IFLR
INTERNATIONAL FINANCIAL LAW REVIEW

JOBS Act Quick Start

A brief overview of the JOBS Act

2016 Update

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About the firm

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The Jumpstart Our Business Startups (JOBS) Act, or JOBS Act, is sure to jumpstart capital raising for emerging companies, as well as facilitate capital formation for existing public companies of all sizes. Given our longstanding commitment to serve emerging companies and the breadth of our capital markets and corporate practices, we supplemented our JOBS Act page, www.mofo.com/jumpstart, with the MoFo Jumpstarter blog. Visit www.mofojumpstarter.com for up to the minute news and commentary.

Contents

About the authors 1
About the firm 2
Introduction 5

CHAPTER 1
The IPO on-ramp 15

CHAPTER 2
The IPO process 26

CHAPTER 3
Applying Title I to other transactions 39

CHAPTER 4
Private offerings 42

CHAPTER 5
Crowdfunding 55

CHAPTER 6
Regulation A+ 68

CHAPTER 7
Exchange Act registration thresholds 79

CHAPTER 8
Research 83

CHAPTER 9
Other capital formation discussions 93

Appendix A 102
Appendix B 105
Appendix C 107

Introduction

Many market participants were taken by surprise by the enactment of the Jumpstart Our Business Startups (JOBS) Act. The JOBS Act, HR 3606, was passed by the United States House of Representatives on March 8, 2012. On March 22, the Senate passed HR 3606 with an amendment to Title III (providing for the crowdfunding exemption with enhanced investor protections). On March 27, the House of Representatives accepted the Senate's amendment, and on April 5, President Obama signed the JOBS Act into law.[1] To many, this may sound like a quick path for legislation, especially when considered in the context of a Congress that seemed virtually deadlocked and unable to reach the consensus required to take action on pressing issues. When considered closely and in context, however, it becomes clear that the Act was the culmination of an at least year-long bipartisan effort in both the House and Senate to address concerns about capital formation and unduly burdensome Securities and Exchange Commission (SEC) regulations.

The JOBS Act affects both exempt and registered offerings, as well as the reporting requirements for certain public issuers. A centrepiece of the Act is an IPO on-ramp approach for a class of emerging growth companies (Title I), with confidential SEC staff review of draft IPO registration statements, scaled disclosure requirements, no restrictions on test-the-waters communications with qualified institutional buyers (QIBs) and institutional accredited investors before and after filing a registration statement, and fewer restrictions on research (including research by participating underwriters) around the time of an offering. In addition, the JOBS Act directs the SEC to amend its rules to:

- eliminate the ban on general solicitation and general advertising in Rule 506 offerings when sales are only to accredited investors, along with comparable changes to Rule 144A (Title II);
- establish a small offering exemption for crowdfunding (Title III); and
- create a new exemption for offerings up to $50 million (Title IV).

The JOBS Act also raises the holder-of-record threshold for mandatory registration under the Securities Exchange Act of 1934, as amended (the Exchange Act) (Titles V and VI). In the chapters that follow, we discuss each of these measures in greater detail, but before we do so, it is important to understand the concerns that led legislators to act in concert to adopt the JOBS Act.

The lifecycle for emerging companies in the United States

For a long time in the United States, a company's financing lifecycle was generally fairly predictable. A growing company usually financed its business through investments from friends and family, then perhaps from angel investors, and finally, if the company was successful, from venture capital firms. Given the application of section 5 of the Securities Act of 1933, as amended (the Securities Act)[2] to public offerings of securities, a company was required to limit itself to conducting small rounds of financing, relying on various available exemptions from the registration requirements of the Securities Act, and to target principally sophisticated institutional investors. The securities that a company sold in these private or exempt offerings were classed as restricted securities, which means that the securities had never been offered pursuant to a registration statement and were subject to certain transfer restrictions. After various successful private financing rounds, the company's management and venture investors would begin to consider an IPO. Once a company was an SEC-reporting issuer, it became subject to a comprehensive regulatory framework. Although this regulatory framework may have imposed requirements that seemed onerous (at the time), being a public company offered distinct benefits. Once public, a company generally had many more financing opportunities. Already public companies relied on raising additional capital to finance their growth through follow-on public offerings, underwritten by one or more investment banks. From time to time, an already public company also might conduct a private placement or other exempt offering as part of an overall financing plan. Over time, as the capital markets in the United States have undergone changes and as regulations have evolved, the cost-benefit calculus for

many companies has changed. Many companies have concluded that going public might not be the most desirable liquidity event and remaining private longer or considering acquisition alternatives might be more appealing. A bit of background on the securities regulatory framework will help illustrate why the analysis changed for many companies.

Securities regulatory framework

A privately held company (or a company that does not have securities that are publicly traded in the United States), whether domestic or foreign, that would like to access the US markets first must determine whether it is willing to subject itself to the ongoing securities reporting and disclosure requirements, as well as the corporate governance requirements that are part and parcel of registering securities publicly in the United States. An issuer may conduct a public offering in the United States by registering the offer and sale of its securities pursuant to the Securities Act, and also by registering its securities for listing or trading on a US securities exchange pursuant to the Exchange Act.[3] Instead, an issuer may choose to access the US capital markets by offering its securities in an offering exempt from the registration requirements of the Securities Act. Finally, a private company that elects to postpone, or seeks to avoid, becoming a public company may become subject to SEC reporting obligations inadvertently if it has: total assets exceeding $10 million as of the last day of its fiscal year, and a class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited investors (for banks and bank holding companies, a class of equity securities held of record by 2,000 or more persons), whether or not that class of equity securities is listed on a national securities exchange.

Section 5 of the Securities Act sets forth the registration and prospectus delivery requirements for securities offerings.[4] In connection with any offer or sale of securities in interstate commerce or through the use of the mails, section 5 requires that a registration statement must be in effect and a prospectus meeting the prospectus requirements of section 10 of the Securities Act must be delivered before sale.[5] This means that the Securities Act generally requires registration for any sale of securities, although it also provides exemptions or exclusions from this general registration requirement. The purpose of the Securities Act is to ensure that an issuer provides investors with all information material to an investment decision about the securities that it is offering. The registration and prospectus delivery requirements of section 5 require filings with the SEC and are intended to protect investors by providing them with sufficient information about the issuer and its business and operations, as well as about the offering, so that they may make informed investment decisions. These apply to offerings that are made to the general public (regardless of the sophistication of the offerees). The SEC presumes that distributions not involving public offerings (or widespread distributions) do not involve the same public policy concerns as offerings made to a limited number of offerees that have access to the same kind of information that would be included in a registration statement. That information can be conveyed by providing disclosure or by ensuring that the offerees have access to the information. There are a number of regulatory restrictions on communications for issuers that undertake a public offering, given that the SEC always has emphasised that the prospectus should be the principal document used by investors in making their investment decisions.

IPO and Exchange Act registration

In connection with an initial public offering of securities, an issuer must provide extensive information about its business and financial results. The preparation of the registration statement is time-consuming and expensive. Once the document is filed with the SEC, the SEC will review it closely and provide the issuer with detailed comments. The comment process may take as long as 60 to 90 days once a document has been filed with, or submitted to, the SEC. Once all of the comments have been addressed and the SEC staff is satisfied that the registration statement is properly responsive, the registration statement may be used in connection with the solicitation of offers to purchase the issuer's securities. Depending upon the nature of the issuer and the nature of the securities being offered by the issuer, the issuer may use one of various forms of registration statement. Once an issuer has determined to register its securities under the Securities Act, the issuer usually will also apply to have that class of its securities listed or quoted on a securities exchange, and in connection with doing so will register its securities under the Exchange Act. The Exchange Act imposes two separate but related obligations on issuers: registration obligations and reporting obligations. If an issuer becomes subject to the reporting requirements of the Exchange Act, the issuer remains subject to those requirements until, in the case of exchange-listed securities, those securities are delisted, or, in the case of securities listed by reason of the issuer's asset size and number of record holders, the issuer certifies that it meets certain requirements.

Once an issuer conducts an IPO in the United States or has a class of securities listed or traded on a national

securities exchange, the issuer will be generally subject to the reporting requirements of the Exchange Act. Issuers that have undertaken an IPO or that are SEC-reporting companies also will become subject to many other rules and regulations.

Over time, the regulatory burdens for public companies have increased. In 2002, following a series of widely reported corporate scandals involving fraudulent accounting practices and governance abuses, the United States adopted legislation affecting all public companies, the Sarbanes-Oxley Act of 2002.[6] Sarbanes-Oxley imposed a broad series of requirements relating to corporate governance, enhanced public disclosure, and the imposition of civil and criminal penalties for wrongdoing. Sarbanes-Oxley and its associated rules:

- require that CEOs and CFOs certify the accuracy and completeness of their companies' periodic reports and impose criminal penalties for false certification;
- require the establishment and regular evaluation of disclosure controls and procedures, and internal control over financial reporting designed to ensure the accuracy and completeness of the information reported to the SEC and for the preparation of financial statements;
- require the establishment by all listed companies of an independent audit committee;
- require the disgorgement of compensation by CEOs and CFOs following an accounting misstatement that results from misconduct;
- impose limitations on trading by officers and directors during retirement plan blackout periods;
- prohibit the extension of credit to related parties; and
- require the SEC to review a registrant's filings once every three years.

Although relief from compliance with certain of these requirements was provided to smaller companies, increased compliance costs and increased liability may have had a chilling effect on IPOs.

To (or not to) go public

Many commentators have noted that, over time, the US capital markets have become less competitive and the number of companies seeking to go public has declined. For example, in communications from Congressman Darrell Issa, chairman of the House Committee on Oversight and Government Reform, to Mary Schapiro, chairman of the SEC (discussed further below), Issa noted that the number of IPOs in the US plummeted from an annual average of 530 during the 1990s to about 126 since 2001, with only 38 in 2008 and 61 in 2009.[7] The number of companies listed on the main US exchanges peaked at more than 7,000 in 1997 and, as of the date of the letter, had been declining to about 4,000.[8] Meanwhile, the letter cited that the value of transactions in private company shares had grown, almost doubling in 2010 to $4.6 billion from about $2.4 billion in 2009, and was expected to increase to $6.9 billion for 2011.[9] Other reports published during the same time period cited similar statistics and highlighted that smaller companies were disproportionately affected, with most IPOs that were completed involved larger companies and a significant offering size. Although commentators would have been ready to stipulate that the number of IPOs had declined, there would be little agreement regarding the causes for the decline. Quite a number of different theories have been advanced to explain this phenomenon. Academics active in this area have grouped the theories into two broad categories: first, those attributing the decline to regulatory overreach; and second, those attributing the decline to changes in the ecosystem or market structure changes.

Many studies indicate that companies are waiting longer to go public as a result of anticipated costs associated with Sarbanes-Oxley compliance, as well as the additional costs associated with being a public company. For example, a public company must incur costs for D&O insurance, director compensation (especially audit committees), and disclosure controls and SEC reporting costs. Foreign issuers may be wary of the increased liability that comes with being an SEC-reporting company, as well as of the litigious environment in the United States. Many executive officers of privately held companies also are concerned that going public will limit their flexibility. As officers of a public company, they are required to make very difficult decisions, including decisions regarding financial reporting, accounting estimates, and accounting policies, while they are subject to more scrutiny and more risk as a result of their choices. Given the prospect of shareholder litigation and other litigation concerns, their determinations become fraught with risk. Earnings pressure and the need to respond to many constituencies (such as research analysts, large institutional holders, and aggressive hedge fund holders) may affect the decision-making processes. This may inhibit their desire to take risk and may lead them to be more conservative than they otherwise would be. A recent survey found that, in fact, the principal reason given by senior managers of privately held companies for remaining private is that they would like to preserve decision-making control.[10] In addition, actually conducting an IPO will be time-consuming and expensive given the disclosure and financial statement requirements.

Over time, more financing alternatives have developed for issuers. An issuer could choose to avail itself of one of

the exemptions from registration and conduct private offerings. There have been many regulatory changes that have provided greater legal certainty as to the availability of private offering exemptions, such as the safe harbours contained in Regulation D, especially Rule 506. In large measure, as a result of these changes, a number of securities offering methodologies involving exempt offerings have developed and become increasingly popular. Many of these offering methodologies have come to resemble the process used for public distributions of securities. Investors have become more receptive to participating in private placements and owning so-called restricted securities as the limitations on hedging or transferring restricted securities have been relaxed. More recently, private secondary markets have developed that provide liquidity opportunities for holders of the securities of private companies to sell their positions.

Other commentators and academics note that a variety of market structure changes may be the cause of or may contribute to the decline of IPOs, especially smaller company IPOs. During the 1990s and early 2000s, consolidation in the investment banking sector led to the disappearance of many boutique or speciality investment banks that had as their focus financing transactions for smaller companies. Some commentators point to the drop in bid-ask spreads that took place following decimalisation in 2001. In 2003, as a result of the fallout from the dot-com bust, rules and regulations were adopted that imposed restrictions on research analyst coverage and required the separation of research and investment banking activities. The burdensome regulations imposed significant compliance costs on investment banks with research activities and changed the nature of research coverage. As a result, the fewer, larger investment banks that remained after industry consolidation focused their resources on covering fewer companies (usually giving preference to larger, well-capitalised companies). These various factors seemed to change the economics associated with smaller company IPOs and tend to favour IPOs by larger, more established companies. Also, the view developed that larger companies, with a longer track record and more predictable earnings histories, make better public companies or are better able to function as public companies.

SEC developments

The SEC has tried to keep pace with changes in the capital markets and has consistently introduced reforms that sought to balance investor protection needs with the need to provide issuers with access to capital. Since the early 1980s, the SEC has undertaken a number of steps to facilitate capital formation. The SEC has, among other changes, created and modified the integrated disclosure system, instituted and expanded the continuous and delayed offerings processes, permitted the electronic submission of most SEC filings, and generally tried to accommodate the needs of both large and small issuers. In 2005, the SEC undertook a series of changes related to securities offerings and offering-related communications, referred to as securities offering reform. Although this reform benefited principally the largest and most sophisticated issuers (well-known seasoned issuers, or WKSIs), the changes also expanded the range of permissible communications, even during IPOs.

In December 2004, the SEC established the Advisory Committee on Smaller Public Companies to "assist the SEC in evaluating the current securities regulatory system relating to disclosure, financial reporting, internal controls, and offering exemptions for smaller public companies."[11] The Advisory Committee charter stated that its objective was "to assess the impact of the current regulatory system for smaller companies under the securities laws of the United States and to make recommendations for changes."[12] The Advisory Committee considered the effect of many new regulatory requirements on smaller public companies, as well as capital raising alternatives for smaller companies. In 2006, it issued its final report, containing 33 recommendations, many of which focused on capital formation, including a recommendation that a new private offering exemption from the Securities Act registration requirements be adopted that would not prohibit general solicitation and advertising for transactions with purchasers that do not need all the protections of Securities Act registration requirements. The Advisory Committee noted that the ban on general solicitation in a private offering resulted in excessive concern about the offeree who may never actually purchase securities, rather than on protection of the actual investors. The Committee also noted that, given the pace of technological change, the bank had become outmoded and limited issuers from using the internet and other tools to communicate with potential investors. This was not the first time that a recommendation had been made to ease the prohibition on general solicitation. In 2007, practitioners that were members of an American Bar Association Committee submitted a letter to the SEC containing recommendations for a comprehensive overhaul of the securities laws governing the private placement of securities.[13] The letter cited problems with the private offering process that impacted capital formation. In May 2007, the SEC approved publication of eight releases designed to update and improve federal securities

regulations that significantly affect smaller public companies and their investors. Ultimately, the holding period requirements under Rules 144 and 145 were shortened, making restricted securities more liquid, and smaller public companies gained limited access to the use of shelf registration statements.

Although all of these reforms modernised the securities offering process, streamlined communications requirements, and addressed certain of the concerns related to private or exempt offerings, the reforms did not squarely address the IPO process, nor did they address many of the thorniest issues arising in exempt offerings.

Proposed changes post-Dodd-Frank

In the aftermath of the financial crisis, and following adoption of the Dodd-Frank Act, there was renewed focus on the effect of regulation on the competitiveness of the US capital markets and on entrepreneurship and emerging companies. As attention in the United States turned to promoting economic activity, the dialogue related to regulatory burdens and their effect on capital formation took on a new sense of urgency.

Issa-Schapiro correspondence

On March 22, 2011, House Committee on Oversight and Government Reform chairman Issa sent a letter to SEC chairman Schapiro. The letter raised concerns about whether the current securities regulatory framework had a negative impact on capital formation, leading to the dearth of IPOs in the United States, as well as the extent to which SEC regulations potentially limited other capital raising activities by small and emerging companies.[14] The letter from Issa also sought specific information regarding economic studies conducted by the SEC staff in these areas, along with information concerning the consideration of costs and benefits in connection with SEC rulemakings. Issa's letter discussed these statistics and raised questions about five topics: the decline of the US IPO market, the communications rules in connection with securities offerings, the 499-shareholder cap under section 12(g) of the Exchange Act, organisational considerations, and new capital raising strategies.

In her response dated April 6, 2011, Schapiro stated she had requested that the SEC staff take a fresh look at the agency's rules in order to develop ideas for the SEC about ways to reduce the regulatory burdens on small business capital formation in a manner consistent with investor protection.[15] Schapiro outlined a number of new SEC initiatives in her response, including SEC staff review of (i) the restrictions on communications in initial public offerings; (ii) whether the general solicitation ban should be revisited; (iii) the number of shareholders that trigger public reporting, including questions regarding the use of special purpose vehicles; and (iv) the regulatory questions posed by new capital raising strategies, such as crowdfunding. Schapiro also indicated that the SEC was in the process of forming a new Advisory Committee on Small and Emerging Companies, which was subsequently convened.

Decline of the IPO market in the United States

Issa's letter cited statistics about the declining US IPO market and asked whether the SEC had evaluated the reasons for such a decline. The letter asked whether the possible reasons for the decline included increasingly complex SEC regulations; costs associated with compliance with the Sarbanes-Oxley Act; the uncertainty generated by the pending rulemakings under the Dodd-Frank Wall Street Reform and Consumer Protection Act (generally known simply as the Dodd-Frank Act); the risk of class-action lawsuits; or the expansion of regulatory, legal, and compliance burdens.[16] The letter also cited examples of the IPOs of Google and GoDaddy.com that were delayed and cancelled, respectively, as evidence of overly burdensome communications rules. In her response, Schapiro discussed various reasons for the decline in the IPO market, such as each company's own situation and market factors at the time of the contemplated IPO. Schapiro stated that it is difficult to determine why a company decides to undertake an IPO or declines to do so. The costs associated with conducting an IPO and becoming a public reporting company factor into the decision as to whether to conduct an IPO. Schapiro stated that the SEC had lowered these costs in recent years and that, in 2010, approximately 40% of first-time registrants were smaller reporting companies. Similarly, in 2010, nearly half of registered offerings conducted by first-time registrants were for offerings of less than $10 million. In a discussion about the challenges faced by early-stage growth companies, Schapiro pointed out that such companies have greater difficulty raising capital because of the lack of disclosure on a regular basis, smaller and more variable cash flows, a smaller asset base, and a larger percentage of intangible assets.

Schapiro also stated that while there are studies that show that the number of US IPOs had declined,[17] other studies conducted by SEC staff members indicate that for the period 1995–2007, the US market's share of global IPOs in terms of total dollar proceeds and average dollar proceeds was much higher than those of the United Kingdom and Hong Kong.[18] The other reason for companies to favour an IPO in the European markets is

that the underwriters' spread is significantly lower than in the United States. For example, the gross spread in the United States for an offering size between $25 million and $100 million is approximately 7%, while in Europe it would be approximately 4% for a similar offering.

The impact of the communications rules

In his letter, Issa indicated that the communication rules governing the offerings of securities potentially conflict with the promotion of disclosure and transparency and the First Amendment. He requested an explanation for the potential harm to a non-accredited investor that may realistically result from the receipt of an advertisement by an issuer of unregistered securities that is targeted at accredited investors or QIB. In her response, Schapiro described the communications rules that apply to registered and unregistered offerings. Under the Securities Act, for registered offerings, an issuer's ability to communicate varies depending on the three phases of the registration process called the pre-filing period, quiet period, and the post-effective period.[19] During the pre-filing period before filing a registration statement, an issuer may not offer securities.[20] During the quiet period (or waiting period), an issuer can make oral offers but cannot make written offers other than through a prospectus that complies with section 10 of the Securities Act.[21] In the post-effective period, an issuer can sell and deliver securities as long as a final prospectus that complies with section 10(a) of the Securities Act accompanies or precedes the delivery of the securities.

Schapiro discussed the offering reforms adopted in 2005 that liberalised an issuer's ability to communicate during offerings.[22] She also clarified that had these rules been effective when Google and Salesforce.com conducted their IPOs, the SEC would not have imposed a cooling-off period to address gun jumping concerns. Schapiro's letter points out that with respect to offerings not registered under the Securities Act, issuers relying on section 4(a)(2) of the Securities Act or its safe harbour, Rule 506 of Regulation D, generally are not allowed to use a general solicitation or advertising to attract investors to their offering. In addition, the SEC adopted Rule 155, another safe harbour, that allows companies to abandon a public offering and instead raise money through a private offering. Schapiro recognised that some view the general solicitation ban as a significant burden on capital raising and may be unnecessary, as offerees who might be located through general solicitation and who might not purchase the securities would not be harmed.[23] Others, however, support the solicitation ban on the grounds that it helps prevent securities fraud by making it more difficult for fraudsters to attract investors or unscrupulous issuers to condition the market.[24]

The 499-shareholder cap

Issa raised concerns about the 499-shareholder cap under section 12(g) of the Exchange Act as being a fundamental roadblock to private equity capital formation. The letter went on to cite the case of the Facebook equity issuance in which the 499-person threshold would have been overcome by grouping multiple shareholders into single entities. He questioned whether the use of special purpose vehicles (SPVs) for the purpose of facilitating investments in private companies resulted in disjointed or illiquid markets and prevented price discovery.

In her letter, Schapiro stated that Rule 12(g) of the Exchange Act was enacted by Congress in 1964 and that the securities markets have changed significantly since then. The section requires a company to register its securities with the SEC within 120 days after the last day of its fiscal year if, at the end of the fiscal year, the securities are "held of record" by 500 or more persons and the company has "total assets" exceeding $10 million. Schapiro pointed out that today, the vast majority of shares of public companies are held in nominee or so-called street name and, as a result, individual shareholders are not counted because the securities are not held of record by those individuals. Conversely, in private companies, shareholders generally hold their shares directly, or of record, and thus those companies may exceed the 499-shareholder limit under Rule 12(g), which would require them to commence reporting. Schapiro stated in her letter that the issue of how holders are counted and how many holders should trigger registration will need to be examined.

In his letter, Issa also raised concerns about Rule 12g5-1(b)(3) of the Exchange Act. That rule states that if an issuer knows that the form of holding securities of record is primarily used to circumvent section 12(g), the beneficial holders will be deemed the record owners. Noting that this rule has been invoked sparingly, Schapiro stated that this rule is not meant to create uncertainty for issuers, but rather is intended to prevent issuers from circumventing the registration requirements.

Schapiro also noted that Congress has provided the SEC with broad authority, in sections 12(h) and 36 of the Exchange Act, to make exemptions with respect to the section 12(g) registration requirements, and that section 12(g) of the Exchange Act also allows the SEC to define the terms "held of record" and "total assets." Therefore, the SEC has the requisite authority to revise the shareholder threshold if it concludes that doing so is not inconsistent with the public interest or protection of investors.

New capital raising strategies

The letter from Issa raised questions regarding crowdfunding, singling out that approach as a possible new method of capital formation that has gained popularity. Schapiro stated that she understands crowdfunding to be a new method of capital formation whereby groups of people pool money, typically small individual contributions, to support an effort by others to accomplish a specific goal. Initially, such arrangements did not trigger securities law issues because there was no profit participation. Schapiro noted, however, that interest in offering an ownership interest in a developing business and an opportunity for a return on investment capital is growing. She provided an example of crowdfunding as described to the staff as an offering of up to a maximum of $100,000 of equity securities of a company, with individual investments capped at $100. She noted that proponents of this approach to capital formation seek a registration exemption, and the SEC has been exploring several approaches to address this.[25] In considering whether to grant an exemption from registration for such arrangements, Schapiro stated that the SEC would consider, for example, its experience with Securities Act Rule 504, which was revised in 1999 due to concerns about fraud in the market. The widespread use of the internet for capital raising presents additional challenges in this area.

Legislative and other efforts

At more or less the same time that these exchanges were taking place, legislative efforts were moving forward that contemplated other changes to the capital formation process for smaller and emerging companies. Representative David Schweikert introduced the Small Company Capital Formation Act of 2011 in the US House of Representatives, which sought to amend the Regulation A offering threshold from $5 million to $50 million for public offerings by smaller companies.[26] The Small Company Formation Act was introduced after hearings on the topic of capital formation were held in December 2010, during which industry representatives expressed support for Regulation A reform as well as other changes to the capital formation process.

During the same session of Congress, other individual bills were introduced that would have increased the threshold for mandatory registration for all companies under the Exchange Act from 500 persons holding equity securities of record to 1,000 persons, and that would have amended section 12(g) of the Exchange Act by raising the registration threshold from 500 to 2,000 record holders if the issuer is a bank or a bank holding company.[27] Representative Patrick McHenry introduced legislation that would have added a crowdfunding exemption under both section 4 of the Securities Act and section 12(g) of the Exchange Act. Representative Kevin McCarthy introduced legislation to amend section 4(a)(2) of the Securities Act to state specifically that general solicitation and general advertising would not affect the availability of the private placement exemption to registration under section 5 of the Securities Act, and to direct the SEC to remove the prohibition against general solicitation and advertising for securities issued under Rule 506 of Regulation D, provided that all purchasers of the securities are accredited investors and that the issuer took reasonable steps set forth by the SEC to ascertain that the holder is indeed an accredited investor. Of course, these individual legislative proposals were the precursors to the JOBS Act.

