U.S. Securities and Exchange Commission

Final Rule:
Offshore Offers and Sales
(Regulation S)

Part 1 of 2

SECURITIES AND EXCHANGE COMMISSION

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OFFSHORE OFFERS AND SALES

AGENCY: Securities and Exchange Commission.

ACTION: Final Rule.

SUMMARY: The Securities and Exchange Commission is adopting amendments to the Regulation S safe harbor procedures for offshore sales of equity securities of U.S. issuers and the reporting requirements applicable to those transactions. The amendments are designed to stop abusive practices in connection with offerings of equity securities purportedly made in reliance on Regulation S.

EFFECTIVE DATES: (60 days after publication in the Federal Register) except §§249.308, 249.308a, 249.308b, 249.310 and 249.310b (the amendments to Forms 8-K, 10-Q, 10-QSB, 10-K and 10-KSB) will become effective on January 1, 1999.

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SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the "Commission") is adopting amendments to Rule 903 [1] of Regulation S, [2] the issuer safe harbor under the Securities Act of 1933 [3] for offshore offerings of securities, to address abusive practices that have developed. The amendments apply to the offshore sales of equity securities of domestic issuers. The Commission is also adopting amendments to Rule 144(a)(3) [4] and a new Rule 905 [5] that classify these equity securities as "restricted securities," as defined in Rule 144 under the Securities Act. In addition, Rule 905 makes clear that offshore resales under Rule 904 [6] of restricted equity securities of domestic issuers will not alter the status of these securities as restricted securities after the resale. The Commission also is replacing the current requirement that reporting issuers file a Form

8-K to disclose Regulation S sales of equity securities within 15 days of the transaction with a requirement that these sales be reported on Forms 10-Q, 10-QSB, 10-K or 10-KSB, as appropriate. In addition to these changes, the Commission is adopting other technical amendments to Regulation S to make the rule clearer and more concise.

I. EXECUTIVE SUMMARY

The Commission adopted Regulation S in 1990 as a safe harbor from the registration requirements of the Securities Act for offshore offers and sales of securities. Although the regulation has proved successful for many types of offerings, abuses in connection with sales of domestic equity securities have been common. Regulation S has been used as a means of perpetrating fraudulent and manipulative schemes, especially schemes involving the securities of thinly capitalized or "microcap" companies. These types of securities are particularly vulnerable to fraud and manipulation because little information about them is available to investors.

The Commission is seeking to enhance investor protection with respect to microcap securities through various initiatives, including amendments to Regulation S. The changes to the regulation adopted today should prevent further abuses of this rule, but also allow continued reliance on Regulation S in legitimate offshore offerings.

The Regulation S amendments adopted today are as follows:

• equity securities placed offshore by domestic issuers under Regulation S will be classified as "restricted securities" within the meaning of Rule 144, so that resales without registration or an exemption from registration will be restricted; [7]

• to avoid confusion between the holding period for "restricted securities"

under Rule 144 and the "restricted period" under Regulation S, the term "restricted period" will be renamed the "distribution compliance period";

• the distribution compliance period for these securities will be lengthened from 40 days to one year;

• certification, legending and other requirements, which currently are applicable only to sales of equity securities by non-reporting issuers, will be imposed on these equity securities;

• as a means to alert purchasers of these equity securities to potential restrictions on hedging their positions in these securities, purchasers will be required to agree that their hedging transactions with respect to such securities will be conducted in compliance with the Securities Act, such as Rule 144 thereunder; and

• offshore resales under Rule 901 [8] or 904 of equity securities of domestic issuers that are "restricted securities," as defined in Rule 144, will not affect the restricted status of these securities.

The amendments are substantially as proposed with some important differences. To avoid undue interference with offshore offering practices of foreign companies, the amendments will apply to the equity securities of U.S. issuers, but not to the equity securities of foreign issuers. The distribution compliance period applicable to issuers and distributors under

Rule 903 will be extended to one year, rather than the proposed two years, to align Regulation S more precisely with the Rule 144 resale restrictions. In addition, promissory notes will not be prohibited in Regulation S transactions; rather, the notes must satisfy certain conditions set forth in Rule 144 before the purchaser can resell pursuant to that rule. These conditions should ensure that promissory notes are not used as a means to distribute securities into the United States. This refined approach will still forestall abuses related to the use of promissory notes in Regulation S transactions. Finally, the change from Form 8-K reporting to quarterly reporting will be delayed to allow the Commission staff to monitor developments under the amended rule.

II. BACKGROUND OF PROPOSALS AND COMMENTERS' CONCERNS

The Commission has acted to stem abuses of Regulation S by issuers, affiliates and others involved in the distribution process who were using Regulation S as a guise for distributing securities into the U.S. markets without the protections to investors of registration of the securities under the Securities Act. The Commission first stated its position about these abuses in a June 1995 interpretive release that described certain problematic practices under Regulation S. [9] The Commission also has instituted enforcement proceedings against participants in abusive Regulation S transactions. [10]

As a result of the continuation of certain of these abusive practices and in response to the comment letters received on the Interpretive Release, the Commission on February 20, 1997, proposed new restrictions to Regulation S to stop these abusive practices for placements of equity securities by domestic companies. [11] In addition, the Commission proposed to make these restrictions apply to foreign companies where the principal trading market for their securities is in the United States because of concerns that abusive practices might develop in the future. The Commission proposed to classify these equity securities of domestic and foreign companies placed offshore under Regulation S as "restricted securities" within the meaning of Rule 144, and to revise the applicable offering restrictions to ensure that these equity securities could not be sold or resold to U.S. persons (unless pursuant to registration or an exemption). [12]

The comments on the proposals were mixed. [13] A number of commenters supported the proposed amendments as necessary and appropriate to curb abusive practices and to facilitate legitimate offshore capital raising by U.S. companies. Others believed the proposals would severely restrict the ability of U.S. companies to access alternative offshore sources of capital. Several commenters objected to the extension of the revisions in the rule to foreign private issuers that have their principal market in the United States. These commenters urged that the application of the new resale restrictions, including the legending and stop transfer requirements, would be inconsistent with the requirements of offshore trading markets and public offering practices.

III. AMENDMENTS ADOPTED TODAY

A. Scope of the Amendments

1. Will Not Apply to Foreign Issuers for Which the United States is the

Principal Market

Although abusive practices under Regulation S have not been evident in offerings by foreign issuers, the Commission was concerned that abusive practices might develop in the future since the economic incentives for indirect distributions and resales into the United States are the same for equity offerings of both domestic companies and foreign companies where the principal market for their securities is in the United States. [14] Therefore, the Commission proposed that the Regulation S changes would treat these offerings similarly both with respect to the new Regulation S requirements, as well as the "restricted securities" classification under Rule 144.

The commenters strongly opposed this approach. They pointed out that subjecting foreign issuer securities to these restrictions was unnecessary in light of the absence of abuses with respect to those securities. They also asserted that there should be no presumption that a foreign issuer offering securities overseas is doing so to avoid the registration and disclosure requirements of the U.S. federal securities laws, even when it has a substantial trading market for its securities in the United States. Moreover, in the view of some these commenters, there is no reason to assume that indirect unregistered distributions into the United States will occur when these foreign issuers' securities are sold offshore.

