Federal Securities Law Blog

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JOBs Act:
Guidance, Issues, Requirements, Amendments, and FAQs for navigating the JOBs Act.

JOBs Act Update: Crowdfunding

The JOBS Act significantly impacts the securities laws, including through a new way to raise money known as "crowdfunding."

The JOBS Act creates a new securities registration exemption known as "crowdfunding" that issuers can rely on to sell up to $1 million worth of securities to non-accredited investors as long as no individual investor invests more than: (a) $2,000 or 5% of the investor's annual income in any 12-month period (for investors with annual income or net worth less than $100,000); or (b) 10% of the investor's annual income or net worth up to $100,000 in any 12-month period (for investors with annual income or net worth in excess of $100,000). And, these "crowdfunders" do not count toward the newly-increased shareholders of record threshold that triggers Exchange Act registration under Section 12(g).

The securities may only be issued through a registered broker-dealer or "funding portal" over the internet that complies with additional requirements. The issuer has certain disclosure requirements during the offering process and following the offering.

Crowdfunding is a popular concept among those who see it as a way to empower smaller investors and smaller companies without access to traditional angel investors. However, regulators, including SEC Chairman Schapiro, have raised concerns that crowdfunding may be ripe for fraud among small investors most in need of SEC protection.

JOBs Act Update: Rule 506 Private Placements are a Little Less "Private"

Section 201 of the Jumpstart Our Business Startups Act, or JOBS Act, requires the SEC to change the rules of a Rule 506 private placement to allow for general solicitation or general advertising so long as all purchasers are accredited investors.

Currently, Rule 502(c) prohibits an issuer in a private placement, or any person on its behalf, from offering or selling securities by any form of general advertising, including any ad, article, or notice published in any newspaper or magazine, on TV, or over the radio.

Depending on how the Commission revises its rules, this change could significantly expand the way companies seek investors for private offerings. Imagine cold calls, Internet pop-ups, billboards, and hedge fund ads on TV. Of course the issuer will have to take reasonable steps to verify that purchasers are accredited investors, which is something responsible issuers do anyway.

Proponents argue lifting the ban on advertising promotes transparency, while critics (including key members of the Commission) argue the ban is an important protection against general solicitations reaching unsophisticated investors who may be duped by unscrupulous offers.

The JOBS Act further provides that any person who maintains a platform or mechanism for such advertisements does not have to register as a broker-dealer as long as they receive no compensation in connection with the purchase or sale of a security and do not have possession of customer funds or securities, among other requirements.

JOBs Act Update: Increased Threshold for Exchange Act Registration

Currently, under Section 12(g) of the Securities Exchange Act of 1934, companies with more than $10 million in assets whose equity securities are held of record by more than 500 holders must file periodic reports with the SEC. While the $10 million threshold had been raised from time to time over the years from an original $1 million level, the 500 holders of record requirement has never been changed.

Title V of the Jumpstart Our Business Startups Act, or JOBS Act, amends Section 12(g)(1) of the Exchange Act to increase the holders of record threshold for most issues to either (i) 2,000 persons, or (ii) 500 persons who are not accredited investors. For banks and bank holding companies, the threshold number of record holders will be increased to 2,000 persons.

Title V of the JOBS Act also provides that persons holding securities received pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act of 1933 (e.g., because they were issued under Rule 701 of the Securities Act) will be excluded from being counted as holders of record for purposes of the Section 12(g) calculation. The JOBS Act notably did not otherwise alter how holders of record are determined and beneficial owners of securities who hold shares in “street name” will generally not be counted as holders of record. Shares held in “street name” by the Depository Trust Company will continue to be calculated by reference to the number of DTC participants through which shares are held, consistent with current SEC guidance, rather than the number of underlying beneficial owners.

Title VI of the JOBS Act amends Section 12(g)(4) of the Exchange Act (which permits termination of registration of any class of securities with less than 300 holders of record) and Section 15(d) (which permits suspension of periodic reporting obligations with respect to any class of securities with less than 300 holders of record) to provide for termination or suspension of reporting obligations with respect to securities of a

bank or bank holding company that are held of record by less than 1,200 persons.

The impact of these changes provides many issuers, especially banks and bank holding companies, with room to raise additional capital, without fear of triggering public company reporting requirements.

JOBs Act Update: $50 Million Public Offering Exemption ("Super" Regulation A)

Section 401 of the Jumpstart Our Business Startups Act, or JOBS Act, permits securities offerings of up to $50 million in any 12-month period under a new exemption to be established by the SEC under Section 3(b) of the Securities Act of 1933. Regulation A (the small public offering exemption) provides the current exemption under Section 3(b), which is capped at $5 million and is not available to Exchange Act reporting companies. The $5 million cap is arguably one of the biggest disadvantages of a Regulation A offering.