In March 2011, the US Treasury Department convened the Access to Capital Conference to "gather insights from capital markets participants and solicit recommendations for how to restore access to capital for emerging companies – especially public capital through the IPO market." At this conference, a small group of professionals representing broad sectors of the IPO market decided to form the IPO Task Force to examine the challenges that emerging growth companies face in pursuing IPOs, and to provide recommendations for restoring effective access to the public markets for emerging growth companies.

The Task Force published its report, titled Rebuilding the IPO On-Ramp, in October 2011.[28] In the report, the Task Force noted that after achieving a one-year high of 791 IPOs in 1996, the US IPO market severely declined from 2001 to 2008, averaging only 157 IPOs per year during that period, with a low of 45 in 2008, with IPOs by smaller companies showing the steepest declines. The report presents a nuanced view of the causes of this decline, pointing to a series of regulatory and market structure changes. The report notes that these changes have coalesced and, as a result, have had the effect of driving up costs for smaller companies looking to go public; constraining the amount of information available to investors about such companies; and shifting the economics of investment banking away from long-term investing in such companies and toward high-frequency trading of large-cap stocks, thus making the IPO process less attractive to, and more difficult for, smaller companies. The report made four principal recommendations to the Treasury Department: providing an on-ramp (or phasing in of disclosure requirements) for smaller companies that complete IPOs; improving the availability and flow of information for investors before and after an IPO; lowering the capital gains tax rate for investors who

purchase shares in an IPO and hold these shares for a minimum of two years; and educating issuers about how to succeed in the new capital markets environment. The Task Force stressed that these recommendations purport only to adjust the scale of current regulations, not change the focus on investor protection.

In December 2011, legislation, titled the Reopening American Capital Markets to Emerging Growth Companies Act of 2011, was introduced that incorporated many of the recommendations included in the Task Force report, including a proposal to amend section 2(a) of the Securities Act and section 3(a) of the Exchange Act by creating a new category of issuer called an "emerging growth company" and exempting these emerging growth companies, at least initially, from certain requirements. This legislation formed the basis of much of Title I of the JOBS Act.

The legislative efforts received a boost when, in January 2012, President Obama expressed support for a number of these initiatives. During his State of the Union address, the President emphasised the need to foster innovation and encourage start-ups and small businesses. On January 31, 2012, the President released the Startup America Legislative Agenda to Congress, which reflected support for an increase in the offering threshold in Regulation A, a "national framework" for crowdfunding, and the adoption of an IPO on-ramp. Shortly thereafter, the individual legislative initiatives referenced above coalesced into a single legislative proposal.

The JOBS Act and the IPO market

In the years following enactment of the JOBS Act, the IPO market in the United States has improved substantially. Market participants attribute the health of the US IPO market largely to overall improved economic conditions. Growing US companies continue to debate whether to pursue an IPO or to defer an IPO and rely on private placements to raise capital. In part, the ability to submit an IPO registration statement confidentially and the ability to test the waters with certain institutional investors has made it easier for many prospective IPO issuers to explore the IPO alternative. According to published statistics, 2014 was the best year since 2000 for the number of US IPOs and the gross proceeds raised through IPOs. In 2014, there were 297 IPOs, which raised US$85.61 billion. Of course, during the same period, we have borne witness to the phenomenon of "unicorns," or privately held companies with a market value of at least $1 billion. Many successful private companies have found that they can raise substantial amounts in private placements to large institutional investors, often including the same types of institutions that historically would have invested principally or exclusively in IPOs or in publicly held companies. Perhaps it is too soon to judge whether the JOBS Act has brought significant or long lasting change to the capital formation process in the United States.

In any event, market participants and legislators were encouraged by this IPO activity and sought to advance additional measures that would either enhance various provisions of the JOBS Act or otherwise promote capital formation. As we discuss further in Chapter 9, some of these proposals were recommended by the SEC's Advisory Committee on Smaller Public Companies or by other small business groups. Although there was discussion in the popular press about the possibility of a "JOBS Act 2.0" and certain measures indeed found strong bipartisan support in the US Congress, there was no catalyst to help advance a series of broader reforms. Finally, a number of enhancements to the JOBS Act and other securities law - related measures found their way into a highway and transportation infrastructure bill as riders. This legislation, which is titled the Fixing America's Surface Transaction Act (the FAST Act), was enacted on December 4, 2015.[29]

In the chapters that follow, we provide a summary of the main provisions of the JOBS Act and a discussion of their effect on capital formation.

ENDNOTES

1 Jumpstart Our Business Startups Act, Pub. L. No. 112-106.

2 Securities Act of 1933, 48 Stat. 74 (May 27, 1933), codified at 15 USC section 77a *et seq.*

3 Securities Exchange Act of 1934, 48 Stat. 881 (June 6, 1934), codified at 15 USC section 78a *et seq.*

4 15 USC section 77e.

5 15 USC section 77e(b).

6 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in various sections of 15 U.S.C. and 18 U.S.C.), section 301, 302, 404, 406, 407 and 906.

7 *See* http://www.gt.com/staticfiles//GTCom/Public%20companies%20and%20capital %20markets/Files/IPO%20crisis%20-%20June%202010%20-%20FINAL.pdf.

8 *See id.*

9 *See* http://online.wsj.com/article/SB10001424052748704630004576249182275134552.html?KEYWORDS=%22new+stock+rules%22.

10 *See* James C. Brau & Stanley E. Fawcett, *Initial Public Offerings: An Analysis of Theory and Practice*, 61 J. Fin. 399 (2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=530924.

11 Securities Act Release No. 33-8514, 87 S.E.C. Docket 1138 (Feb. 28, 2006); Exchange Act Release No. 34-50864, 84 S.E.C. Docket 1340 (December 16, 2004).

12 Advisory Committee on Smaller Public Companies, Charter, *available at* http://sec.gov/info/smallbus/acspc.shtml.

13 Letter from Keith F. Higgins, Chair, ABA Committee on Federal Regulation of Securities, to John W. White, Director, Division of Corporation Finance (March 22, 2007), *available at* www.abanet.org/buslaw/committees/CL410000pub/comments/20070322000000.pdf.

14 *See* http://www.knowledgemosaic.com/resourcecenter/Issa.041211.pdf.

15 *See* http://www.sec.gov/news/press/schapiro-issa-letter-040611.pdf.

16 Dodd-Frank Wall Street Reform and Consumer Protection Act (codified at section 12 U.S.C. section 5301 et seq.).

17 *See, e.g.* D. Weild and E. Kim, *A Wake Up Call for America*, Grant Thornton LLP (2009); Committee on Capital Markets Regulation, Continued Erosion in Competitiveness of the U.S. Equity Markets (2009).

18 *See* C. Caglio, K. Weiss Hanley and Marietta-Westberg, *Going Public Abroad: The Role of International Markets for IPOs* (February 2011).

19 The Securities Act does not state when the pre-filing period begins. The SEC has stated that an issuer will be in registration at least from the time it begins preparing the related registration statement or the time it has reached an understanding with an underwriter, even if all the terms or conditions of the underwriting arrangement have not been agreed upon. *See* Release No. 33-5009, *Publication of Information Before or After the Filing and Effective Date of a Registration Statement Under the Securities Act of 1933* (October 7, 1969); Release No. 33-5180, *Guidelines for Release of Information by Issuers Whose Securities Are in Registration* (August 16, 1971).

20 *See* Securities Act section 5(c).

21 *See* Securities Act section 5(b)(1).

22 *See* Release No. 33-8591, *Securities Offering Reform* (July 19, 2005), *available at* http://www.sec.gov/rules/finaI/33-8591.pdf.

23 *See*, e.g., Final Report of the Advisory Committee on Smaller Public Companies to the U.S. Securities and Exchange Commission (April 23, 2006), http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf; Joseph McLaughlin, *How the SEC Stifles Investment – and Speech*, The Wall Street Journal (February 3, 2011). Concerns about the scope of the Commission's rules on general solicitation and advertising have been raised by the participants in the annual SEC Government-Business Forum on Small Business Capital Formation. *See* 2009 Annual SEC Government-Business Forum on Small Business Capital Formation Final Report (May 2010), *available at* http://www.sec.gov/info/smallbus/gbfor28.pdf.

24 *See Pinter v. Dahl*, 486 U.S. 622, 644 (1988) ("The purchase requirement clearly confines section12 liability to those situations in which a sale has taken place. Thus, a prospective buyer has no recourse against a person who touts unregistered securities to

him if he does not purchase the securities.”).

25 For example, crowdfunding was discussed at the SEC’s November 2010 Forum on Small Business Capital Formation. Participants in the Forum recommended that the SEC consider implementing a new exemption from Securities Act registration for crowdfunding, which would include offerings of up to $100,000 and a cap on individual investments not to exceed $100. In January 2011, representatives from the Division of Corporation Finance’s Office of Small Business Policy met with a group from the Small Business & Entrepreneurship Council, which advocated an exemption from registration requirements for crowdfunding offerings meeting specific requirements. In addition, the Office of Small Business Policy and other members of the Division of Corporation Finance Staff discussed crowdfunding with representatives from the North American Securities Administrators Association, the organisation of state securities regulators, at a conference held on March 28, 2011.

26 HR 1070, *available at* http://www.gpo.gov/fdsys/pkg/BILLS-112hr1070ih/pdf/BILLS-112hr1070ih.pdf.

27 Note that this change merely puts into the statute the current requirements of SEC rules under sections 12(g) and 15(d).

28 *Available at* http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.

29 Fixing America’s Surface Transportation Act (Pub. L. No. 114-94).

CHAPTER 1

The IPO on-ramp

Title I of the JOBS Act establishes a new process and disclosure regime for IPOs by a new class of companies referred to as emerging growth companies (EGCs). As discussed in the Introduction, Title I of the JOBS Act was enacted based, in part, on the recommendations of the Task Force, which sought ways to improve the offering process as a means of encouraging more IPOs in the United States. As truly the centrepiece of the JOBS Act, Title I contemplates, for those companies that qualify as EGCs, confidential SEC staff review of draft IPO registration statements, scaled disclosure requirements, no restrictions on test-the-waters communications with qualified institutional buyers (QIBs) and institutional accredited investors before and after filing a registration statement, and fewer restrictions on research (including research by participating underwriters) around the time of an offering. Because Title I was retroactively effective to December 9, 2011 for issuers that qualified as EGCs, it has had the most significant impact to date on the regulation of capital formation transactions.

Given the immediate effectiveness of Title I of the JOBS Act, the SEC staff provided interpretive guidance in the form of frequently asked questions that are posted on the SEC's website. The FAQs were initially issued on April 16, 2012 and were updated on May 3, 2012 and September 28, 2012.[1] The FAQs also were updated recently to address changes brought about by the FAST Act. These FAQs are not rules or regulations of the SEC, but rather reflect the views of the staff of the SEC's Division of Corporation Finance.

The definition of EGC

In order to qualify for the IPO on-ramp contemplated by Title I of the JOBS Act, an issuer must qualify as an EGC, which is determined for the purpose of the reporting, accounting, auditing and corporate governance breaks that the company may use if it went public through a registered securities offering on or after December 9, 2011, and for an IPO at any time during the process when the EGC is making use of the Title I provisions.

The $1 billion in revenue test

An EGC is defined for purposes of Title I as an issuer (including a foreign private issuer) with total annual gross revenues of less than $1 billion (subject to inflationary adjustment by the SEC every five years) during its most recently completed fiscal year.[2] The SEC indicates that the phrase "total annual gross revenues" means total revenues of the issuer (or a predecessor of the issuer, if the predecessor's financial statements are presented in the registration statement for the most recent fiscal year), as presented on the income statement in accordance with US generally accepted accounting principles (GAAP).[3] If a foreign private issuer is using International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) as its basis for presentation, then the IFRS revenue number is used for this test.[4] Because an issuer must determine its EGC status based on revenues as expressed in US dollars, the SEC staff indicates that a foreign private issuer's conversion of revenues should be based on the exchange rate as of the last day of the fiscal year.[5] For financial institutions, the SEC has indicated that total annual gross revenues should be determined in the manner consistent with the approach used for determining status as a "smaller reporting company," which looks to all gross revenues from traditional banking activities. For this purpose, a financial institution must include all gross revenues from traditional banking activities. Banking activity revenues include interest on loans and investments, dividends on investments, fees from loan origination, fees from trust and investment services, commissions, brokerage fees, mortgage servicing revenues, and any other fees or income from banking or related services. Revenues do not include gains and losses on dispositions of investment portfolio securities (although it may include gains on trading account activity if that is a regular part of the institution's activities).[6]

By way of example, the SEC indicates that, in applying the revenue test for determining EGC status, a calendar year-end issuer that would like to file a registration statement for an initial public offering of common equity securities in January 2013 (which would present financial

statements for 2011 and 2010 and the nine months ended September 30, 2012 and 2011) should look to its most recently completed fiscal year, which would be the most recent annual period completed, regardless of whether financial statements for the period are presented in the registration statement. In this example, the most recent annual period completed would be 2012.[7]

Applicability of the December 9, 2011 effective date

An issuer can qualify as an EGC if it first sold its common stock in a registered offering on or after December 9, 2011. The SEC has indicated that this eligibility determination is not limited to initial public offerings that took place on or before December 8, 2011, in that it could also include an offering of common equity securities under an employee benefit plan on Form S-8, as well as a selling shareholder's registered secondary offering.[8] The SEC notes that just having a registration statement go effective on or before December 8, 2011 is not a bar to EGC status, as long as no common equity securities were actually sold off of the registration statement on or before December 8, 2011.[9]

Qualification for EGC status

The SEC has indicated that asset-backed issuers and registered investment companies do not qualify as EGCs; however, business development companies qualify.[10] The SEC may determine, through the course of its review process or otherwise, that other particular types of issuers are not EGCs for the purposes of Title I of the JOBS Act.

Previously public issuers

An issuer that succeeds to a predecessor's Exchange Act registration or reporting obligations under Rules 12g-3 and 15d-5 will not qualify for EGC status if the predecessor's first sale of common equity securities occurred on or before December 8, 2011, as the predecessor was not eligible for that EGC status.[11]

The SEC has addressed the EGC status of an issuer that was once an Exchange Act reporting company but is not required to file Exchange Act reports.[12] The SEC notes that such an issuer can take advantage of the benefits of EGC status, even though its initial public offering of common equity securities occurred on or before December 8, 2011. In this regard, the SEC indicates that if an issuer would otherwise qualify as an EGC but for the fact that its initial public offering of common equity securities occurred on or before December 8, 2011, and such issuer was once an Exchange Act reporting company but is not required to file Exchange Act reports, then the SEC would not object if such issuer takes advantage of all of the benefits of EGC status for its next registered offering and thereafter, until it triggers one of the disqualification provisions in sections 2(a)(19)(A)-(D) of the Securities Act. This position is not available to an issuer that has had the registration of a class of its securities revoked pursuant to Exchange Act section 12(j). The SEC goes on to note that, based on the particular facts and circumstances, the EGC status of an issuer may be questioned if it appears that the issuer ceased to be a reporting company for the purpose of conducting a registered offering as an EGC. The SEC recommends that issuers with questions relating to these issues should contact the Division of Corporation Finance's Office of the Chief Counsel.

This interpretation seeks to address EGC status for those companies that were taken private through private equity or management buyouts with the expectation of a liquidity event or exit through an IPO in the future, which have made up a relatively significant portion of the IPO market in recent years.

Losing EGC status

Status as an EGC is maintained until the earliest of:

- the last day of the fiscal year in which the issuer's total annual gross revenues are $1 billion or more;
- the last day of the issuer's fiscal year following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act (for a debt-only issuer that never sold its common equity pursuant to an Exchange Act registration statement, this five-year period will not run);
- any date on which the issuer has, during the prior three-year period, issued more than $1 billion in non-convertible debt; or
- the date on which the issuer becomes a "large accelerated filer," as defined in the SEC's rules.[13]

With regard to the $1 billion debt issuance test, the SEC has indicated that the three-year period covers any rolling three-year period, which is not in any way limited to completed calendar or fiscal years.[14] The SEC also noted that it reads "non-convertible debt" to mean any non-convertible security that constitutes indebtedness (whether issued in a registered offering or not), thereby excluding bank debt or credit facilities.[15] The debt test references debt issued, as opposed to issued and outstanding, so that any debt issued to refinance existing indebtedness over the course of the three-year period could be counted multiple times. The SEC has indicated, however, that the staff will not object if an issuer does not double count the principal amount from a private placement and the principal amount from the related Exxon Capital or A/B exchange offer.[16]

	Example 1: Forward acquisition	Example 2: Reverse merger
$1B annual revenues test	In 2012, look to Company A's revenues for 2011. In 2013, look to Company A's revenues for 2012, which will include Company B's revenues from October 1, 2012.	In 2012, look to Company D's revenues for 2011. In 2013, look to Company D's revenues for 2012, which will include Company C's revenues from October 1, 2012.
Five-year anniversary test	Look to Company A's date of first sale.	Look to Company C's date of first sale.
$1B issued debt during previous three years test	Look to Company A's debt issuances, which will include Company B's debt issuances from October 1, 2012.	Look to Company D's debt issuances, which will include Company C's debt issuances from October 1, 2012.
Large accelerated filer test	At December 31, 2012, look to Company A's market value at June 30, 2012. At December 31, 2013, look to Company A's market value (which will include Company B's) at June 30, 2013.	At December 31, 2012, look to Company C's market value at June 30, 2012. At December 31, 2013, look to Company C's market value (which will include Company D's) at June 30, 2013.

The SEC also addressed two specific examples and how the EGC status of the issuer would be determined in the event of an acquisition or reverse merger.[17]

- In Example 1, Company A acquires Company B for cash or stock, in a forward acquisition. Company A is both the legal acquirer and the accounting acquirer.
- In Example 2, Company C undertakes a reverse merger with Company D, an operating company. Company D is presented as the predecessor in the post-transaction financial statements.

In each example, the companies' fiscal year is the calendar year; the transactions occur on September 30, 2012; and FAQ 24, which relates to succession of Exchange Act obligations, is not implicated. In determining whether Company A and Company C trigger any of the disqualifications from the definition of EGC in section 2(a)(19)(A), (B), (C) or (D) (referenced above), the SEC staff notes the following framework:

Timing of the EGC determination

Securities Act Rule 401(a) provides that "the form and contents of a registration statement and prospectus shall conform to the applicable rules and forms as in effect on the initial filing date of such registration statement and prospectus," and applies to registration statements at the initial filing date, not at the time that a registration statement is submitted for confidential review.[18] Therefore, an issuer must qualify as an EGC at the time of submission in order to use the confidential review process for a registration statement, or any amended submission of the registration statement. If an issuer loses EGC status while the SEC staff is reviewing the registration statement on a confidential basis, then the issuer must file the registration statement and all of the draft submissions in order to proceed with the review process. When the EGC files the registration statement, the issuer's EGC status is retained while that registration statement is in registration by operation of Securities Act Rule 401(a). With regard to the use of the permitted test-the-waters communications under Securities Act section 5(d) (discussed below), an issuer must determine whether it qualifies as an EGC at the time it engages in the test-the-waters communications. In this regard, the SEC has noted that if the issuer later loses its EGC status by the time the registration statement is filed, then the issuer would not retroactively lose the ability to utilise prior test-the-waters communications.[19]

EGC grace period

The FAST Act amends the Securities Act in order to provide a grace period permitting an issuer that qualified as an EGC at the time it made its first confidential submission of its IPO registration statement and subsequently during the IPO process ceases to be an EGC to continue to be treated as an EGC through the earlier of:

the date on which the issuer consummates its IPO pursuant to that registration statement, or the end of the one-year period beginning on the date the company ceases to be an EGC.[20]

Benefits available to EGCs

When an issuer qualifies as an EGC, it may take advantage of a number of benefits in connection with its IPO and subsequent public reporting and corporate governance. These benefits are designed to facilitate the public offering process, promote communications in and around the time of the IPO, and allow the EGC to ease into certain public reporting, accounting, auditing, and corporate governance requirements.

EGC communications

Title I of the JOBS Act provides EGCs, or any other person they authorise, the flexibility to engage in oral or written communications with QIBs and institutional accredited investors in order to gauge their interest in a proposed offering, whether before or following the first filing of any registration statement, subject to the requirement that no security may be sold unless accompanied or preceded by a Securities Act section 10(a) prospectus.[21] This provision allows an EGC to test the waters for a potential IPO by communicating with investors and gauging their potential interest in the offering.[22] An EGC can use the test-the-waters provision with respect to any registered offerings that it conducts while qualifying for EGC status. There are no form or content restrictions on these communications, and there is no requirement to file written communications with the SEC. In the course of reviewing the registration statements of an EGC, the SEC staff has requested the EGCs submit any written test-the-waters materials to the SEC, so that the SEC staff can determine whether those materials would provide any guidance as to information that should be included in the prospectus.

The SEC has addressed the interplay of these test-the-waters communications, and the requirements of Exchange Act Rule 15c2-8(e).[23] Rule 15c2-8(e) requires that a broker-dealer make available a copy of the preliminary prospectus (before the effective date) for a registered offering of securities before soliciting orders from customers. If read broadly, the prohibitions of Rule 15c2-8(e) might constrain the types of activities that are permissible during test-the-waters discussions. The FAQs note that while the JOBS Act does not amend Rule 15c2-8(e) (that is, the JOBS Act does not modify the meaning of the term "solicit"), an EGC or a financial intermediary acting on the EGC's behalf may engage in discussions with institutional investors to gauge their interest in purchasing EGC securities before the EGC has filed its registration statement with the SEC and after the EGC has filed its registration statement. During this period, the underwriter may discuss price, volume and market demand and solicit non-binding indications of interest from customers. Soliciting such a non-binding indication of interest, in the absence of other factors, would not constitute a solicitation for purposes of Rule 15c2-8(e).

The JOBS Act also permits a broker-dealer to publish or distribute a research report about an EGC that proposes to register an offering under the Securities Act or has a registration statement pending, and the research report will not be deemed an offer under the Securities Act, even if the broker-dealer will participate or is participating in the offering. Further, no SRO or the SEC may adopt or maintain any rule or regulation prohibiting a broker-dealer from publishing or distributing a research report or making a public appearance with respect to the securities of an EGC following an offering or in a period before expiration of a lock-up.[24] These provisions are discussed in greater detail in Chapter 8.

Confidential review process for EGC IPO registration statements

Title I provides that the SEC's staff must review all EGC initial public offering registration statements confidentially.[25] Title I provides that an EGC may confidentially submit a draft registration statement for an initial public offering for non-public review, provided that the initial confidential submission and all amendments are publicly filed with the SEC no later than 21 days before the issuer's commencement of a road show.[26] More recently, the FAST Act amended this requirement and reduced the 21-day period to a 15-day period.[27] The SEC requires that confidential draft registration statements and amendments be submitted through the SEC's electronic filing system (known as EDGAR) using submission form types DRS and DRS/A, respectively. No filing fee is due at the time of submitting the draft registration statement.[28]

A confidential submission of a draft registration statement is not required to be signed by the registrant or by any of its officers or directors, nor is it required to include the consent of auditors and other experts, as it is not filed with the SEC.[29] While Securities Act section 6(e)(1) requires that the initial confidential submission and all amendments thereto be publicly filed with the SEC not later than 15 days before the date on which the issuer commences a road show, the SEC notes that upon public filing, the previous confidential submissions are not required to be signed and do not require consents.[30]

The SEC expects that any registration statement submitted for confidential review will be substantially complete at the time of initial submission, including a signed audit report and the required exhibits (however, the registration statement itself is not required to be signed or to include the consent of auditors and other experts). The SEC will defer review of any draft registration statement that is materially deficient.[31]

The confidential submission of a draft registration does not constitute the filing of a registration statement for the purposes of the prohibition in Securities Act section 5(c) against making offers of a security in advance of filing a registration statement.[32]

Test-the-waters communications and the now 15-day filing requirement

The JOBS Act amended Securities Act section 6(e) to provide that confidential registration statement submissions must be publicly filed with the SEC at least 21 days before the issuer conducts a road show. As noted above, this period has now been reduced to 15 days. The term "road show" is defined as "an offer … that contains a presentation regarding an offering by one or more members of the issuer's management … and includes discussion of one or more of the issuer, such management, and the securities being offered."[33] Given the breadth of this definition, the SEC has addressed the issue of whether the test-the-waters communications under Securities Act section 5(d) that are discussed above could be considered a road show for the purposes of triggering this public filing requirement.[34]

The SEC has noted that in a traditional underwritten public offering where test-the-waters communications are not used, the road show could be easily identified as "those meetings traditionally viewed as the road show when the emerging growth company and underwriters begin actively marketing the offering." Under these circumstances, the EGC would be able to estimate when it expects to begin that road show, and then publicly file the registration statement and all of the confidential submissions at least 15 days before that date. Because Securities Act section 5(d) specifically contemplates test-the-waters communications taking place before filing a registration statement, and in the interest of reading the provisions in a consistent fashion, the SEC will not object if an EGC does not treat test-the-waters communications conducted in reliance on Securities Act section 5(d) as a road show for purposes of Securities Act section 6(e). The SEC notes, however, that if an issuer were to have meetings or other communications that meet the definition of a road show and which do not fall within the test-the-waters communications contemplated by section 5(d), then the public filing requirement would be triggered based on the timing of such meetings. If an EGC does not conduct a traditional road show and does not engage in activities that would come within the definition of a road show, other than test-the-waters communications that comply with Securities Act section 5(d), the SEC staff indicates that the issuer's registration statement and confidential submissions should be filed publicly no later than 15 days before the anticipated date of effectiveness of the registration statement.[35]

Registration statement disclosure for EGCs

The SEC has indicated that an EGC must identify itself as an EGC on the cover page of the prospectus.[36] In addition, SEC staff comments on EGC registration statements have requested the following disclosures:

- a description of how and when a company may lose EGC status;
- a brief description of the various exemptions that are available to an EGC, such as exemptions from Sarbanes-Oxley section 404(b) and the Say-on-Pay/Say-on-Golden Parachute provisions; and
- the EGC's election under section 107(b) of the JOBS Act for extended transition to new or revised accounting standards.

