang on SEC action.)

For many public banks, there's no question that they will remain so. But for an estimated 500 community banking companies, deregistration now becomes a possibility. Further, banks that were hovering near the old borderline--sometimes having to engage in last-minute maneuvers to pull down their number of shareholders of record to avoid crossing the line--now have some breathing room.

"We were right there at the line, right at 500," a community bank CEO told us over lunch the other day. He sighed with visible relief in discussing the April signing of the JOBS Act.

Not a simple decision

"For community banks, it was a big hit," overall, said Jennifer McCain, of Maynard Cooper & Gale, PC. Under the old rules, community banks often faced a balancing act, attempting to raise capital without passing the threshold for becoming a public bank.

This issue involves a fair degree of detail and minutiae, once a decision has been reached. In late April, ABA presented a telephone briefing, "The New Deregistration Thresholds Under the JOBS Act: What Community Bankers Should Know." Experts, including McCain, participating in the program discussed many of the early details to be examined by banks considering taking advantage of the law. But they also spoke more strategically.

A key point behind this section of the program concerned the role of a bank board as guardian of the interests of shareholders.

Ordering briefing CD

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This article is a summary of a very complex two-hour telephone briefing, and we recommend that any institution contemplating moves under the JOBS Act purchase a recording of the entire event.

ABA members only, with questions, may also wish to contact Diana Preston, vice-president and senior counsel, and deputy general counsel of the ABA Securities Association, at dpreston@aba.com

No doubt, the costs of being an SEC reporting company can be significant, involving not only the direct duties but also those imposed by legislation such as the Sarbanes-Oxley Act. Years ago, when the effective dates of "SOX" approached, community banks that had eagerly sought the perceived prestige of being an SEC reporter frequently explored steps they could take to "go private" and get out from under the shadow of SOX. Some did so, some ran up against the federal limits that have now been undone.

As explained by the speakers, the decision to deregister is not a simple one. It's nothing to decide as if the matter were nothing more than the approval of last month's minutes.

"The decision is a very important corporate move and should not be taken lightly," said speaker Robert Fleetwood, partner at Barack Ferrazzano Kirschbaum & Nagelberg LLP. "As you work through this, remember your duty of care."

Fleetwood noted that his firm has clients who, while having fewer than 1,200 shareholders, don't plan to deregister. He said that those companies' strategic plans call for growing their shareholder bases, and that they don't intend to contain their shareholder group to fewer than the new 2,000 holder limit, where registration would be required.

"There are a lot of nuances to consider here," said Fleetwood.

Key considerations

Among questions listed by Fleetwood and partner Sarah Bernstein:

- What impact could deregistration have on the company's stock price? Could no longer being a public company make the bank's shares less desirable, thus lowering the price and affecting existing holders?

- What effect could deregistration have on shareholders' liquidity?

- What impact could deregistration have on the perceptions of shareholders and others regarding the company's stance now and in the future?

- How might a clear decision to keep the shareholder base below the new 2,000 threshold affect willingness of local market makers to continue providing a means of trading shares? It was pointed out that some market-makers may have been doing so in anticipation that a bank would eventually go public. Market-makers may reconsider their participation.

- What impact would deregistration have on the company's ability to trade in the future? Companies that deregister would have to leave stock exchanges, for instance, though Fleetwood pointed out that existing forums such as the "pink sheets" and newer, evolving markets for trading community bank shares provide, or could provide, a means of trading the stocks outside of traditional channels.

- What impact would deregistration, or the decision to avoid the new threshold, have on institutional investors who have a piece of the bank? Such investors may not care for stock that isn't going to be actively traded.

- What impact would deregistration have on employees and employment-related programs? Would going private affect existing options and other equity-based rewards programs? Could there be an effect on employee stock ownership programs?

- Could key employees' decision to remain with the bank be affected in some way by the decision to deregister?

- Could deregistration affect the prestige of the bank in its community? Could the wrong interpretation be put on deregistration?

- More strategically, if the bank's plans include making acquisitions in the future, a key "currency" for buying other institutions (other than failed or failing banks from the government) may be your bank's own shares. Could deregistering devalue that stock-as-currency?

• Could deregistering affect future ability to raise capital?

• How might deregistration have on the bank's insurance costs? Bernstein pointed out that directors' and officers' liability coverage might become cheaper if the bank deregistered.

The message, overall, was that the board that is reviewing the public-private question must take many factors into account. Deregistering the bank is a decision, said Bernstein, that must be made for the right reasons, not just for the sake of getting rid of some of the federal regulatory burden.

Voices beyond the board's

Speakers said that while the board and management must consult carefully on this issue, it's not just their decision, in some cases.

For example, a bank's state and federal regulators will expect to be consulted when the board is weighing a decision of this importance.

Various elements of the company may influence how the regulators feel about deregistration. A bank that has been scrutinized by examiners over capital may run into resistance.

And if a bank or its holding company is under a formal or informal enforcement action, that may also play a role in how regulators view a proposed deregistration.

Interests of existing shareholders

Existing shareholders can be part of the equation, as well. Speakers said that a bank that wishes to shrink its shareholder base to below 1,200, in order to deregister, will have to take steps to slim down the base.

Stock purchases, stock splits, and other actions accomplish the mechanics, but some transactions may require shareholder approval, and Bernstein stated, can trigger rights for dissenting shareholders.

Some transactions may require the assistance of experts and demand a stock valuation. Disclosure of a bank's stock valuation may put data in the hands of hostile investors. What they could do with that data must be considered,

Bernstein said.

Bernstein also said that where shareholders are being bought out, to shrink the shareholder base, laws beyond the JOBS Act must be considered. State law, in the form of statutes, governing court decisions, and state common law, may play a part.

Given all this, "it's important for the board to consider the appropriate price at which to make repurchases," for example, said McCain.

An unexpected wrinkle affects savings and loan holding companies. Due to a legislative oversight, such companies weren't covered by the JOBS Act. This oversight has to be fixed by corrective legislation, which is being pursued in Congress.

Other factors to watch

The program also looked at other aspects of the JOBS Act that may be helpful to community banks, in time. These won't be effective until SEC issues rules.

One matter concerns private placements. At present, issuers of private placements of securities cannot make general solicitations to attract potential investor in these private offerings. This could sometimes make it hard to get the word out that the local bank was looking for new investors.

The JOBS Act would allow issuers to promote private placements, using print, television, internet, and other advertising. An important restriction is that all purchasers would have to be "accredited investors." Briefly, as far as individual investors not connected to the institution, they would have to have a net worth, excluding their home, of \$1 million. (This can include the net worth of a spouse.) Or they would have to have income exceeding \$200,000 in each of the two most recent years, and reasonable expectation of similar income in the current year. (If a spouse's income is counted, the threshold rises to \$300,000.)

The JOBS Act also includes additional new wrinkles intended to bring capital into all kinds of businesses.

[This article was posted on June 1, 2012, on the website of ABA Banking Journal, www.ababj.com.]