HINSHAW

Alerts

Congress Passes JOBS Act in Effort to Make Raising Capital Easier

April 5, 2012
Corporate / Financial Institutions Alert

On March 8, 2012, the U.S. House of Representatives approved a package of six bills designed to boost access to private capital (the JOBS Act). The JOBS Act was passed by the Senate on March 22, 2012 with some revisions. The House approved the Senate version on March 27, 2012. and President Obama signed the legislation on April 5, 2012.

The JOBS Act eases restrictions on the sale of securities, increases the number of shareholders a company must have before becoming subject to the SEC's reporting and disclosure rules and provides that "emerging growth companies" will be exempt from certain financial disclosure and governance requirements for up to five years.

H.R. 3606 – Emerging Growth Companies

Many companies are reluctant to undertake an initial public offering (IPO) because in doing so they will become subject to various SEC rules and regulations thereafter.

H.R. 3606 affords companies that file an IPO a temporary reprieve from certain SEC regulations by exempting an emerging growth company (EGC) from these regulations for up to five years. An EGC is defined as a company with gross revenues of less than $1 billion in its most recently completed fiscal year. An EGC will retain such status until the earlier of: (1) the fifth anniversary of the date it first sold securities pursuant to an IPO registration statement; (2) the last day of the fiscal year in which it first exceeds $1 billion in annual gross revenues; (3) the time it becomes a large accelerated filer (an SEC registered company with a public float of at least $700 million); or (4) the date on which the EGC has, within the previous three years, issued $1 billion of non-convertible debt.

The provisions of H.R. 3606 will be effective upon the enactment of the JOBS Act.

H.R. 3606 provides that when registering its securities in an IPO, an EGC need only present two (rather than three) years of audited financial statements, thereby saving registration expenses. In any other registration statement, an EGC need not present selected financial data or an MD&A discussion for any period prior to the earliest audited period presented in the IPO.

Attorneys

Timothy M. Sullivan

Service Areas

Business & Commercial Transactions

Business Formation

Mergers & Acquisitions

Securities

H.R. 3606 allows an EGC to submit the company's IPO registration statement and any amendments for confidential review and comment by the SEC prior to the EGC's public filing of the registration statement. After the registration statement has been approved by the SEC, the EGC must file the IPO registration statement, as amended, at least 21 days prior to commencing a road show for the offering. Confidential IPO submissions are not subject to Freedom of Information Act requests.

Other measures intended to ease the IPO process would:

- permit an EGC and persons acting on its behalf to "test the waters" by communicating (orally or in writing) with qualified institutional buyers or institutions that are accredited investors to determine whether such investors might have an interest in a contemplated securities offering. These communications can be made before or after the filing of a registration statement;
- allow brokers and dealers to publish or distribute a research report about an EGC that is the subject of a proposed public offering of common equity securities, before or after the registration statement is filed or effective, even if the broker or dealer is participating or will participate in the offering;
- prohibit any restrictions regarding who may arrange for communications between securities analysts and potential IPO investors;
- remove restrictions which prohibit securities analysts from participating in communications with an EGC's management in connection with an IPO; and
- allow brokers or dealers to publish or distribute any research report or make any public statement about an EGC's securities during the standard lock-up period or any other post-IPO period.

The legislation provides that an EGC will not have to comply with Section 404(b) of Sarbanes-Oxley which requires that the accountants for a public company to attest to, and report on, management's assessment of its internal controls. EGCs are also exempt from any: (1) future audit firm rotation rules that may be adopted by the SEC and any rule adopted by the Public Company Accounting Oversight Board unless the SEC decides that application of such rules to EGCs is necessary; or (2) new or revised financial accounting standards until such rules are applicable to private companies.

During this exemption period, an EGC will not have to comply with the "Say-On-Pay", "Shareholder Approval of Golden Parachute Compensation" and "Disclosure of Pay Versus Performance" provisions that were included as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act; the SEC rules to implement the last listed provision have not been adopted. Furthermore, an EGC may elect smaller reporting company scaled back disclosure under Item 402 of Regulation S-K with respect to executive compensation disclosures. This exemption reduces the number of named executive officers for whom compensation disclosure is required to three from five. Moreover, H.R. 3606 eliminates the requirement for an EGC to provide a compensation discussion and analysis (CD&A) in its proxy statement.

