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Technical Line

Update of our 17 May 2012 edition

Implementing the JOBS Act

In this issue:

What you need to know

- The JOBS Act created a new category of issuer called an emerging growth company, for which certain SEC reporting requirements will be phased in over five years.
- Emerging growth companies can submit IPO registration statements and amendments to the SEC on a confidential basis.
- The SEC staff is issuing interpretive guidance to address implementation questions.
- The JOBS Act allows greater access to funding without triggering public registration requirements.

Overview

The Jumpstart Our Business Startups Act (JOBS Act or Act), enacted 5 April 2012, gives private companies greater access to capital and makes it easier for certain companies to go public.

The Act created a new category of issuer called an emerging growth company (EGC) to encourage initial public offerings. Certain regulatory requirements are phased in for EGCs during a five-year period known as an initial public offering (IPO) "on-ramp."

The JOBS Act also modified triggers for public registration and reporting by amending Section 12(g) of the Exchange Act to increase the number of record holders that triggers a company's obligation to register and report as a public company. In addition, the Act allows private companies to raise capital through new exemptions from registration that require Securities and Exchange Commission (SEC) rulemaking. These include (1) creating a new category of exempt offerings of up to $50 million raised over a 12-month period and (2) allowing private companies to raise small amounts of capital from a large group of investors through a process called crowdfunding without adding to the record holder count that triggers Exchange Act registration.

This publication updates our 17 May 2012 Technical Line on the JOBS Act to address the frequently asked questions (FAQs) issued by the SEC staff and the first rule mandated by the JOBS Act that the SEC has proposed.

Key considerations

Implementation

The provisions in Title I of the JOBS Act related to EGCs were effective immediately and did not require SEC rulemaking. The SEC is expected to adopt conforming changes to its existing rules and regulations to resolve conflicts with the Act's provisions. In the meantime, the SEC staff has indicated that an EGC that complies with the scaled executive compensation disclosures and delayed auditor attestation of internal control over financial reporting allowed by the JOBS Act would still comply with the disclosure provisions of the Exchange Act. Thus, chief executives and chief financial officers of EGCs can still certify that the company's periodic report complies with Section 13(a) or 15(d) of the Exchange Act, as required by the Sarbanes-Oxley Act.

Disclosure provisions in Title I of the JOBS Act supersede conflicting SEC rules and regulations.

Given the self-executing nature of the EGC provisions, the staff of the SEC's Division of Corporation Finance has issued a series of FAQs[1] on implementing the JOBS Act including (1) EGC eligibility and disclosure, (2) confidential submission of EGC registration statements and (3) the amended registration and deregistration record holder thresholds in Section 12(g) of the Exchange Act.

Other provisions of the JOBS Act require rulemaking by the SEC. As previously discussed, the SEC will need to adopt rules to implement the crowdfunding exemption and the new category of exempt offerings of up to $50 million over a 12-month period.

How we see it

- Although rulemaking may not be required for many of the EGC-related provisions, the SEC will likely adopt conforming changes to its existing rules to resolve conflicts with the Act's provisions that are already in effect.
- The SEC staff has issued more than 50 FAQs to address EGC implementation questions. We do not expect the SEC staff to continue to issue large numbers of FAQs. Instead, the staff likely will address additional implementation questions on a case-by-case basis.

Emerging growth companies

Which companies qualify?

An EGC is defined as a company with "total annual gross revenues" of less than $1 billion in its most recent completed fiscal year. The SEC staff has stated that "total annual gross revenues" means total revenues presented on the income statement in accordance with US GAAP. If the financial statements for the most recent year are those of a predecessor of the issuer, the predecessor's revenues should be used.

When evaluating EGC eligibility, the issuer's most recent completed fiscal year would be the most recent annual period completed, regardless of whether financial statements for that period are presented in the registration statement. For example, the most recent completed fiscal year for a calendar year-end issuer that files a registration statement for an initial public offering of common equity securities in January 2013 would be its 31 December 2012 year-end, even though the registration statement includes only financial statements for 2011 and 2010 and the nine months ended 30 September 2012 and 2011. The issuer would be an EGC if its 2012 revenues were less than $1 billion, even if its revenues in 2011 or any prior year exceeded $1 billion.