The commenters also noted that if equity securities issued by these foreign companies are deemed restricted securities, the issuers in essence would be applying to their offshore offerings many of the standard practices used in U.S. private placements. The certification and purchaser agreement requirements would impose a significant burden on foreign issuers that wish to conduct public offerings in their home jurisdictions. In addition, many foreign stock exchanges will not permit trading of legended securities. The commenters asserted that the legending and stop transfer restrictions, as well as to a lesser extent the disclosure and certification requirements that would be imposed by the rule, would impede both public offerings and trading in those securities on offshore public markets that do not accept legended stock for trading. [15] As a result, the classification of foreign equity securities as "restricted" could create a strong disincentive for foreign companies to list their securities on U.S. markets.

While the Commission remains concerned with the potential for abuse, it has determined not to extend, at this time, the new requirements to the securities of foreign private issuers, regardless of the relative size of their U.S. markets to their worldwide trading. [16] The Commission agrees that absent a showing of abuse, imposing significant new restrictions on the offshore offering practices of foreign companies is not warranted. However, the Commission will monitor practices in this area, and will revisit the issue if abuses occur. Meanwhile, purchasers of these securities are reminded that Regulation S does not provide a safe harbor for resales of securities into the United States, and any resales must be made pursuant to a registration statement or an exemption from the Securities Act. Regardless of the foreign issuer's compliance with the Regulation S requirements, purchasers cannot purchase securities and resell them into the United States under circumstances in which they would be deemed statutory underwriters unless they register those resales. [17]

2. Will Apply to Public Offerings

Several commenters expressed the view that the proposed restrictions, including the designation of equity securities issued under Regulation S as restricted securities, were inconsistent with offshore public offering practices and the requirements of foreign trading markets. These commenters urged the Commission to adopt a distinction based on whether there was or will be a public trading market for the securities offshore following the offer, or whether the offering was subject to a foreign regulatory scheme governing public offerings.

Since most of the concerns in this respect were raised with regard to the extension of the requirements to foreign private issuers, those concerns are substantially addressed by the Commission's decision to limit the applicability of the new restrictions to domestic issuers. As discussed below, [18] the Commission believes that offering practices can be adopted to allow the new restrictions to be applied in the context of a public offering by domestic issuers, including share acquisitions. The existence of an offshore trading market would not eliminate the potential for abuse; for example, an offering could be made at a discount to purchasers offshore who may engage in an illegal distribution back into the United States. The Commission also is concerned that otherwise limited distributions to a small group of offshore investors easily could be structured as underwritten public offerings to avoid any additional restrictions on resales by those investors back into the United States. Accordingly, the amendments do not incorporate a distinction based upon whether a public trading market for the securities exists offshore, or whether the securities were issued in a public offering.

3. Will Apply to All Equity Securities of Domestic Companies,

Including Convertible Securities

Consistent with the proposal, the new procedures and restrictions and the "restricted securities" classification will apply only to offerings of equity securities. Rule 405 of Regulation C under the Securities Act defines the term "equity security" to include stock, securities convertible or exchangeable into stock, warrants, options, rights to purchase stock, and other types of equity-related securities. [19] The Commission is not applying the new restrictions to offerings of straight debt securities because the nature of the trading markets for debt securities appears not to have facilitated similar abusive practices. However, the new restrictions will apply to offerings of convertible debt securities because Regulation S abuses have involved the use of convertible or exchangeable securities and warrants. [20]

Commenters addressing the issue of whether the restrictions should apply to convertible securities urged the Commission to adopt the approach incorporated into Rule 144A. Under that approach, a convertible security is not treated as the same class as the underlying equity security if it has a conversion premium exceeding a specified percentage threshold over the market price of the underlying securities at the time of issuance. [21] If this approach were used in Regulation S, convertible securities with a sufficient conversion premium would not be subject to the new restrictions applicable to equity.

The new rules and restrictions will apply to all equity securities of U.S. issuers, including exchangeable or convertible securities and warrants, without regard to the conversion or exercise premium or other factors. It is clear that these securities can and have been used in abusive transactions.

The potential for abuse exists whenever a domestic issuer can create offshore, in a transaction not subject to the registration provisions of the U.S. securities laws, pools of equity securities that appear to be immediately tradeable back into the United States because of their unrestricted status. The Commission is reluctant to specify a conversion premium and thus possibly be viewed as condoning abusive practices in securities set above that threshold. In any event, given the volatility of the markets for the types of small capitalization companies in which the Commission has witnessed abuses, it would be difficult to set an appropriate threshold for all types of issuers. Finally, as discussed below, even with application of the new restrictions to convertible securities, the Commission does not believe that Regulation S will eliminate the use of these securities as a means to lower a U.S. issuer's cost of capital. Many issuers do not need to rely on Regulation S with respect to their sales of convertible securities because they can use Form S-3 to register the securities.

4. Will Apply to Securities in Employee Benefit Plans

Equity securities offered and sold to non-U.S. resident employees through an employee benefit plan governed by foreign law have not been subject to a distribution compliance period regardless of the domicile of the issuer or U.S. market interest in its securities. Since new Rule 905 would extend to all equity securities of domestic issuers, however, the proposals would classify those equity securities as restricted securities within the meaning of Rule 144 when issued to the employee.

Several commenters believed that it was inappropriate to require non-U.S. resident employees to accept restricted securities pursuant to their employee benefit plans. To the extent reporting U.S. issuers believe it is necessary to give their non-U.S. resident employees immediate access to the U.S. public markets in order to sell the security, Form S-8, which is effective immediately upon filing, is available to permit the issuer to register the securities on a streamlined basis. Consequently, the Commission has determined to apply Rule 905 to these securities as proposed.

B. Distribution Compliance Periods

As explained in greater detail in the Proposing Release, [22] the issuer safe harbor distinguishes three categories of securities offerings, based upon factors such as the jurisdiction of incorporation of the company whose securities are being sold, the company's reporting status under the Securities Exchange Act of 1934 ("Exchange Act"), [23] and the degree of U.S. market interest in the issuer's securities. [24] The Commission proposed shifting U.S. reporting companies to "Category 3" and lengthening the distribution compliance period applicable to domestic equity securities. The effect of the proposals would have been to lengthen the distribution compliance period for U.S. reporting companies from 40 days to two years. Issuers previously subject to Category 3 for their equity offerings -- non-reporting domestic issuers and foreign issuers with a significant U.S. market interest for their securities -- would have had their distribution compliance period extended from one to two years. During this period, issuers, distributors, and their affiliates would have been required to comply with the documentation and disclosure requirements imposed by Rule 903, and any offers and sales during this period could not be made to a U.S. person and still qualify for the safe harbor. In response to concerns raised

by commenters, the Commission is adopting a modified version of these proposals.

In addition, to further avoid confusion between the requirements applicable to issuers and distributors as a condition to perfecting their Rule 903 safe harbor and the Rule 144 safe harbor applicable to resales of the securities into the United States by the purchasers of those securities, the restricted period has been renamed the "distribution compliance period." This should clarify that the availability of the safe harbor to the issuer and distributors has no bearing on whether purchasers of Regulation S securities may be acting as statutory underwriters if they purchase with a view to reselling into the U.S. markets.