H.R. 1070 – Private Placement Offerings

Section 3 of the Securities Act of 1933 (the 1933 Act) exempts various securities from the provisions of the 1933 Act. Under this exemption, a company may conduct an offering of up to $5 million as provided in Regulation A. Regulation A allows a company to use an abbreviated offering statement which must be filed with the SEC and delivered to investors. The mini-registration statement must contain certain business and financial information about the company; this disclosure, however, is substantially less cumbersome than the comparable disclosures required in a registration statement under the 1933 Act, such as Forms S-1 or S-3. A company choosing to rely on the Regulation A may use general solicitation and advertising prior to filing with the SEC. Furthermore, a company does not become subject to the full set of public reporting obligations solely by virtue of making a Regulation A offering.

H.R. 1070 will allow companies to issue securities without having to register the sales with the SEC. Offering materials will have to be filed with the SEC. However, the amount of information that will have to be disclosed would be significantly less than what would be required under a full registration. Furthermore, except as noted below, a company will not have to comply with the SEC's regulations following the closing of the offering.

H.R. 1070 directs the SEC to adopt rules to exempt the following class of securities from the provisions of the 1933 Act:

- The aggregate offering amount of all securities offered and sold within the prior 12-month period in reliance on this exemption must not exceed $50 million.
- The securities may be offered and sold publicly.
- The securities will not be "restricted securities" within the meaning of the federal securities laws and the regulations. Restricted securities must be resold in a public offering or in a transaction which is exempt under federal securities laws.
- The civil liability provision in Section 12(a)(2) of the 1933 Act (liability for misrepresentations or omissions in the offering document) will apply to any person offering or selling such securities.
- The company may solicit interest in the offering prior to filing any offering statement with the SEC.
- The SEC will require the company to file audited financial statements with the SEC annually.

The SEC may required that the registration statement contain audited financials and other information about the company's business as the SEC deems appropriate. The SEC may require a company issuing exempted securities to make available to investors and file with the SEC periodic disclosures regarding the company, its business operations, its financial condition, its corporate governance principles, its use of investor funds, and other appropriate matters. The SEC may suspend or terminate such requirements.

The rule adopted by the SEC may only exempt the following securities: equity securities, debt securities and debt securities convertible or exchangeable to equity interests, including any guarantees of such securities.

H.R. 4088 – Number of Record Holders—Bank Holding Companies and Banks

Bank holding companies (like all companies) with more than 500 "shareholders of record" and $10 million in assets must register their securities with the SEC and file periodic reports (10-Ks, 10-Qs) and proxy and other materials with the SEC. Similarly, banks with more than 500 "shareholders of record" must register their securities with the appropriate Federal banking agency (the Fed, FDIC or OCC) and file periodic reports (10-Ks, 10-Qs) and proxy and other materials with the appropriate Federal banking agency.

Registering and complying with various securities regulations can be very costly for small banks and bank holding companies. As a consequence, as these entities approach the 500-shareholder limit, they may be reluctant to seek out new investors when they need to raise capital.

H.R. 4088 significantly increases the number of "shareholders of record" a bank holding company may have before it has to register with the SEC or a bank may have before it has to register with the FDIC, the Fed or the OCC.

This legislation will increase the registration threshold from 500 to 2,000 "shareholders of record". This will allow such entities to bring in new shareholders and help them avoid the time and expense of registering with the SEC or the Fed, FDIC or OCC.

Under current rules, in order to deregister from the SEC (or the FDIC, Fed or OCC), a bank holding company or bank must have fewer than 300 "shareholders of record".

H.R. 4088 increases the deregistration threshold to 1,200, thereby making it easier for such entities to escape the registration regimen.

The SEC must adopt rules implementing these changes within one year of the enactment of the JOBS Act.

It should be noted that when selling securities in a private placement, a company must secure a federal exemption and an exemption in each state where prospective investors reside. Securing such exemptions can be difficult. H.R. 4088 does not address this issue. For a discussion of some of the federal and Illinois exemptions available for the sale of securities, go to "Securities Rules for Private Equity Financings" at http://www.hinshawlaw.com/securities-rules-for-private-equity-financings-02-29-2012/.