The SEC staff requests that if the EGC has elected to opt out of the extended transition period for new or revised accounting standards, then it must include a statement that the election is irrevocable. If the EGC has elected to use the extended transition period, then risk factor disclosure must explain that this election allows an EGC to delay the adoption of new or revised accounting standards that have different effective dates for public and private companies until those standards apply to private companies. The SEC staff also requests that the EGC state in the risk factors that, as a result of this election, the EGC's financial statements may not be comparable to issuers that comply with public issuer effective dates. A similar statement is also requested in the EGC's critical accounting policy disclosures in MD&A.

An EGC is required to present only two years of audited financial statements in its initial public offering registration statement.[37] An EGC may also limit its MD&A to only cover those audited periods presented in the audited financial statements. The SEC has indicated that, notwithstanding Securities Act section 7(a)(2)(A)'s reference to "any other" registration statement, the SEC staff will not object if an EGC presenting two years of audited financial statements limits the selected financial data included in its initial public offering registration

statement to only two years.[38] For financial statements required under Rules 3-05 and 3-09 of Regulation S-X under the Securities Act (Regulation S-X), the SEC staff will not object if only two years of financial statements are provided in the registration statement, even if the significance tests result in a requirement to present three years of financial statements for entities other than the issuer.[39] The SEC staff has further noted that it will not object if an issuer presents the ratio of earnings to fixed charges required by Item 503(d) of Regulation S-K under the Securities Act (Regulation S-K) for the same number of years for which it provides selected financial data.[40]

The FAST Act also amended the financial information requirement for EGCs. As a result of the FAST Act amendments, an EGC may omit historical financial information for certain periods otherwise required by Regulation S-X at the time of filing or confidential submission, if the EGC reasonably believes the information will not be required to be included at the time of the contemplated offering.[41] By way of example, this change would allow an EGC to omit 2013 financial statements in a December 2015 filing if it does not intend to consummate the offering until its year-end 2015 audited financial statements are available (at which point 2014 and 2015 financial statements will be included in the registration statement). In December 2015, the SEC staff provided guidance on this change, clarifying that the accommodation applies to all historical financial information required to be presented pursuant to Regulation S-X, including, for example, financial statements for an acquired company. The SEC staff also explained in its guidance that an EGC cannot use this accommodation to exclude the most recent interim period required by Regulation S-X, even if that period will be replaced with a longer interim or annual period in the final registration statement (e.g., for a January 2016 filing where an EGC expects to consummate the offering after its year-end 2015 audited financial statements are available, it can omit 2013 as noted above but cannot omit the nine-month periods ended September 30, 2015 and September 30, 2014).[42] This new accommodation may prove to be a significant cost-saving measure.

An EGC may comply with the executive compensation disclosures applicable to a "smaller reporting company" as defined in the SEC's rules, which means that an EGC need provide only a Summary Compensation Table (with three rather than five named executive officers and limited to two fiscal years of information), an Outstanding Equity Awards Table, and a Director Compensation Table, along with some narrative disclosures to augment those tables. EGCs are not required to provide a Compensation Discussion and Analysis, or disclosures about payments upon termination of employment or change in control.[43]

Disclosure, corporate governance, accounting and auditing relief

Title I of the JOBS Act provides relief from a number of requirements for EGCs following an initial public offering. An EGC will not be subject to the Say-on-Pay, Say-on-Frequency or Say-on-Golden Parachute vote required by the Dodd-Frank Act and the SEC rules, for as long as the issuer qualifies as an EGC.[44] An issuer that was an EGC, but lost that status, will be required to comply with the Say-on-Pay vote requirement as follows: in the case of an issuer that was an EGC for less than two years, by the end of the three-year period following its IPO; and for any other issuer, within one year of having lost its EGC status.[45] An EGC also is not subject to any requirement to disclose the relationship between executive compensation and the financial performance of the company, or any requirement to disclose the CEO's pay relative to the median employee's pay (should either such requirements ever be proposed and adopted by the SEC pursuant to the Dodd-Frank Act).[46]

Under section 107(b) of the JOBS Act, an EGC will not be required to adopt any update to FASB's Accounting Standards codification after April 5 2012 that has different effective dates for public companies and private companies that are not "issuers" under section 2(a) of Sarbanes-Oxley, until those standards apply to private companies. Under this provision, EGCs are able to take advantage of the extended transition period contemplated in those limited situations where there is a different effective date specified for private companies. If a new or revised accounting standard does not apply at all to private companies, then no transition would be permitted for EGCs, or if an accounting standard applies to both public and private companies, but provides for the same effective date for both types of companies, then no transition would be permitted for EGCs. Section 107(b)(1) of the JOBS Act provides that an EGC "must make such choice at the time the company is first required to file a registration statement, periodic report, or other report with the Commission" and to notify the SEC of such choice. The SEC has noted that EGCs should notify the SEC staff of the issuer's choice at the time of the initial confidential submission, and if an EGC is already in registration or subject to Exchange Act reporting, then the statement must appear in its next amendment to the registration statement or in its next periodic report.[47] Section 107(b)(2) provides that any decision to optout of the extended transition period for complying with new or revised accounting standards is irrevocable; however, the SEC

allows an EGC that opted into the extended transition period provision to subsequently opt out, as long as it complies with the applicable provisions of the JOBS Act and discloses its opting-out in the first periodic report or registration statement following the decision to do so.

An EGC is not subject to any potential rules or standards requiring mandatory audit firm rotation or a supplement to the auditor's report that would provide additional information regarding the audit of the company's financial statements (auditor discussion and analysis), should such requirements ever be proposed or adopted by the Public Company Accounting Oversight Board (PCAOB). Any other new auditing standards adopted by the PCAOB will not apply to EGC audits unless the SEC determines that such requirement is necessary and appropriate for investor protection.[48]

An EGC is not subject to the requirement for an auditor attestation of internal controls pursuant to section 404(b) of Sarbanes-Oxley. The EGC is subject to the requirement that management establish, maintain, and assess internal control over financial reporting, once that is phased-in for a issuer conducting an initial public offering after the first year.[49]

Other than the provisions for extended transition to new or revised accounting standards discussed above, an EGC may decide to follow only some of the scaled disclosure provisions and corporate governance breaks available for EGCs.[50]

The SEC will not object if a foreign private issuer that qualifies as an EGC complies with the scaled disclosure provisions available to emerging growth companies to the extent relevant to the form requirements for foreign private issuers.[51]

Required studies

The JOBS Act requires that the SEC conduct a number of studies. Under Title I, within 90 days of enactment of the Act, the SEC was required to present to Congress the findings of a study that examines the impact of decimalisation on initial public offerings and the impact of this change on liquidity for small- and mid-cap securities. If the SEC determined that securities of emerging growth companies should be quoted or traded using a minimum increment higher than $0.01, the SEC may, by rule, not later than 180 days following enactment of the Act, designate a higher minimum increment between $0.01 and $0.10.[52] Also under Title I, within 180 days of enactment, the SEC was required to present to Congress its findings and recommendations following a review of Regulation S-K that is intended to analyse current registration requirements and determine whether these requirements can be updated, modified or simplified in order to reduce costs and other burdens on emerging growth companies.[53]

Decimalisation

On July 20, 2012, the SEC delivered to Congress the report required by section 106 of the JOBS Act.[54] The study notes the observations of the IPO Task Force regarding the changing market structure and economics arising from the shift to decimal stock quotes, which point toward a negative impact on the economic sustainability of sell-side research and the greater emphasis placed on liquid, very large capitalisation stocks at the expense of smaller capitalisation stocks. The SEC's study takes a three-pronged approach to examining the issues: (i) reviewing empirical studies regarding tick size and decimalisation; (ii) participation in, and review of materials prepared in connection with, discussions concerning the impact of market structure on small and middle capitalisation companies and on IPOs as part of the SEC Advisory Committee on Small and Emerging Companies; and (iii) a survey of tick-size conventions in foreign markets.

The SEC concluded that decimalisation may have been one of a number of factors that have influenced the IPO market, and that the existing literature did not isolate the effect of decimalisation from the many other factors. The SEC also noted that markets have evolved significantly since decimalisation was implemented over a decade ago, and that other countries have used multiple tick sizes rather than the one-size-fits-all approach implemented in the United States. Based on the observations reported in the study, the SEC recommends that the SEC should not proceed with specific rulemaking to increase tick sizes, but should rather consider additional steps that may be needed to determine whether rulemaking should be undertaken, which might include soliciting the views of investors, companies, market professionals, academics and others on the broad topic of decimalisation and the impact on IPOs and the markets. In May 2015, the SEC approved a proposal by the national securities exchanges and the Financial Industry Regulatory Authority (Finra) for a two-year tick-size pilot programme that will have as its objective assessing whether wider tick sizes enhance market quality for the securities of small cap companies. The pilot programme will run for at least two years and will include stocks of companies with $3 billion or less in market capitalisation, an average daily trading volume of one million shares or less, and a volume-weighted average price of at least $2.00 for every trading day.

Regulation S-K

On December 23, 2013, the SEC delivered to Congress the report required by section 108 of the JOBS Act.[55] The SEC was mandated to review Regulation S-K in the context of the new class of issuers referred to in the JOBS Act as EGCs. In connection with this review, the SEC staff chose to consider the background of the development of disclosure requirements and potential recommendations for revisiting disclosure requirements in a broad manner. The SEC staff reviewed, among other things, Regulation S-K, SEC releases and comment letters on SEC regulatory actions pertaining to Regulation S-K. The SEC staff also reviewed public comments that were submitted regarding section 108 of the JOBS Act. In light of the focus of the mandate in section 108 of the JOBS Act, the SEC staff did not review two subparts of Regulation S-K, Regulation AB and Regulation M-A.

The SEC staff noted that while the study conducted in connection with the section 108 report serves as an important starting point, further information gathering and review is warranted in order to formulate specific recommendations regarding specific disclosure requirements. The SEC staff stated that "input from market participants is needed to facilitate the identification of ways to update or add requirements for disclosure that is material to an investment or voting decision, ways to streamline and simplify disclosure requirements to reduce the costs and burdens on public companies, including emerging growth companies, ways to enhance the presentation and communication of information and to understand how technology can play a role in addressing any of these issues." In addition, the SEC staff noted in the report that economic analysis is necessary to inform any reevaluation of disclosure requirements.

The SEC staff recommended the development of a plan to review systematically the SEC's disclosure requirements for public companies, including Regulations S-K and S-X, and the related rules concerning the presentation and delivery of information. Among the factors that will be considered in the review are disclosure requirements developed through SEC interpretations, as well external factors that may have contributed to the length and complexity of filings and the costs of compliance (e.g., SEC enforcement actions and judicial opinions). After conducting this detailed review, the SEC staff would make specific recommendations for proposed rule and form changes.

The SEC staff has identified two alternative frameworks for structuring such a review: a comprehensive approach and a targeted approach. The SEC staff believes that any such review could be more effective if it were to:

- Emphasise a principles-based approach as a critical aspect of the disclosure framework.
- Evaluate the appropriateness of current scaled disclosure requirements and whether further scaling would be appropriate for EGCs or other categories of issuers.
- Evaluate methods of information delivery and presentation, through both the EDGAR system and other means.
- Consider ways to present information that would improve the readability and navigability of disclosure documents, as well as discouragement of repetition and the disclosure of immaterial information.

The SEC's Division of Corporation Finance is currently engaged in its disclosure effectiveness review. As part of this review, the Division is considering the disclosure requirements in Regulation S-K and Regulation S-X, and assessing whether such requirements are outdated, repetitive, or can otherwise be revised in order to improve disclosures made by public companies.

The FAST Act included a few provisions requiring the SEC to take actions within 180 days of the statute's enactment to permit issuers to submit a "summary page" on Form 10-K that cross-references related disclosures included throughout the form. It also required a revision of Regulation S-K in order to further scale or eliminate requirements to ease the burden on EGCs, accelerated filers, smaller reporting companies and other smaller issuers, while still providing all material information to investors and to eliminate provisions of Regulation S-K, required for all issuers, that are duplicative, overlapping, outdated or unnecessary, and for which the SEC determines no further study is necessary to determine the efficacy of such revisions to Regulation S-K. The FAST Act also requires the SEC to conduct another study (this time within 360 days of the statute's enactment) to determine how to best modernise and simplify Regulation S-K in a manner that reduces the costs and burdens to issuers while still providing all material information.

Appendix A DISCLOSURE AND RELATED REQUIREMENTS		
	Before JOBS Act	**Under JOBS Act**
Financial information in SEC filings	• Three years of audited financial statements • Two years of audited financial statements for smaller reporting companies • Selected financial data for each of five years (or for life of issuer, if shorter) and any interim period included in the financial statements	• Two years of audited financial statements • Certain financial statements may be omitted from confidential submissions and filings if these will not be required to be included at the time of consummation of the IPO • Not required to present selected financial data for any period before the earliest audited period presented in connection with an IPO • Within one year of IPO, EGC would report three years of audited financial statements
Confidential submissions of draft IPO registration statement	• No confidential filing for US issuers • Confidential filing for FPIs only in specified circumstances	EGCs (including FPIs that are EGCs) may submit a draft IPO registration statement for confidential review before public filing, provided that such submission and any amendments are publicly filed with the SEC not later than 15 days before the EGC conducts a road show, superseding the SEC's December 2011 position on confidential submissions by FPIs.
Communications before and during offering process	Limited ability to test the waters	EGCs, either before or after filing a registration statement, may test the waters by engaging in oral or written communications with QIBs and institutional accredited investors to determine interest in an offering
Auditor attestation on internal controls	• Auditor attestation on effectiveness of internal controls over financial reporting required in second annual report after IPO • Non-accelerated filers not required to comply	Transition period for compliance of up to five years
Accounting standards	Must comply with applicable new or revised financial accounting standards	• Not required to comply with any new or revised financial accounting standard until such standard applies to companies that are not subject to Exchange Act public company reporting • EGCs may choose to comply with non-EGC accounting standards but may not selectively comply
Executive compensation disclosure	• Must comply with executive compensation disclosure requirements, unless a smaller reporting company (which is subject to reduced disclosure requirements) • Upon adoption of SEC rules under Dodd-Frank will be required to calculate and disclose the median compensation of all employees compared to the CEO	• May comply with executive compensation disclosure requirements by complying with the reduced disclosure requirements generally available to smaller reporting companies • Exempt from requirement to calculate and disclose the median compensation of all employees compared to the CEO • FPIs entitled to rely on other executive compensation disclosure requirements
Say-on-pay	• Must hold non-binding advisory stockholder votes on executive compensation arrangements • Smaller reporting companies are exempt from say-on-pay	Exempt from requirement to hold non-binding advisory stockholder votes on executive compensation arrangements for one to three years after no longer an EGC

ENDNOTES

1 Frequently Asked Questions of General Applicability on Title I of the JOBS Act (April 16, 2012; May 3, 2012 and September 28, 2012), *available at* http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm (SEC Title I FAQs).
2 Securities Act section 2(a)(19), 15 USC 77b(a).
3 SEC Title I FAQs, *supra* note 1 at Question 1.
4 *Id.*
5 *Id.*
6 SEC Title I FAQs, supra note 1 at Question 23, referencing section 5110.2(c) of the Division of Corporation Finance Financial Reporting Manual, *available at* http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf.
7 SEC Title I FAQs, *supra* note 1 at Question 51.
8 SEC Title I FAQs, *supra* note 1 at Question 2.
9 *Id.*
10 SEC Title I FAQs, *supra* note 1 at Questions 19-21.
11 SEC Title I FAQs, *supra* note 1 at Question 24.
12 SEC Title I FAQs, *supra* note 1 at Question 54.
13 Securities Act section 2(a)(19), 15 USC 77b(a).
14 SEC Title I FAQs, *supra* note 1 at Question 17.
15 *Id.*
16 SEC Title I FAQs, *supra* note 1 at Question 18.
17 SEC Title I FAQs, *supra* note 1 at Question 47.
18 SEC Title I FAQs, *supra* note 1 at Question 3.
19 *Id.*
20 section 71002 of the FAST Act, amending section 6(e)(1) of the Securities Act.
21 JOBS Act section105(c), amending Securities Act section 5, 15 USC 77e.
22 Without the availability of the test-the-waters provisions in Securities Act section 5(d), an issuer could potentially be deemed to be “gun jumping” when communicating with investors about an actual or potential offering, based on the timing and nature of such communications.
23 Frequently Asked Questions About Research Analysts and Underwriters (August 22, 2012), *available at* http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm, at Question 1.
24 Sections 105(c) and 105(d) of the JOBS Act.
25 Section 106(a) of the JOBS Act, amending Securities Act section 6, 15 USC 77(f). A foreign private issuer that qualifies as an EGC may opt to use the Division of Corporation Finance’s policy titled *Non-Public Submissions from Foreign Private Issuers* if they meet the circumstances that the Division has outlined in that policy, *available at* http://www.sec.gov/divisions/corpfin/internatl/nonpublicsubmissions.htm.
26 For this purpose, the term “road show” is defined in Securities Act Rule 433(h)(4).
27 Section 71001 of the FAST Act.
28 Frequently Asked Questions on the Confidential Submission Process for Emerging Growth Companies (April 10, 2012), *available at* http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm (SEC Confidential Submission FAQs) at Question 5.
29 SEC FAQs, *supra* note 1 at Question 52.
30 *Id.*
31 SEC Confidential Submission FAQs, *supra* note 26, Question 7.
32 SEC Confidential Submission FAQs, *supra* note 26, Question 6.
33 Securities Act Rule 433(h)(4).
34 SEC Confidential Submission FAQs, *supra* note 26, Question 8.
35 SEC Confidential Submission FAQs, *supra* note 26, Question 9.
36 SEC Title I FAQs, *supra* note 1, Question 4.
37 Securities Act section 7(a)(2)(A), 15 USC 77g(a)(2)(A).
38 SEC Title I FAQs, *supra* note 1 at Question 11. The SEC would not object if an issuer that has lost its EGC status does not present, in subsequently filed registration statements and periodic reports, selected financial data or a ratio of earnings to fixed charges for periods before the earliest audited period presented in its initial Securities Act or Exchange Act registration statement. *See* SEC Title I FAQs, *supra* note 1 at Question 50.
39 SEC Title I FAQs, *supra* note 1 at Question 16.
40 SEC Title I FAQs, *supra* note 1 at Question 27.
41 Section 71003 of the FAST Act.
42 Fixing America’s Surface Transportation (FAST) Act.
43 JOBS Act section102(c).
44 Exchange Act section 14A(e), 15 USC 78n-1(e).
45 *Id.*
46 *See* Dodd-Frank Act section 953(b)(1).
47 SEC Title I FAQs, *supra* note 1 at Question 13.
48 JOBS Act section 104, amending Sarbanes-Oxley Act

section 103(a)(3).

49 JOBS Act section 103, amending Sarbanes-Oxley Act section 404(b).

50 JOBS Act section 107.

51 SEC Title I FAQs, *supra* note 1 at Question 8.

52 JOBS Act section 106(b).

53 JOBS Act section 108.

54 Report to Congress on Decimalisation (July 2012), *available at* http://www.sec.gov/news/studies/2012/decimalisation-072012.pdf.

55 Report on Review of Disclosure Requirements in Regulation S-K (December 2013), *available at* http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

CHAPTER 2

The IPO process

As we discussed in the Introduction, there are important considerations to be analysed in connection with pursuing an IPO. Even given many changes in the capital markets, and the improved liquidity of private or restricted securities, there are significant advantages to be gained as a result of being a public company. Aside from the immediate capital raising opportunity of the IPO, going public will create a liquid public market for the issuer's securities. The issuer's security holders will have an opportunity to monetise their investment in the company. The issuer also will have an acquisition currency and be able to use its stock as consideration in a strategic transaction. After the IPO, the issuer also will have many more capital raising alternatives. All of these advantages will have to be weighed carefully against the costs of undertaking an IPO, as well as the burdens and expense of life as a public company. A bit of this calculus has been made easier for companies that qualify as EGCs. An EGC will have the opportunity to pursue an IPO through an initial confidential submission process. Should the issuer determine that the market will not be receptive to the offering, or that other alternatives are more appealing, it can withdraw from the process without the stigma of a failed deal. In addition, an EGC may benefit from the disclosure accommodations made available by the JOBS Act. As a public company, an EGC also will have the opportunity to ease into many corporate governance requirements. This phase-in approach may result in important cost-savings for an EGC. Also, the EGC will have the benefit of getting accustomed to life as a public company and adding additional staff or retaining service providers before it has to comply with some of the more burdensome requirements.

In addition to changing some of the dynamics that might figure into an issuer's decision-making about an IPO, the JOBS Act also has changed the IPO process itself for EGCs. Below, we discuss briefly the IPO process and highlight along the way a number of the most important decisions that an EGC should consider, and conclude by discussing the opportunities for an issuer that qualifies as a foreign private issuer, or FPI, arising from the JOBS Act.

Pre-IPO planning

Even though an EGC will have an opportunity to submit its IPO registration statement through the confidential submission process, and proceed on a confidential basis without a public filing, the issuer will still have to undertake a fair bit of planning before committing to proceed with a filing.

Most companies will have to make legal and operational changes before proceeding with an IPO. A company cannot wait to see if its IPO is likely to be successful before implementing most of these changes. Many corporate governance matters, federal securities law requirements (including Sarbanes-Oxley), as well as applicable securities exchange requirements must be met when the IPO registration statement is filed, or the issuer must commit to satisfy them within a set time period.

A company proposing to list securities on an exchange should review differing governance requirements of each exchange, as well as their respective financial listing requirements, before determining which exchange to choose. Similarly, an issuer will want to consider whether to retain additional senior management or enter into employment agreements with key executive officers and systematise its compensation practices. An issuer must also address other corporate governance matters, including board structure, committees and member criteria, related-party transactions, and director and officer liability insurance. The company should undertake a thorough review of its compensation scheme for its directors and officers as well, particularly its use of equity compensation. The issuer also will want to review all prior securities issuances for compliance with federal and state securities laws, including the limits of Rule 701.

Primary and secondary offerings

An IPO may consist of the sale of newly issued shares by the company (a primary offering), or a sale of already issued shares owned by shareholders (a secondary offering), or a combination of these. Underwriters may prefer a primary offering because the company will retain all of the proceeds to advance its business. However, many IPOs include secondary shares, either in the initial part of the offering or as part of the 15% over-allotment option

granted to underwriters. Venture capital and private equity shareholders view a secondary offering as their principal realisation event. An issuer must consider whether any of its shareholders have registration rights that could require the issuer to register shareholder shares for sale in the IPO.

Cheap stock

"Cheap stock" describes options granted to employees of a pre-IPO company during the 18–24 months before the IPO where the exercise price is deemed (in hindsight) to be considerably lower than the fair market value of the shares at grant date. If the SEC determines (during the comment process) that the company has issued cheap stock, the company must incur a compensation expense that will have a negative impact on earnings. The earnings impact may result in a significant one-time charge at the time of the IPO as well as going-forward expenses incurred over the option vesting period. In addition, absent certain limitations on exercisability, an option granted with an exercise price that is less than 100% of the fair market value of the underlying stock on the grant date will subject the option holder to an additional 20% tax pursuant to section 409A of the Internal Revenue Code.

The dilemma that a private company faces is that it is unable to predict with certainty the eventual IPO price. A good-faith pre-IPO fair market value analysis can yield different conclusions when compared to a fair market value analysis conducted by the SEC in hindsight based on a known IPO price. There is some industry confusion as to the acceptable method for calculating the fair market value of non-publicly traded shares and how much deviation from this value is permitted by the SEC. Companies often address this cheap stock concern by retaining an independent appraiser to value their stock options. It now appears, however, that most companies are using one of the safe-harbour methods for valuing shares prescribed in the section 409A regulations.

Governance and board members

Even with the accommodations available to an EGC, a company still must comply with significant corporate governance requirements imposed by the federal securities laws and regulations and the regulations of the applicable exchanges, including with regard to the oversight responsibilities of the board of directors and its committees. A critical matter is the composition of the board itself. All exchanges require that, except under limited circumstances, a majority of the directors be "independent" as defined by both the federal securities laws and regulations and exchange regulations. In addition, boards should include individuals with appropriate financial expertise and industry experience, as well as an understanding of risk management issues and public company experience. A company should begin its search for suitable directors early in the IPO process even if it will not appoint the directors until after the IPO is completed. The company can turn to its large investors as well as its counsel and underwriters for references regarding potential directors.

The Sarbanes-Oxley Act and the Dodd-Frank Act require publicly traded companies to implement corporate governance policies and procedures that are intended to provide minimum structural safeguards to investors. Certain of these requirements are phased in after the IPO. Again, quite a number of these requirements will be applicable to an EGC and should be carefully considered. Key provisions include:

- Prohibition of most loans to directors and executive officers (and equivalents thereof).
- The CEO and CFO of a public company must certify each SEC periodic report containing financial statements.
- Adoption of a code of business conduct and ethics for directors and senior executive officers.
- Required "real time" reporting of certain material events relating to the company's financial condition or operations.
- Disclosure of whether the company has an "audit committee financial expert" serving on its audit committee.
- Disclosure of material off-balance sheet arrangements and contractual obligations.
- Audit committee approval of any services provided to the company by its audit firm, with certain exceptions for *de minims* services.
- Whistleblower protections for employees who come forward with information relating to federal securities law violations.
- Compensation disgorgement provisions applicable to the CEO and CFO upon a restatement of financial results attributable to misconduct.
- The exchanges' listing requirements contain related substantive corporate governance requirements regarding independent directors; audit, nomination, and compensation committees; and other matters.