An issuer with EGC status loses its eligibility as an EGC five years after its common equity IPO or earlier if it meets any of the following criteria:

- Has annual revenues exceeding $1 billion[2]
- Issues more than $1 billion in nonconvertible debt securities over a rolling three-year period, including securities issued in registered or unregistered offerings
- Becomes a large accelerated filer (i.e., a seasoned issuer with public float of $700 million or more)

Once an issuer loses its EGC status, it cannot reclaim EGC status (e.g., if its annual revenues fall below $1 billion following its IPO).

Assuming none of the criteria above have been met earlier, an issuer will lose its EGC status on the last day of the fiscal year that includes the fifth anniversary of the date of the first sale of common equity securities under an effective registration statement. For example, if the first sale of common equity securities (i.e., common equity IPO) for a calendar year-end company occurred in March 2012, the company would lose its EGC status on 31 December 2017.

The $1 billion in nonconvertible debt test is the only test measured on a rolling basis rather than at a point in time (i.e., it's performed continuously, not at the end of a quarter or at year-end). The test should consider nonconvertible debt securities "issued" during the rolling three-year period, even if not currently outstanding. The SEC staff has interpreted the phrase "issued more than $1 billion nonconvertible debt" in the Act to be limited to debt securities (e.g., borrowings from banks would be excluded). In addition, the SEC staff stated that it will not object if an EGC excludes debt securities issued in an A/B exchange offer (i.e., Form S-4 exchange offer of registered debt securities for 144A debt securities), because the debt securities issued in the registered exchange offer are identical to and replace securities that were issued in the nonpublic offering.

How we see it

- Although issuers may generally retain EGC status for up to five years after an IPO, they will need to monitor their eligibility. Changes in an EGC's business (such as unexpected increases in revenue or changes in public float) could lead to earlier-than-anticipated financial reporting obligations.
- Certain issuers may meet the definition of an EGC before their first sale of common equity securities under an effective registration statement. For example, a company may file its initial registration statement under the Securities Act of 1933 covering an offering of securities other than common stock (e.g., debt securities). Because the five-year limitation is triggered by the first sale of common equity securities under an effective registration statement, such an issuer may remain an EGC indefinitely as long as it does not trip other exit provisions.

An EGC is required to publicly file its initial registration statement and all amendments previously submitted confidentially.

Testing EGC eligibility after an acquisition

Evaluating EGC eligibility after a significant acquisition will differ depending on whether the acquisition is accounted for as a forward or reverse acquisition under Topic 805 of the Accounting Standards Codification (ASC). The following examples illustrate how the tests would be applied for forward and reverse acquisitions.

Company A acquires Company B on 30 September 2012 for cash or stock in a business combination accounted for as a forward acquisition. That is, Company A is both the legal and accounting acquirer. Both companies have a calendar year-end.

Company C acquires Company D, an operating company, on 30 September 2012 for stock in a business combination accounted for as a reverse acquisition. That is, Company D is the accounting acquirer and is presented as the predecessor in the post-transaction financial statements. Company C (the legal acquirer) and Company D (the accounting acquirer) both have a calendar year-end.

Companies A and C would evaluate their EGC status, after the transaction, as follows:

EGC eligibility test	Company A Forward acquisition	Company C Reverse acquisition
Revenue test	In 2012, eligibility should be based on Company A's revenues for 2011. In 2013, eligibility should be based on Company A's revenues for 2012, which will include Company B's revenues from 1 October 2012.	In 2012, eligibility should be based on Company D's revenues for 2011. In 2013, eligibility should be based on Company D's revenues for 2012, which will include Company C's revenues from 1 October 2012.
Five-year anniversary test	Begins on Company A's date of first sale of registered common equity securities.	Begins on Company C's date of first sale of registered common equity securities.
Revolving debt securities test	Determined based on Company A's debt issuances, which will include Company B's debt issuances from 1 October 2012.	Determined based on Company D's debt issuances, which will include Company C's debt issuances from 1 October 2012.
Large accelerated filer test	At 31 December 2012, evaluate based on Company A's market value at 30 June 2012. At 31 December 2013, evaluate based on Company A's market value (which will include Company B) at 30 June 2013.	At 31 December 2012, evaluate based on Company C's market value at 30 June 2012. At 31 December 2013, evaluate based on Company C's market value (which will include Company D) at 30 June 2013.