1. Extension of the Distribution Compliance Period

A distribution compliance period is required for Category 2 and Category 3 offerings under the issuer safe harbors because there is a greater likelihood that the securities will flow back into the United States. The purpose of the distribution compliance period is to ensure that during the offering period and the subsequent aftermarket trading that takes place offshore, the persons relying on the safe harbor -- issuers, distributors and their affiliates -- are not engaged in an unregistered, non-exempt distribution into the United States capital markets. [25] In addition to the prohibition against selling to U.S. persons during the distribution compliance period, these persons are subject to special requirements designed to provide assurance that the securities will come to rest offshore.

The Commission proposed the two-year distribution compliance period to make the restrictions on issuers and distributors consistent with the Rule 144 holding periods applicable to purchasers of the Regulation S securities under new Rule 905 and the amendments to Rule 144. The commenters generally agreed that the current 40-day distribution compliance period was insufficient to protect against use of an offshore offering to make an indirect offering into the United States, at least with respect to equity securities of domestic issuers. Some commenters argued, however, that the two-year period was not necessary and that a 90-day period, like that originally proposed when Regulation S was first formulated, would be sufficient. [26]

Consideration was given to eliminating the distribution compliance period altogether, on the premise that since the equity securities issued under Regulation S could not be sold back into the U.S. markets for a period of two years unless sold in a manner consistent with the Rule 144 requirements, the additional requirements of the distribution compliance period were unnecessary. However, the documentation, disclosure and certification requirements linked to the distribution compliance period, as well as the prohibition against offers and sales to a U.S. person during the distribution compliance period, provide important additional protections and assurance that, at least from the perspective of the distribution participants, the securities have come to rest offshore. Extending those requirements for a period of time after the closing of the offering is necessary, particularly with respect to distributors of those securities who may immediately make a market for the securities offshore. The purposes of the protections would be defeated if the requirements are applied only to the initial purchasers.

The Commission has decided to extend the distribution compliance period

substantially beyond 40 days to one year. The expiration of the one-year period will coincide with the period when limited resales may begin under Rule 144. At that point, the distribution compliance period is unnecessary. A two-year distribution compliance period, as originally proposed, could be confusing to apply because the distribution compliance period under Regulation S would cover a longer period than the holding period under Rule 144.

2. Offering Restrictions

Category 2 and Category 3 of Rule 903 require that "offering restrictions" [27] be implemented during the distribution compliance period. For offerings classified as Category 3, these offering restrictions include agreements by distributors that the securities will only be sold in accordance with the Securities Act or Regulation S, and a requirement for disclosure in all offering materials to the same effect. The amendments adopted today do not affect these requirements other than to:

• lengthen the period during which they must be implemented, as a result of the lengthening of the distribution compliance period; and

• require that additional language be provided in the mandated agreements and on the securities themselves, so that purchasers have notice that hedging transactions not in compliance with the Securities Act are prohibited.

3. Purchaser Agreements and Certifications

Category 3 imposes additional requirements not included in Category 2 relating to purchaser certifications and agreements. Those requirements will be imposed on equity offerings of domestic reporting companies for the first time under the amendments. In addition, the issuer and distributors will be subject to the additional requirements for a longer period, as a result of the longer distribution compliance period.

In keeping with a more restrictive approach to the types of Regulation S offerings where the Commission has observed the greatest potential for abuse, the Commission is adopting amendments that will require purchasers of equity securities in Category 3 offerings to agree to resell the securities, or to engage in hedging transactions, only in accordance with the registration or exemptive provisions of the Securities Act, or in accordance with Regulation S. [28] This agreement by purchasers of the covered equity securities should help ensure that purchasers have notice of the resale restrictions applicable to the securities. Purchasers of domestic equity securities of reporting companies also will now be required to certify that they are not U.S. persons and are not acquiring the securities for the account or benefit of a U.S. person, or that they are U.S. persons who purchased securities in a transaction that did not require registration under the Securities Act. This certification procedure should make it clear to all parties involved in the Regulation S offering that the rule may not be used to circumvent the registration requirements of the Securities Act. This should prevent some of the "sham" transactions described in the Interpretive Release where issuers or distributors "park" securities offshore with affiliates or shell entities that are actually owned by U.S. persons.

4. Legending and Stop Transfer Requirements

Under the amendments, Category 3 will now require all domestic issuers of

equity securities to place a legend on the securities sold offshore under Regulation S. This legend will advise that transfer of such securities is prohibited other than in accordance with Regulation S, pursuant to registration under the Securities Act, or pursuant to an available exemption from registration. The legend requirement will provide notice to any subsequent purchasers of the resale restrictions applicable to the securities. Legending equity securities of domestic reporting issuers until the expiration of the current 40-day distribution compliance period appears to be a common practice under Regulation S. The extension of the express legending requirement to reporting companies, when limited to domestic issuers, should not impose a different or new burden. In addition, as proposed, the current legending requirement is being amended, so that purchasers are aware that hedging transactions may not be conducted except in compliance with the Securities Act.

Category 3 also requires an issuer, by contract or a provision in its bylaws, articles, charter or comparable document, to refuse to register any transfer of securities unless made in accordance with the registration or exemptive provisions of the Securities Act, or in accordance with Regulation S. This requirement imposes on issuers a monitoring role similar to that which is often imposed in connection with unregistered private placements. In light of the abuses in this area, domestic reporting issuers should be held more accountable for compliance in these offerings.

Commenters were concerned that these procedures -- which have existed under Category 3 since before the adoption of Regulation S [29] and now are merely being extended to a broader class of issuers -- are inconsistent with public offering practices and that imposing these requirements will prevent the issuer from engaging in offshore public offerings or listings. Since these concerns were raised principally with respect to foreign issuers, they have been addressed by the decision not to extend Category 3 to reporting foreign issuers that have their principal market in the United States. [30] With respect to domestic issuers, although these requirements will not be complied with easily in an offshore public offering, the need to develop mechanisms to prevent abuse is clear. Absent measures like those required in Category 3, the Commission is concerned that abusive practices will continue. [31] Domestic reporting companies that find it too cumbersome to take advantage of the Regulation S safe harbor when conducting a public offering would simply register under the Securities Act or resort to other exempt offerings.

C. New Rule 905 -- Restricted Securities

Because some of the abusive practices under Regulation S have involved activities by persons other than issuers, distributors and their affiliates (investors who purchase Regulation S securities with a view to distributing those securities into the U.S. markets at the end of the 40-day distribution compliance period), the Commission believes that it is appropriate to clarify the legal obligations of purchasers of securities under Regulation S. The Commission proposed new Rule 905, and amendments to Rule 144(a)(3), to classify covered equity securities (of both reporting and non-reporting issuers) placed offshore under Regulation S as "restricted securities" within the meaning of Rule 144. By expressly defining these Regulation S securities as falling within the definition of "restricted securities" under the Rule 144 resale safe harbor, purchasers of those securities are provided with clear guidance regarding when and how those securities may be resold in the United States without registration under the Securities Act.

Several commenters believed that subjecting offshore purchasers of Regulation S securities to the Rule 144 holding periods would impair liquidity in those securities to such an extent that the safe harbor would no longer provide an alternative source of capital for U.S. companies. Instead, U.S. issuers would either have to register the offering or rely on a separate exemption, such as Regulation D or Section 4(2) under the Securities Act for private offerings.