Selecting the underwriters

A company will identify one or more lead underwriters that will be responsible for the IPO. A company chooses an underwriter based on its industry expertise, including the knowledge and following of its research analysts, the breadth of its distribution capacity, and its overall

reputation. A company should consider the underwriter's commitment to the sector and its distribution strengths. For example, does the investment bank have a particularly strong research distribution network, or is it focused on institutional distribution? Is its strength domestic, or does it have foreign distribution capacity? The company may want to include a number of co-managers in order to balance the underwriters' respective strengths and weaknesses.

A company should keep in mind that underwriters have at least two conflicting responsibilities: to sell the IPO shares on behalf of the company and to recommend to potential investors that the purchase of the IPO shares is a suitable and a worthy investment. In order to better understand the company – and to provide a defence in case the underwriters are sued in connection with the IPO – the underwriters and their counsel are likely to spend a substantial amount of time performing business, financial, and legal due diligence in connection with the IPO and making sure that the prospectus and any other offering materials are consistent with the information provided. The underwriters will market the IPO shares, set the price (in consultation with the company) at which the shares will be offered to the public, and, in a so-called firm commitment underwriting, purchase the shares from the company and then re-sell them to investors. In order to ensure an orderly market for the IPO shares, after the shares are priced and sold, the underwriters are permitted in many circumstances to engage in certain stabilising transactions to support the stock.

The IPO process

The public offering process is divided into three periods:

- the pre-filing period between determining to proceed with a public offering and the actual SEC filing of the registration statement; the company is in the "quiet period" and subject to potential limits on public disclosure relating to the offering;
- the waiting or pre-effective period between the SEC filing date and the effective date of the registration statement; during this period, the company may make oral offers, but may not enter into binding agreements to sell the offered security; and
- the post-effective period between effectiveness and completion of the offering.

The registration statement

A registration statement contains the prospectus, which is the primary selling document, as well as other required information, written undertakings of the issuer and the signatures of the issuer and the majority of the issuer's directors. It also contains exhibits, including basic corporate documents and material contracts. US companies generally file a registration statement on Form S-1. Most non-Canadian foreign private issuers use a registration statement on Form F-1, although other forms may be available. There are special forms available to certain Canadian companies.

The prospectus

The prospectus describes the offering terms, the anticipated use of proceeds, the company, its industry, business, management and ownership, and its results of operations and financial condition. Although it is principally a disclosure document, the prospectus also is crucial to the selling process. A good prospectus sets forth the investment proposition.

As a disclosure document, the prospectus functions as an insurance policy of sorts in that it is intended to limit the issuer's and underwriters' potential liability to IPO purchasers. If the prospectus contains all SEC-required information, includes robust risk factors that explain the risks that the company faces, and has no material misstatements or omissions, investors will not be able to recover their losses in a lawsuit if the price of the stock drops following the IPO. A prospectus should not include puffery or overly optimistic or unsupported statements about the company's future performance. Rather, it should contain a balanced discussion of the company's business, along with a detailed discussion of risks and operating and financial trends that may affect its results of operations and prospects.

SEC rules set forth a substantial number of specific disclosures required to be made in the prospectus. In addition, federal securities laws, particularly Rule 10b-5 under the Exchange Act, require that documents used to sell a security contain all the information material to an investment decision and do not omit any information necessary to avoid misleading potential investors. Federal securities laws do not define materiality; the basic standard for determining whether information is material is whether a reasonable investor would consider the particular information important in making an investment decision. That simple statement is often difficult to apply in practice.

An issuer should be prepared for the time-consuming drafting process, during which the issuer, investment bankers, and their respective counsel work together to craft the prospectus disclosure.

Financial information

The IPO registration statement for an EGC must include

audited financial statements for the last two fiscal years; financial statements for the most recent fiscal interim period, comparative with interim financial information for the corresponding prior fiscal period (may or may not be audited depending on the circumstances); and income statement and condensed balance sheet information for the last two years and interim periods presented.

Early on, the issuer should identify any problems associated with providing the required financial statements in order to seek necessary accommodation from the SEC. These statements must be prepared in accordance with US GAAP or IFRS as adopted by the IASB, as they will be the source of information for Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). The SEC will review and comment on the financial statements and the MD&A. The SEC's areas of particular concern include: revenue recognition; business combinations; segment reporting; financial instruments; impairments of all kinds; deferred tax valuation allowances; compliance with debt covenants; fair value; and loan losses.

The pre-filing period

The pre-filing period begins when the company and the underwriters agree to proceed with a public offering. During this period, key management personnel will generally make a series of presentations covering the company's business and industry, market opportunities, and financial matters. The underwriters will use these presentations as an opportunity to ask questions and establish a basis for their due diligence defence.

From the first all-hands meeting forward, all statements concerning the company should be reviewed by the company's counsel to ensure compliance with applicable rules. Communications by an issuer more than 30 days before filing a registration statement are permitted as long as they do not reference the securities offering. Statements made within 30 days of filing a registration statement that could be considered an attempt to pre-sell the public offering may be considered an illegal prospectus, creating a gun jumping violation. This might result in the SEC's delaying the public offering or requiring prospectus disclosures of these potential securities law violations. Press interviews, participation in investment banker-sponsored conferences, and new advertising campaigns are generally discouraged during this period.

In general, at least four to six weeks will pass between the distribution of a first draft of the registration statement and its filing with the SEC. To a large extent, the length of the pre-filing period will be determined by the amount of time required to obtain the required financial statements.

The waiting period

Responding to SEC comments on the registration statement

The SEC targets 30 calendar days from the registration statement filing date to respond with comments. The SEC review process has not changed as a result of the JOBS Act, although the issuer should anticipate that it will receive comments from the SEC staff regarding its EGC-related disclosures. Once the registration statement is submitted, a team of SEC staff members is assigned to review the filing. The team consists of accountants and lawyers, including examiners and supervisors. The SEC's objective is to assess the company's compliance with its registration and disclosure rules.

It is not unusual for the first SEC comment letter to contain a significant number of comments to which the issuer must respond both in a letter and by amending the registration statement.

The SEC's principal focus during the review process is on disclosure. In addition to assessing compliance with applicable requirements, the SEC considers the disclosures through the eyes of an investor in order to determine the type of information that would be considered material. The SEC's review is not limited to the registration statement. The staff will closely review websites, databases, and magazine and newspaper articles, looking in particular for information that the staff thinks should be in the prospectus or that contradicts information included in the prospectus.

It is easy to anticipate many of the matters that the SEC will raise in the comment process. The SEC makes the comment letters and responses from prior reviews available on its website, so it is possible to determine the most typical comments arising during the IPO process. Overall, the SEC staff looks for a balanced, clear presentation of the information required in the registration statement. Some of the most frequent comments raised by the SEC staff on disclosure, other than the financial statements, include:

Front cover and gatefold: Has the EGC included disclosure on the front cover identifying itself as an EGC? Given that a number of issuers that are EGCs have completed their IPOs, an EGC pursuing an IPO may review its filings and see the type of language that the SEC staff expects to see on the cover page. For an issuer that chooses to use artwork, the SEC staff will consider whether the artwork presents a balanced presentation of the company's business, products, or customers.

Prospectus summary: Is the presentation balanced? Again, in the summary section, the SEC staff will expect to see a brief discussion that identifies that the issuer is an EGC and is electing to rely on certain accommodations available to EGCs.

Risk factors: Are the risks specific to the company and devoid of mitigating language? The SEC also will expect to see certain risk factors relating to the issuer's status as an EGC.

Use of proceeds: Is there a specific allocation of the proceeds among identified uses and, if funding acquisitions is a designated use, are acquisition plans identified?

Selected financial data: Does the presentation of non-GAAP financial measures comply with SEC rules?

MD&A: Does the discussion address known trends, events, commitments, demands, or uncertainties, including the impact of the economy, trends with respect to liquidity, and critical accounting estimates and policies?

Business: Does the company provide support for statements about market position and other industry or comparative data? Is the disclosure free of, or does it explain, business jargon? Are the relationships with customers and suppliers, including concentration risk, clearly described?

Underwriting: Is there sufficient disclosure about stabilisation activities (including naked short selling), as well as factors considered in early termination of lockups and any material relationships with the underwriters?

Exhibits: Do any other contracts need to be filed based on disclosure in the prospectus?

After the SEC has provided its initial set of comments, it is much easier to determine when the registration process is likely to be completed and the offering can be made. In most cases, the underwriters prefer to delay the offering process and to avoid distributing a preliminary prospectus until the SEC has reviewed at least the first filing and all material changes suggested by the SEC staff have been addressed.

Preparing the underwriting agreement, comfort letter and other documents

During the waiting period, the company, the underwriters and their counsel, and the company's independent auditor will negotiate a number of agreements and other documents, particularly the underwriting agreement and the auditor's comfort letter.

The underwriting agreement is the agreement pursuant to which the company agrees to sell, and the underwriters agree to buy, the shares and then sell them to the public; until this agreement is signed, the underwriters do not have an enforceable obligation to acquire the offered shares. The underwriting agreement is not signed until the offering is priced. In the typical IPO, the underwriters will have a "firm commitment" to buy the shares once they sign the underwriting agreement.

Underwriters' counsel will submit the underwriting agreement, the registration statement, and other offering documents for review to Finra, which is responsible for reviewing the terms of the offering to ensure that they comply with Finra requirements. An IPO cannot proceed until the underwriting arrangement terms have been approved by Finra.

In the comfort letter, the auditor affirms its independence from the issuer and the compliance of the financial statements with applicable accounting requirements and SEC regulations. The auditor also will note period-to-period changes in certain financial items. These statements follow prescribed forms and are usually not the subject of significant negotiation. The underwriters will also usually require that the auditor undertake certain agreed-upon procedures in which it compares financial information in the prospectus (outside of the financial statements) to the issuer's accounting records to confirm its accuracy.

Marketing the offering

During the waiting period, marketing begins. Before the JOBS Act, it was the case that the only written sales materials that could be distributed during this period were the preliminary prospectus and additional materials known as "free writing prospectuses," which must satisfy specified SEC requirements. Binding commitments cannot be made during this period. The underwriters will receive indications of interest from potential purchasers, indicating the price they would be willing to pay and the number of shares they would purchase. Once SEC comments are resolved, or it is clear that there are no material open issues, the issuer and underwriters will undertake a two- to three-week road show, during which company management will meet with prospective investors.

Once SEC comments are cleared and the underwriters have assembled indications of interest for the offered securities, the company and its counsel will request that the SEC declare the registration statement effective at a certain date and time, usually after the close of business of the US securities markets on the date scheduled for pricing the offering.

The post-effective period

Once the registration statement has been declared effective and the offering has been priced, the issuer and the managing underwriters execute the underwriting agreement, and the auditor delivers the final comfort letter. This occurs after pricing and before the opening of trading on the following day. The issuer then files a final

prospectus with the SEC that contains the final offering information.

On the third or fourth business day following pricing, the closing occurs, the shares are issued, and the issuer receives the proceeds. The closing completes the offering process. Then, for the following 25 days, aftermarket sales of shares by dealers must be accompanied by the final prospectus or a notice with respect to its availability. If during this period there is a material change that would make the prospectus misleading, the issuer must file an amended prospectus.

SPECIAL JOBS ACT-RELATED CONSIDERATIONS

Confidential submissions

As explained in Chapter 1, an EGC may make a confidential submission of its registration statement, provided that the initial confidential submission and all amendments are publicly filed with the SEC no later than 15 days before the commencement of the issuer's road show.

Although an EGC may file confidentially, and a confidentially-submitted draft registration statement is not required to be signed by the issuer and its officers or directors, nor is it required to contain a signed auditors' consent, the confidential submission should be a complete registration statement. The SEC may decide not to review a draft submission that is deemed incomplete or materially deficient. This will just slow down the IPO process. Moreover, the issuer and its advisers should understand, as noted above, that the initial confidential submission will become publicly available. As a result, the issuer, its advisers and the entire working group should approach the preparation of a confidential submission with the same rigour as they would approach the preparation of a registration statement that will be publicly filed and available to all, including the issuer's competitors.

There are few, if any, disadvantages to the confidential submission process. An issuer will be able to make a confidential submission and proceed with the review process without the glare of publicity, and without having competitors become aware of the proposed offering. The issuer will have greater flexibility to control the timing of the offering. If the market seems inhospitable to an offering, the issuer may decide to delay the process and will not subject itself to public scrutiny for doing so. If the issuer needs to withdraw the filing, again, it will be able to do so without the stigma associated with a failed or withdrawn offering.

An issuer and its bankers and advisers may not, however, have as much insight into the IPO market given the confidential filing process. For example, bankers may not be aware of competitors (that are EGCs) that also are pursuing IPOs because the competitors also may be proceeding with their offerings on a confidential basis. Often having information about other companies in the IPO queue may be important because it may factor into decisions on timing of marketing the deal, as well as decisions regarding valuation.

Often an issuer will decide to pursue a dual-track approach, whereby it will decide to undertake an IPO and also consider M&A alternatives. The IPO filings often serve to make acquisitive competitors that may be interested in new opportunities aware of the issuer and the issuer's performance. It may be more difficult to pursue a dual-track strategy during the confidential submission process. Of course, an issuer that is relying on the confidential submission process may choose to make an announcement regarding its intentions to pursue an IPO, and a few companies have issued such press releases. Since the confidentiality obligation rests with the SEC, and not with the issuer, a press release of this sort is permissible, although it should be considered carefully given that it undoes many of the benefits associated with the confidential process.

Marketing the offering

Section 5(c) of the Securities Act prohibits offers of a security before a registration statement is filed. While gun jumping can be a serious concern, the 2005 safe harbours created by Securities Offering Reform have provided considerable guidance to companies about this issue. Further, the ability of EGCs to test the waters before filing, together with the elimination of the ban on general solicitation in connection with certain private placements also effected by the JOBS Act, have also significantly reduced concerns about gun jumping. In addition, the confidential submission of a draft registration does not constitute the filing of a registration statement for the purposes of the prohibition in Securities Act section 5(c) against making offers of a security in advance of filing a registration statement.[1]

Section 5(b)(1) prohibits written offers other than by means of a prospectus that meets the requirements of section 10 of the Securities Act, such as a preliminary prospectus. The bans are designed to prohibit inappropriate marketing, conditioning or hyping of the security before all investors have access to publicly available information about the company so that they can make informed investment decisions. From the first all-hands

organisational meeting forward, all statements concerning the company should be reviewed by the company's counsel to ensure compliance with applicable rules.

Testing the waters

The JOBS Act provides an EGC or any other person, such as its underwriter, that it authorises to act on its behalf with the flexibility to engage in oral or written communications with QIBs and institutional accredited investors in order to gauge their interest in a proposed offering, whether before (irrespective of the 30-day communications safe harbour) or following the first filing of any registration statement, subject to the requirement that no security may be sold unless accompanied or preceded by a section 10(a) prospectus.

An EGC may use the testing-the-waters provision with respect to any registered offerings that it conducts while it qualifies for EGC status. There are no form or content restrictions on these communications, and there is no requirement to file written communications with the SEC. The SEC staff will ask to see any written test-the-waters materials during the course of the registration statement review process to determine whether those materials provide any guidance as to information that the SEC staff believes should be included in the prospectus.

The JOBS Act does not amend section 5(b)(1) of the Securities Act, which requires that written offers must include the information required by section 10. Therefore, in order to make written offers, an EGC or a foreign private issuer must first file (not just submit) its registration statement with the SEC and have a preliminary prospectus available, irrespective of the expected commencement of the road show. In the pre-filing period, test-the-waters communications must be limited to QIBs and institutional investors, since even an EGC cannot make offers to the public until it files the registration statement publicly.

Before engaging in any test-the-waters discussions, an EGC should consult with its counsel and coordinate closely with the underwriter. As noted above, during the comment process, the SEC staff will ask whether the issuer engaged in testing the waters, and will want to see any written materials used for this purpose. In addition, as we discuss below, issuer's counsel and the underwriter and its counsel will want an opportunity to review and comment on the material. Any written materials used for this purpose should be consistent with the information included in the issuer's registration statement. An issuer also will want to be certain that the issuer is not sharing any information that may be deemed confidential in the course of these discussions. An investor approached during this phase generally will not want to be in possession of any information that will remain confidential, and that may be material, even following the issuer's IPO. In addition, as discussed further below, an issuer will be required to make certain representations and warranties to the underwriters in the underwriting agreement relating to any test-the-waters activities and materials.

Many companies contemplating an IPO in the United States, especially foreign private issuers, were surprised by the restrictions on offering related communications imposed by SEC regulations. Critics noted that these communications restrictions limited an issuer's opportunity to reach potential investors early in the process and, therefore, an issuer was forced to incur significant expense in pursuing an IPO and might not have any information about the level of investor interest and potential valuations until the road show. In other jurisdictions, especially in Europe and Asia, issuers and the financial intermediaries acting on their behalf have considerably more flexibility. Often in European or Asian offerings, a lead or cornerstone investor might be secured early in the offering process. As a result of these concerns, the ability to conduct test-the-waters communications was well received. In practice, however, we understand that few EGCs are conducting these conversations early in the offering process. To the extent that EGCs are benefiting from the enhanced flexibility, the test-the-waters conversations are taking place shortly before the commencement of the road show, and not early in the offering process. It may be that, over time, the market will adapt and test-the-waters communications may become more commonplace.

It is also important to remember that the test-the-waters flexibility still is more limited than the approach that may be familiar to foreign issuers. As noted in Chapter 1, during the test-the-waters phase an EGC may engage in discussions with institutional investors but the EGC and the underwriter cannot obtain a purchase commitment. The underwriter may discuss price, volume and market demand and solicit non-binding indications of interest from customers.

Private offerings during the IPO process

An issuer may need to raise capital while it is pursuing an IPO. Historically, there was some concern about concurrent offerings. An issuer that had publicly filed a registration statement had to consider carefully with its counsel whether the public filing constituted a general solicitation that precluded the issuer from availing itself of the private placement exemption to complete a financing during the pendency of its IPO. For some time,

practitioners relied on existing no-action letter guidance that was somewhat narrowly construed as permitting a concurrent private placement to QIBs and to a handful of institutional accredited investors.[2] This fairly limited approach was modified over time and a more expansive view was expressed by the SEC first in 2007 and confirmed in Compliance and Disclosure Interpretations.[3] The C&DI, confirming the guidance in the SEC's 2007 release, provides that

under appropriate circumstances, there can be a side-by-side private offering under Securities Act section [4(a)(2)] or the Securities Act Rule 506 safe harbor with a registered public offering without having to limit the private offering to qualified institutional buyers and two or three additional large institutional accredited investors, as under the Black Box (June 26, 1990) and Squadron, Ellenoff (Feb. 28, 1992) no-action letters issued by the Division, or to a company's key officers and directors, as under our so-called "Macy's" position.[4]

The SEC also clarified that a company can make a valid private placement if the investors are identified by means other than the registration statement.

Given this viewpoint, and even without considering the relaxation of the prohibition on general solicitation in respect of certain Rule 506 offerings, it is clear that an EGC could either during the confidential phase or after the public filing of its registration statement contact institutional investors and discuss a potential private financing. It is easy to envision that a test-the-waters conversation may morph into a discussion with an institutional investor about a potential private placement. An EGC should take care to be clear in its conversations with potential investors, and ensure that any potential investors understand whether they are participating in a private placement transaction, and purchasing securities that will be restricted securities, and not expressing an interest in participating in the IPO.

The JOBS Act has contributing to a further blurring of the lines between private placements and public offerings given the relaxation of the prohibition against general solicitation and the introduction of exemptions for certain limited offerings pursuant to section 3(b)(2) and crowdfunding.

Flipping from confidential to public

In a typical IPO, the issuer will continue to work with its counsel during the waiting period in order to address the SEC's comments on its filing, and also concurrently work on finalising various ancillary agreements, including the underwriting agreement and lock-up agreements. The underwriter and its counsel usually recommend that an issuer wait to finalise, and print a preliminary prospectus or red herring until the issuer and its counsel have responded to and addressed all of the significant comments raised by the SEC during the review process. This ensures that the issuer will not have to recirculate its preliminary prospectus as a result of any change arising during the review process. The underwriter will wait to commence the road show until the preliminary prospectus is prepared.

In the case of an EGC IPO, there may be an additional dynamic to be considered. An EGC that is relying on the confidential submission process may want to consider when to make its first "public" filing. As discussed in Chapter 1, and above, an EGC is required to file publicly with the SEC at least 15 days before the commencement of the issuer's road show. The EGC may want to make a public filing before that for a variety of reasons, however. The EGC may want to file publicly earlier in the process, perhaps after it has undergone one or two amendments, in order to have it known to competitors or to strategic investors that the company is proceeding with an IPO and to make the registration statement available freely. This may be helpful if the issuer is contemplating a dual-track approach. It may be helpful in order to permit the underwriter to interest institutional investors in preliminary test-the-waters type discussions. Some institutional investors may be reluctant to commit the time and resources to meeting with a company or evaluating a potential investment if they believe that the offering is in a very preliminary stage. An EGC will want to consult with counsel and consider carefully its decision to transition from a confidential process to a public process.

Disclosures and other accommodations

We noted that one of the principal benefits of the IPO on-ramp approach is that an EGC may choose to rely on some of the disclosure accommodations made available by Title I of the JOBS Act. An EGC may choose to present only two years of audited financial information (and only two years of summary and selected financial data, as well as an abbreviated MD&A discussion) in its registration statement. An EGC and its counsel will want to consider whether the EGC will want to present information for a third year although it is not required. In some cases, the underwriter will have strong views regarding the information that should be presented in the registration statement. For example, the underwriter may take the view that the issuer's competitors that are already SEC-reporting companies provide financial information for a longer period and it will be important to investors that the EGC provide comparable information. The underwriter may

believe that institutional investors in that industry sector may demand three years of financial information. It may be the case that there are important trends in either the issuer's business and results of operations or in the industry as a whole that make it important to present three years of information in order to ensure that an investor will be able to evaluate all of the information that may be deemed material to an investment decision, including, perhaps, trends in the issuer's business or in the industry. According to certain published reports, only a small percentage of EGCs have availed themselves of the ability to provide information for a shorter period.

EGCs also have the option of relying on the smaller reporting company scaled disclosure requirements for executive compensation. This means, for example, that an EGC could omit a Compensation Discussion and Analysis section and present only a summary compensation table. An EGC may decide to include more substantial executive compensation disclosures in its future filings. An EGC should consult with its counsel, as well as with the underwriter, regarding these disclosures.

An EGC also will have to decide whether it will opt out of the extended transition period provided for an EGC to comply with new or revised accounting standards. An EGC's decision in this regard is irrevocable and will have to be disclosed in its registration statement. Here, again, the issuer will want to consider this decision carefully and discuss it with its counsel and its auditors. The underwriter may also have a view. To date, many EGCs have opted out of the extended transition period, although it is possible that market practice will evolve over time as participants become more accustomed to the JOBS Act provisions.

Underwriting agreements

Underwriting agreements have been revised to address JOBS Act changes. An underwriting agreement for an EGC will contain representations and warranties by the EGC regarding its status as an EGC at each of the relevant times (when it made its confidential submission with the SEC, when it undertook any test-the-waters communications, on the date of execution of the underwriting agreement, and so on). The EGC will be asked to represent that it has not engaged in any test-the-waters communications other than with QIBs or institutional accredited investors, and except as agreed with the underwriters. To the extent that it has distributed written materials, the EGC will be asked to make certain representations regarding the accuracy of those materials. Similarly, the EGC will be asked to make certain covenants to the underwriters, which will include an agreement to notify the underwriters if, at any time before the later of the time when a prospectus is required to be delivered in connection with the offering, and the completion of the lock-up period, the issuer no longer qualifies as an EGC. In addition, the lock-up language applicable to an EGC also will be revised to account for the quiet period changes included in the JOBS Act.

FOREIGN PRIVATE ISSUERS

Our discussions have focused on US domestic issuers; however, foreign issuers that are considering accessing the US. capital markets will have available to them almost all of the benefits of the JOBS Act. A foreign issuer must choose between undertaking a public offering in the United States, which would have the result of subjecting the issuer to ongoing securities reporting and disclosure requirements, and undertaking a limited offering that will not subject the issuer to US reporting obligations. A public offering in the United States offers distinct advantages for foreign issuers. The US public markets remain among the most active and deepest equity markets in the world. In recent years, however, many foreign issuers may have been discouraged by the regulatory burdens associated with being a US reporting company, including those imposed by the Sarbanes-Oxley Act and the Dodd-Frank Act. For foreign issuers that qualify as EGCs, the IPO on-ramp process has made the United States more hospitable.[5]

A foreign private issuer (FPI) is any issuer (other than a foreign government) incorporated or organised under the laws of a jurisdiction outside of the United States, unless more than 50% of the issuer's outstanding voting securities are held directly or indirectly by residents of the United States, and any of the following applies: (i) the majority of the issuer's executive offices or directors are United States citizens or residents; (ii) the majority of the issuer's assets are located in the United States; or (iii) the issuer's business is principally administered in the United States. An FPI may become subject to US securities law reporting requirements either by conducting a public offering in the United States by registering the offering and sale of its securities pursuant to the Securities Act, or by listing a class of its securities on a US national securities exchange through registration pursuant to the Exchange Act or becoming subject to the Exchange Act requirements if a class of its equity securities is held of record by 2,000 or more persons or 500 non-accredited investors.

Important benefits are available to FPIs. For example, an FPI may exit or deregister its securities more easily than a domestic US issuer. An FPI must test its qualification only once a year, and, should it fail to qualify as an FPI, it has six months to transition to the US domestic reporting

system. US domestic issuers generally must file their annual reports on Form 10-K within three months following the end of their fiscal year. By contrast, an FPI must file its annual report on Form 20-F within four months of the fiscal year covered by the report. This allows an FPI slightly more time to prepare the required information. An FPI has no legal obligation to file quarterly reports. By contrast, US domestic issuers must file a quarterly report on Form 10-Q. Unlike a US domestic issuer, an FPI has no legal obligation to file proxy solicitation materials on Schedule 14A or 14C in connection with annual or special meetings of its security holders. An FPI has no legal obligation to establish an audit committee. The securities exchanges generally provide alternative corporate governance requirements for listed FPIs, which are less burdensome than those for listed US domestic issuers. An FPI is exempt from the SEC's disclosure rules for executive compensation on an individual basis, but is required to provide certain information on an aggregate basis. An FPI may prepare its financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) without reconciliation to US generally accepted accounting principles (US GAAP).

