You Went Dark. Now What?

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During the past three years, a significant number of community banks and their holding companies (collectively, banks) throughout the United States elected to "go dark" by taking advantage of a provision in The Jumpstart Our Business Startups Act (JOBS Act). These banks were able to suspend their reporting obligations under Section 12(g) of the Securities Exchange Act of 1934 (Exchange Act) and deregister with the Securities and Exchange Commission (SEC) because they had fewer than 1,200 shareholders of record.[1]

As described in our Summer 2012 edition of *The Bankers' Statement*,[2] there were a number of compelling reasons for community banks with thinly-traded stocks to suspend their SEC filing requirements and go dark. Most importantly, the suspension of SEC filing requirements provided many banks with significant cost savings in the form of reduced accounting, legal and compliance costs associated with filing periodic reports (*i.e.*, Forms 10-K, 10-Q and 8-K), proxy statements, and Forms 3, 4 and 5 with the SEC. In addition, going dark allowed these banks to decrease the burden on their management and staff related to SEC reporting, increase their flexibility in determining what information to publicly disclose and simplify and/or eliminate certain corporate governance requirements.

However, there are downsides to deregistering with the SEC and going dark. In particular, deregistration can limit a bank's options when it needs to raise additional capital to increase its capital ratios or to fund growth or acquisitions.

Limitations on Raising Capital by Non-Reporting Banks

For banks that have deregistered with the SEC, the effort, time and expense associated with conducting a registered public offering is usually prohibitive. In addition, it can be difficult and costly for such banks to use their stock as acquisition currency because, in most cases, the issuance of the bank's stock to the shareholders of the target institution would require registration under federal and state securities laws. SEC-reporting companies are often able to use short-form registration statements and/or incorporate significant amounts of information and disclosures by reference in their SEC registration statements. However, non-reporting banks must create and assemble from scratch most of the information and disclosures required to be included in an SEC registration statement. This can be a daunting and costly endeavor.

So what does a non-reporting bank do when it wants to raise capital or acquire another financial institution? Fortunately, these banks have other options.

Raising Capital Through Private Placements

In the past few years, we have represented a number of banks, both SEC-reporting and non-reporting, that have raised significant amounts of capital through unregistered private placements of equity and debt securities. These private placements are conducted pursuant to specific exemptions under federal and state securities laws.

Typically, private placements of securities are conducted in reliance upon Regulation D, promulgated by the SEC under the Securities Act of 1933, as amended (1933 Act), and corresponding state law exemptions, which specifically exempt certain non-public offerings and sales of securities from registration. To comply with Regulation D, a private placement must be structured and conducted in accordance with certain requirements and limitations, including the following:

- **Size of Offering.** The aggregate amount of securities that can be sold in a private placement under Regulation D may be limited, depending upon the type of offering and the investors who participate in the offering. If certain requirements are met, however, Regulation D can permit the sale of an unlimited amount of securities.
- **Number and Type of Investors.** In most private placements, only accredited investors are permitted to purchase securities, except that a limited number (up to 35) of non-accredited investors may be permitted to participate if certain requirements are met. For purposes of Regulation D, an individual is an "accredited investor" if he or she either (1) earned income that exceeded $200,000 (or $300,000 together with his or her spouse) in each of the prior two years and reasonably expects the same for the current year, or (2) has net worth over $1 million, either alone or together with his or her spouse (excluding the value of the person's primary residence and any loans secured by that residence (up to the value of the residence)). There are various other requirements for entities to be accredited.
- **General Solicitation or Advertising.** To comply with Regulation D, a private placement will generally need to be conducted without using any general solicitation or advertising. Instead, a bank will generally be permitted to offer and sell its securities only to investors with whom the bank has a substantial pre-existing business or personal relationship.[3] This precludes a bank, for example, from advertising the private placement in a local newspaper or broadly offering the securities for sale to all customers or community members.
- **Disclosure.** Regulation D requires certain disclosures to be made to non-accredited investors under certain circumstances. In addition, appropriate disclosures must be made to all investors in order to comply with the anti-fraud provisions of federal and state securities laws. These disclosures are typically included in a confidential "private placement memorandum" (also referred to as an "offering

memorandum”) which describes the terms and conditions of the offering and provides other material information regarding the offering and the bank, including information regarding its business, financial condition, results of operation and capitalization and the risks associated with an investment in the bank’s securities.

- **“Bad Actor” Disqualification.** Pursuant to Rule 506(d) of Regulation D, which was adopted by the SEC in September of 2013, a bank is disqualified from using Regulation D for the sale of securities if the bank or its affiliated persons (including any of the bank’s directors or executive officers or any beneficial owner of 20% or more of the bank’s outstanding voting securities) has engaged in certain specified “bad acts” during the 10 years prior to the sale. The disqualifying bad acts include being convicted of any felony or misdemeanor (i) in connection with the purchase or sale of any security or (ii) involving a false filing with the SEC.
- **Required Filings.** To qualify for an exemption under Regulation D, a bank must file a Form D with the SEC no later than 15 days after the first date of sale of securities in the private placement. The Form D is a short form that includes only basic information regarding the issuer, any broker-dealer involved in the private placement, and the amount of securities being sold. Additional filings are usually required to be made in the states where investors reside. These state filings can vary and, in some cases, require filings to be made before any offer or sale occurs.