Securities issued under the new $50 million exemption may be sold publicly and will not be considered restricted securities. The new exemption requires the SEC to issue implementing rules regarding delivery of the offering statement and other information about the issuer to investors. Issuers must file audited financial statements annually and may solicit interest in the offering before filing an offering statement, subject to additional rules to be set by the SEC. The JOBS Act does not set a deadline for this rulemaking.

The JOBS Act - Creation of the "Emerging Growth Company"

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act of 2012, the JOBS Act. The Act implements measures relating to the IPO process and reporting requirements for a new category of issuer known as the "emerging growth company," or EGC. The Act defines an EGC as a company with annual gross revenues of less than $1 billion during its most recent fiscal year. A company will retain its EGC status until the earliest of:

- The first fiscal year after its annual revenues exceed $1 billion.
- The first fiscal year following the fifth anniversary of its IPO.
- The date on which the company had, during the previous three-year period, issued more than $1 billion in non-convertible debt.
- The date on which the company qualifies as a large accelerated filer.

IPO Process

The Act amends applicable federal securities laws to exempt EGCs from:

- The requirement to publicly file an IPO registration statement. An EGC may confidentially submit its registration statement and any amendments to the SEC.
- The requirement to include three years of audited financial statements in an IPO registration statement. EGCs only need to include two years of audited financial statements. Likewise, the MD&A need only include two years of discussion and analysis.
- Restrictions on communications ahead of public offerings, provided the EGC communicates only with qualified institutional buyers or accredited investors. This allows EGCs to "test the waters" before a contemplated offering.

The Act also eases the rules on research relating to EGCs. Under the Act brokers and dealers are permitted to publish or otherwise distribute research reports on an

EGC at any time before, during, or after an offering without creating a gun-jumping or other violation of Section 5 of the Securities Act. Furthermore, the Act allows for securities analysts to participate in communications with an EGC and other personnel of the broker, dealer, or investment bank.

Reporting Relief

The Act amends applicable federal securities laws to provide relief to EGCs with respect to disclosure requirements, including:

- Permitted compliance with the less burdensome executive compensation disclosure under Item 402 of Regulation S-K applicable to smaller public companies.
- Exemption from the "say on pay" provisions of the Dodd-Frank Act.
- Relief from the auditor attestation of internal controls required by Section 404(b) of the Sarbanes-Oxley Act of 2002.
- Not having to comply with PCAOB rules regarding mandatory audit firm rotation or an expanded auditor report.

These changes should ease the regulatory burdens and costs of becoming a public company.

SEC Issues JOBS Act FAQs

On April 10, 2012, the SEC Division of Corporation Finance issued Frequently Asked Questions to provide guidance on the implementation and application of the Jumpstart Our Business Startups Act (the "JOBS Act"), based on its current understanding of the JOBS Act and in light of its existing rules, regulations and procedures. These FAQs address questions relating to the confidential submission of registration statements for review pursuant to new Securities Act Section 6(e). Section 6(e) provides that an emerging growth company may confidentially submit to the SEC a draft registration statement for confidential, non-public review by the SEC staff prior to public filing, provided that the initial confidential submission and all amendments are publicly filed not later than 21 days before the date on which the issuer conducts a road show, as defined in Securities Act Rule 433(h)(4).

SEC Issues Additional JOBS Act FAQs: Changes to the Requirements for Exchange Act Registration and Deregistration

On April 11, 2012, the SEC Division of Corporation Finance issued additional Frequently Asked Questions to provide guidance on the implementation and application of the Jumpstart Our Business Startups Act (the "JOBS Act"), based on its current understanding of the JOBS Act and in light of its existing rules, regulations and procedures. These FAQs address questions relating to the changes to the requirements for Securities Exchange Act of 1934 (the "Exchange Act") registration and deregistration. Specifically, the FAQs address questions relating to how these changes affect the requirement of issuers (including bank holding companies) to register a class of equity security under Section 12(g) of the Exchange Act and the ability of bank holding companies to deregister a class of equity security under Section 12(g) of the Exchange Act or to suspend a reporting obligation under Section 15(d) of the Exchange Act.