1. Advantages of Regulation S

Notwithstanding the concerns raised by commenters, the Commission believes Regulation S will continue to offer significant advantages over the private offering exemptions. U.S. issuers can sell securities offshore without regard to the sophistication or number of purchasers in the offering or the size of the offering. Similarly, unlike Rules 505 and 506 of Regulation D, Regulation S does not contain specific information requirements. In addition, Regulation S permits issuers and distributors to advertise an offering offshore (consistent with the prohibition against directed selling efforts and the offshore transaction requirements) in a manner that would not be consistent with the prohibition against general solicitation in a private placement in the United States. Like the private offering exemptions, Regulation S will continue to afford U.S. issuers a means to sell securities without the potential delay and "market overhang" caused by registering equity securities under the Securities Act.

Purchasers will continue to have several sources of liquidity in addition to reliance on Rule 144. Offshore purchasers can continue to rely upon the Rule 904 safe harbor for offshore resales. They can also resell in the United States pursuant to exemptions other than Rule 144, including Rule 144A. Finally, and perhaps most importantly, it is possible that purchasers in Regulation S offerings could insist upon registration rights as do purchasers in private placements under Section 4(2) or Regulation D as a means of obtaining liquidity in the U.S. markets. [32] Particularly in the case of reporting companies, a Regulation S offering coupled with on demand registration rights provides an issuer with ready access to foreign capital while according purchasers access to U.S. markets for liquidity. [33]

2. Resales of Restricted Securities

Rule 905 also addresses the resale of restricted securities under Rule 904. Rule 905 clarifies that the resale of restricted securities offshore under Rule 904 does not "wash off" the restricted status of those securities to allow them to be freely resold into the United States by the purchaser. Several commenters argued that it was impossible to keep track of the restricted status of securities trading in offshore securities markets. With the widespread adoption of uncertificated securities and rules of offshore markets that prohibit the listing of legended securities, these commenters observed that the approach simply was not practicable.

By not extending Rule 905 to securities of foreign private issuers, the principal concerns of the commenters in this respect should be addressed. [34] Although some commenters have expressed concern that the certification and legending requirements may hinder free trading on offshore securities markets, without these requirements the potential for easy evasion of Rule 144’s resale limitations for domestic equity securities is high. Absent the mandatory certification and legending requirements, the purchaser would not be on notice that it is subject to any restrictions on the

resale of those securities into the United States. [35] It is possible that some markets can accommodate such securities, or may adapt to accommodate them in the future. Consequently, the Commission is adopting Rule 905 as proposed for domestic equity securities.

3. Retroactive Application of Rule 905

Rule 905 will not be applied retroactively to classify domestic equity securities previously sold under Regulation S as restricted securities under Rule 144. However, the provision of Rule 905 that codifies the Commission's interpretive position that resales offshore do not "wash off" restrictions will apply to offerings taking place before the effective date. This position was stated in the Interpretive Release and reiterated in the Regulation S Proposing Release.

D. Promissory Notes

Under the proposal, Regulation S would have prohibited the use of promissory notes or other executory obligations as payment for domestic equity securities. The proposal was designed to address abuses where the offshore purchaser used a promissory note to pay all or a portion of the purchase price of the securities. In some cases, the notes were secured only by the Regulation S securities; in other cases, the notes were unsecured. Some notes provided recourse to the buyer if the note was not repaid; others did not. Purchasers have resold the securities into the U.S. markets upon expiration of the 40-day distribution compliance period and used the proceeds of the resale to repay the note. Under such an arrangement, the issuer and purchaser clearly expect a U.S. resale to provide the funds necessary to repay the note; in economic substance, the issuer is raising funds from the U.S. public markets.

Rather than exclude such transactions from the coverage of the safe harbor, some commenters recommended that the Commission adopt the alternative approach suggested in the Proposing Release -- that is, to toll the holding period under Rule 144 until certain conditions are satisfied, similar to the tolling approach taken under Rule 144 with respect to promissory notes and other similar obligations. The Commission has decided to adopt this approach because it is persuaded that this approach will address concerns about the use of promissory notes to raise funds in the U.S. markets, since the securities purchased pursuant to Regulation S will be fully paid for before the securities can be resold into the U.S. markets pursuant to Rule 144. In that case, the resale of the securities into the U.S. markets under Rule 144 would not be used to raise funds to repay the promissory note. Under the approach adopted, promissory notes or similar obligations or contracts can be accepted as payment to purchase domestic equity securities under Regulation S. The holding period will not begin to run for the purchaser, however, unless the following conditions are satisfied: the promissory note, obligation or contract provides for full recourse against the purchaser of the securities, and is secured by collateral (other than the securities purchased) having a fair market value at least equal to the purchase price of the securities purchased. In addition, after the holding period requirement has been satisfied, the promissory note, obligation or contract must be paid in full before the resale of the securities under Rule 144. This ensures that the funds obtained through the Rule 144 resales will not be used to pay off the promissory note.

E. Reporting of Regulation S Transactions

As a result of amendments adopted by the Commission in October 1996, [36] sales of equity securities by domestic issuers under Regulation S are required to be reported on Form 8-K within 15 days of occurrence. All other unregistered sales of equity securities by domestic issuers (e.g., private placements) must be reported quarterly in the issuer's Form 10-Q and in its Form 10-K (for the last fiscal quarter). At the time the Commission adopted the Form 8-K 15-day reporting requirement, the Commission stated that if it extended the distribution compliance period for sales of equity securities under Regulation S, it would consider revising the reporting requirement.

The commenters generally favored dropping the Form 8-K requirement, although some thought that the Form 8-K report was important to stop abuses, and provided timely notice to shareholders and the markets of a material development concerning the issuer. Since equity securities sold under Regulation S will now be deemed restricted securities and thus cannot enter the U.S. public markets any faster than securities issued in an exempt private placement, the benefits of expedited Form 8-K reporting is minimal. Accordingly, the Form 8-K filing requirement is being eliminated, and these sales will be reported on Forms 10-Q, 10-QSB, 10-K or 10-KSB, as applicable. [37]

The Commission has determined to delay the effectiveness of this amendment, however, to allow the Commission staff to monitor closely developments under the amended Regulation S safe harbor procedures during a transition period. Accordingly, the Form 8-K report will not be required for any Regulation S sales occurring after January 1, 1999.

Following the October 1996 adoption of the Form 8-K reporting requirement, the Commission staff received inquiries regarding the need to report on Form 8-K unregistered sales of equity securities by U.S. companies to their non-U.S. resident employees pursuant to employee benefit plans. To the extent that the sales qualify for Category 1 treatment under Rule 903 of Regulation S, issuers may report the sales on an aggregated basis on the Form 10-Q, rather than on a current basis on Form 8-K, prior to January 1, 1999.

F. Technical And Clarifying Revisions

As proposed, the Commission is adopting non-substantive technical and clarifying revisions to Regulation S to make the rule more concise and understandable. The principal changes include:

• revising the captions of the three sections of the Rule 903 issuer safe harbor to refer to them as commonly known: "Category 1," "Category 2" and "Category 3";

• revising the Rule 903 issuer safe harbor to state clearly for each category what procedures are to be followed and what securities are eligible for each category;

• combining some definitions within Rule 902, the definition section of Regulation S, and moving certain definitions to the Rule 903 safe harbor to make the rule easier to read and understand;

• updating the list of "designated offshore securities markets" in Rule 902;

• if the same terms are already defined elsewhere in the Commission's rules and regulations, deleting those definitions from Rule 902 and adding

cross-references to the definitions contained elsewhere; and

• generally editing the language in the rule to make it more

understandable.