An FPI may submit its initial registration statement on a confidential basis to the SEC staff if it is listed or is concurrently listing its securities on a non-US securities exchange, it is being privatised by a foreign government, or it can demonstrate that the public filing of the initial registration statement would conflict with the law of an applicable foreign jurisdiction. An FPI may separately use the confidential registration statement review procedures available to an EGC, if it qualifies as an EGC. An FPI can qualify to be treated as an EGC if it has total gross revenues of under $1 billion during its most recently completed fiscal year. Total annual gross revenues means total revenues as presented on the income statement under US GAAP or IFRS as issued by the IASB, if used as the basis of reporting by an FPI. If the financial statements of an FPI are presented in a currency other than US dollars, total annual gross revenues for purposes of determining whether an FPI is an EGC should be calculated in US dollars using the exchange rate as of the last day of the most recently completed fiscal year.

An FPI seeking to raise capital by selling securities (or ADRs) in the US must file a registration statement on Form F-1 with the SEC. The registration statement on Form F-1 requires significant disclosure about the foreign issuer's business and operations, and is similar to, but less onerous than, the Form S-1 that most US issuers use for their IPOs. The SEC staff has made clear that an FPI that qualifies as an EGC and that is using a Form F-1 may avail itself of all of the disclosure accommodations available to domestic EGCs. An FPI that is an EGC also may avail itself of all other benefits available to domestic EGCs, including the governance related accommodations, the ability to test the waters, and the flexibility to have broker-dealers publish or distribute research reports about the company.

A foreign issuer also may decide to access the US capital markets through an exempt offering, such as an offering to QIBs or an offering made in reliance on section 4(a)(2) or Rule 506. Once the SEC rulemaking relating to the relaxation of the prohibition on general solicitation is finalised, foreign issuers will be able to benefit from greater communications flexibility in connection with Rule 506 and Rule 144A offerings. It is not clear whether a foreign issuer will be able to rely on the offering exemption under section 3(b)(2). A foreign issuer cannot rely on the crowdfunding exemption.

MARKET TRENDS RELATING TO JOBS ACT ACCOMMODATIONS

Since the JOBS Act took effect on April 5, 2012, there have been a number of trends in the IPO market. Companies electing EGC status come from many industries, although the largest groups of EGC IPO issuers are from the pharmaceutical, technology, real estate, energy and healthcare industries. FPIs also are taking advantage of Title I (approximately 15% of all EGC issuers in 2013 and 21% of all EGC issuers in 2014). Standard disclosure has been developed by the IPO market regarding the election of EGC status and the chosen IPO on-ramp accommodations. In addition, there have been a number of trends with respect to the IPO on-ramp accommodations chosen by EGC issuers, which we describe below.

Confidential submissions

An EGC may submit its IPO registration statement confidentially in draft form for SEC staff review, provided that the initial confidential submission and all amendments are publicly filed with the SEC within 15 days prior to the commencement of the EGC's roadshow. The confidential submission process permits an EGC to commence the SEC review process without publicly disclosing sensitive strategic, proprietary, and financial information. In addition, in the case of adverse market conditions, weak investor demand in response to testing-the-waters communications, or regulatory concerns, an

EGC may withdraw its draft registration statement and terminate the IPO process without ever making a public filing, thus removing a potential disincentive to commencing an IPO and permitting the immediate pursuit of a private placement or an M&A transaction instead.

The confidential submission process has been particularly popular among EGCs and has gained market acceptance. The vast majority of EGCs that priced an IPO since the JOBS Act took effect (over 90%) have confidentially submitted at least one draft registration statement prior to publicly filing and the majority of EGCs have submitted at least two draft registration statements prior to making their first public filing. Much of the discussion related to the confidential submission process has been focused on the timing of moving from the confidential submission to the first public filing, which is often based on having the 15-day period run in order to meet the IPO roadshow schedule and the desire to pursue a dual-track IPO/M&A strategy.

The confidential submission process appears thus far to be used primarily to keep the IPO process secret from competitors and the market without having to disclose sensitive strategic, proprietary, and financial information. However, not all EGCs have availed themselves of the confidential submission process. Some EGCs have forgone the process based on the belief that a public filing helps attract bidders in the case of a dual-track IPO/M&A strategy. However, a small number of EGCs engaged in a dual-track IPO/M&A strategy have, for strategic reasons, used the confidential submission process and publicly announced the confidential submission in a Securities Act Rule 135 compliant press release (in order to avoid gun jumping).

Testing-the-waters communications and research coverage

Testing-the-waters communications and research practices also are still evolving. The decision whether, when, and how to use testing-the-waters communications is being made on a case-by-case basis by EGC issuers and their underwriters. When testing-the-waters communications have been used, they have been used mainly for "meet the management" presentations rather than presentations regarding valuation. With respect to research practices, although analysts employed by participating broker-dealers may publish research on EGCs earlier than currently allowed for non-EGCs, robust pre-deal research in connection with EGC IPOs has not emerged. In fact, most offering participants have been voluntarily restricting research publication for an agreed period following EGC IPOs (typically 25 days).

Reduced financial statements and selected financial data

Taking advantage of the scaled financial disclosures has gained some market acceptance, with less than half of all EGCs electing to provide only two years of audited financial statements rather than three years. The decision to take advantage of the scaled financial disclosures though is being made on a case-by-case basis, depending on whether the extra year of financial statements is needed to understand the EGC's "story" (less important in the case of a biotechnology or development stage company) or show investors the EGC's longer-term trends and historical growth trajectory (more important for a company with an operating history).

Extended transition for new or revised GAAP accounting pronouncements

EGCs are not required to comply with new or revised GAAP accounting pronouncements until those pronouncements apply to private companies, giving EGCs a longer transition than public companies in situations where a different effective date exists for a GAAP accounting pronouncement specified for private companies. However, the majority of EGCs have not taken advantage of this extended transition period for compliance with new or revised GAAP accounting pronouncements because it might create an unfavourable comparison with competitors, and the EGC's IPO registration statement must still satisfy the relevant Regulation S-X requirements.

Scaled executive compensation disclosures

EGCs are permitted to provide scaled executive compensation disclosure under the requirements generally available to smaller reporting companies. As a result, an EGC may: (1) omit the detailed Compensation Discussion and Analysis (CD&A); (2) provide compensation disclosure covering the top three (including the CEO), rather than the top five, executive officers for a period of two years as compared to three years; and (3) omit four of the six executive compensation tables required for larger companies. The vast majority of EGC IPO issuers in 2014 that otherwise would have been required to include traditional executive compensation disclosures (ie issuers other than FPIs, externally managed Reits, commodity pools, etc) elected to take advantage of the reduced disclosure, with many omitting the CD&A section and including only a Summary Compensation Table and Outstanding Equity Awards Table covering three rather

than five named executive officers and limiting the tabular disclosures to two years.

Exemption from auditor attestation report

EGCs are exempt from the requirements under Sarbanes-Oxley Act section 404(b) to have an auditor attest to the quality and reliability of the company's internal control over financial reporting, and the exemption remains valid for so long as the company retains its EGC status. In contrast, all other newly public companies, regardless of size, generally have until their second annual report to provide the auditor attestation report, and smaller public companies (generally those with a public float of less than $75 million) are permanently exempted. Almost all EGCs have indicated that they intend to take advantage of (or reserve the right to do so in the future) the exemption from providing the auditor attestation report under Sarbanes-Oxley Act section 404(b).

ENDNOTES

1 SEC Confidential Submission FAQs, supra note 26, Question 6.
2 *See*, *e.g.*, Division of Corporation Finance no-action letters to Black Box Incorporated (June 26 1990) and Squadron Ellenoff, Pleasant & Lehrer (February 28 1992).
3 The SEC's integration guidance can be found in the Regulation D Proposing Release, *Revisions of Limited Offering Exemptions in Regulation D, 33-8828* (August 3 2007), *available at* http://www.sec.gov/rules/proposed/2007/33-8828.pdf., pp. 52-56. *See also* the SEC's Compliance and Disclosure Interpretations – Securities Act sections (last updated November 26 2008), Question 139.25.
4 *See, e.g.,* C&DI – Securities Act sections, Question 139.25.
5 Rule 3b-4(c) of the Securities Exchange Act of 1934, as amended [hereinafter Exchange Act]. An FPI is permitted to assess its status as an FPI once a year on the last business day of its second fiscal quarter, rather than on a continuous basis, and may avail itself of the FPI accommodations, including use of the FPI forms and reporting requirements, beginning on the determination date on which it establishes its eligibility as an FPI. If an FPI determines that it no longer qualifies as an FPI, it must comply with the reporting requirements and use the forms prescribed by US domestic companies beginning on the first day of the fiscal year following the determination date. SEC Release No. 33-8959. Note that if an FPI loses its status as an FPI it will be subject to the reporting requirements for a US domestic issuer, and while previous SEC filings do not have to be amended upon the loss of such status, all future filings would be required to comply with the requirements for a US domestic issuer. "Financial Reporting Manual," Division of Corporation Finance, Topic 6120.2, available at http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml. Also note that if an FPI is reincorporated as a US entity, a registration statement on a domestic form (Form S-4) will be required for the exchange of shares with the new US domestic issuer. *Id.* at Topic 6120.8.

CHAPTER 3

Applying Title I to other transactions

While Title I of the JOBS Act is largely focused on capital raising transactions, there is nothing in the JOBS Act or in the SEC's interpretations to suggest that the IPO on-ramp provisions in Title I should not also apply in the context of other transactions conducted by EGCs pursuant to a Securities Act registration statement. The SEC's Division of Corporation Finance has provided guidance in the form of frequently asked questions indicating that EGCs may rely on certain of the disclosure, communications and confidential submission benefits for EGCs in the context of merger and exchange offer transactions.[1] An overriding principle of the guidance in these FAQs is that an EGC which avails itself of the Title I provisions in the context of an exchange offer or a merger must comply with all of the pre-existing applicable rules for tender offers and proxy solicitations, which might, in some cases, conflict with the more liberal communications approach contemplated by Title I of the JOBS Act. The SEC has also provided guidance regarding the EGC status of issuers that are spun off from SEC reporting issuers.

Availability of test-the-waters communications

As discussed in Chapter 1, Title I of the JOBS Act provides EGCs, or any other person authorised to act on their behalf, the flexibility to engage in oral or written communications with QIBs and institutional accredited investors in order to gauge their interest in a proposed offering, whether before or following the first filing of any registration statement, subject to the requirement that no security may be sold unless accompanied or preceded by a prospectus.[2] An EGC could use this test-the-waters provision with respect to any registered offerings that it conducts while it qualifies for EGC status. There are no form or content restrictions on these communications, and there is no requirement to file written communications with the SEC (although the SEC staff requests that written communications be submitted to them when they review an EGC's registration statement).

The SEC has confirmed that an EGC may use test-the-waters communications with QIBs and institutional accredited investors pursuant to Securities Act section 5(d) in connection with an exchange offer or merger.[3] In addition, the SEC staff notes that an EGC must make all required filings under the Exchange Act for any written communications made in connection with, or relating to, the exchange offer or merger. In this regard, the SEC notes that the JOBS Act did not amend the exchange offer or merger requirements under the Exchange Act, such as filings required under Exchange Act Rules 13e-4(c), 14a-12(b), and 14d-2(b), for pre-commencement tender offer communications and proxy soliciting materials in connection with a business combination transaction.

Confidential draft registration statement submissions

As discussed in Chapter 1, Title I added paragraph (e) to section 6 of the Securities Act to provide that the SEC must review all EGC initial public offering registration statements confidentially, if an EGC chooses to submit a draft registration statement to the SEC. An EGC may confidentially submit a draft registration statement for an initial public offering for non-public review, provided that the initial confidential submission and all amendments are publicly filed with the SEC no later than 15 days (reduced from 21 days) before the issuer's commencement of a road show.[4]

The SEC has indicated that an EGC may use the confidential submission process in section 6(e) of the Securities Act to submit a draft registration statement for an exchange offer or a merger that constitutes its initial public offering of common equity securities.[5] If an EGC uses the confidential submission process to submit a draft registration statement for an exchange offer or merger that constitutes its initial public offering of common equity securities, the SEC notes a number of obligations under the Securities Act and Exchange Act with respect to the transaction.

If an EGC does not commence its exchange offer before the effectiveness of the registration statement, the EGC must publicly file the registration statement (including the initial confidential submission and all amendments thereto) at least 15 days before the earlier of the commencement date of the road show, if any, or the

anticipated date of effectiveness of the registration statement. This applies in the case of all exchange offers that do not use early commencement, including those that do not qualify for early commencement under the provisions of Rules 13e-4(e)(2) and 14d-4(b) regarding going-private transactions and roll-up transactions.

An EGC that commences its exchange offer before effectiveness of the registration statement pursuant to Securities Act Rule 162 must publicly file the registration statement (including the initial confidential submission and all amendments thereto) at least 15 days before the earlier of: the commencement date of the road show, if any, or the anticipated date of effectiveness of the registration statement, but no later than the date of commencement of the exchange offer in light of the filing requirement under Exchange Act Rules 13e-4(e)(2) and 14d-4(b).

For the early commencement of exchange offers subject only to Regulation 14E, an EGC must file its registration statement at least 15 days before the earlier of the commencement date of the road show, if any, or the anticipated date of effectiveness of the registration statement, but no later than the date of commencement of the exchange offer.

An EGC must also make the required filings under Securities Act Rule 425 (unless it is relying on the Securities Act section 5(d) provision for test-the-waters communications) and Exchange Act Rules 13e-4(c) and 14d-2(b) for pre-commencement tender offer communications. An EGC must also file the tender offer statement on Schedule TO on the date of commencement of the exchange offer under Exchange Act Rules 13e-4(b) and 14d-3(a), as applicable.

In a merger where the target company is subject to Regulation 14A or 14C and the registration statement of the EGC acquirer includes a prospectus that also serves as the target issuer's proxy or information statement, the acquirer must publicly file the registration statement (including the initial confidential submission and all amendments thereto) at least 15 days before the earlier of the date of commencement of the road show, if any, or the anticipated date of effectiveness of the registration statement. In addition, the acquirer must make the required filings under Securities Act Rule 425 (unless it is relying on the Securities Act section 5(d) provision for test-the-waters communications) and Exchange Act Rule 14a-12(b) for any soliciting material, as applicable.[6]

Financial statement requirements

The SEC has stated that if a target company which does not qualify as a "smaller reporting company" is to be acquired by an EGC that is not a shell company and will present only two years of its financial statements in its registration statement for the exchange offer or merger, the SEC will not object if, in the registration statement filed for the merger or exchange offer, the EGC presents only two years of financial statements for the target company.[7]

Spin-offs

The SEC has also addressed the EGC status of an issuer in the context of spin-offs and similar transactions. In circumstances where a public parent issuer decides to spin-off a wholly-owned subsidiary, register an offer and sale of the wholly-owned subsidiary's common stock for an initial public offering, or transfer a business into a newly-formed subsidiary for purposes of undertaking an initial public offering of that subsidiary's common stock, the subsidiary would not necessarily trigger any of the disqualification provisions in sections 2(a)(19)(A)-(D) of the Securities Act, and would thus be considered an EGC if it had less than $1 billion in revenues during its most recently completed fiscal year.[8] This analysis is focused on whether the issuer, and not its parent, meets the EGC requirements. The SEC notes that, based on the particular facts and circumstances, the EGC status of an issuer under these circumstances may be questioned if it appears that the issuer or its parent is engaging in a transaction for the purpose of converting a non-EGC into an EGC, or for the purpose of obtaining the benefits of EGC status indirectly when it is not entitled to do so directly. The SEC recommends that issuers with questions relating to these issues should contact the Division of Corporation Finance's Office of the Chief Counsel.

ENDNOTES

1 Frequently Asked Questions of General Applicability on Title I of the JOBS Act (April 16, 2012; May 3, 2012; and September 28, 2012), *available at* http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm (SEC Title I FAQs).
2 JOBS Act section105(c), amending Securities Act section 5, 15 USC 77e.
3 SEC Title I FAQs, *supra* note 1 at Question 42.
4 For this purpose, the term "road show" is defined in Securities Act Rule 433(h)(4).
5 SEC Title I FAQs, *supra* note 1 at Question 43.
6 SEC Title I FAQs, *supra* note 1 at Question 44.
7 SEC Title I FAQs, *supra* note 1 at Question 45.
8 SEC Title I FAQs, *supra* note 1 at Question 53.

CHAPTER 4

Private offerings

Title II of the JOBS Act directs the SEC to eliminate the ban on general solicitation and general advertising for certain offerings under Rule 506 of Regulation D under the Securities Act (Rule 506), provided that the securities are sold only to accredited investors, and offerings under Rule 144A under the Securities Act (Rule 144A), provided that the securities are sold only to persons who the seller (or someone acting on the seller's behalf) reasonably believes is a QIB.

Rule 506 is the most popular means for conducting a private offering because it permits issuers to raise an unlimited amount of money and pre-empts state securities laws. In recognition of concerns about restrictions on communications in private offerings, Title II of the JOBS Act directs the SEC to revise Rule 506 to provide that the prohibition against general solicitation or general advertising in Rule 502(c) of Regulation D shall not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors, and to require that issuers using general solicitation or general advertising in connection with Rule 506 offerings take reasonable steps to verify that purchasers of securities are accredited investors, using methods to be determined by the SEC. Under the SEC's existing definition, an accredited investor is a person who falls within one of the categories specified in the definition, or a person who the issuer reasonably believes falls within one of those categories. With respect to Rule 144A, Title II of the JOBS Act directs the SEC to revise the rule to provide that securities may be offered to persons other than QIBs, including by means of general solicitation or general advertising, provided that the securities are sold only to persons that the seller (or someone acting on the seller's behalf) reasonably believes is a QIB. The JOBS Act specifies that any offering made pursuant to Rule 506 that uses general advertising or general solicitation will not be deemed a public offering.

Title II of the JOBS Act also specifies that persons who maintain certain online or other platforms to conduct Rule 506 offerings that will use general advertising or general solicitation will not, by virtue of this activity, be required to register as a broker or a dealer pursuant to Exchange Act section 15, provided that enumerated conditions are satisfied. In order to qualify for this exemption, such a platform must not receive transaction-based compensation, take possession of customer funds or securities, or be subject to an Exchange Act statutory disqualification.

On July 10, 2013, the SEC adopted final rules as directed by Title II of the JOBS Act to eliminate the ban on general solicitation and general advertising for certain offerings under Rule 506 and offerings under Rule 144A. The final rules became effective September 23, 2013.

Rule 506 of Regulation D

Rule 506 is considered a safe harbour for the private offering exemption of section 4(a)(2) of the Securities Act. Rule 506 has proven to be an attractive means for conducting private offerings, because an issuer using it can raise an unlimited amount of money. Prior to adoption of the SEC's final rules, the conditions for using Rule 506 were as follows:

- The issuer cannot use general solicitation or advertising to market the securities;
- The issuer may sell its securities to an unlimited number of "accredited investors" and up to 35 other purchasers. Unlike Rule 505 of Regulation D (Rule 505), all non-accredited investors, either alone or with a purchaser representative, must be sophisticated: they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment;
- An issuer must decide what information to give to accredited investors, so long as it does not violate the antifraud prohibitions of the federal securities laws, with non-accredited investors receiving disclosure documents that are generally the same as those used in registered offerings, and if the issuer provides information to accredited investors, it must make this information available to non-accredited investors as well;
- The company must be available to answer questions

from prospective purchasers;
- Financial statement requirements are the same as for Rule 505; and
- Purchasers receive "restricted securities."

Issuers making use of the Rule 506 exemption do not have to file a registration statement with the SEC, but they must file a Form D after they first sell their securities. Form D is a brief notice that includes the names and addresses of the issuer's owners and promoters and information concerning the offering.

For the purposes of Regulation D, an "accredited investor" includes:
- a bank, insurance company, registered investment company, business development company, or small business investment company;
- an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;
- a charitable organisation, corporation, or partnership with assets exceeding $5 million;
- a director, executive officer, or general partner of the company selling the securities;
- a business in which all the equity owners are accredited investors;
- a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds $1 million at the time of the purchase, excluding the value of the primary residence of such person;
- a natural person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; or
- a trust with assets in excess of $5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes.

Prior to the adoption of the SEC's final rules, Rule 506 did not include any bad actor limitations with respect to the issuer, its affiliates and offering participants. Bad actor disqualification provisions were mandated pursuant to section 926 of the Dodd-Frank Act. We describe the bad actor limitations adopted by the SEC below.

Rule 144A

Rule 144A is a safe harbour exemption from the registration requirements of section 5 of the Securities Act for certain offers and sales of qualifying securities by certain persons other than the issuer of the securities. Rule 144A is available only for resales of qualifying securities. Prior to the adoption of the SEC's final rules, the exemption applied to re-offers and re-sales of securities to QIBs. The securities eligible for resale under Rule 144A are securities of US and foreign issuers that are not listed on a US securities exchange or quoted on a US automated inter-dealer quotation system. Rule 144A also provides that re-offers and re-sales in compliance with the rule are not distributions and that the reseller is therefore not an underwriter within the meaning of section 2(a)(11) of the Securities Act. A reseller that is not the issuer, an underwriter, or a dealer can rely on the exemption provided by section 4(a)(1) of the Securities Act. Resellers that are dealers can rely on the exemption provided by section 4(a)(3) of the Securities Act.

SEC rulemaking under Title II of the JOBS Act

Discussion related to relaxing the ban on general solicitation has been going on since the early 1990s. Speeches and statements by SEC staff members over the years have commented on, and acknowledged, the need to revisit private placement exemptions in light of changes in communications patterns. The legal community also has given close consideration to these questions, going as far back as the late 1990s and early 2000s. In 2001, the American Bar Association's Committee on the Federal Regulation of Securities submitted a comment letter to the SEC that suggested relaxation of the ban on general solicitation. At around the same time, the American Bar Association's Task Force for the Review of the Federal Securities Laws also proposed that a private offering would qualify for an exemption from registration based on the eligibility of the purchasers of the securities and the restrictions on re-sales, and not on the number of offerees. The Advisory Committee on Smaller Public Companies, formed in 2004, advocated a relaxation of the ban on general solicitation. In 2007, the SEC proposed a relaxation of the ban on general solicitation in the context of private offerings to a new category of "large accredited investors."[1] As mentioned above, on July 10, 2013, the SEC issued final rules amending Rule 506 and Rule 144A[2]; and the final rules became effective on September 23, 2013.

Final rules eliminating the prohibition against general solicitation and general advertising in Rule 506 and Rule 144A offerings

The final rules eliminate the prohibition against general solicitation and general advertising contained in Rule 502(c) of Regulation D with respect to offers and sales of securities made pursuant to Rule 506, provided that all purchasers are accredited investors. The final rules require that for offerings involving the use of general solicitation,

issuers take reasonable steps to verify that the purchasers of the securities are accredited investors. The final rules also provide that securities may be offered pursuant to Rule 144A to persons other than qualified institutional buyers, provided that the securities are sold only to purchasers that the seller (or someone acting on the seller's behalf) reasonably believes is a qualified institutional buyer. The SEC staff also has issued guidance in the form of compliance and disclosure interpretations (CD&Is) relating to the Rule 506(c) and Rule 144A amendments.[3]

Eliminating the prohibition against general solicitation

The SEC's final rules implement a bifurcated approach to Rule 506 offerings. An issuer may still choose to conduct a private offering without using general solicitation pursuant to Rule 506(b). Under new Rule 506(c), general solicitation and general advertising are permitted so long as:

- the issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors;
- all purchasers of securities are accredited investors, either because they come within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they qualify as accredited investors, at the time of the sale of the securities; and
- the conditions of Rules 501, 502(a), and 502(d) of Regulation D are satisfied.[4]

The SEC noted that the exemption applies only to offerings made pursuant to the safe harbour provided by Rule 506(c), and it does not apply to offerings relying on the Securities Act section 4(a)(2) exemption in general.[5] As a result, in a transaction made pursuant to Rule 506(c), the section 4(a)(2) exemption is not available. Section 4(a)(2) remains available in Rule 506(b) offerings.

The SEC also confirmed that the effect of section 201(b) of the JOBS Act is to permit privately offered funds (including private equity funds and hedge funds, among others) to make a general solicitation under amended Rule 506 without losing the ability to rely on the exclusions from the definition of an investment company available under section 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940, as amended (the Investment Company Act).[6]

Reasonable steps to verify accredited investor status

The SEC indicated in the final rules that "reasonable efforts" to verify investor status will be a fact-based objective determination based on the SEC's prior principles-based guidance. New Rule 506(c) does not mandate any specific procedure that issuers must follow to be assured that the steps they have taken to verify that the purchasers of their securities are accredited investors are reasonable. In the adopting release, the SEC stated that "[w]hether the steps taken are 'reasonable' will be an objective determination by the issuer (or those acting on its behalf), in the context of the particular facts and circumstances of each purchaser and transaction."[7] The SEC noted that "reasonable efforts" to verify investor status may differ depending on the facts and circumstances, and the SEC indicated that it may be appropriate to consider the nature of the purchaser, the nature and amount of information about the purchaser, and the nature of the offering, as follows:

- **The nature of the purchaser.** The SEC describes the different types of accredited investors, including broker-dealers, investment companies or business development companies, employee benefit plans, and wealthy individuals and charities.
- **The nature and amount of information about the purchaser.** Simply put, the SEC states that "the more information an issuer has indicating that a prospective purchaser is an accredited investor, the fewer steps it would have to take, and vice versa."[8]
- **The nature of the offering.** The nature of the offering may be relevant in determining the reasonableness of steps taken to verify status: issuers may be required to take additional verification steps to the extent that solicitations are made broadly, such as through a website accessible to the general public, or through the use of social media or email. By contrast, less intrusive verification steps may be required to the extent that solicitations are directed at investors that are pre-screened by a reliable third party.