Sales of bank stock are exempt under federal law and most state laws. Therefore, banks in most cases do not have to secure such exemptions.

H.R. 2167 - Number of Record Holders

This legislation will increase the registration threshold to 2,000 “shareholders of record” or 500 “shareholders of record” who are not accredited investors (as defined by the SEC). H.R. 2167 also directs the SEC to adopt rules which provide that the definition of “held of record” will not include securities that are held by persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the 1933 Act. Furthermore, persons acquiring shares in a crowdfunding transaction (as discussed below) will not be counted towards this threshold.

The SEC’s Rule 701 exempts securities offered to employees under written benefit plans by companies that are not registered with the SEC from the registration requirements of Section 5 of the 1933 Act.

The SEC must also adopt safe harbor provisions that companies can follow when determining whether holders of their securities received the securities pursuant to an employee compensation plan in transactions that were exempt from the registration requirements of Section 5 of the Securities Act.

The increase in the number of “shareholders of record”, coupled with the exclusion of employees acquiring securities pursuant to an employee compensation plan and person acquiring shares in a crowdfunding when counting holders of record, will allow such entities to bring in new shareholders and should help companies avoid the time and expense of registering with the SEC.

H.R. 2167, unlike H.R. 4088, does not change the deregistration threshold.

It should be noted that when selling securities in a private placement, a company must secure a federal exemption and an exemption in each state where prospective investors reside. Securing such exemptions can be difficult. H.R. 2167 does not address this issue. For a discussion of some of the federal and Illinois exemptions available for the sale of securities, go to “Securities Rules for Private Equity Financings” at http://www.hinshawlaw.com/securities-rules-for-private-equity-financings-02-29-2012/.

H.R. 2930 – Crowdfunding

H.R. 2930 addresses “crowdfunding” which is a capital raising strategy in which groups of people pool money, which is then used to invest in start-up companies. The SEC has also been reviewing crowdfunding issues.

H.R. 2930 amends Section 4 of the 1933 Act by adding a new Section 4(6). This provision will exempt private placements from the registration requirements of Section 5 of the 1933 Act, provided that:

- The aggregate amount sold within the previous 12-month period does not exceed $1 million.
- The aggregate amount sold to any investor within the previous 12-month period must not exceed:

(i) the greater of $2,000 or 5% of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and
(ii) 10% of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000:

A crowdfunding transaction must be conducted through a broker or a funding portal (as defined below).

Crowdfunding offerings meeting the requirements of the exemption will be exempt form state blue sky regulation relating to registration, documentation and offering requirements.

Securities held by persons who purchase such securities in transactions described above will not be deemed to be “held of record”. Therefore, such persons will not count when determining whether the company must register with the SEC.

With respect to shares acquired under the crowdfunding rules, a purchaser may not transfer such securities during the one-year period beginning on the date of purchase, unless such securities are sold to:

- the company that issued the securities;
- an accredited investor; or
- to a member of the family of the purchaser in connection with a death or divorce

Brokers and Funding Portals. A broker or a funding portal acting as an intermediary in a crowdfunding transaction must:

- register with the SEC as:
  - a broker; or
  - a funding portal (as defined below);
- register with any applicable self-regulatory organization;
- provide such disclosures, including disclosures related to risks and other investor education materials, as the SEC determines appropriate;
- ensure that each investor:
  - reviews investor-education information, in accordance with standards established by the SEC;
  - positively affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor can bear such a loss; and
  - answers questions demonstrating:
    (i) an understanding of the level of risk generally applicable to investments in startups, emerging businesses and small companies; and
    (ii) an understanding of the risk of illiquidity;
- complete background and securities enforcement regulatory history check on each officer, director and person holding more than 20% of the outstanding equity of the company;
- provide to the SEC and to potential investors certain information, at least 21 days prior to the first day on which securities are sold to any investor;
- ensure that all offering proceeds are only provided to the company when the aggregate capital raised from all investors is equal to or greater than the target offering amount, and allow all investors to cancel their commitments to invest;
- make an effort to ensure that no investor in a 12-month period has purchased securities offered pursuant to the crowdfunding provisions that, in the aggregate, from all companies, exceed the investment limits set forth above;
- protect the privacy of information collected from investors;
- not compensate promoters, finders or lead generators for providing personal identifying information of any potential investor; and
- prohibit its directors, officers or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in a company using its services.