Effective date

The JOBS Act states explicitly that an issuer whose "first sale of common equity securities" under an effective registration statement (e.g., Forms S-1, S-8, S-11) occurred on or before 8 December 2011 cannot qualify as an EGC. Issuers whose registration statements were effective on or before 8 December 2011 may qualify as EGCs if their first sale of common equity occurred after 8 December 2011. In addition, the SEC staff clarified that a company that has issued only debt securities pursuant to an effective registration statement on or before 8 December 2011 can qualify as an EGC as long as it isn't disqualified by any of the other conditions.

However, the SEC staff also clarified that the phrase "first sale of common equity securities" in the JOBS Act is not limited to a company's initial primary offering of common equity securities for cash. It could also include, for example, offering common equity pursuant to an employee benefit plan on Form S-8, as well as a selling shareholder's secondary offering on a resale registration statement.

How we see it

The SEC Advisory Committee on Small and Emerging Companies (the Advisory Committee) is considering a potential recommendation to expand the eligibility of EGC status for small publicly traded companies with capitalization of $250 million or less. At its 7 September 2012 meeting in San Francisco, the Advisory Committee discussed disclosure rules for smaller public companies and whether EGC status should be extended to existing public companies that meet all of the criteria of an EGC except for the timing of their initial public equity offering.

Eligibility of other issuers

The SEC staff clarified that business development companies, a category of closed-end investment companies that are not required to register under the Investment Company Act of 1940, are eligible to qualify as EGCs. However, issuers of asset-backed securities under Regulation AB and investment companies registered under the Investment Company Act of 1940 are not eligible to be EGCs.

The SEC staff stated that when a company completes a transaction after which it becomes the successor to its predecessor's Exchange Act registration and reporting obligations, if the predecessor was not eligible to be an EGC because its first sale of common equity securities occurred before 8 December 2011, the company (i.e., the successor) also is not eligible to be an EGC.

Confidential registration statement submission

In a major change from past practice, an EGC can submit its IPO registration statement and subsequent amendments to the SEC on a confidential basis. Through the confidential registration statement submission process, the SEC staff will be able to comment and the company will be able to respond confidentially before filing publicly.

Even though the initial registration statement and subsequent amendments can be submitted on a confidential basis, an EGC is required to publicly file all prior confidential submissions no later than 21 days before its road show. If an EGC does not conduct a traditional road show or engage in activities within the definition of a road show, it is required to publicly file the same information (its registration statement, initial confidential submission and all amendments) at least 21 days before the anticipated effective date of the registration statement.

As it does with nonconfidential registration statements, the SEC staff will publicly release its comment letters and issuer responses on EDGAR no earlier than 20 business days after the effective date of the registration statement. Therefore, in its responses to the SEC staff on its confidential submission, an EGC should identify the information for which it intends to seek confidential treatment pursuant to Rule 83.

In addition to registration statements in connection with an IPO of common equity, the confidential draft registration process is available for registration statements before the "initial public offering date" of common equity. For example, an EGC may submit for confidential review pre-IPO offerings of debt securities (e.g., a draft registration statement for an A/B debt exchange offer on Form S-4).

The JOBS Act explicitly provided for the confidential review accommodation as part of an amendment to the Securities Act but did not make a corresponding change to the Exchange Act. Therefore, the confidential EGC submission process is not available for Exchange Act registration statements (i.e., Form 10).

How we see it

We expect most EGCs to take advantage of the confidential review accommodation. EGCs electing the confidential review process should carefully consider their timing in relation to their road shows, since the SEC staff still may issue comments on their initial "public filings." An EGC electing to take advantage of the confidential review process also should keep its assigned SEC staff reviewers informed about its expected timeline.

The SEC staff expects the initial submission of draft registration statements to be "substantially complete."

Confidential submission requirements

A company must qualify as an EGC at the time it submits a confidential draft registration statement or any amendment to the draft registration statement. However, once an EGC publicly files a registration statement, it is not required to continue to meet EGC status through the effective date or completion of the offering.

As with publicly filed registration statements, EGCs may omit certain limited information from their initial submissions to the SEC, such as the public offering price or other offering-related information. However, the SEC staff expects draft registration statements to be "substantially complete" at the time of submission, including a signed audit report and financial statement exhibits. As with filed registration statements, the confidential submission should include all required financial statements, including those to comply with Rules 3-05, *Financial statements of businesses acquired or to be acquired*, and 3-09, *Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons*, of Regulation S-X.