The SEC stated that these factors are interconnected, and the more indicia that are in evidence that an investor qualifies as an accredited investor, the fewer steps the issuer must take to verify status. The SEC noted that issuers should retain adequate records to document the verification process.

In response to the concerns of many commenters on the proposed rules, in new Rule 506(c), the SEC added the four following specific non-exclusive methods of verifying accredited investor status for natural persons that will be deemed to meet the "reasonable steps to verify" requirement:

- A review of IRS forms for the two most recent years and a written representation regarding the individual's expectation of attaining the necessary income level for the current year;
- A review of bank statements, brokerage statements, statements of securities holdings, certificates of deposit,

tax assessments, and appraisal reports by independent third parties in order to assess assets, and a consumer report or credit report from at least one nationwide consumer reporting agency in order to assess liabilities;
- A written confirmation from a registered broker-dealer, a registered investment adviser, a licensed attorney, or a certified public accountant that such person or entity has taken reasonable steps to verify that the person is an accredited investor within the prior three months and has determined that the person is an accredited investor; and
- With respect to any natural person who invested in an issuer's Rule 506(b) private placement as an accredited investor prior to the effective date of new Rule 506(c) and remains an investor of that issuer, for any Rule 506(c) offering conducted by the same issuer, an issuer can obtain a certification from the person at the time of sale in the new offering that he or she qualifies as an accredited investor.[9]

Because an issuer has the burden of demonstrating that its offering is entitled to an exemption from the Securities Act registration requirements, regardless of the steps an issuer takes to verify accredited investor status, the SEC stated that "it will be important for issuers and their verification service providers to retain adequate records regarding the steps taken to verify that a purchaser was an accredited investor."[10]

The SEC has received inquiries asking whether the SEC staff would provide guidance, presumably on a case-by-case basis, confirming that a specified principles-based verification method constitutes "reasonable steps" for purposes of Rule 506(c).[11] The SEC has indicated that the notion of the SEC staff reviewing and approving specific verification methods seems somewhat contrary to the very purpose of a principles-based rule and will not provide any additional guidance.[12] Further, the SEC has expressed the view that this is an area where issuers and other market participants have the flexibility to think about innovative approaches for complying with the verification requirement of Rule 506(c) and use the methods that best suit their needs, and the SEC will not be quick to second guess decisions that issuers and their advisers make in good faith that appear to be reasonable under the circumstances.[13]

Reasonable belief

The SEC confirmed the view that Congress did not intend to eliminate the existing "reasonable belief" standard in Rule 501(a) of Regulation D or for Rule 506 offerings. It confirmed that if a person were to supply false information to an issuer claiming status as an accredited investor, the issuer would not lose the ability to rely on the proposed Rule 506(c) exemption for that offering, provided the issuer "took reasonable steps to verify that the purchaser was an accredited investor and had a reasonable belief that such purchaser was an accredited investor."[14]

Form D amendments

The SEC also amended Form D to add a separate check box for issuers to indicate whether they are claiming an exemption under Rule 506(c).[15] Meredith Cross, former director of the SEC's Division of Corporation Finance, noted at the open meeting for the proposed rules that it was the SEC staff's intention to form a multi-divisional task force to monitor these offerings as a means of gaining insight into market practices.

Final amendment to Rule 144A

As amended, Rule 144A(d)(1) only requires that securities sold in reliance on the rule be sold to a QIB, or to a person that the seller and any person acting on behalf of the seller reasonably believes is a QIB.[16] The SEC also amended Rule 144A to eliminate references to offer and offeree.[17] The SEC also noted that the general solicitation now permitted by Rule 144A will not affect the availability of the section 4(a)(2) exemption or Regulation S for the initial sale of securities by the issuer to the initial purchaser.[18]

The SEC also clarified that for ongoing Rule 144A offerings that commenced before the effective date of the new rules, offering participants will be entitled to conduct the portion of the offering following the effective date of the new rules using a general solicitation, without affecting the availability of Rule 144A for the portion of the offering that occurred prior to the effective date.[19]

Integration with offshore offerings

The SEC addressed the interplay between concurrent offerings made outside the United States in reliance on Regulation S and inside the United States made in reliance on Rule 506 or Rule 144A where there is a general solicitation or general advertising. Of particular concern is the requirement in Regulation S that there be no directed selling efforts in the United States.

The SEC reaffirmed its position that an offshore offering conducted in compliance with Regulation S would not be integrated with a concurrent domestic unregistered offering that is conducted in compliance with Rule 506 or Rule 144A, even if there is a general solicitation or general advertising. This position is consistent with the SEC's views regarding integration of concurrent offshore offerings made in compliance with Regulation S and registered domestic offerings.

Disqualification of felons and other bad actors from Rule 506 offerings

On July 10, 2013, the SEC adopted amendments to rules promulgated under Regulation D to implement section 926 of the Dodd-Frank Act.[20] The amendments add "bad actor" disqualification requirements to Rule 506, which prohibit issuers and others, such as underwriters, placement agents, directors, executive officers, and certain shareholders of the issuer from participating in exempt securities offerings, if they have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws. The amendments were originally proposed on May 25, 2011.[21] In light of concerns raised by investor and consumer advocates that the relaxation of the prohibition against general solicitation in certain Rule 506 offerings would lead to an increased incidence of fraud, the SEC took action on the bad actor provisions at the same time as it promulgated the final Rule 506 amendments. The final rules (collectively, the bad actor rule) became effective on September 23, 2013.

The new disqualification provisions apply to all Rule 506 offerings, regardless of whether general solicitation is used. Section 926 of the Dodd-Frank Act requires the SEC to adopt rules that would make the Rule 506 exemption unavailable for any securities offering in which certain "felons" or other "bad actors" are involved. The new provisions generally track those in section 926 of the Dodd-Frank Act and Rule 262 of Regulation A under the Securities Act (Regulation A). Since the final rule became effective, the SEC staff has provided additional guidance on various interpretative matters in various series of CDIs as discussed below. Although it was anticipated that the relaxation of the prohibition against general solicitation in certain Rule 506 offerings and Rule 144A offerings would have a significant effect on the exempt offering market, at least in the short-term, the bad actor disqualification provisions have had a more immediate impact on offering practices. Issuers and financial intermediaries have had to establish policies and procedures and revise documentation in order to address these provisions.

Covered persons

The disqualification provisions in Rule 506(d)(1) apply to the following "covered persons":

- the issuer and any predecessor of the issuer;
- any affiliated issuer;
- any director, executive officer, other officer participating in the offering, general partner, or managing member of the issuer;
- any beneficial owner of 20% or more of any class of the issuer's outstanding voting equity securities, calculated on the basis of voting power;
- any promoter (as defined in Rule 405) connected with the issuer in any capacity at the time of the sale;
- any investment manager of an issuer that is a pooled investment fund;
- any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities (a "compensated solicitor");
- any general partner or managing member of any such investment manager or compensated solicitor; or
- any director, executive officer, or other officer participating in the offering of any such investment manager or compensated solicitor or general partner or managing member of such investment manager or compensated solicitor.[22]

In the case of financial intermediaries likely to be involved in a private placement under Rule 506, the SEC applied the current standards in Rule 505. Because Rule 505 transactions do not involve underwritten public offerings, but rather the use of compensated placement agents and finders, the term "underwriters" in Rule 262 of Regulation A is replaced with "any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers (compensated solicitors)."[23]

Rule 506(d)(3) provides that the disqualification provisions do not apply to events relating to any affiliated issuer that occurred before the affiliation arose if the affiliated entity is not (i) in control of the issuer or (ii) under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

Two key changes from the categories of covered persons discussed in the proposing release are the inclusion in Rule 506(d)(1) of "executive officers" (ie those performing policy-making functions) of the issuer and the compensated solicitor, instead of just "officer," and a change to 20% from 10% shareholders of the issuer.

Disqualifying events

The final rule includes eight categories of disqualifying events. They are:

- Criminal convictions;
- Court injunctions and restraining orders;
- Final orders (as defined in Rule 501(g) of Regulation D) of certain state regulators (such as securities, banking, and insurance) and federal regulators, including the US Commodity Futures Trading Commission (CFTC);
- SEC disciplinary orders relating to brokers, dealers,

municipal securities dealers, investment advisers, and investment companies and their associated persons;

- Certain SEC cease and desist orders;
- Suspension or expulsion from membership in, or suspension or barring from association with a member of, a securities self-regulatory organisation (SRO);
- SEC stop orders and orders suspending a Regulation A exemption; and
- US Postal Service false representation orders.[24]

A discussion of each of these categories appears below.

Criminal convictions. Rule 506(d)(1)(i) provides for disqualification of any covered person who has been convicted of any felony or misdemeanour in connection with the purchase or sale of any security, involving the making of any false filing with the SEC, or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, or paid solicitor of purchasers of securities. The rule includes a five-year look-back period for criminal convictions of issuers, their predecessors, and affiliated issuers, and a ten-year look-back period for other covered persons.[25]

Court injunctions and restraining orders. Similar to Rule 262 of Regulation A, Rule 506(d)(1)(ii) disqualifies any covered person from relying on the exemption for a sale of securities if such covered person is subject to any order, judgment, or decree of any court of competent jurisdiction, entered within five years before such sale, that, at the time of such sale, restrains or enjoins such person from engaging in or continuing any conduct or practice (i) in connection with the purchase or sale of any security, (ii) involving the making of a false filing with the SEC, or (iii) arising out of the conduct of business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, or paid solicitor of purchasers of securities.[26]

Final orders of certain regulators. Final orders of regulatory agencies or authorities are covered by Rule 506(d)(1)(iii). That section disqualifies any covered person who is subject to a final order of: a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or an officer of a state performing like functions); an appropriate federal banking agency; the CFTC; or the National Credit Union Administration. The order must be final and:

- at the time of such sale, bar the person from:
- associating with an entity regulated by such commission, authority, agency, or officer;
- engaging in the business of securities, insurance, or banking; and
- engaging in savings association or credit union activities; or
- constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct entered within ten years of such sale.

In a change from the proposing release, the rule also added CFTC final orders as disqualification triggers. In adding CFTC final orders, the SEC noted that the CFTC (rather than the SEC) has authority over investment managers of pooled investment funds that invest in commodities and certain derivative products. The SEC reasoned that, absent adding CFTC final orders as a disqualifying trigger, regulatory sanctions against those investment managers would not likely trigger disqualification.[27]

Final orders. Rule 501(g) of Regulation D defines a "final order" as "a written directive or declaratory statement issued by a federal or state agency described in Rule 506(d)(1)(iii) under applicable statutory authority that provides for notice and an opportunity for a hearing, which constitutes a final disposition or action by that federal or state agency."[28] The definition is based on the Finra definition.

Fraudulent, manipulative, or deceptive conduct. Rule 506(d)(1)(iii)(B) provides that disqualification must result from final orders of the relevant regulators that are "based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct." Despite the suggestions of commenters, the SEC did not define "fraudulent, manipulative, or deceptive conduct," did not exclude technical or administrative violations, and did not limit Rule 506(d)(1)(iii) to matters involving scienter.[29]

SEC disciplinary orders. Currently under Rule 262(b)(3), issuers and other covered persons that are subject to an SEC order entered pursuant to sections 15(b), 15B(a), or 15B(c) of the Exchange Act, or sections 203(e) or (f) of the Investment Advisers Act of 1940 (the Advisers Act), are disqualified from relying on the exemption available under Regulation A under the Securities Act. Under the cited provisions of the Exchange Act and the Advisers Act, the SEC has the authority to order a variety of sanctions against registered brokers, dealers, municipal securities dealers, and investment advisers, including the suspension or revocation of registration, censure, placing limits on their activities, imposing civil money penalties, and barring individuals from being associated with specified entities and from participating in the offering of any penny stock.

The SEC has historically required disqualification periods to run only for as long as an act is prohibited or

required to be performed pursuant to an order. Therefore, censures are not disqualifying and a disqualification based on a suspension or limitation of activities expires when the suspension or limitation expires. Rule 506(d)(1)(iv) codifies this position, but removes the reference to section 15B(a) of the Exchange Act. No look-back period was added to the rule.[30]

Certain SEC cease and desist orders. Although not required by section 926 of the Dodd-Frank Act, the Commission added an additional disqualification trigger, using its existing authority previously used to create bad actor provisions. Under Rule 506(d)(1)(v), an offering will be disqualified if any covered person is subject to any order of the SEC entered within five years before such sale that, at the time of such sale, orders the person to cease and desist from committing or causing a future violation of: (i) any scienter-based anti-fraud provision of the federal securities laws, including, without limitation, section 17(a)(1) of the Securities Act, section 10(b) of the Exchange Act and Rule 10b-5 thereunder and section 206(1) of the Advisers Act, or any other rule or regulation thereunder; or (ii) section 5 of the Securities Act. Note that the disqualification provision for section 5 of the Securities Act does not require scienter, which is consistent with the strict liability standard imposed by section 5.[31]

Suspension or expulsion from SRO membership or association with an SRO member. Rule 506(d)(1)(vi) disqualifies any covered person that is suspended or expelled from membership in, or suspended or barred from association with a member of, an SRO, for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade. This provision does not include a look-back period.[32]

SEC stop orders and orders suspending the Regulation A exemption. Rule 506(d)(1)(vii) imposes disqualification on an offering if a covered person has filed (as a registrant or issuer), or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the SEC that, within five years before such sale, was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such sale, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued.[33]

US Postal Service false representation orders. The final disqualification provision is enumerated in Rule 506(d)(1)(viii), which disqualifies any covered person that is subject to a US Postal Service false representation order entered within five years preceding the sale of securities, or is, at the time of such sale, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the U.S. Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.[34]

Reasonable care exception

Rule 506(d)(2)(iv) creates a reasonable care exception that would apply if an issuer can establish that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of a covered person. The reasonable care exception helps preserve the intended benefits of Rule 506 and avoids creating an undue burden on capital raising activities, while giving effect to the legislative intent to screen out felons and bad actors.[35]

In order to rely on the reasonable care exception, the issuer would need to conduct a factual inquiry, the nature of which would depend on the facts and circumstances of the issuer and the other offering participants. In such an inquiry, an issuer would need to consider various factors, such as the risk that bad actors present, the presence of screening and other compliance mechanisms, the cost and burden of the inquiry, whether other means used to obtain information about the covered persons is adequate, and whether investigating publicly available information is reasonable.[36]

Transition issues

Although the look-back provisions of Rule 506(d) reach back to disqualifying events prior to the effectiveness of the rule, Rule 506(d)(2)(i) provides that disqualification will not arise as a result of triggering events that occurred prior to the date of the amendments. However, Rule 506(e) requires written disclosure to purchasers, at a reasonable time prior to the sale, of matters that would have triggered disqualification except that they occurred prior to the rule's effective date. This disclosure requirement applies to all Rule 506 offerings, regardless of whether purchasers are accredited investors. Failure to make such disclosures will not be an "insignificant deviation" within the meaning of Rule 508 of Regulation D; consequently, relief under that rule will not be available for such failure.[37]

The SEC staff has provided additional guidance on the application of the rule through various CD&Is, including those issued on November 13, 2013, December 4, 2013, January 3, 2014 and January 23, 2014.[38]

Proposed amendments

Regulation D and Form D

Also on July 10, 2013, the SEC issued proposed rules for comment that would impose a number of investor protection measures in connection with Rule 506(c) offerings.[39] These include a proposed amendment to Rule 503 of Regulation D in order to implement additional compliance requirements relating to the filing of a Form D. In connection with a Rule 506(c) offering, an issuer would be required to file a Form D not later than 15 calendar days from the commencement of general solicitation efforts. In addition, in order to provide the SEC with more information regarding these types of offerings, the issuer would be required to file a final amendment to the Form D within 30 days after the completion of such an offering. Along the same lines, in order to make additional information available to the SEC, the proposal would revise Form D in order to request additional information in the context of Rule 506(c) offerings. The SEC also proposed an amendment to Rule 507 of Regulation D in order to promote compliance with the Form D filing requirement by implementing certain disqualification provisions where the issuer and its affiliates failed to comply with Form D filing requirements. The SEC would have the authority to grant waivers upon a showing of good cause by the issuer. The proposal also included the introduction of a new Rule 509 of Regulation D, which would require an issuer engaging in a Rule 506(c) offering to include certain legends on any written general solicitation materials. The required legends would alert potential investors of the type of offering, that the offering is available only to certain investors, and that the offering may involve certain risks. The proposal also would require that for a temporary period of two years, issuers must file with the SEC any written solicitation materials. These materials would not be available to the public. The proposal also solicited comment on the definition of "accredited investor" and on whether there should be additional requirements relating to the communications used in general solicitation.

Private funds and Rule 156

The SEC proposed to require private funds making Rule 506(c) offerings to file written general solicitation materials with the SEC on a temporary basis. The SEC also proposed to amend Rule 156 under the Securities Act, the anti-fraud rule that applies to sales literature of registered investment companies. The rule amendments would apply the guidance to sales literature of private funds making general solicitations under Rule 506.

Rule 156 under the Securities Act prevents registered investment companies from using sales literature that is materially misleading in connection with the offer and sale of securities. The comment period for the proposed rules has closed, and it is not clear whether the proposed rules will be adopted, or if adopted, the form in which the SEC will adopt them.

The SEC's proposed rules were quite controversial. As of the date of this writing, no further action has been taken relating to these proposed rules.

Impact of Rule 506 amendments on broker-dealers, investment advisers, CPOs, and CTAs

The amendments to Rule 506 affect issuers, as well as broker-dealers, investment advisers, commodity pool operators (CPOs), and commodity trading advisers (CTAs). Registered broker-dealers often act as intermediaries that facilitate Rule 506 offerings, while investment advisers (including CPOs and CTAs) organise and sponsor pooled investment funds that conduct Rule 506 offerings in an issuer capacity. Broker-dealers, investment advisers, CPOs, and CTAs may be affected directly or indirectly by the amendments to Rule 506 in several ways, which we describe below.

Bad actor rule

SEC disciplinary orders relating to broker-dealers, municipal securities dealers, investment advisers, and investment companies and their associated persons constitute disqualifying events under the bad actor rule. The scope of the bad actor rule has also been expanded by using the term "investment manager" rather than "investment adviser." This is meant to ensure that control persons of pooled funds that deal in instruments other than securities, such as commodities, real estate, and certain derivatives, are covered persons and subject to disqualification under the bad actor rule. This revision recognised that, unlike operating companies making Rule 506 offerings, most pooled investment funds engaging in Rule 506 offerings function through their investment managers and their personnel and have few, if any, employees. Broker-dealers and other registered persons that participate in private placements will have to implement compliance policies and procedures in order to permit them to be in a position to represent to any issuers with which they are working on a Rule 506 offering that they are not "bad actors." In the aftermath of the financial crisis, a number of financial institutions were subject to governmental orders that are considered disqualifying events. These financial institutions have had to seek waivers from the SEC in order not to be disqualified from participating in private placements.

An issuer may rely on Rule 506's exemption even if there is a disqualification as to a covered person, such as a broker-dealer, if the issuer can demonstrate that it did not know and, in the exercise of reasonable care, it could not have known about the disqualification at the time of the sale of securities. Although issuers are generally required to exercise that reasonable care and conduct associated factual inquiries themselves, when a registered broker-dealer acts as placement agent, it may be sufficient for the issuer to make inquiries concerning the relevant set of covered officers and controlling persons and to consult publicly available databases concerning the past disciplinary history of the relevant persons.

Use of general solicitation

Existing Finra rules governing offering-related communications take on greater significance with the wider availability of general solicitation in private placements. This includes Finra Rule 5123 (requiring Finra members selling securities issued by non-members in certain private placements to file the private placement memorandum, term sheet, or other offering documents with Finra within 15 days of the date of the first sale of securities) and Finra Rule 2210 (establishing pre-approval, filing, content, and record retention requirements with respect to communications with retail investors). Furthermore, both broker-dealers and investment advisers participating in offerings in conjunction with issuers relying on Rule 506(c) will continue to be subject to Finra or SEC rules generally prohibiting false or untrue statements. Broker-dealers participating in offerings in conjunction with issuers relying on Rule 506(c) would continue to be subject to Finra rules regarding communications with the public, which, among other things: (1) generally require all member communications to be based on principles of fair dealing and good faith, to be fair and balanced, and to provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service; and (2) prohibit broker-dealers from making false, exaggerated, unwarranted, promissory, or misleading statements or claims in any communications. As a result, it may be difficult to advertise effectively while still complying with these Finra rules.

In addition, while CPOs are generally required to register with the CFTC and comply with its rules, certain exemptions are available under CFTC Regulations 4.7(b) and 4.13(a)(3) for CPOs who offer and accept investments only from accredited investors and other qualified persons without "marketing to the public." As a result of the ambiguity arising from the CFTC regulations, many funds have refrained from relying on Rule 506(c) offerings. In September 2014, the staff of the CFTC issued exemptive relief in CFTC Letter No. 14-116, addressing CFTC Regulations 4.13 and 4.7 for CPOs that rely on the JOBS Act and use general solicitation or general advertising.[40] The relief requires the CPO to affirmatively notify the CFTC that it will be using general solicitation or general advertising and to provide certain representations, but it is self-effectuating. Market participants, however, expected broader relief that would have amended the regulations, covered other relevant CFTC rules and regulations, and provided relief to CTAs.

Investor verification

An issuer may verify that its investors are accredited by, among other ways, obtaining written confirmation from a registered broker-dealer, an SEC-registered investment adviser, a licensed attorney, or a certified public accountant that such person or entity has taken reasonable steps within the prior three months to verify that the purchaser is an accredited investor and has determined that such purchaser is an accredited investor. The rationale behind this provision is that these third parties are all subject to various other regulatory, licensing, and examination requirements.

Matchmaking sites

Matchmaking sites have come to play a more significant role in capital formation in recent years. A matchmaking site generally relies on the internet in order to "match" or introduce potential investors to companies that may be interested in raising capital. However, in order to avoid the requirement to register as a broker-dealer, a matchmaking site will limit the scope of its activities. Under section 3(a)(4) of the Exchange Act, a "broker" is defined as any person that is "engaged in the business of effecting transactions in securities for the account of others." The SEC has noted that a person "effects transactions in securities if he or she participates in such transactions 'at key points in the chain of distribution,'" and that a person is "engaged in the business" if he or she receives transaction-related compensation, holds himself out "as a broker, as executing trades, or as assisting others in completing securities transactions."[41] The determination as to whether an entity is acting as a "broker" is complex. The SEC closely considers many criteria and the specific facts and circumstances. Generally, though, the SEC has attributed great significance to whether the person receives transaction-based compensation. Given that acting as an unregistered broker-dealer would be met with serious consequences, many matchmaking sites sought further SEC guidance. Prior to the enactment of the JOBS Act, the SEC staff issued several

no-action letters to matchmaking sites that sought relief from the requirement to register as broker-dealers. The no-action letter relief generally was conditioned on the requirement that the matchmaking site: (1) not provide any advice, endorsement, analysis, or recommendation about the merits of securities; (2) not receive compensation that is contingent on the outcome or completion of any securities transaction ("transaction-based compensation"); (3) not participate in any negotiations related to securities transactions; (4) not have any role in effecting securities trades; (5) not receive, transfer, or hold any investor funds or securities; and (6) not hold itself out as a broker-dealer.[42]

Section 201(b) of the JOBS Act provides further legal certainty. Pursuant to this section, in the absence of other activities that would require registration, a matchmaking site is exempt from the requirement to register as a broker-dealer if in connection with Rule 506 offerings: (1) it does not receive compensation based on the purchase or sale of securities; (2) it does not handle customer funds or securities; and (3) it is not a "bad actor." A matchmaking site may maintain "a platform or mechanism that permits the offer, sale, purchase, or negotiation of or with respect to securities, or permits general solicitations, general advertisements, or similar or related activities by issuers of such securities, whether online, in person, or through any other means."[43] A matchmaking site also may provide "ancillary services" in connection with Rule 506 offerings, which include "due diligence services, in connection with the offer, sale, purchase, or negotiation of such security, so long as such services do not include, for separate compensation, investment advice or recommendations to issuers or investors;" and "the provision of standardized documents to the issuers and investors, so long as such person or entity does not negotiate the terms of the issuance for and on behalf of third parties and issuers are not required to use the standardized documents as a condition of using the service." This provision applies only to the activities of matchmaking sites in Rule 506 offerings. Although many articles in the popular press refer to the use of the internet to offer securities in Rule 506 offerings to accredited investors as "crowdfunding" or "accredited investor crowdfunding," it is important to note that the transactions taking place on such sites do not rely on the exemption under section 4(a)(6) of the Securities Act for crowdfunded offerings, and that the exemption from broker-dealer registration would not be available for crowdfunded offerings or for Regulation A offerings.[44] Crowdfunded offerings must be conducted by either a registered broker-dealer or a registered funding portal.