JOBS Act: New Law Facilitates Raising Capital

On April 5, 2012, the Jumpstart Our Business Startups Act of 2012, or JOBS Act, became law. The new law makes significant changes to how businesses can raise capital, among other changes described below:

- Eases IPO process and reporting requirements for emerging growth companies
- Reduces general solicitation and general advertising restrictions for certain private placements
- Creates new $50 million small public offering exemption
- Creates "crowdfunding" private placement exemption
- Increases the number of shareholders a private company may have without having to publicly report under the Exchange Act

Emerging Growth Companies

The JOBS Act implements measures relating to the IPO process and reporting requirements for a new category of issuer known as the "emerging growth company," or EGC. The new law defines an EGC as a company with annual gross revenues of less than $1 billion during its most recent fiscal year. A company can retain its EGC status for up to five years after going public depending on if it exceeds certain thresholds for annual revenue, market cap, and issuances of non-convertible debt.

During the IPO process, an EGC has reduced reporting and disclosure requirements and fewer restrictions on communications ahead of public offerings in order to "test the waters" before a contemplated offering. An EGC may also submit a draft of its registration statement for confidential, nonpublic review. Following an IPO, an EGC continues to have reduced reporting and disclosure requirements, including relief from auditor attestation of internal controls as required by Section 404(b) of the Sarbanes-Oxley Act of 2002.

Private Placements – Fewer Restrictions on General Solicitation and Advertising

By July 4, 2012, the SEC must revise Regulation D to allow general solicitation and general advertising for certain private placements of securities under Rule 506 and certain resales under Rule 144A. Depending on how the SEC revises its rules, this change could expand the ways companies seek investors for private offerings.

For example, in addition to loosening advertising and soliciting restrictions, the new law allows for online platforms to match companies with investors and exempts such platforms from broker-dealer registration if certain requirements are met. Furthermore, companies may now be able to advertise initial purchasers or placement agents in press releases announcing offerings. The implications of the law could affect how public and private offerings become integrated and whether multiple exemptions from registration of private placements can apply to a single issuer. At a minimum, issuers should revaluate how they identify accredited investors.

$50 Million Public Offering Exemption (Regulation A+)

The JOBS Act directs the SEC to create a new securities exemption to permit offerings of up to $50 million in any 12-month period. Before the JOBS Act, the securities laws gave the SEC authority to create a similar exemption, known as Regulation A (the small public offering exemption), but a Regulation A offering must be capped at $5 million and is not available to public companies. The $5 million cap is arguably one of the biggest disadvantages of a Regulation A offering.

Securities issued under the new $50 million exemption known as “Regulation A+” may be sold publicly and will not be considered restricted securities. The new exemption requires the SEC to issue implementing rules regarding delivery of the offering statement and other information about the issuer to investors. Issuers must file audited financial statements annually and may solicit interest in the offering before filing an offering statement, subject to additional rules to be set by the SEC. The JOBS Act does not set a deadline for this rulemaking.

For some issuers the new Regulation A+ could be a viable alternative for raising capital to an initial public offering or a Regulation D private placement.

Crowdfunding

The JOBS Act creates a new securities registration exemption known as "crowdfunding" that issuers can rely on to sell up to $1 million worth of securities to non-accredited investors as long as no individual investor invests more than:

a) $2,000 or 5% of the investor's annual income in any 12-month period (for investors with annual income or net worth less than $100,000); or

b) 10% of the investor's annual income or net worth up to $100,000 in any 12-month period (for investors with annual income or net worth in excess of $100,000).

The SEC has 270 days to enact the necessary rules to allow for crowdfunding. The securities may only be issued through a registered broker-dealer or "funding portal" over the internet that complies with additional requirements. The issuer has certain disclosure requirements during the offering process and following the offering.

Once the necessary SEC rules are in place, entrepreneurs and startups that do not typically have access to traditional venture capital will have the ability to raise money from a broad group of investors through the internet and social media.

Threshold for Exchange Act Registration

Currently, under Section 12(g) of the Securities Exchange Act of 1934, companies with more than $10 million in assets whose equity securities are held of record by more than 500 holders must file periodic reports with the SEC. The new law increases the holders of record threshold for most issues to either (i) 2,000 persons, or (ii) 500 persons who are not accredited investors. For banks and bank holding companies, the threshold number of record holders has been increased to 2,000 persons. Banks and bank holding companies can also now deregister and suspend Exchange Act reporting if the number of holders of record of a class of securities falls below 1,200 (increased from 300).

The impact of these changes would provide many issuers, especially banks and bank holding companies, with room to raise additional capital, without fear of triggering public company reporting requirements, and may also cause some banks to consider deregistration.