If an EGC discovers a material error in the financial statements submitted in the confidential draft registration statement, it is required to include restatement disclosures until those financial statements are updated for the next annual period. This is similar to what happens with nonconfidential submissions.

The confidential submission of the draft registration statement does not constitute a "filing." As a result, the draft registration statement does not have to be signed on behalf of the company or include the consent of auditors and other experts.

Confidential submission process

The SEC has updated EDGAR[3] to accept confidential submissions of draft registration statements. The new system allows EGCs to electronically file previously submitted draft registration statements instead of including them as exhibits to their first publicly filed registration statement. EGCs now must submit or file registration statements and amendments as well as related correspondence via EDGAR.

An EGC will not need to submit its draft registration statement under cover of a Rule 83 request to preserve confidentiality. However, if the company proceeds with its offering, the previous confidential submission will need to be filed publicly at least 21 days before the company's road show.

How we see it

As with all companies contemplating an initial public offering, planning is critical. The separate disclosures and filing procedures related to EGC status should be considered in the IPO planning process.

EGC scaled disclosures during IPO on-ramp period

The JOBS Act exempts an EGC from certain requirements during the on-ramp period. These scaled disclosures generally allow for temporary, not permanent, relief. An EGC is not required to follow all of these scaled disclosure provisions. Except for the accounting standards provision discussed below, an EGC may take an "a la carte" approach and decide to comply with some EGC scaled disclosures and other full SEC disclosure requirements.

Number of audited financial statement periods

An EGC is not required to provide more than two years of audited financial statements in the registration statement for an IPO of its common equity securities. The SEC staff has said that it will not object if, in subsequent registration statements before an EGC's first annual report on Form 10-K, an EGC does not present audited financial statements for any period before the earliest audited period presented in its IPO registration statement. For example, if a calendar-year EGC filed a Form S-1 in September 2012 following its May 2012 common equity IPO, the SEC staff would require audited financial statements for only 2011 and 2010. However, EGCs should consider the following limitations on this relief:

- The two-year accommodation does not apply to Securities Act or Exchange Act registration statements filed before the company's IPO of common equity.
- In post-IPO annual reports, an EGC must include the same number of periods as non-EGC issuers (i.e., three years of audited financial statements unless the company is eligible for relief as a smaller reporting company).

EGCs also may limit their discussion under Item 303 of Regulation S-K, *Management Discussion and Analysis of financial condition and results of operations*, to include only periods presented in the audited financial statements.

An EGC is not exempt from complying with XBRL requirements,[4] which generally begin with its first Form 10-Q following its IPO.

Selected financial data (Item 301 of Regulation S-K)

An EGC is not required to present selected financial data in any registration statement or periodic report for any period before the earliest audited period presented in its initial Securities Act or Exchange Act registration statement. That means the selected financial data will "build" in subsequent annual reports until the full five-year selected financial data is provided. The SEC staff has said that an EGC may present the ratio of earnings to fixed charges (Item 503(d) of Regulation S-K) for the same number of years for which it provides selected financial data.

The SEC staff has stated that it would not object if, after losing EGC status, an issuer elects not to present selected financial data (or a ratio of earnings to fixed charges, if required) for periods before the earliest audited period presented in its initial Securities Act or Exchange Act registration statement.

Financial statement requirements of 'other entities'

In addition to presenting its own financial statements, an issuer may be required to present up to three years of financial statements of other entities in its registration statement (e.g., financial statements of acquired businesses and equity method investees under Rules 3-05 and 3-09 of Regulation S-X, respectively). If the significance test otherwise requires three years of audited financial statements for these other entities, an EGC that presents only two years of audited financial statements in its registration statement also is allowed to present only two years of audited financial statements for these entities.

Executive compensation disclosures

In its IPO registration statement and subsequent periodic reports, an EGC may provide executive compensation disclosures in a manner consistent with a smaller reporting company and is not required to include a Compensation Discussion and Analysis. As a result, the tabular executive compensation disclosure requirements are significantly reduced for EGCs.

EGCs also are not required to comply with the "say-on-pay" provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which require companies to hold a shareholder advisory vote on executive compensation and golden parachutes.