IV. CERTAIN FINDINGS

Section 23(a) of the Exchange Act [38] requires the Commission to consider any anti-competitive effects of any rules it adopts thereunder and the reasons for its determination that any burden on competition imposed by such rules is necessary or appropriate to further the purposes of the Exchange Act. Furthermore, Section 2 [39] of the Securities Act and Section 3 [40] of the Exchange Act, as amended by the National Securities Markets Improvement Act of 1996, [41] provide that whenever the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission also shall consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The Commission has considered the amendments discussed in this release in light of the comments received in response to the Proposing Release and the standards in Section 23(a) of the Exchange Act. [42] The Commission adopted Regulation S in 1990 to provide a safe harbor from the registration requirements of the Securities Act for offshore offers and sales of securities. Since the adoption of Regulation S, the Commission has become aware of abuses of this rule in connection with sales of domestic equity securities. The Commission is adopting the amendments to prevent further abuses of this rule.

In compliance with Section 2 of the Securities Act, which requires the Commission to consider whether the action will promote competition, it is important to note that the amendments will impose certain burdens on purchasers of equity securities issued by domestic companies, as well as on the issuers themselves, that may place domestic issuers at a competitive disadvantage in raising funds through Regulation S transactions as compared to foreign issuers. For example, purchasers of domestic equity securities sold pursuant to Regulation S may have to wait a longer period of time before they can publicly resell the securities into the United States. In addition, these purchasers will have to provide certification that they are not U.S. persons that may result in additional recordkeeping burdens on issuers and distributors who must maintain records of this compliance. Of course, any U.S. law applicable only to U.S. issuers will have some competitive effect on domestic issuers compared to foreign issuers. However, the Commission believes that such restrictions are necessary to deter abuses of the rule. Because abusive practices under Regulation S primarily have involved domestic companies, the Commission believes that it is not necessary at this time to apply additional restrictions on sales of equity securities by foreign issuers.

Although the amendments will impose certain burdens on both purchasers and issuers of equity securities issued by domestic companies, the Commission anticipates that the overall effect of the amendments will be to enhance efficient capital formation. By deterring abusive market practices, the amendments will protect investors and promote capital formation by enhancing investors' confidence in the integrity of Regulation S offerings.

The Commission is adopting amendments to relax the requirements to report unregistered sales of equity securities made pursuant to Regulation S. Such sales will now be reported on a delayed basis on Forms 10-Q, 10-QSB, 10-K and 10-KSB, rather than Form 8-K. However, investors will continue to have sufficient information regarding changes in outstanding securities of public companies. These amendments could decrease Form 8-K filing burdens for some reporting issuers, although the new requirements to report unregistered equity sales on a quarterly basis could result in an offsetting increase in reporting. Nonetheless, the Commission believes the amendments will promote efficiency and capital formation, and will not unnecessarily burden competition.

V. COST-BENEFIT ANALYSIS

The Commission adopted Regulation S to enhance access to offshore securities markets for both foreign and domestic issuers. Regulation S provides a safe harbor from the registration requirements of the Securities Act for offshore offers and sales of securities. In spite of the overall success of this rule, Regulation S has been abused with respect to sales of equity securities by domestic issuers. Abuses have occurred in which these securities have inappropriately been distributed back into the United States after the Regulation S transaction in violation of U.S. laws and regulations. As a result of these abuses, fraudulent schemes involving millions of dollars have been perpetrated through the use of Regulation S.

The amendments to Regulation S will prevent further abusive practices under this rule, and will protect investors and promote capital formation by enhancing the integrity of the securities markets. At the same time, the amendments will permit continued reliance on Regulation S for legitimate offshore offerings.

The amendments will impose restrictions on purchasers of equity securities of U.S. issuers, as well as on the issuers themselves, that may make it more costly for such issuers to raise funds through Regulation S placements. For instance, some purchasers may now have to wait a longer period of time before they can publicly resell the securities into the United States. In addition, the amendments will require purchasers of domestic equity securities sold under Regulation S to provide certification that they are not U.S. persons. This may impose additional recordkeeping burdens on issuers and distributors that must maintain records of such compliance, which could make Regulation S sales of their equity securities more costly for these issuers. However, the Commission believes that these restrictions are needed to prevent abusive practices that have occurred under Regulation S. By deterring abusive market practices, the amendments will protect investors and promote capital formation by enhancing investors' confidence in the integrity of the securities markets.

Based on a review by Commission staff of Form 8-Ks filed by issuers to report equity sales made under Regulation S, the Commission estimates that approximately 500 Exchange Act reporting companies conduct approximately 550 sales pursuant to Regulation S each year and that over $5 billion in equity sales will be affected by the amendments. The total number of companies affected by the amendments is not known because non-reporting companies are not required to file Form 8-K and the Form 8-K reporting requirement only applies to sales of equity securities under Regulation S.

Although the new requirements, such as the purchaser certifications and

purchaser and distributor agreements, may increase costs to issuers, the Commission believes that the increase will be negligible. According to an informal survey taken by Commission staff of attorneys in private practice whose clients could be expected to rely on these safe harbors, domestic issuers that sell equity securities under Regulation S already comply with the certification and legending requirements of Category 3 as a matter of common practice. No new costs will be imposed on domestic issuers as a result of formally extending the Category 3 requirements to sales of equity securities by domestic issuers. The new requirements with respect to hedging transactions under Regulation S are expected to have a negligible impact on costs because the amendments will only require issuers to add an additional sentence with respect to hedging on the securities, and in the purchaser agreements. Private practitioners surveyed by the Commission staff have indicated that the increased costs as a result of the amendments with respect to hedging are insignificant.

The amendments to Forms 8-K, 10-Q, 10-QSB, 10-K and 10-KSB relax the requirements to report unregistered sales of equity securities by delaying the reporting of the unregistered sale. The sufficiency of the information provided to investors about unregistered offerings made by public companies should not be affected. However, the Commission believes the reduction in burdens and costs will be negligible. As a result of these amendments, information on unregistered offerings (include private placements and Regulation S offerings) during a given time period will now be available to investors in one filing.