SEC Issues Additional JOBS Act FAQs: Generally Applicable Questions on Title I of the JOBS Act

On April 16, 2012, the SEC Division of Corporation Finance issued additional Frequently Asked Questions to provide guidance on the implementation and application of the Jumpstart Our Business Startups Act (the "JOBS Act"), based on its current understanding of the JOBS Act and in light of its existing rules, regulations and procedures. These FAQs address questions of general applicability under Title I of the JOBS Act. Title I provides scaled disclosure provisions for emerging growth companies, including, among other things, two years of audited financial statements in the Securities Act of 1933 registration statement for an initial public offering of common equity securities, the smaller reporting company version of Item 402 of Regulation S-K, and no requirement for Sarbanes-Oxley Act Section 404(b) auditor attestations of internal control over financial reporting. Title I also enables emerging growth companies to use test-the-waters communications with Qualified Institutional Buyers or "QIBs" and institutional accredited investors and liberalizes the use of research reports on emerging growth companies.

SEC Guidance for JOBS Act

During April 2012, the SEC provided guidance regarding the Jumpstart Our Business Startups Act of 2012, or JOBS Act, which became law on April 5, 2012. The most recent guidance is in the form of Frequently Asked Questions on Title I, available May 3, 2012, as a supplement to prior FAQs on Title I issued April 16, 2012. Title I of the JOBS Act provides scaled disclosure provisions for emerging growth companies, including, among other things, (i) two years of audited financial statements in the registration statement for an initial public offering of common equity securities, (ii) the smaller reporting company version of Item 402 of Regulation S-K, and (iii) no requirement for Sarbanes-Oxley Act Section 404(b) auditor attestations of internal control over financial reporting. Title I also enables emerging growth companies to use test-the-waters communications with Qualified Institutional Buyers and institutional accredited investors, and liberalizes the use of research reports on emerging growth companies. The FAQs clarify how an issuer can qualify as an emerging growth company, applicable dates for qualification and registration, and various reporting and disclosure requirements.

On April 11, 2012, the SEC issued FAQs to provide guidance regarding Title V and Title VI of the JOBS Act. These titles provide for an increase in the number of holders of record that triggers periodic reporting requirements with the SEC under the Exchange Act. The FAQs provide information regarding how issuers can terminate a not yet effective registration process, or alternatively deregister an effective registration, if the issuer no longer meets the registration requirements as a result of the increase in the threshold of shareholders of record. The FAQs further clarify that an issuer may exclude from the holders of record calculation persons who received securities pursuant to an employee compensation plan in transactions exempted from registration requirements, even though the Commission has not yet revised the definition of "held of record" as required by the new law.

Also on April 11, 2012, the SEC requested public comments before proposing any rulemaking under the JOBS Act.

Finally, on April 10, 2012, the SEC issued FAQs to provide guidance regarding the confidential submission of registration statements for review pursuant to new Securities Act Section 6(e). Section 6(e) provides that an emerging growth company may confidentially submit to the Commission a draft registration statement for confidential, non-public review prior to public filing. The FAQs clarify which registration statements are eligible for submission, among other specific requirements.

NYSE Proposes Amendments to Listing Requirements to Accomodate the JOBS Act

In response to the enactment of the Jumpstart Our Business Startups Act (the "JOBS Act"), the New York Stock Exchange ("NYSE") proposes to amend Sections 102.01C and 103.01B of the NYSE's Listed Company Manual (the "Manual") to permit the listing of companies on the basis of two years of reported financial data as permitted under the JOBS Act.

Specifically, these amendments provide that a company which qualifies as an emerging growth company ("EGC") may choose to include only two years of audited financial data in the registration statement used in connection with the "first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act of 1933" (the "initial public offering date"), rather than the three years of audited financial data that had previously been required. In addition, for as long as a company remains an EGC, it is not required to file selected financial data for any period prior to the earliest period for which it had included audited financial statements in its initial public offering registration statement in (i) any subsequent registration statement filed under the Securities Act of 1933 or (ii) any Exchange Act of 1934 registration statement.

An issuer that is an EGC will continue to be considered an EGC until the earliest of:

- the last day of the fiscal year during which it had total annual gross revenues of at least $1 billion;
- the last day of the fiscal year following the fifth anniversary of its initial public offering date;
- the date on which it has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or
- the date on which it is considered to be a "large accelerated filer" under the Exchange Act.

The proposed NYSE Rule is similar to approach taken by Nasdaq with respect to the initial listing standards for its Nasdaq

Global Select Market in Nasdaq Marketplace Rules 5310(g) and (h). In adopting the proposed rule changes, the NYSE noted that the proposed amended listing standards would not establish lower initial listing requirements than all other national securities exchanges, as the amended standards would still be significantly more stringent than those applied by the Nasdaq Capital Market.