Compliance with auditor attestation of internal controls over financial reporting

The JOBS Act defers the requirement to have the independent auditor assess an EGC's internal controls over financial reporting (ICFR) under Section 404(b) of the Sarbanes-Oxley Act. However, an EGC still must comply with the Section 404(a) requirement that management assess its ICFR, generally beginning with its second annual report on Form 10-K. Only non-accelerated filers are permanently exempt from Section 404(b). As stated above, EGCs are not relieved of other reporting obligations, such as the requirement that the CEO and CFO provide certifications in the EGC's periodic reports under Sections 302 and 906 of the Sarbanes-Oxley Act.

How we see it

It's not clear how investors will react to a company's EGC status. The perception of an EGC will likely develop over time as more companies take advantage of the scaled disclosure provisions available to EGCs and investors have more time to assess the perceived risks associated with EGCs, their more limited disclosures and reduced compliance requirements.

Accounting and auditing standards issued after the JOBS Act

Accounting standards

Section 107(b) of the JOBS Act exempts an EGC from adopting new or revised accounting standards effective for public companies if private companies have a delayed effective date. Instead, the effective date for private companies will apply to EGCs.

However, an EGC can opt out of the extended private company transition period provided for complying with new or revised accounting standards (i.e., opt in to the transition otherwise applicable to public companies). If an EGC initially decides to take advantage of the extended transition period, the SEC staff has indicated that it will not object if an EGC subsequently elects to follow the requirements for public companies. If an EGC decides to opt in to public company transition provisions, that election is irrevocable and applies to all new or revised accounting standards.

The accounting standards provision applies only to new or revised accounting standards issued after the JOBS Act was enacted. That is, an EGC must comply as a public company with all accounting standards issued before 5 April 2012, even if the effective date of a particular standard is after 5 April 2012.

It is also important to highlight that the JOBS Act addresses only new or revised standards with different effective dates for public and private companies. That is, no accommodation is provided to EGCs for a new or revised accounting standard that applies only to public companies (e.g., if a revised standard on segment disclosures or earnings per share were to be issued).

Note: The SEC staff has not provided guidance about whether an EGC that elects to follow private company transition dates could selectively "early adopt" new Accounting Standards Updates that allow early adoption by private companies.

The accounting standards provision applies only to new or revised accounting standards issued after the JOBS Act was enacted.

How we see it

Given the significance of the pending joint projects of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), it may be more important for an EGC to maintain comparability by following the same transition as other public companies.

PCAOB auditing standards

The JOBS Act contains an explicit exemption that an EGC's independent auditor not be required to comply with future changes to Public Company Accounting Oversight Board (PCAOB) auditing standards related to mandatory audit firm rotation or an Auditor's Discussion and Analysis (if adopted). An EGC's independent auditor also would not be subject to other new auditing standards issued by the PCAOB, unless the SEC decides that such standards should apply to EGCs after considering the protection of investors and whether the action will promote efficiency, competition and capital formation.

Disclosure of EGC status

An EGC should disclose its status on the cover page of the prospectus, both in a draft registration statement submitted to the SEC staff on a confidential basis and in the registration statement filed publicly. Companies that are already subject to Exchange Act reporting and qualify for EGC status were expected to disclose their EGC status in their periodic reports.

The SEC staff expects EGCs to disclose how and when they may lose EGC status. In addition, EGCs should describe the exemptions that are available to EGCs, including those related to auditor attestation on the effectiveness of ICFR under Section 404(b).

As we previously noted, if an EGC chooses to opt in to the public company transition provisions of new or revised accounting standards, that decision is irrevocable. The SEC staff expects EGCs that have opted in to make a statement that the election is irrevocable.

For an EGC electing to take advantage of the extended private company transition period for complying with new or revised accounting standards, the SEC staff expects additional risk factor disclosures. Such disclosures would explain that the election allows the company to delay adoption of new or revised accounting standards that have different transition dates for public and private companies. The risk factor disclosures also should state that, as a result, the company's financial statements may not be comparable to those of companies that comply with public company effective dates. A similar statement also should be included within the company's management discussion and analysis (MD&A) section on critical accounting policies and estimates.

The SEC staff has indicated that if an EGC elects to take advantage of the scaled disclosures and removes disclosures provided in a previously submitted or filed registration statement (for example, if an EGC removed its third year of audited financial statements that reported poor results), the staff may seek disclosures about the removal of the previous disclosures.

Loss of eligibility

To qualify for relief, a company must qualify for EGC status when it submits its confidential registration statement and any related amendments, and when it publicly files its initial public registration statement.