In order to provide additional guidance relating to matchmaking sites, the SEC staff issued guidance in the form of Frequently Asked Questions.[45] Also, in March 2013, the SEC's Division of Trading and Markets provided the first no-action relief from registration as a broker-dealer after the issuance of the JOBS Act in a letter to FundersClub (FundersClub) and FundersClub Management (FC Management).[46] In the letter, the SEL indicated that the Division would not recommend enforcement action under section 15(a)(1) of the Exchange Act if FundersClub and FundersClub Management operated a platform through which its members could participate in Rule 506 offerings. FundersClub identifies start-up companies in which its affiliated fund will invest, and then posts information about the start-up companies on its website so that the information is only available to FundersClub members, who are all accredited investors. The FundersClub members may submit non-binding indications of interest in an investment fund which is relying on Rule 506 to conduct the offering. When a target level of capital is reached, the indication of interest process is closed, and FundersClub reconfirms investors' interest and accredited investor status and negotiates the final terms of the investment fund's investment in the start-up company. Members may withdraw their indications of interest at any time. In this process, FundersClub and FundersClub Management do not receive any compensation, however some administrative fees are charged. FundersClub and FundersClub Management intend to be compensated through their role in organizing and managing the investment funds (at a rate of 20% or less of the profits of the investment fund, but never exceeding 30%). The SEC staff notes in the no-action letter that FundersClub's and FundersClub Management's current activities appear to comply with section 201 of the JOBS Act, in part because they and each person associated with them receive no compensation (or the promise of future compensation) in connection with the purchase or sale of securities. However, once FundersClub, FundersClub Management, or persons associated with them receive compensation or the promise of future compensation, as described in their incoming letter, they will no longer be able to rely on section 201 of the JOBS Act. The SEC staff issued similar no-action relief to AngelList.[47]

These letters are narrowly focused, and do not address whether other registrations (such as registration as an investment adviser) would be required to be obtained. Also, the letters do not address or comment on any issues related to "general solicitation" or the means by which investors are identified or contacted. Given the popularity of matchmaking sites, an issuer may consider using such a service in connection with a proposed Rule 506 offering.

The issuer and its counsel should familiarise itself with the business model and the operations of the matchmaking site. It will be essential for the issuer to understand whether the site is relying on the exemption under section 201 of the JOBS Act, or whether it is a registered broker-dealer, and the functions or services that the site will provide in connection with the financing. In addition, the issuer also will need to understand whether the activities of the site are organised in a manner that would constitute a "general solicitation," requiring the issuer to rely on Rule 506(c) for its exemption and thereby triggering a need to conduct additional investor verification.

Guidance from the SEC staff on general solicitation and related issues

After the adoption of the final rules relaxing the prohibition against general solicitation for Rule 506(c) offerings, there was considerable debate regarding the types of communications that would constitute a "general solicitation." For years, market participants had functioned without a precise definition for the term "general solicitation." It was understood that the SEC would interpret the term broadly and that the term would encompass communications relating to an offering of securities that were not directed at specific individuals or entities with which the issuer or a financial intermediary acting on the issuer's behalf had a pre-existing substantive relationship. Over the years, the staff of the SEC had provided guidance regarding the types of activities that were sufficient to establish a relationship prior to an offering of securities being made. In any event, many issuers and investors did not want to be deemed, by virtue of their communications, to be engaged in Rule 506(c) offerings, which would require that they undertake additional investor verification procedures. Also, many issuers were interested in using matchmaking platforms in order to assist them with Rule 506(b) offerings. Perhaps as a result of these developments, the staff of the SEC's Division of Corporation Finance provided guidance in the form of a number of C&DIs that reaffirmed longstanding principles relating to the types of communications that would or would not be viewed as constituting a "general solicitation."[48] The SEC staff clarified that communications that are directed to persons with whom the issuer or its agent has a pre-existing substantive relationship also would not be considered to be a general solicitation. Of course, by contrast, unrestricted communications relating to an offering made using the internet would constitute a general solicitation. The C&DIs also reiterate that regularly released factual business communications would not be considered a general solicitation. Persons other than registered broker-dealers and investment advisers can have a pre-existing relationship with a prospective offeree. Presentations at business plan competitions, demo days or venture fairs and the like should be evaluated and considered based on the facts and circumstances. If there is no mention made of a securities offering or the attendees are known to the issuer or confirmed to be sophisticated investors, one might conclude that there is no general solicitation.

Most matchmaking sites limit their advertising or solicitation activities, or primarily rely on Rule 506(b) offerings made to investors with whom they have a pre-existing substantive relationship. In order to ensure that their offerings are made in compliance with Rule 506(b), these sites generally rely on guidance issued by the SEC staff in various no-action letters, including the IPONet no-action letter issued to a broker-dealer and its affiliate.[49] Under the conditions described in IPONet, the SEC staff concluded that no general solicitation or advertising was involved because of the established principle that "a general solicitation is not present when there is a pre-existing, substantive relationship between an issuer, or its broker-dealer, and the offerees." The SEC staff considered the sufficiency of the qualification process implemented by a non-broker-dealer website operator that solicited investor interest in hedge funds in the no-action letter issued to Lamp Technologies Inc.[50] Lamp imposed a thirty-day waiting period from the time that an investor was first granted access to the restricted site and the first investment. The SEC staff noted that this was a satisfactory means of satisfying the no general solicitation requirement solely in the context of offerings of private hedge funds. The SEC interpretive guidance and the IPONet and Lamp no-action letters provide a roadmap for using internet-based communications in the context of an exempt offering of securities. In the above-mentioned C&DIs, the SEC staff reaffirmed this guidance and noted that the 30-day period may not be a hard and fast requirement. The SEC staff also issued a no-action letter in which it passed upon certain methods used by a platform-based sponsor in order to establish a substantive relationship with potential investors in venture capital funds.[51] The no-action letter is significant in that it extends the prior guidance relating to reliance by an issuer on the pre-existing relationship formed by a broker-dealer with its clients to a registered investment adviser. Also, the no-action letter makes clear that in order to establish a pre-existing substantive relationship, a registered person or other intermediary must not only obtain information about a prospective investor's financial sophistication and status, but it also must have the means to, and must, verify this information.

ENDNOTES

1 SEC Release No. 33-8828 (August 3, 2007), *available at* http://www.sec.gov/rules/proposed/2007/33-8828.pdf.
2 SEC Release Nos. 33-9415 (July 10, 2013), *available at* http://www.sec.gov/rules/final/2013/33-9415.pdf
3 *See* http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.
4 *Supra* note 3, at 20.
5 *Id.* at 12.
6 *Id.* at 47.
7 *Id.* at 20, 28-29.
8 *Id.* at 31.
9 *Id.* at 35.
10 *Id.* 28-29.
11 *See* speech of Keith F. Higgins, Director, Division of Corporation Finance, titled "Keynote Address at the 2014 Angel Capital Association Summit" (March 28, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370541320533#.U2PsBBnD-Hs.
12 *Id.*
13 *Id.*
14 *Id.* at 44.
15 *Id.* at 45.
16 *Id.* at 56.
17 *Id.* at 55.
18 *Id.*
19 *Id.* at 57.
20 SEC Release No. 33-9414 (July 10, 2013), *available at* http://www.sec.gov/rules/final/2013/33-9414.pdf.
21 SEC Release No. 33-9211 (May 25, 2011), *available at* http://www.sec.gov/rules/proposed/2011/33-9211.pdf.
22 *Supra* note 19, at 13.
23 *Id.* at 29.
24 *Id.* at 30.
25 *Id.* at 33.
26 *Id.* at 36.
27 *Id.* at 39.
28 *Id.* at 49.
29 *Id.*
30 *Id.* at 52.
31 *Id.* at 54.
32 *Id.* at 59.
33 *Id.* at 60.
34 *Id.* at 61.
35 Regulation D already has a provision, Rule 508, under which "insignificant deviations" from the terms, conditions, and requirements of Regulation D will not result in the loss of the exemption if the person relying on the exemption can show that: (i) the failure to comply did not pertain to a term, condition, or requirement directly intended to protect that individual or entity; (ii) the failure to comply was insignificant with respect to the offering as a whole; and (iii) a good faith and reasonable attempt was made to comply. The SEC does not believe that Rule 508 of Regulation D would cover circumstances in which an offering was disqualified under Rule 506(d).
36 *Supra* note 19, at 62.
37 *Id.* at 73.
38 *See* http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.
39 SEC Release Nos. 33-9416 (July 10, 2013), *available at* http://www.sec.gov/rules/proposed/2013/33-9416.pdf.
40 Letter from the Division of Swap Dealer and Intermediary Oversight, CFTC, *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/14-116.pdf.
41 *See* SEC Denial of No-Action Request to Oil-N-Gas, Inc. (June 8, 2000); SEC Denial of No-Action Request to Progressive Technology Inc. (October, 11 2000); and SEC Denial of No-Action Request to 1st Global, Inc. (May 7, 2001).
42 *See* Angel Capital Electronic Network, SEC No-Action Letter (October 25 1996); E-Media, LLC, SEC No-Action Letter (December 14, 2000); Swiss American Securities, Inc. and Streetline, Inc., SEC No-Action Letter (May 28, 2002); The Investment Archive, LLC, SEC No-Action Letter (May 14, 2010); Roadshow Broadcast, LLC, SEC No-Action Letter (May 6, 2011); and S3 Matching Technologies LP, SEC No-Action Letter (July 19, 2012).
43 JOBS Act section 201(c)(2).
44 For more information regarding crowdfunding offerings, *see* Chapter 5 (Crowdfunding).
45 *See* Frequently Asked Questions About the Exemption from Broker-Dealer Registration in Title II of the JOBS Act, *available at*

http://www.sec.gov/divisions/marketreg/exemption-broker-dealer-registration-jobs-act-faq.htm.
46 *See* FundersClub Inc. and FundersClub Management LLC, SEC No-Action Letter (March 26, 2013).
47 *See* AngelList LLC, SEC No-Action Letter (March 28, 2013).
48 Compliance and Disclosure Interpretations (C&DIs), Securities Act Rules (updated August 6, 2015), questions 256.23 to 256.32, *available at* http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm
49 *See* IPONet, SEC No-Action Letter (July 26, 1996)
50 *See* Lamp Technologies, Inc,. SEC No-Action Letter (May 29, 1997).
51 *See* Citizen VC, Inc., SEC No-Action Letter (August 6, 2015).

CHAPTER 5

Crowdfunding

Title III of the JOBS Act addresses crowdfunding, an outgrowth of social media that provides an emerging source of funding for a variety of ventures. Crowdfunding works based on the ability to pool money from individuals who have a common interest and are willing to provide small contributions for a venture. Given the difficulty in relying on existing exemptions from registration for crowdfunding efforts involving the offer and sale of securities, Title III of the JOBS Act amended section 4(a) of the Securities Act to add a new paragraph (6), which provides for a new crowdfunding exemption from SEC registration (subject to rulemaking by the SEC), as well as pre-emption from state Blue Sky laws.

Crowdfunding can be used to accomplish a variety of goals (such as raising money for a charity or other causes of interest to the participants), but when the goal is of a commercial nature and there is an opportunity for crowdfunding participants to participate in the venture's profits, it is likely that federal and state securities laws will apply. Absent an exemption from registration with the SEC, or registering the offering with the SEC, crowdfunding efforts that involve the offer and sale of securities are in all likelihood illegal. In addition to SEC requirements, those seeking capital through crowdfunding need to be aware of state securities laws, which include varying requirements and exemptions. By crowdfunding through the internet, a person or venture can be exposed to potential liability at the US federal level, in all fifty states, and potentially in foreign jurisdictions.

Existing exemptions present some problems for persons seeking to raise capital through crowdfunding. Regulation A requires a filing with the SEC and disclosure in the form of an offering circular, which would make conducting a crowdfunding offering difficult. The Regulation D exemptions generally would prove too cumbersome (with the possible exception of Rule 504), and a private offering approach or the intrastate offering exemption is inconsistent with widespread use of the internet for crowdfunding.

The potential illegality of crowdfunding efforts involving the offer and sale of securities was demonstrated in the SEC enforcement action *In the matter of Michael Migliozzi II and Brian William Flatow*,[1] which the SEC brought against two individuals in connection with their efforts to allegedly raise small contributions using the internet in order to purchase Pabst Brewing Company for $300 million. Migliozzi and Flatow settled the proceeding, consenting to a cease and desist order relating to the alleged violation of the registration provisions of the Securities Act. The order indicates that Migliozzi and Flatow established the BuyaBeerCompany.com website and then used Facebook and Twitter to advertise the website. They sought pledges from participants in the crowdfunding effort, and in return participants were told that if the $300 million necessary to purchase Pabst was raised, the participants would receive a "crowdsourced certificate of ownership," as well as an amount of beer of a value equal to the money invested. While no monies were ever collected from the crowdfunding participants who made the pledges, the SEC alleged that Migliozzi and Flatow nonetheless violated the registration provisions of the federal securities laws by offering the security (in this case, the crowdsourced certificate of ownership) without registering the offer with the SEC or having an exemption, such as the private placement exemption, available for the offer.

In recent years, crowdfunding advocates have requested that the SEC consider implementing an exemption from registration under the federal securities laws for crowdfunding efforts. For example, a rulemaking petition submitted by the Sustainable Economies Law Center suggested that the SEC exempt crowdfunding offerings of up to $100,000, with a cap on individual investments not to exceed $100.[2] Also, following an SEC Forum on Small Business Capital Formation, the Small Business & Entrepreneurship Council submitted comments suggesting that the SEC adopt a small business offering exemption for offerings of less than $1 million with a limit on the amount any one individual could contribute to no more than 10% of the previous year's stated income of the issuer or up to $10,000 per individual. Before enactment of Title III of the JOBS Act, the SEC was considering whether to implement an exemption for crowdfunding, in

addition to a variety of other measures to encourage capital formation.

When HR 3606 was originally adopted in the House of Representatives, the bill included Title III, titled "Entrepreneur Access to Capital." This Title provided for an exemption from registration under the Securities Act for offerings of up to $1 million, or $2 million in certain cases when investors were provided with audited financial statements, provided that individual investments were limited to $10,000 or 10% of the investor's annual income. The exemption was conditioned on issuers and intermediaries meeting a number of specific requirements, including notice to the SEC about the offering and the parties involved with the offering, which would be shared with state regulatory authorities. The measure would have permitted an unlimited number of investors in the crowdfunding offering and would have pre-empted state securities regulation of these types of offerings (except that states would be permitted to address fraudulent offerings through their existing enforcement mechanisms). The House measure also contemplated that the issuer would state a target offering amount, and a third-party custodian would withhold the proceeds of the offering until the issuer has raised 60% of the target offering amount. The provision also contemplated certain disclosures and questions for investors and provided for an exemption from broker-dealer registration for intermediaries involved in an exempt crowdfunding offering.

After it was adopted, the House crowdfunding measure drew a significant amount of criticism, with much of that criticism focused on a perceived lack of investor protections. In a letter to the Senate leadership, thenSEC chairman Mary Schapiro noted that "an important safeguard that could be considered to better protect investors in crowdfunding offerings would be to provide for oversight of industry professionals that intermediate and facilitate these offerings" and also noted that additional information about companies seeking to raise capital through crowdfunding offerings would benefit investors.

In the Senate, an amendment to HR 3606 that was submitted by Senator Merkley and approved by the Senate provided additional investor protections for exempt crowdfunding offerings. Many of these protections may now present difficulties as the SEC and market participants seek to make use of the JOBS Act crowdfunding exemption.

TITLE III OF THE JOBS ACT

Title III of the JOBS Act addresses crowdfunding by providing an exemption from registration provided that:

- the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, is not more than $1 million;
- the aggregate amount sold to any investor by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, does not exceed:
  - the greater of $2,000 or 5% of the annual income or net worth of the investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000, or
  - 10% of the annual income or net worth of an 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;
- the transaction is conducted through a registered broker or funding portal that complies with the requirements of the exemption; and
- the issuer complies with a number of specific informational and other requirements specified under the exemption.

Title III specified that the SEC must issue rules to implement this provision not later than 270 days following enactment. In October 2013, the SEC issued proposed rules to implement the crowdfunding exemption, which we discuss below. The final rules were adopted in October 2015.

Requirements as to intermediaries

An exempt crowdfunding offering must be made through an intermediary that has registered with the SEC as a broker or as a so-called funding portal. Funding portals will not be subject to registration as a broker-dealer but would be subject to an alternative regulatory regime with oversight by the SEC and the Financial Industry Regulatory Authority (Finra), to be determined by rulemaking at the SEC and Finra. A funding portal is defined as an intermediary for exempt crowdfunding offerings that does not:

- offer investment advice or recommendations;
- solicit purchases, sales, or offers to buy 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 other activities as the SEC may determine by rulemaking.

A crowdfunding intermediary must provide specified disclosures to investors and take other steps related to the offering oriented toward investor protection, such as:
- ensuring that all offering proceeds are only provided to issuers when the amount equals or exceeds the target offering amount and allowing for cancellation of commitments to purchase in the offering;
- ensuring that no investor in a 12-month period has invested in excess of the limit described above in all issuers conducting exempt crowdfunding offerings;
- taking steps to protect privacy of information;
- not compensating promoters, finders, or lead generators for providing personal identifying information of personal investors;
- prohibiting insiders from having any financial interest in an issuer using that intermediary's services; and
- meeting any other requirements that the SEC may prescribe.

Requirements as to issuers

Issuers also must meet specific conditions in order to rely on the exemption, including making filings with the SEC and providing to investors and intermediaries information about the issuer (including financial statements, which would be reviewed or audited depending on the size of the target offering amount), its officers, directors, and greater than 20% shareholders, and risks relating to the issuer and the offering, as well specific offering information such as the use of proceeds for the offering, the target amount for the offering, the deadline to reach the target offering amount, and regular updates regarding progress toward reaching the target. A crowdfunding issuer will also be subject to reporting requirements after the offering, as the SEC may determine pursuant to its rules. Securities sold in crowdfunding offerings are not restricted securities, but they are subject to transfer restrictions for one year following the sale.

The SEC's rules adopted under Title III will also prohibit issuers from advertising the terms of the exempt offering, other than to provide notices directing investors to the funding portal or broker, and will require disclosure of amounts paid to compensate solicitors promoting the offering through the channels of the broker or funding portal.

A purchaser in a crowdfunding offering could bring an action against an issuer for rescission in accordance with section 12(b) and section 13 of the Securities Act, as if liability were created under section 12(a)(2) of the Securities Act, in the event that there are material misstatements or omissions in connection with the offering.

The crowdfunding exemption is only available for domestic issuers that are not reporting companies under the Exchange Act and that are not investment companies, or as the SEC otherwise determines is appropriate. Bad actor disqualification provisions similar to those required under Regulation A are also required for exempt crowdfunding offerings.

The Title III exemption pre-empts state securities laws by making exempt crowdfunding securities "covered securities"; however, some state enforcement authority and notice filing requirements would be retained. State regulation of funding portals will also be pre-empted, subject to limited enforcement and examination authority.

Proposed rules

On October 23, 2013, the SEC issued its proposed rulemaking, referred to as "Regulation Crowdfunding," to implement the crowdfunding exemption.[3] The proposal acknowledged that regulation of these offerings requires adapting disclosure-based principles and the existing approach to broker-dealer regulation and oversight to an entirely new public offering rubric.

Regulation Crowdfunding consisted of five subparts totaling 20 individual rules under new section 4(a)(6) of the Securities Act. As discussed above, Title III of the JOBS Act is quite prescriptive, so the SEC's proposed rules followed closely the statutory requirements. Nonetheless, commenters reacted quite harshly to the SEC's proposed rules, noting that the proposed disclosure requirements, financial statement requirements, and ongoing reporting requirements would be too burdensome especially when considered in light of the small amounts that can be raised under Regulation Crowdfunding.

Final rules

In October 2015, two years after the release of the proposed rules, the SEC adopted final crowdfunding rules. These rules become effective in May 16, 2016. The SEC's Form Funding Portal becomes effective on January 29, 2016 so that entities that seek to register as funding portals may begin the process. Below, we summarise the principal requirements of Regulation Crowdfunding. Rule references are to those under Regulation Crowdfunding.

Limit on capital raised

Consistent with the statutory limitations, Rule 100(a)

provides that an issuer may sell up to $1 million in any 12-month period to investors in an offering made pursuant to the exemption. Of course, an issuer may consider conducting other exempt offerings in close proximity with its crowdfunded offering. In calculating the amounts sold for purposes of the threshold, amounts sold by a predecessor or by an entity under common control with the issuer will be aggregated with the amounts sold by the issuer.

Individual investment limits

The SEC modified the investor limits from those included in its proposed rules. The final rules make clear that the individual investor limit is an aggregate limit, which applies to all investments made by the individual over a 12-month period in crowdfunded offerings and not to a specific offering. An investor will be limited to investing:

(1) The greater of: $2,000 or 5% of the lesser of the investor's annual income or net worth if either annual income or net worth is less than $100,000; or

(2) 10% of the lesser of the investor's annual income or net worth, not to exceed an amount sold of $100,000, if both annual income and net worth are $100,000 or more.

As we discuss below, the issuer can rely on the intermediary's calculation of the investment limit; provided that the issuer does not have knowledge that the investor has exceeded, or would exceed, the investment limits as a result of participating in the issuer's offering.

Offering through an intermediary

An issuer would only be able to engage in an offering through a registered broker-dealer or through a funding portal, and an issuer can only use one intermediary for a particular offering or concurrent offerings made in reliance on the exemption. The offering must be conducted online only through the intermediary's platform so that the "crowd" has access to information, and there is a forum for an exchange of information among potential offering participants. A "platform" is defined as "a program or application accessible via the internet or other similar electronic communication medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on section 4(a)(6) of the Securities Act."

Eligible issuers

The ability to engage in crowdfunding is not available to all issuers. By statute, the following issuers cannot rely on crowdfunding transactions under section 4(a)(6):

- issuers not organised under the laws of a state or territory of the United States or the District of Columbia;
- issuers already subject to the Exchange Act reporting requirements;
- investment companies as defined in the Investment Company Act of 1940 or companies that are excluded from the definition of "investment company" under section 3(b) or 3(c) of the Investment Company Act; and
- any issuer that the SEC, by rule or regulation, determines appropriate.

The final rules also exclude:

- issuers disqualified from relying on section 4(a)(6), or "bad actors;"
- issuers that have sold securities in reliance on section 4(a)(6) and have failed, to the extent required, to make required ongoing reports required by Regulation Crowdfunding during the two-year period immediately preceding the filing of the required new offering statement; and
- any issuer that is a development-stage company that has no specific business plan or purpose, or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.

Disclosure requirements

The statute sets out a number of required disclosures in any section 4(a)(6) offering. An issuer that elects to engage in a crowdfunding offering must comply with disclosure requirements, including: an initial disclosure about the offering on Form C, amendments to Form C to report material changes (Form C-A), periodic updates on the offering on Form C-U and ongoing annual filings until a filing obligation is terminated. The annual filing must be made on Form C-AR and a termination notice on Form C-TR.

Form C

The Form C would be filed with the SEC, and the intermediary would post the filing or provide a link to the filing for investors. The Form C must include disclosures relating to the issuer's business, officers, directors and control persons, use of proceeds, capital structure, and financial results, as discussed below in more detail. In many respects, the Form C requirements resemble those for Form 1-A used in connection with Regulation A offerings. The final Form C also includes an optional Q&A format that issuers may elect to use to provide certain disclosures.

Basic issuer information would be required, including: the entity name, the form of entity, the jurisdiction of

formation, formation date, address, website, number of employees, the issuer's website on which an investor can find the issuer's annual report, and the date by which such report will be made available, whether the issuer or any predecessor previously failed to comply with the ongoing reporting requirements of Regulation Crowdfunding. In addition, the form must disclose certain basic information about the intermediary, including: the intermediary's SEC file number and Finra CRD number and fees being paid to the intermediary, expressed either as a dollar amount or as a percentage of the offering amount, and a description of the intermediary's financial interests in the transaction and in the issuer. In addition, the form will require a narrative discussion that addresses, among other things, the use of proceeds, the offering size, offering price, the issuer's business, a discussion of the issuer's results of operations, management and executive compensation, beneficial ownership, capital structure, related party transactions, and risks associated with an investment in the issuer's securities.

Financial statement requirements

In a change from the proposed rules, the final rules provide some accommodations with respect to financial statement requirements depending upon the target offering size and for first-time issuers. Based on target offering size, the requirements are as follows:

- **$100,000 or less:** the amount of total income, taxable income, and total tax or equivalent line items, as reported on the federal tax forms filed by the issuer for the most recently completed year (if any), certified by the principal executive officer of the issuer, and the financial statements of the issuer, also certified by the principal executive officer. If financial statements of the issuer are available that have either been reviewed or audited by a public accountant independent of the issuer, then these financial statements must be provided instead of the materials described in the preceding sentence.
- **More than $100,000 and less than $500,000:** financial statements of the issuer reviewed by a public accountant independent of the issuer. If financial statements of the issuer are available that have been audited by a public accountant independent of the issuer, the issuer must provide those instead of the reviewed statements.
- **More than $500,000:** financial statements of the issuer audited by a public accountant independent of the issuer; provided, however, that for issuers that are first-time issuers, offerings that have a target offering amount of more than $500,000 but not more than $1 million, financial statements of the issuer reviewed by a public accountant independent of the issuer. If audited statements are available, those must be provided instead.

Financial statements must be prepared in accordance with US GAAP. Audited financial statements must be conducted in accordance either with American Institute of Certified Public Accountants (AICPA) standards (referred to as US GAAS) or Public Company Accounting Oversight Board (PCAOB) standards. These requirements are similar to those applicable for Tier 1 offerings made under Regulation A. A signed audit report must accompany audited financial statements.

Other required filings

An issuer would be required to amend its Form C disclosures using Form C/A for any updates or material changes. An issuer also is required to file progress updates with the SEC on a Form C-U. An issuer that completes a crowdfunded offering must file with the SEC and post on its website an annual report on Form C-AR along with financial statements of the issuer certified by its principal executive officer within 120 days of the end of the issuer's fiscal year. The annual report is required to contain the same information required in the offering statement, as described above.

Termination of reporting

An issuer must file with the SEC a Form C-TR to terminate its reporting obligation within five days of the date on which it becomes eligible to do so. An issuer can terminate its ongoing reporting requirements upon the earliest to occur of the following:

- the issuer is required to file reports under the Exchange Act;
- the issuer has filed at least one annual report and has fewer than 300 holders of record;
- the issuer has filed at least three annual reports and has total assets that do not exceed $10 million;
- the issuer or another party purchases or repurchases all of the securities issued pursuant to section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or
- the issuer liquidates or dissolves in accordance with state law.