The Commission is amending Regulation S to clarify the legal obligations of purchasers of securities under that rule. Some of the abuses under Regulation S have involved activities by persons other than issuers, distributors and their affiliates -- investors who purchased with a view to distributing the securities into the U.S. markets at the end of the distribution compliance period. The Commission is attempting to address this abuse by defining these securities as "restricted securities" under the Rule 144 resale safe harbor. However, the Commission does not believe that this classification will be unduly burdensome for purchasers in Regulation S offerings. The holding periods under Rule 144 were shortened [43] at the same time that the Regulation S amendments were proposed, and some purchasers of securities sold under Regulation S may be able to demand registration rights. If a purchaser decides to resell the securities under the Rule 144 safe harbor, the Commission does not believe that the requirement to file a Form 144 under those circumstances will be unduly burdensome, especially given the benefits of resale under that safe harbor. The Commission estimates that this amendment will result in approximately 750 additional filings on Form 144 per year, and an increase of approximately 1,500 hours per year in total annual reporting and recordkeeping burdens. [44] The Commission estimates that the total increase in costs as a result of this amendment will be approximately $45,000 per year. [45]

Restricted shares normally must be sold at a discount relative to the price of shares that are freely tradable in the public markets. The size of that price discount reflects, at least in part, the compensation buyers of shares receive for giving up the ability to readily sell the shares immediately in the public market. The size of the price discount is affected by a variety of factors including how long the restricted shares must be held before they can be sold in the public markets. Discounts are likely to increase with the length of the distribution compliance period. Therefore, the Commission

expects discounts on Regulation S securities to increase as a result of the increase in the minimum distribution compliance period from 40 days to one year. However, it is difficult to determine how large that increase is likely to be, and no commenters provided any empirical data in this regard. The Commission's Office of Economic Analysis' study of recent sales of Regulation S shares indicates that they were sold at an average discount of approximately 22%. Studies that have measured price discounts of shares subject to the longer Rule 144 restricted periods found that the discounts averaged about 20% in the 1980-1987 period according to one study, and 34% in the 1981-1988 period according to another study. [46] The average price discount of more recent sales of shares subject to Rule 144 may be smaller because the restricted periods were shortened by one year. [47]

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

This Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with the Regulatory Flexibility Act [48] with respect to the amendments.

A. The Need for and Objectives of the Amendments to Regulation S

The amendments to Regulation S are designed to stop abuses under Regulation S in which domestic issuers conduct offshore placements of their securities under Regulation S that result in indirect distributions of these securities into the U.S. markets without the protection of registration under the Securities Act.

B. Summary of Significant Issues Raised by the Public Comments

The Commission requested comment with respect to the Initial Regulatory Flexibility Analysis ("IRFA") prepared in connection with the Proposing Release, but did not receive any comments that specifically addressed the IRFA.

C. Description and Estimate of the Number of Small Entities That the

Amendments Will Affect

These amendments will affect persons that are small entities, as defined by the Commission's rules, but only in the same manner as larger entities. The Commission is aware of approximately 1100 Exchange Act reporting companies that currently satisfy the definition of "small business" under Rule 0-10 [49] of the Exchange Act. While the Commission sought comment on the number of non-reporting issuers that may be affected by the proposed changes, commenters did not provide any additional data on such number. However, there is no reliable way of determining how many non-reporting companies may be subject to Regulation S. Furthermore, there is no reliable way of determining how many small businesses may become subject to the Commission's registration and reporting obligations in the future.

Based on a review by Commission staff of a sample of the Form 8-Ks filed with the Commission to report Regulation S equity sales, [50] approximately 500 Exchange Act reporting companies conduct approximately 550 sales pursuant to Regulation S each year, and will be affected by the amendments. The Commission estimates that over 160 of these reporting companies would meet the Regulatory Flexibility Act definition of small

business. However, the Commission has only been receiving data regarding offshore placements of equity securities under Regulation S since November 18, 1996, and does not have any long-term data that would enable the Commission to develop precise estimates of the number of small businesses that may actually rely on Regulation S, or that may otherwise be affected by the amendments. Commenters did not provide any additional quantitative data in that regard. In addition, the Form 8-K reporting requirement only applies to sales of equity securities by domestic reporting issuers, and does not apply at all to non-reporting companies. As a result, the total number of small entities that conduct sales under Regulation S will exceed the numbers referenced above.

D. Description of the Projected Reporting, Recordkeeping and Other Compliance Requirements of the Amendments

Regulation S is being amended to include new reporting, recordkeeping and other compliance requirements. In general, compliance with the new reporting and other compliance requirements will require the professional skills of attorneys and paralegals specializing in securities or corporate law. The Commission is lengthening the distribution compliance period during which persons relying on the Regulation S safe harbor may not sell to U.S. persons and must institute certain precautionary measures against such sales. The Commission also is classifying these securities as "restricted securities" within the meaning of Rule 144. As a result, purchasers of these securities may resell these securities under the Rule 144 safe harbor, and would be required to comply with the conditions of that safe harbor, including the Rule 144 holding periods. These amendments may reduce incentives to conduct equity placements under Regulation S due to a perceived reduction in the liquidity of these securities absent registration under the Securities Act or a valid exemption.

The amendments will impose on reporting domestic issuers certification, legending and other requirements that previously only applied to sales of equity securities by non-reporting issuers. These requirements are intended to assure that participants in the distribution, as well as the purchasers, are aware of the restricted nature of these securities. The amendments will expand the current purchaser and distributor agreement requirements to require that purchasers and distributors agree not to engage in hedging transactions with respect to these securities unless the transaction complies with the Securities Act, [51] and will ensure that participants in the Regulation S offerings are aware of and comply with these restrictions.

Because equity securities of domestic issuers placed under Regulation S will be treated as "restricted securities" under Rule 144, the holding period will be tolled for securities purchased with a promissory note unless certain conditions under Rule 144 are satisfied. These amendments are designed to address abuses involving hedging transactions and the use of promissory notes that result in indirect distributions of securities into the U.S. markets without the protection of registration. These additional purchaser requirements could increase recordkeeping and compliance burdens. However, they are expected to have an indirect impact on small U.S. businesses because, in most cases, the purchasers of securities sold under Regulation S would be non-U.S. persons.

The new amendments to Regulation S also will clarify that offshore resales under Rule 904 of equity securities of domestic issuers that are "restricted securities," as defined in Rule 144, will not affect the restricted status of

those securities. These changes clarify the requirement that holders of restricted securities may not remove the restrictions by selling the securities offshore.

The amendments to Forms 8-K, 10-Q, 10-QSB, 10-K and 10-KSB will relax the requirements to report unregistered sales of equity securities by delaying the reporting of the unregistered sale. However, the sufficiency of the information provided to investors regarding changes in outstanding securities of public companies should not be affected. The amendments to Forms 8-K, 10-QSB and 10-KSB will affect small entities, as defined by the Commission's rules. The Commission expects that the amendments will reduce Form 8-K filing burdens for some reporting companies that qualify as small businesses. However, as a result of the requirement to report unregistered sales of equity securities on Forms 10-Q, 10-QSB, 10-K and 10-KSB, there will be an offsetting increase in reporting with no net effect on overall reporting burden.

E. Description of Steps Taken to Minimize Effect on Small Entities and

Consideration of Alternative Approaches

All of the amendments are being imposed on all domestic issuers. Small businesses will be able to obtain the protections of Regulation S on the same basis as larger entities. The Commission considered and rejected several alternatives to the amendments applicable to small businesses because it believes that the alternative approaches would not be consistent with the Commission's statutory mandate of investor protection. One alternative would be to establish differing compliance or reporting requirements or timetables that take into account the resources available to small entities. This alternative would not be consistent with the intent of the amendments to forestall abusive practices under Regulation S, especially because some of the abuses have involved the securities of small issuers.

Another alternative would be to clarify, consolidate or simplify the amendments with respect to small businesses. It would be difficult to further clarify, consolidate or simplify the amendments and concurrently prevent abuses under Regulation S. The Commission believes the amendments impose the minimum requirements necessary to prevent further abuses under Regulation S.

