Banking Law

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What's Fair is Fair for Bank Holding Companies: Using Fairness Hearings in Mergers to Avoid SEC Registration

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Following President Obama's signing of the "Jumpstart Our Business Startups Act" (the "JOBS Act") last week, private bank holding companies ("BHCs") can now avoid registration under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), so long as they have less than two thousand (2,000) shareholders of record at the end of any fiscal year. This is a substantial increase from the five hundred (500)-shareholder threshold in effect prior to adoption of the JOBS Act. By avoiding Exchange Act registration, BHCs will not have to file annual and quarterly reports with the SEC or incur the other substantial costs and expenses associated with being a registered company. This is particularly advantageous for BHCs since they, unlike other issuers, can list their securities on the Over-the-Counter Bulletin Board without registering under the Exchange Act and can achieve some semblance of liquidity in their stock.

Separately, in the context of mergers and acquisitions, BHCs that used stock as all or part of any acquisition currency were often faced with the daunting task of preparing a robust registration statement on Form S-4 knowing that at the end of the year after completion of an acquisition, they were likely to have more than 500 shareholders and thereby become a reporting company. Following the adoption of the JOBS Act, however, BHCs should take another look at using a California fairness hearing to issue their securities rather than filing a registration statement with the SEC.

Section 3(a)(10) of the Securities Act of 1933, as amended, provides for an exemption from registering securities with the SEC in exchange for other securities if the terms of such issuance and exchange are approved in a state fairness hearing. California is one of only a handful of states to offer such a hearing process. Pursuant to 25142 of the California Corporations Code, California accords the opportunity for an issuer of stock in a merger to seek a fairness hearing as part of the application for qualification of the offer and sale of the securities being used in the acquisition.

Prior to the JOBS Act, a BHC with 400 shareholders seeking to acquire another financial institution with 250 shareholders and wanting to use its stock as currency would have faced a SEC registration requirement. Now, a successful fairness hearing will allow the acquiring BHC to obtain the requisite permit and exemption under the federal securities laws and applicable California state securities laws. Assuming compliance with all other applicable laws, following the acquisition, the acquiring BHC will be positioned at the end of the year with over 600

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shareholders but with no obligation to register with the SEC. Had the BHC used a Registration Statement on Form S-4, instead, to issue its stock in the acquisition, it would be subject to all the applicable filing and regulatory obligations imposed on Exchange Act registrants.

In the above scenario, prior to the passage of the JOBS Act, the acquiring BHC in the scenario above could certainly have used a fairness hearing to issue its stock in an acquisition, but at the end of the year in which the acquisition occurred, the acquiring BHC would have been required to register under the Exchange Act. Thus, the fairness hearing merely delayed the inevitable SEC registration. Following the passage of the JOBS Act, however, the acquiring BHC can completely avoid filing with the SEC (and use fairness hearings on an ongoing basis) until it reaches 2,000 shareholders.