Banks are strongly encouraged to consult with a securities attorney before proceeding with any private placement to ensure that it is structured and conducted in compliance with all applicable securities laws. If the private placement is not done properly, the bank can be subject to enforcement actions initiated by federal and/or state securities authorities and, additionally, investors in the private placement may have rescission rights.

“Re-Registering” with the SEC

Private placements typically are less useful when issuing stock in connection with an acquisition. Generally, unless the target financial institution is closely held by a small number of shareholders, it is extremely difficult for a bank to use its own stock as consideration in an acquisition without registering the sale of the stock with the SEC. In most cases, the shareholders of the target financial institution will be too numerous and/or will include a large number of non-accredited investors, and the transaction generally cannot be structured to qualify for an exemption under applicable federal and state securities laws.

In view of the foregoing, most non-reporting banks use an all-cash transaction to avoid registration with the SEC. However, for those banks that have recently deregistered with the SEC, filing a registration statement with the SEC to register the sale and issuance of stock in an acquisition may still be a viable option. In fact, we have recently worked with a community bank in Ohio that successfully maneuvered this re-registration process with the SEC shortly after it went dark.

To “re-register,” a non-reporting bank must file a registration statement[4] with the SEC under the 1933 Act. Unfortunately, because the bank is not an SEC-reporting company, it cannot incorporate by reference any information or disclosures from prior Form 10-K, 10-Q and 8-K filings or proxy statements. Instead, the registration statement must contain all of the financial and non-financial information that would be required to be included in periodic filings by an SEC-reporting company. This includes, among other things, audited financial statements and related disclosures, management’s discussion and analysis of financial condition and results of operations (MD&A), disclosures regarding the bank's directors and executive officers (including compensation disclosures), disclosures regarding the bank's business, regulation and competition, and securities ownership information. Similar information regarding the target information must also be included.

While the amount of information required to be included in the SEC registration statement is significant, a non-reporting bank that has recently deregistered with the SEC may be in a better position to prepare and compile the necessary information in a timely and cost-efficient manner. Even banks that deregistered several years ago are at least familiar with those requirements and the disclosures involved. This is because these banks previously prepared the same type and level of information and disclosures (including MD&A) for inclusion in their periodic reports filed with the SEC prior to deregistration. Therefore, these banks will often have the capabilities and processes to compile the required information and disclosures.

It is important to note that the "re-registration" process does not end with the filing of the registration statement with the SEC. Once a bank files a registration statement that becomes effective under the 1933 Act, the bank will again become subject to the reporting obligations under the Exchange Act, at least on a temporary basis. Under SEC rules, a company that has filed a registration statement under the 1933 Act must thereafter file periodic reports under the Exchange Act, including Forms 10-Q and 8-K. This obligation to file reports under the Exchange Act continues at least until the company files its Annual Report on Form 10-K covering the year in which the registration statement went effective. After the filing of the Form 10-K, however, the bank's obligation to file reports can again be suspended provided that the bank has fewer than 1,200 shareholders of record as of the beginning of the fiscal year. However, if the bank intends to be an active acquirer, it may make sense to remain an SEC-reporting company to facilitate future acquisitions using the bank's stock.

Conclusion

While deregistering with the SEC and going dark can limit a bank's options, there are still options available for non-reporting banks to raise capital. Non-reporting banks can often raise significant amounts of capital through private placements of securities without the need for registration with the SEC. In addition, for banks that have deregistered with the SEC, the process of re-registering with the SEC may be a viable alternative. In either case, banks should work closely with their advisers, including securities counsel, to ensure that the transaction is structured and implemented in compliance with applicable laws and regulations.

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[1] Within the first year alone following the adoption of the JOBS Act, at least 100 Banks elected to deregister with the SEC. *See* Dina ElBoghdady, *100 banks end reporting to SEC under new law*, The Washington Post (January 30, 2013) http://www.washingtonpost.com/business/economy/100-banks-end-reporting-to-sec-under-new-law/2013/01/30/bf15226e-6b00-11e2-95b3-272d604a10a3_story.html

[2] Anthony D. Weis, *SEC Deregistration – Shedding Some Light on Going Dark*, Vorys Bankers' Statement (Summer 2012).

[3] In September, 2013, the SEC amended Regulation D to adopt new Rule 506(c), which permits the use of general solicitation and advertising under certain circumstances and, therefore, allows an issuer to offer and sell its securities to accredited investors with whom the issuer does not have a substantial pre-existing business or personal relationship. However, in order to use new Rule 506(c), an issuer must take reasonable steps to verify that all of the investors are, in fact, accredited investors. Because the new verification requirements are rather onerous (e.g., receiving and reviewing an investor's tax returns, bank statements and other financial records), most companies thus far have been reluctant to take advantage of new Rule 506(c).

[4] If the registration relates to the sale and issuance of stock in a merger or acquisition, the appropriate SEC registration statement will be Form S-4.