In addition to these alternatives, the Commission has considered establishing separate requirements for small businesses that are based on performance rather than design standards. However, in the context of providing a safe harbor from the Commission's registration requirements for offshore offerings, the adoption of performance standards would be inconsistent with the Commission's statutory mandate to require full and fair disclosure of material information to investors, in compliance with the federal securities laws, and would not provide the kind of legal certainty that practitioners seek in a safe harbor rule.

Finally, the Commission has considered exempting small businesses from coverage of the amendments. However, the amendments are intended to address abusive practices that have occurred under Regulation S, including abuses that have involved the securities of small issuers, such that further distinctions between companies based on size would not be appropriate.

The Commission believes that by adopting the amendments, it is balancing

its objective of preventing abuses under Regulation S with its statutory mandate of maximizing investor protection in a manner that is more appropriate than other alternatives.

Although the amendments to Regulation S may affect the ability of some small businesses to access offshore capital, the amendments should be sufficient to curb abusive practices under Regulation S without entirely foreclosing the offshore market for unregistered offshore offerings of equity securities by domestic issuers. Moreover, the recent adoption of shortened holding periods under Rule 144 should help reduce any negative effect on small businesses.

VII. PAPERWORK REDUCTION ACT

As set forth in the Proposing Release, the amendments to Regulation S could affect changes to collections of information within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). [52] As a result of these amendments, equity securities of domestic issuers that are issued offshore under Regulation S will be deemed "restricted securities" as defined in Rule 144 under the Securities Act. Purchasers of these securities, and any subsequent purchasers, could resell these securities into the U.S. markets according to the conditions of Rule 144. These conditions include the requirement that these purchasers file a notice of proposed sale on Form 144 that discloses information about the issuer of the securities, the seller, the securities to be sold and the proposed manner of sale. In addition, the amendments to Forms 8-K, 10-Q, 10-QSB, 10-K and 10-KSB will relax the reporting requirements pertaining to unregistered sales of equity securities by delaying the reporting of the unregistered sale. Regulation S issuers will no longer have the burden of filing Form 8-K to report unregistered sales of equity securities. However, as a result of the requirement to report unregistered sales of equity securities on Forms 10-Q, 10-QSB, 10-K and 10-KSB, there will be an offsetting increase in reporting burden, with no net effect on the reporting burden relating to these Forms.

Under the proposed amendments, reporting foreign issuers with their primary market in the United States would have been subject to additional collections of information. Several commenters objected to this aspect of the proposals. As a result, the amendments as adopted do not apply to these foreign issuers, and the overall paperwork burden is somewhat reduced.

Regulation S provides a safe harbor from registration that is available on a voluntary basis to issuers and other parties. However, if an issuer or other person chooses to rely on the Regulation S safe harbor, it is required to provide the applicable collections of information. To the extent the required collections of information are filed with the Commission, such as Form 144 and the Exchange Act periodic reports, they will not be kept confidential.

The collection of information requirements affected by the amendments were submitted to OMB for review and were approved by OMB, which assigned the following control numbers: Form 144, control number 3235-0101; Form 8-K, control number 3235-0060; Form 10-K, control number 3235-0063; Form 10-Q, control number 3235-0070; Form 10-QSB, control number 3235-0416; and Form 10-KSB, control number 3235-0420. The collection of information requirements are in accordance with Section 3507 [53] of the PRA. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the agency

displays a valid OMB control number. The descriptions and estimated burdens for the collection of information requirements were set forth in the Proposing Release.

FOOTNOTES

-[1]- 17 CFR 230.903.

-[2]- 17 CFR 230.901 - 230.905 and Preliminary Notes.

-[3]- 15 U.S.C. 77a et seq.

-[4]- 17 CFR 230.144(a)(3).

-[5]- 17 CFR 230.905.

-[6]- 17 CFR 230.904.

-[7]- Rule 905, which classifies these securities as "restricted," will not be applied retroactively. See infra Section III.C.3.

-[8]- 17 CFR 230.901.

-[9]- Securities Act Release No. 7190 (June 27, 1995) (60 FR 35663(July 10, 1995)) (the "Interpretive Release").

-[10]- See SEC v. Schiffer , Litigation Release No, 15435 (Aug. 7, 1997); In re GFL Ultra Fund Ltd. , Securities Act Release No. 7423 (June 18, 1997); SEC v. PanWorld Minerals Int'l, Inc. , Litigation Release No. 15380 (June 2, 1997); SEC v. Members Service Corp. , Litigation Release No. 15371 (May 22, 1997); SEC v. Rosenfeld , Litigation Release No. 15274 (Mar. 5, 1997); United States v. Sung and Feher , Litigation Release No. 14901 (May 6, 1996); In re Candie's, Inc. , Securities Act Release No. 7263 (Feb. 21, 1996); SEC v. Scorpion Technologies, Inc. , Litigation Release No. 14814 (Feb. 9, 1996); SEC v. Sarivola ; Litigation Release No. 14704 (Oct. 31, 1995); SEC v. EnvirOmint Holdings, Inc. , Litigation Release No. 14683 (Oct. 6, 1995); SEC v. Softpoint, Inc. , Litigation Release No. 14480 (Apr. 27, 1995); SEC v. Rehtorik , Litigation Release No. 13975 (Feb. 23, 1994); SEC v. Westdon Holding & Inv., Inc. , Litigation Release No. 13263 (June 5, 1992).

-[11]- Securities Act Release No. 7392 (Feb. 20, 1997)(62 FR 9258 (Feb. 28, 1997))(the "Proposing Release").

-[12]- The Commission proposed to revise the offering restrictions imposed by Regulation S by: (1) aligning the Regulation S restricted period for these equity securities with the Rule 144 holding periods by lengthening the restricted period from 40 days or one year, as applicable, to two years; (2) by imposing certification, legending and other requirements; (3) by requiring purchasers of these securities to agree not to engage in hedging transactions unless the transactions comply with the Securities Act; (4) by prohibiting the use of promissory notes to pay for these securities; and (5) by clarifying that offshore resales of equity securities that are "restricted securities," as defined in Rule 144, will not "wash off" the restricted status of these securities.

-[13]- The 47 comment letters received are available for inspection and copying in the Commission's public reference room. Refer to file number S7-8-97. The twelve comment letters that were submitted via electronic

mail may be viewed at the Commission's web site: http://www.sec.gov.

-[14]- The Commission proposed defining "principal market in the United States" for a security as when more than 50% of all trading in such class of securities took place in, on or through the facilities of securities exchanges and inter-dealer quotation systems in the United States in the shorter of the issuer's prior fiscal year or the period since the issuer's incorporation. This definition differs from the "substantial U.S. market interest" test that is used to determine whether a foreign issuer qualifies for less restrictive treatment under Category 1 of Rule 903. See Proposing Release at Section II.

-[15]- A number of commenters also noted that the 50% threshold for determining the principal market as being in the United States that was proposed by the Commission was too low and would make the restrictions applicable to a large number of foreign issuers. One commenter noted that even if the standard were 100% of the reported trading volume, 10% of the foreign companies listed in the United States are traded solely in the United States and would be subject to the new requirements. See generally, "U.S. Investors Look Across the Atlantic," THE WASHINGTON POST, Aug. 31, 1997, at H2 (because of U.S. investor interest in foreign stocks, the New York Stock Exchange may be the principal market for many leading European companies).