If a company loses its EGC eligibility at any time during the confidential review process (e.g., because, since the initial submission date, a fiscal year has been completed with revenues exceeding $1 billion), it must file a public registration statement to continue the registration process and must comply with requirements for non-EGCs. In that event, any previous confidential draft submissions should be filed at the same time the initial public registration statement is filed.

Under Securities Act Rule 401(a), a company's status at the time of the initial filing date of its registration statement determines the requirements for the content of that registration statement. Therefore, if a company loses its EGC eligibility after its initial public filing, it may continue to use the EGC disclosure provisions through effectiveness of the registration statement.

Issuers that lose their EGC status would not be able to regain that status.

Foreign private issuer considerations

Foreign private issuers (FPIs) can qualify as EGCs. To determine an FPI's "total annual gross revenues," the SEC staff has indicated that total revenues under US GAAP should be used for FPIs that reconcile to US GAAP. For FPIs that present their financial statements under IFRS, as issued by the IASB, total revenue under IFRS should be used.

An FPI that qualifies as an EGC may comply with the scaled disclosure provisions available to EGCs, if relevant to the form requirements for FPIs.

An FPI that meets the definition of an EGC may use the confidential EGC submission procedures. Historically, many FPIs were provided a similar accommodation under which the SEC staff performed a confidential review of draft registration statements.

However, the SEC staff has conformed its accommodation for nonpublic submissions by eligible FPIs and EGCs. As a result, eligible FPIs must publicly file all nonpublic draft registration statements at the time of their first public registration statement. In addition, all SEC staff comments and FPI responses will be posted on EDGAR following completion of the registration process.

Amendments to Exchange Act Section 12(g)

The JOBS Act modified certain triggers for public registration and reporting by amending Exchange Act Section 12(g). It increased the number of record holders that triggers a company's obligation to register and report as a public company to 2,000 people (or 500 people who are not accredited investors) from 500 people. For a bank or bank holding company, the trigger is 2,000 people, even if none are accredited investors.

In addition, the JOBS Act excludes from the record holder definition (1) current and former employees who received securities through an employee stock compensation plan that is exempt from registration and (2) holders of securities issued through permitted crowdfunding.

The SEC staff has said the amendments to the Exchange Act registration threshold are immediately effective, even though the JOBS Act directs the SEC to adopt a "safe harbor" to exclude from the record holder count exempt securities received through employee compensation plans. For companies that have recently triggered a reporting obligation under Section 12(g), the SEC staff has clarified that the company is not required to register under the Exchange Act if it does not meet the higher threshold under the JOBS Act, even if the requirement to register was triggered before the legislation was enacted on 5 April 2012.

If a private company has filed an Exchange Act registration statement on the basis of the former thresholds and the registration statement is not yet effective, the company may withdraw the registration statement if it is no longer required to register under the JOBS Act. If the company has registered a class of equity securities under Section 12(g), it will have to maintain that registration unless it is eligible to deregister.

In addition, the JOBS Act amended Sections 12(g) and 15(d) of the Exchange Act of 1934 to raise the threshold below which a bank or bank holding company may terminate registration and suspend its reporting obligation to 1,200 record holders from 300. The current threshold of 300 record holders for non-banks and non-bank holding companies remains unchanged.

The JOBS Act requires the SEC to revise the definition of "held of record" to exclude persons who received securities under an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act. Although the SEC has not yet revised the definition of "held of record," the SEC staff has confirmed that as of the enactment date an issuer (including a bank holding company) may exclude persons who received securities pursuant to an employee compensation plan in Securities Act exempt transactions, regardless of whether the person remains an employee.

As previously indicated, the record holder definition also excludes holders of securities issued through permitted crowdfunding. However, the crowdfunding exemption is not effective until the SEC issues final rules implementing the crowdfunding provisions of the JOBS Act.

How we see it

The JOBS Act gives private companies more flexibility to issue stock to employees as compensation because these shareholders would no longer be counted among record holders who could trigger public registration. Private companies may consider revising employee compensation plans to better align company objectives and compensation. The Act also allows private companies to raise capital from more accredited investors without triggering a public reporting obligation.

Crowdfunding

The JOBS Act allows private companies to raise small amounts of equity capital from a large pool of investors (e.g., through the internet), a process commonly referred to as "crowdfunding."

The use of crowdfunding is prohibited until the SEC adopts rules to implement the exemption.