Rules for Companies Selling Securities. Under the crowdfunding provision, a company that offers or sells securities must file with the SEC and provide to investors and the relevant broker or funding portal, and make available to potential investors:

- the name, legal status, physical address and website address of the company;
- the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20% of the shares of the company;
- a description of the business of the company and the anticipated business plan of the company;
- a description of the financial condition of the company, including, for offerings that, together with all other offerings of the company under the crowdfunding provisions within the preceding 12-month period, have, in the aggregate, target offering amounts of:

(i) $100,000 or less:

(I) the income tax returns filed by the company for the most recently completed year (if any); and
(II) financial statements of the company, which shall be certified by the principal executive officer of the company to be true and complete in all material respects;

(ii) more than $100,000, but not more than $500,000, financial statements reviewed by a public accountant who is independent of the company, using professional standards and procedures for such review or standards and procedures established by the SEC, for such purpose; and

(iii) more than $500,000 (or such other amount as the SEC may establish, by rule), audited financial statements;

- a description of the stated purpose and intended use of the proceeds of the offering sought by the company with respect to the target offering amount;
- the target offering amount, the deadline to reach the target offering amount and regular updates regarding the progress of the company in meeting the target offering amount;
- the price to the public of the securities or the method for determining the price, provided that, prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities;
- a description of the ownership and capital structure of the company, including:

(i) terms of the securities of the company being offered and each other class of security of the company, including how such terms may be modified, and a summary of the differences between such securities, including how the rights of the securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the company;

(ii) how the exercise of the rights held by the principal shareholders of the company could negatively impact the purchasers of the securities being offered;

(iii) how the securities being offered are being valued and examples of methods for how such securities may be valued by the company in the future, including during subsequent corporate actions; and

(iv) the risks to purchasers of the securities relating to minority ownership in the company, the risks associated with corporate actions, including additional issuances of shares, a sale of the company or of assets of the company, or transactions with related parties.

The company:

- cannot advertise the terms of the offering, except for notices which direct investors to the funding portal or broker;
- may not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal, without taking such steps to ensure that such person clearly discloses the receipt, past or prospective, of such compensation, upon each instance of such promotional communication; and
- will have to file with the SEC and provide to investors annual reports of the results of operations and financial statements of the company.

Funding Portal. A funding portal is any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to the crowdfunding provision, that does not:

- offer investment advice or recommendations;
- solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal;
- compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;

- hold, manage, possess or otherwise handle investor funds or securities; or
- engage in such other activities as the SEC, determines appropriate.

H.R. 2940 – Advertising in Private Placements under Rule 506 and Sales of Restricted Securities under Rule 144A

One of the exemptions available to companies selling securities in a private placement is set out in Rule 506 of Regulation D; this Rule allows a company to sell any amount of securities in a private placement to an unlimited number of accredited investors and up to 35 non-accredited investors. The benefit of Rule 506 is that securities sold under this Rule are "covered securities" exempt from state securities laws. Rule 144A permits resales of restricted securities without registration to qualified institutional buyers (large institutional investors with more than $100 million in investable assets).

However, securities pursuant to Rule 506 or Rule 144A may not be sold by form of general solicitation or general advertising. This prohibition includes any advertisement, article, notice or other communication published in a newspaper or similar media (such as the Internet) or broadcast over television or radio (and the Internet). The Rules do not allow a seller to conduct any seminar or meeting where the attendees have been invited by any general solicitation or advertising.

Within 90 days of the enactment of the JOBS Act, the SEC must revise its rules to provide that the prohibition against general solicitation or general advertising does not apply to offers and sales of securities made pursuant to Rule 506 and Rule 144A, provided that all purchasers of the securities, in the case of Rule 506, are accredited investors or, in the case of Rule 144A, all of the purchasers are qualified institutional buyers. The revised Rule 506 must also require the company to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the SEC.

The lifting of the prohibition on advertising and solicitation in Rule 506 will allow companies to use various media to contact a larger number of accredited investors.

For further information, please contact Tim Sullivan, Micheal D. Morehead or your regular Hinshaw attorney.

Download PDF