-[16]- The Commission currently is considering other alternatives to prevent fraudulent practices that may occur in connection with the securities of foreign issuers. See Securities Exchange Act Release No. 34-39670 (Feb. 17, 1998).

-[17]- See Interpretive Release at n.17; Proposing Release at n.41.

-[18]- See infra Section III.C.1.

-[19]- 17 CFR 230.405. Under the amendments adopted today, non-participating preferred stock and asset-backed securities would continue to be treated in the same manner as debt securities for purposes of the Regulation S safe harbors and the restricted security classification. See Rule 902(a)(17 CFR 230.902(a)), (formally Rule 903(c)(4)).

-[20]- See "Pirates' Play?", BARRON'S, Jan. 7, 1997, at 17.

-[21]- See Rule 144A(d)(3)(i) (17 CFR 230.144A(d)(3)(i)). See also Securities Act Release No. 6862 (Apr. 23, 1990) (55 FR 17933 (April 30, 1990)) at nn.25 and 26 for a discussion of how the conversion or exercise premium is determined for purposes of Rule 144A.

-[22]- See Proposing Release at Section II.

-[23]- 15 U.S.C. 78a et seq.

-[24]- See discussion at nn.13-16 of the Proposing Release.

-[25]- See Securities Act Release No. 6863 (Apr. 24, 1990)(55 FR 18306(May 2, 1990))(the "Adopting Release") at Section III.B.

-[26]- The longer distribution compliance periods also extend the time during which the issuer and distributors could not engage in directed selling efforts in the United States. See Adopting Release at Section III.B.1.b. One commenter expressed concern that the two-year distribution compliance

period places an unworkable "black-out" restriction on publication of research regarding the issuer's securities.

-[27]- The term "offering restrictions," as amended, is defined in Rule 902(g) (17 CFR 230.902(g)).

-[28]- Issuers, however, would be free to require purchasers to agree not to engage in any hedging transactions, even if the transaction would be consistent with the Securities Act. The amendments do not impose any new restrictions on hedging practices. The Commission is considering proposed restrictions on hedging under Rule 144 that, if adopted, would be in addition to those currently applicable to restricted securities transactions under that rule. See Securities Act Release No. 7391 (Feb. 20, 1997) (62 FR 9246 (Feb. 28, 1997)) ("Rule 144 Proposing Release")(discusses current and proposed restrictions on hedging restricted securities).

-[29]- See, e.g. , InfraRed Associates, Inc., SEC No-Action Letter (Sept. 13, 1985).

-[30]- The Category 3 requirements, other than legending, already apply to equity offerings by non-reporting foreign issuers where there is a substantial U.S. market interest in the security. The amendments do not affect this aspect of Rule 903.

-[31]- As the Commission noted in the Proposing Release: Regulation S does not require, and the Commission is not proposing, that the legend contain specific language to describe these restrictions. Issuers and distributors should prepare such legends in a form that conveys to holders the restricted nature of the securities and that they can only be resold under Regulation S, pursuant to registration under the Act, or under an exemption. Nor is the legend requirement intended to require that securities sold under Category 3 be in certificated form. Issuers whose securities are in uncertificated form may satisfy the legend requirement by any means which puts holders and subsequent purchasers on notice of the applicable resale restrictions. Proposing Release at Section III.B.4. Depending on the circumstances, the following alternatives, among others, may be sufficient to put holders on notice and prevent a public distribution into the United States: notices of the restrictions to investors on the confirmation or allotment telex, use of global securities held in a depository, and restrictions on trading in the United States through the use of restricted CUSIP numbers.

-[32]- Form S-3 (17 CFR 239.13) is generally available for these types of resale registration statements, even for companies that do not meet the public float requirement for primary offerings under Form S-3, if the securities are listed on a U.S. securities exchange or quoted in the Nasdaq Stock Market.

-[33]- The Commission proposed to amend Rule 903 to make clear that registered or exempt sales to U.S. persons during the distribution compliance period would not impair reliance on Regulation S. Language instead has been added to Preliminary Note 5 to make clear that registered offers and sales to U.S. persons, or offers and sales made pursuant to an exemption such as Rule 144A, are permitted during the distribution compliance period without jeopardizing the issuer's reliance on Regulation S for the offshore offers and sales.

-[34]- For example, because of its limited scope there should be no basis

for a concern that Rule 905 could restrict the ability of a foreign security that was privately placed in the United States to be sold back into its home market offshore in a Rule 904 or Rule 144A transaction.

-[35]- The Commission is adopting the proposed amendment to Rule 144(e)(3)(vii) that codifies the Commission staff's informal position that restricted securities resold offshore pursuant to Regulation S need not be included in the amount of securities that have been resold pursuant to Rule 144 for the purposes of the volume limitations of Rule 144(e).

-[36]- Exchange Act Release No. 37801 (Oct. 10, 1996) (61 FR 54506 (Oct. 18, 1996)).

-[37]- The Commission is not, however, amending Item 701 of Regulation S-K (17 CFR 229.701) and Regulation S-B (17 CFR 228.701) to remove the reference to Form 8-K as proposed. To the extent an issuer chooses voluntarily to report an unregistered sale of securities on Form 8-K, in addition to Forms 10-Q, 10-QSB, 10-K or 10-KSB, the information required by Item 701 must be provided.

-[38]- 15 U.S.C. 78w(a).

-[39]- 15 U.S.C. 77b.

-[40]- 15 U.S.C. 78c.

-[41]- Pub. L. No. 104-290, §106, 110 Stat. 3416 (1996).

-[42]- The finding required by Section 23(a) of the Exchange Act only relates to amendments under the Exchange Act, such as amendments to Forms 8-K and 10-Q, and not to amendments under the Securities Act. In general, the Exchange Act amendments, by easing the Form 8-K reporting requirements, should not affect competition.

-[43]- Securities Act Release No. 7390 (Feb. 20, 1997) (62 FR 9242 (Feb. 28, 1997)).

-[44]- See Proposing Release at Section IX.

-[45]- This estimate assumes that each Form 144 filing requires two hours of preparation at a cost of $60 per filing.

-[46]- See Michael Hertzel and Richard L. Smith, Market Discounts and Shareholder Gains for Placing Equity Privately , J. OF FIN., June 1993; William L. Silver , Discounts on Restricted Stock: The Impact of Illiquidity on Stock Prices , FIN. ANALYSTS J., July-Aug.1991.

-[47]- See Securities Act Release No. 7390, supra note 43.

-[48]- 5 U.S.C. 604.

-[49]- 17 CFR 240.0-10.

-[50]- Since November 18, 1996, sales of equity securities by domestic issuers under Regulation S are required to be reported on Form 8-K within 15 days of occurrence. This reporting requirement does not apply to any issuer who is not subject to the periodic reporting requirements under the Exchange Act, and generally does not apply to foreign issuers. See Exchange Act Release No. 37801, supra note 36.

-[51]- No new restrictions on hedging practices are being imposed as a result of the amendments. See supra note 28.

-[52]- 44 U.S.C. 3501 et seq.

-[53]- 44 U.S.C. 3507.

On to Part II

http://www.sec.gov/rules/final/33-7505.htm