The SEC is required to adopt rules to implement the crowdfunding exemption within 270 days from enactment (i.e., by 31 December 2012). The SEC staff has reminded companies that, until then, use of the crowdfunding exemption is unlawful. The JOBS Act also includes certain limitations on the use of crowdfunding, including that no more than $1 million of securities can be sold in a rolling 12-month period and the aggregate amount sold to any one investor during that period is capped at a specified level based on the annual income or net worth of the investor. If an investor's annual income or net worth is less than $100,000, the aggregate amount sold to the investor cannot exceed the greater of $2,000 or 5% of the investor's net worth or annual income. If an investor's annual income or net worth is $100,000 or more, the aggregate amount sold to the investor cannot exceed 10% of the investor's net worth or annual income, subject to an investment cap of $100,000.

Issuers relying on the crowdfunding exemption will be subject to certain informational and other requirements, including an obligation to file financial statements, which may require independent audit or review depending on the offering size.

Other exempt offerings

The JOBS Act also requires the SEC to adopt or amend SEC regulations to encourage capital formation without requiring an SEC registration statement. These amendments create a new category of public offerings exempt from SEC registration of up to $50 million, raised over a 12-month period through issuance of equity securities, debt securities or debt securities convertible or exchangeable to equity interests, including any guarantees of such securities. Regulation A currently provides a similar exemption for public offerings up to $5 million over 12 months.

The exemption includes investor protection provisions that require audited financial statements to be filed with the SEC on an annual basis and gives the SEC the ability to require periodic disclosures regarding the issuer, its business operations, its financial condition, use of proceeds and other appropriate disclosures for the protection of investors.

Allowing general solicitation and advertising in certain exempt offerings

The JOBS Act also requires the SEC to allow companies to solicit investors and advertise offerings of restricted securities that are exempt from registration because all purchasers are accredited investors. The SEC released a proposed rule[5] in August 2012, with a 30-day comment period.[6] A final rule is expected soon.

Under the proposal, Rule 506(c) of Regulation D would allow any company (public, private, established or start-up) to expand its pool of potential investors without SEC registration. Rule 506(c) also would be available for use by hedge funds, venture capital funds and private equity funds. Issuers relying on the Rule 506(c) exemption would be permitted to advertise their offerings if they take reasonable steps to verify that the actual purchasers are accredited investors, as defined in Rule 501(a) of Regulation D.

What's next?

The JOBS Act requires the SEC to adopt rules to implement (1) the crowdfunding exemption, (2) the new Exchange Act registration thresholds, (3) the new $50 million exemption threshold for public offerings and (4) lifting the ban on general solicitation and advertising in exempt offerings to accredited investors. The SEC has not yet proposed rules to address the first three items. As discussed above, the SEC proposed a rule to implement the fourth item. We expect the SEC to adopt a final rule on general solicitation and advertising in certain exempt offerings soon. The JOBS Act also requires the SEC to conduct a study on how to simplify the Regulation S-K nonfinancial disclosures for EGCs. That study is now overdue.

The SEC is expected to adopt a final rule allowing advertising in certain exempt offerings soon.

The Advisory Committee is expected to recommend that the SEC extend EGC status to small publicly traded companies with capitalizations of $250 million or less. It is unclear whether the SEC will act on such a recommendation.

Following the election, it is unclear how quickly the SEC will be able to act to address its remaining obligations under the JOBS Act. In the meantime, eligible EGCs generally are taking advantage of the confidential IPO submission process, and to a lesser extent the other relief provided under the JOBS Act.

Endnotes:

[1] SEC staff guidance, including its FAQS about the JOBS Act, is available on the SEC's website at: http://www.sec.gov./divisions/corpfin/cfjobsact.shtml.

[2] The JOBS Act requires the SEC to adjust the $1 billion threshold every five years for inflation to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics.

[3] The announcement about the upgrade to EDGAR and instructions are available on the SEC website at http://www.sec.gov/divisions/corpfin/cfannouncements/drsfilingprocedures.htm.

[4] The XBRL rules require a computer-readable tag for each item of financial data in certain SEC filings and are intended to make it easier for investors to compare financial statements.

[5] The proposed rule is on the SEC website at http://www.sec.gov./rules/proposed/2012/33-9354.pdf.

[6] To the Point, SEC proposes allowing solicitation and advertising in certain exempt offerings (SCORE No. CC0355)