

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

⁶ Release 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.

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

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

¹⁰ Final 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).

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

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

¹³ Conforming 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.

¹⁴ In 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.

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