Offering amount and offering mechanics

In connection with a proposed offering, the final rules contemplate that the issuer would include in its disclosures a discussion of the target or maximum amount to be raised, and a discussion of the subscription or offering

process. The description of the subscription process must disclose that investors can cancel their investment up to 48 hours prior to the deadline identified in the offering materials, but if an investor does not cancel the investment, then the investor's funds will be released to the issuer upon closing. The intermediary will notify investors when the target offering amount has been met, and if the target offering amount is not met, then no securities will be sold, and all funds will be returned to investors. If the target offering amount is met prior to the deadline identified in the offering materials, the issuer must provide five days' advance notice before closing the offering early. If an investor does not reconfirm the investment commitment after a material change is made to the offering and disclosed on Form C-A, the investment will be cancelled, and the issuer must return the funds to the investor.

Types of securities offered

The final rules do not limit the types of securities that may be offered in reliance on section 4(a)(6). The release notes that an issuer may offer debt securities and discusses the exemption from the requirement to qualify an indenture under the Trust Indenture Act of 1939, as amended (the Trust Indenture Act), for any offering exempted by section 4 of the Securities Act from the provisions of section 5 of the Securities Act; however, the final rules do not include a specific exemption from Trust Indenture Act requirements for crowdfunded offerings.

Status of securities

Securities sold in a crowdfunded offering pursuant to the exemption would be subject to transfer restrictions. Pursuant to Rule 501, securities issued in a crowdfunded offering could not be transferred by a purchaser for one year from the date of purchase, except for transfers to: the issuer; an accredited investor; a family member of the purchaser or in estate type transfers; and third parties in an SEC-registered offering. The statute exempts securities sold in section 4(a)(6) offerings from the Exchange Act "holder of record" count for the purposes of determining if registration of a class of equity securities is required under section 12(g) of the Exchange Act. An issuer will be required to establish a means for tracking its shareholders. This may require an early-stage company to engage the services of a transfer agent or other similar service provider in order to monitor its security holders.

Integration

An offering made pursuant to the section 4(a)(6) exemption will not be integrated with another exempt offering that precedes the crowdfunded offering or that takes place concurrently or subsequently. The issuer must ensure that it has satisfied all of the conditions for the exemption that it is claiming for each such offering. If the issuer is conducting a Rule 506(c) offering (using general solicitation), it must ensure that the Rule 506(c) offerees were not solicited by means of the communications used for the crowdfunded offering.

Restrictions on advertising and promotion

The final rules limit the ability of the issuer, as well as the ability of others acting on the issuer's behalf, to advertise. Rule 204 sets out the information that may be included in an offering notice. The adopting release notes that this notice is intended to be similar to tombstone ads permitted under Securities Act Rule 134. The issuer would be able to communicate with potential crowdfunding investors if the communications occur through the platform; however, it should be clear to potential investors which platform communications are being made by the issuer or on the issuer's behalf. The final rules do not limit an issuer from being able to continue to engage in regular business communications so long as the issuer does not disclose information about the offering, except as permitted in an offering notice. However, the final rules do not contain an express safe harbor for regularly released business information.

Promoter compensation

Rule 205 prohibits an issuer from compensating, or committing to compensate, directly or indirectly, a person for advertising or promoting a section 4(a)(6) offering through the intermediary's platform, unless the issuer takes reasonable steps to ensure that the person clearly discloses the receipt (past and prospective) of compensation each time that such person makes a promotional communication. A founder or employee of the issuer that engages in promotional activities on the issuer's behalf through the intermediary's platform would be required to disclose in each posting that he or she is engaging in those activities on the issuer's behalf.

Intermediaries

Title III of the JOBS Act provides that a crowdfunded offering must be made through an intermediary that is either a registered broker-dealer or a funding portal. The intermediary is intended to function as a gatekeeper and, in this role, protect investors from fraud. The SEC's final

rules establish a regulatory framework for these intermediaries. As discussed below, in the case of funding portals, the regulatory framework is a scaled back version of the framework applicable to broker-dealers. We discuss the final rules in the sequence of an offering and then provide an overview of the registration, compliance, and other requirements applicable to intermediaries.

Conducting a crowdfunded offering

As discussed above, the final rules require that an offering be made only through one intermediary.

Financial interests in issuer

Rule 300 prohibits directors, officers, or partners (or others having a similar status or performing a similar function) of an intermediary from having any financial interest in an issuer using its services and prohibits such persons from receiving a financial interest in an issuer as compensation for the service provided to or for the benefit of the issuer in connection with the offering. An intermediary cannot have a financial interest in an issuer that is using the intermediary's platform, unless:

- the intermediary receives the financial interest from the issuer as offering compensation; and
- the financial interest consists of securities of the same class and having the same terms as those sold in the offering.

A "financial interest" in an issuer means a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

Measures to reduce risk of fraud

Under Rule 301, an intermediary must have a reasonable basis for believing that the issuer is in compliance with relevant regulations and has established means to keep accurate records of holders of the securities it offers. An intermediary could reasonably rely on the issuer's representations, absent knowledge or other information that would suggest that the representations are not true.

An intermediary must deny access to an issuer if it has a reasonable belief that the issuer or its offering would present a potential for fraud. An intermediary would be required to deny access to its platform to an issuer if the intermediary has a reasonable belief that the issuer, or any of its directors, officers or 20% beneficial owners is subject to a disqualification under Rule 503. An intermediary must conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary, as well as on each of its officers, directors (or any person occupying a similar status or performing a similar function), and 20% beneficial owners.

Account opening

Under Rule 302, no intermediary or associated person may accept an investment commitment until the investor opens an account with the intermediary and the intermediary obtains consent to electronic delivery of materials. An intermediary is required to deliver certain information to each investor, including educational materials, by electronic message with links to information posted on the intermediary's website.

Educational materials

Rule 302 requires that, in connection with establishing an account, an intermediary deliver educational materials in plain English. Any revised materials must be made available to all investors before accepting any additional investment commitments or effecting any further crowdfunded transactions. The rule sets out the topics that must be addressed in the educational materials. An intermediary also would be required to inform investors that disclosure is required regarding any past or prospective compensation paid to a promoter. An intermediary also must disclose the compensation it will receive in connection with crowdfunded offerings.

Issuer information

Under Rule 303, an intermediary must make available to the SEC and potential investors, not later than 21 days prior to the first day on which securities are sold to any investor, any information provided by the issuer under Rules 201 and 203(a). The information must be made publicly available on the intermediary's platform in a manner that reasonably permits a person accessing the platform to save, download, or store the information; this information must be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments; and this information, including any additional information provided by the issuer, must remain publicly available on the intermediary's platform until the offer and sale is completed or cancelled. An intermediary cannot require any person to establish an account with the intermediary in order to receive this information.

Investor qualifications

Securities Act section 4A(a)(8) imposes an obligation on intermediaries to make sure no investor exceeds the statutory investment limitations. The final rules implement this requirement by providing that, before permitting an investor to make an investment commitment on its platform, an intermediary must have a

reasonable basis to believe that the investor satisfies the investment limitations discussed above. The final rules allow reasonable reliance on an investor's representation to this effect.

Investor's acknowledgment of risks

Securities Act section 4A(a)(4) requires an intermediary to ensure that each investor reviews the educational materials, positively affirms that the investor understands that he or she is risking the loss of the entire investment and that the investor could bear such a loss, and answer questions demonstrating an understanding of the level of risk involved in startups. As discussed above, educational materials must be provided at the account opening.

Rule 303 requires that an intermediary, each time before accepting an investment commitment, obtain from the investor a representation that the investor has reviewed the intermediary's educational materials, and understands that the entire investment may be lost and can bear the risk of loss. The intermediary also must ensure, each time before accepting an investment commitment, that each investor answers questions demonstrating their understanding that there are restrictions on the investor's ability to cancel an investment commitment and obtain a return of his or her investment, that it may be difficult for the investor to resell the securities, and that the investor should not invest any funds in a crowdfunding offering unless he or she can afford to lose the entire amount of his or her investment.

Communication channels

Rule 303 requires an intermediary to provide, on its platform, channels through which investors can communicate with one another and with representatives of the issuer about offerings made available on the intermediary's platform, subject to certain conditions. This is intended to provide a centralised and transparent means for members of the public to share their views and to communicate with the issuer. The intermediary cannot participate in the communications; however, the intermediary can set rules regarding the postings or remove postings that use offensive language. Communications should be available for public viewing, but the intermediary would only be able to permit those persons who have opened accounts with it to post comments. With each post, a person must disclose whether such person is a promoter or affiliate of the issuer and whether it has been or will be compensated. The intermediary must keep records of these communications.

Notice of investment commitment

An intermediary, upon receipt of an investment commitment from an investor, must promptly give or send to the investor a notification disclosing: the dollar amount of the commitment, the price of the securities (if known), the name of the issuer, and the date and time by which the investor may cancel the investment commitment. Notification would be required to be provided by email or other electronic media and to be documented in accordance with applicable recordkeeping rules.

Maintenance and transmission of funds

Securities Act section 4A(a)(7) requires that an intermediary "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount." An intermediary that is a registered broker must comply with established requirements under Exchange Act Rule 15c2-4 for the maintenance and transmission of investor funds. Investor funds must be held in escrow until the specified contingency occurs (ie, the targeted amount or the minimum amount is raised) and then the funds would be promptly transmitted to a bank, which has agreed in writing to hold such funds in escrow for the investors and to transmit or return such funds directly to the issuer or to investors, as the case may be. Proceeds are to be transmitted to the issuer only if the target offering amount is met or exceeded.

Because a funding portal cannot receive or handle any funds, it would be required to direct investors to transmit money or other consideration directly to a qualified third party (a registered broker-dealer, a bank, or a credit union) that serves as an escrow agent. A funding portal must promptly direct transmission of funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the offering and the cancellation period for each investor has expired, but no earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided about the issuer and the offering. A funding portal must direct the return of funds to an investor when an investment commitment has been cancelled or the offering is terminated or cancelled.

Confirmation of transaction

At or before the completion of a transaction, the intermediary is required to give or send each investor a notification, similar to a confirmation, disclosing: the transaction date, the type of security, the price and number of securities purchased, the number of securities sold by

the issuer in the transaction, the price at which the securities were sold, certain specified terms of the security (for example, if it is a debt or callable security), and the source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, whether from the issuer or other persons. This notification must be by email or other electronic media and subject to recordkeeping rules.

Completion of offerings, cancellations and reconfirmations

Investors have an unconditional right to cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. Thereafter, an investor cannot cancel any investment commitments made within the final 48 hours (except in the event of a material change to the offering, as discussed below).

If an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering once the target offering amount is reached, provided that: the offering will have remained open for a minimum of 21 days; the intermediary provides notice about the new offering deadline at least five business days prior to the new offering deadline; investors are given the opportunity to reconsider their investment decision and to cancel their investment commitment until 48 hours prior to the new offering deadline; and at the time of the new offering deadline, the issuer continues to meet or exceed the target offering amount.

If there is a material change to the terms of the offering, or the information provided by the issuer regarding the offering, the intermediary must give or send to any potential investors who have made investment commitments notice of the material change. This must state that the investor's investment commitment will be cancelled unless the investor reconfirms his or her commitment within five business days of receipt of the notice. If the investor fails to reconfirm his or her investment within those five business days, the intermediary, within five business days thereafter, must provide or send the investor a notification disclosing that the investment commitment was cancelled, the reason for the cancellation and the refund amount that the investor should expect to receive, and direct the refund of investor funds.

Finally, if an issuer does not complete an offering because the target is not reached or the issuer decides to terminate the offering, the intermediary, within five business days, must give or send to each investor who made an investment commitment a notification disclosing: the cancellation of the offering, the reason for the cancellation, and the refund amount that the investor should expect to receive. It must also direct the refund of investor funds and prevent investors from making investment commitments with respect to that offering on its platform.

Intermediary registration and other requirements

An intermediary must be registered as a broker-dealer with the SEC under section 15(b) of the Exchange Act or a funding portal registered with the SEC in accordance with the requirements of Rule 400. They must also be a member of a national securities association registered under section 15A of the Exchange Act, which is Finra.

Additional requirements on funding portals

The SEC has established a streamlined registration process under which a funding portal would register with the SEC by filing a form, Form Funding Portal, with information consistent with, but less extensive than, the information required for broker-dealers on Form BD. A funding portal would register by completing a Form Funding Portal, which includes information concerning: the funding portal's principal place of business, legal organisation, and disciplinary history, if any; business activities, including the types of compensation the funding portal has received and disclosure of its disciplinary history, if any; Finra membership with any other registered national securities association; and the funding portal's website address(es) or other means of access. A funding portal's registration would become effective the later of: (1) 30 calendar days after the date that the registration is received by the SEC; or (2) the date the funding portal is approved for membership in Finra. In order to promote transparency, all such Forms Funding Portal will be available publicly.

Non-US funding portals

Entities domiciled or organised outside of the United States (nonresident funding portals) are able to act as funding portals; however, they are subject to additional requirements. There must be an information-sharing arrangement in place between the SEC and the competent regulator in the jurisdiction under the laws of which the nonresident funding portal is organised, or where it has its principal place of business. In addition, a nonresident funding portal would be required to have an agent for service of process in the United States, as well as an opinion of counsel addressing the ability of the applicant to provide the SEC and any national securities association of which it is a member with prompt access to its books and records, and to submit to onsite inspection and

examination by the SEC and the relevant national securities association. The nonresident funding portal also would be required to consent that service of any civil action brought by, or notice of any proceeding before, the SEC or any national securities association of which it is a member, in connection with the funding portal's investment-related business, may be given by registered or certified mail to the nonresident funding portal's contact person at the main address or mailing address indicated on the form.

Exemptions from broker-dealer registration and safe harbours

But for the exemption from registration for funding portals that Congress directed in the JOBS Act, a funding portal would be required to register as a broker under the Exchange Act. The SEC's final rules exempt an intermediary that is registered as a funding portal from the requirement to register as a broker-dealer under the Exchange Act, although a funding portal would remain subject to the full range of the SEC's examination and enforcement authority. A funding portal cannot:

- offer investment advice or recommendations;
- solicit purchases, sales, or offers to buy the securities displayed on its platform;
- compensate employees, agents, or other persons for such solicitations based on the sale of securities displayed or referenced on its platform; orhold, manage, possess, or otherwise handle investor funds or securities.

In addition, the final rules set out certain "permitted activities" of a funding portal, such as: providing a channel for investors to communicate about an offering, highlighting particular offerings made through its funding portal based on objective criteria, advising issuers on the offering structure, paying for referrals subject to certain conditions, entering into arrangements with broker-dealers, and limiting the offerings made through its platforms based on particular criteria without risk of being deemed to provide investment advice.

Compliance policies and procedures

A funding portal is required to implement written policies and procedures designed to achieve compliance with applicable regulations. A funding portal will be required to comply with the same privacy rules (Regulation S-P, Regulation S-AM, and Regulation S-ID) applicable to broker-dealers. A funding portal is subject to the SEC's examination and inspection authority. Also, a funding portal is subject to recordkeeping requirements in order to ensure that there is an audit trail for all crowdfunding transactions and communications.

Bad actor provisions

Rule 503 sets out bad actor disqualification provisions. The section 4(a)(6) exemption will not be available for a sale of securities if the issuer, a predecessor of the issuer, an affiliated issuer, any director, officer, general partner or managing member of the issuer, a beneficial owner of 20% or more of the issuer's outstanding voting equity securities, any promoter or solicitor, or any general partner, director, officer, or managing member of any such solicitor is subject to a "statutory disqualification."

Proposed Finra rules

As discussed above, intermediaries must be registered with Finra. On October 23, 2013, Finra issued seven proposed rules (Rules 100, 110, 200, 300, 800, 900, and 1200), referred to as the Funding Portal Rules.[4] The proposed rules reflected an attempt to streamline regulatory requirements in light of the limited scope of activities of a funding portal while maintaining investor protection provisions. On October 9, 2015, before the SEC adopted the final rules discussed above, Finra proposed revised funding portal rules that address a number of the comments it received during the comment period. On January 21, 2016, Finra filed amendments to its proposed rules. The Finra rules must be approved by the SEC. The proposed rules are summarised below.

- Rule 100 would subject funding portals and their associated persons to Finra's bylaws.
- Rule 110 would outline the membership application process (MAP), which is based on the NASD's Rule 1010 Series but is abridged. Finra must make a decision on membership within 60 days of the filing of a membership application (Form FP-NMA). Rule 110 would establish five standards for membership: (a) ability to comply with all applicable laws and regulations of the SEC and Finra; (b) contractual arrangements sufficient to initiate operations; (c) supervisory systems that are sufficient; (d) evidence of direct and indirect funding; and (e) a recordkeeping system. Rule 110 also would permit membership interviews to take place by video, streamline the appeals process, and narrow the events involving a change of control of the member that require Finra approval.
- Rule 200 would require funding portals to observe high standards of commercial honour and just and equitable principles of trade. Rule 200(b) would prohibit a portal from effecting any transaction in, or inducing the purchase or sale of, any security by means of, or by aiding or abetting, any manipulative or fraudulent

device. Rule 200(c) tracks Finra Rule 2210 on advertising and requires that funding portal communications be fair and balanced and would prohibit the use of false and misleading statements and statements that predict future performance.

- Rule 300 would require funding portals to: establish written policies and procedures and supervisory systems reasonably designed to achieve compliance with all applicable rules; timely report to Finra the occurrence of a disqualifying effort affecting the member or an associated person; and report current contact information.
- Rule 800 would provide that information about funding portals and associated persons provided to Finra, including information about disqualifying events, will be made public.
- Rule 900 addresses codes of procedure, including the process for eligibility proceedings for a person to remain associated with a portal despite the existence of a statutory disqualification.
- Rule 1200 addresses arbitration procedures for customer and industry disputes.

Appendix A INTERMEDIARY COMPARISON		
	Broker-dealer	**Funding portal**
Regulatory environment	Well-established SEC and Finra rules regarding registration and ongoing obligations.	New SEC and Finra rules regarding registration and ongoing obligations.
Conduct of business	Handling customer funds and securities, making investment recommendations, compensated for sales of securities, etc.	Restrictions on activities traditionally considered to be those activities characteristic of broker-dealer status.
Costs	Significant registration costs, as well as ongoing compliance costs. A broker-dealer may receive transaction-based compensation.	Less burdensome ongoing obligations, thus lower costs involved. Funding portal cannot receive transaction-based compensation.
Availability of crowdfunding exemption	Available for issuers using broker-dealer's platform.	Available for issuers using funding portal's platform.

ENDNOTES

1 SEC Release No. 33-9216 (June 8, 2011).
2 Sustainable Economies Law Center, Petition for Rulemaking, Petition No. 4 -605, *available at* http://www.sec.gov/rules/petitions/2010/petn4-605.pdf.
3 SEC Release No. 33-9470 (October 23, 2013).
4 Finra Regulatory Notice 13-34 (October 2013).

CHAPTER 6

Regulation A+

As we discuss in Chapter 4, most issuers rely on exemptions from registration adopted pursuant to section 4 of the Securities Act to raise capital. There are, however, a number of other exemptions from registration that may be available to issuers. Section 3(b) of the Securities Act authorises the SEC to adopt rules and regulations exempting securities from registration if the SEC finds that registration "is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering…." One of the exemptions that the SEC adopted pursuant to section 3(b) of the Securities Act is Regulation A.[1] Historically, pursuant to Regulation A, issuers that were not SEC-reporting companies were able to raise up to $5 million in offering proceeds through sales of their securities in interstate offerings without complying with the registration requirements of the Securities Act.[2] Regulation A also provided controlling stockholders, as well as non-affiliates, an opportunity to sell their unregistered securities. A Regulation A offering is not a private offering; in fact, a Regulation A offering is often referred to as a mini-registration. Regulation A incorporated a number of conditions that in certain respects resembled the registration requirements of section 5 of the Securities Act. For example, in order for an issuer to avail itself of the exemption, it must: prepare and file with the SEC an offering statement for the SEC's review and approval; deliver the offering statement to prospective investors; and file periodic reports of sales after completion of the offering.

The requirements for the offering statement were not as onerous as those applicable to a section 10 prospectus. However, due to the low offering threshold, and without a corresponding state blue sky exemption for securities offered in Regulation A offerings, prior to the enactment of the JOBS Act, Regulation A did not provide a viable capital raising vehicle for smaller companies, and Rule 506 of Regulation D, which has no offering threshold, became the most commonly used exemption from registration.

Regulation A reform had been considered a number of times over the course of the last few years. However, it was not until 2011 and 2012 that legislative efforts to amend the offering exemption took shape. As discussed below, these legislative proposals, if passed, would have raised the offering threshold and modernised existing Regulation A. Ultimately, however, many of these concepts were incorporated into Title IV of the JOBS Act, titled Small Company Capital Formation. Title IV of the JOBS Act amends section 3(b) of the Securities Act, increasing the dollar threshold for a Regulation A-style offering, but did not actually amend then existing Regulation A.

History of Regulation A and Regulation A reform

Regulation A was enacted during the Great Depression to promote capital formation for small businesses. One of the SEC's primary purposes in adopting Regulation A was to provide a simple and efficient process by which small businesses could raise limited amounts of capital, while ensuring that investors had access to current information. When originally enacted, section 3(b) authorised the SEC to exempt only "small" issues involving offerings of $100,000 or less. Over time, this dollar threshold was adjusted. In 1980, the small issue exemption was increased by Congress to $5 million.[3] The SEC did not actually increase the threshold until 1992, however.[4] In 1992, the US economic downturn[5] provided the necessary backdrop for the SEC to modernise Regulation A in order to promote small business capital formation.[6] Reinvigorating small business was linked to creating job opportunities and spurring economic growth.[7] In July 1992, the SEC adopted a number of small business-related initiatives that included significant amendments to Regulation A.[8] These changes were intended to facilitate "access to the public market for start-up and developing companies and … [to reduce] the costs for small businesses to undertake to have their securities traded in the public markets."[9] The amendments increased the threshold amount to $5 million in any 12-month period, including no more than $1.5 million in non-issuer resales. Also, the amendments permitted issuers to use a simplified disclosure document and to test the waters before preparing the mandated offering circular. The SEC also extended the safe harbour

provisions for forward-looking statements to statements made in a Regulation A offering circular or any written material submitted to the SEC. Finally, the SEC clarified that an issuer would not be precluded from relying on the exemption if it had endeavoured in good faith to comply with the terms, conditions, and requirements of Regulation A. The availability of Regulation A was conditioned upon meeting certain substantive and procedural requirements.[10] The principal requirement related to the dollar size of the offering. If that requirement was met, the issuer was required to file the appropriate forms with the SEC. Failure to comply with either the dollar limit or the filing requirements resulted in the loss of the exemption and a violation of section 5 of the Securities Act.

There had been various efforts to amend Regulation A. Commentators noted that, while over the years the offering threshold had been increased to $5 million, the dollar amount had not kept pace with changes related to capital formation. In 2009, the recommendation to raise the dollar threshold made it into the final report of the SEC's Government-Business Forum on Small Business Capital Formation.[11] Increasing the Regulation A dollar threshold was also discussed at the SEC's Government-Business Forum on Small Business Capital Formation on November 18, 2010.[12]

Statistics demonstrated that the offering threshold of Regulation A was too low and did not align with market realities.[13] In connection with a hearing before the House Committee on Financial Services on December 8, 2010, regarding increasing the Regulation A offering threshold from $5 million to $30 million, William R Hambrecht, chairman and CEO of WR Hambrecht + Co, stated that, "according to public records, since 2005 there have only been 153 Regulation A filings and of those 153, an astoundingly low number of 13 have actually priced."[14] Representative Barney Frank, who chaired the hearing, noted that the proposal to amend Regulation A should not be "a partisan or terribly controversial one." Following the financial crisis, concerns about the availability of capital for smaller, emerging companies intensified, which led, in March 2011, to the introduction of legislation that would have increased the Regulation A offering threshold. On March 14, 2011, Representative David Schweikert introduced in the US House of Representatives the Small Company Capital Formation Act,[15] which was designed to encourage small companies to access the capital markets – allowing them to invest and hire employees.[16] In introducing the proposed legislation, Schweikert, vice-chairman of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, said: "Taking a small business public is an important, but expensive process that requires millions in underwriting costs … Raising the Regulation A threshold to $50 million is one way to lower those costs and promote economic growth and job creation. At a time when so many small businesses are in need of capital, this is a common sense proposal that will make our capital markets more vibrant and competitive."[17]

As discussed in the Introduction, the Small Company Capital Formation Act was part of a broader effort to address US job creation and economic competitiveness and to amend or repeal certain sections of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[18] In connection with the legislative proposal, the House Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing on March 16, 2011 regarding these legislative proposals to promote job creation, capital formation, and market certainty, including the Small Company Capital Formation Act.[19] Industry representatives testified in support of the proposed Regulation A reform,[20] as exemplified by testimony from David Weild, senior adviser of Grant Thornton, who provided an analysis of the devastating decline in numbers of small IPOs, demonstrating that small businesses and entrepreneurs could not access the capital they needed to grow and create jobs.[21] Weild applauded the Small Company Capital Formation Act as the beginning of an initiative to revive the small IPO market. In addition to the cost benefits for small companies, he noted that an increased offering threshold would open up the Regulation A exemption to an offering size that would allow companies to list on the NYSE and NASDAQ, and to avail themselves of the blue sky exemption, thus avoiding very costly state-by-state filings. This legislation would have amended section 3(b) of the Securities Act by requiring the SEC to increase the aggregate offering amount to $50 million for exempt offerings of securities. The legislation also would have amended section 18(b)(4) of the Securities Act by including in the definition of "covered security": rule or regulation adopted pursuant to section 3(b)(2) and such security is —

(i) offered or sold through a broker or dealer;

(ii) offered or sold on a national securities exchange; or

(iii) sold to a qualified purchaser …"[22]

Accordingly, certain Regulation A offerings would have been pre-empted from state blue sky review.[23]

In June 2011, the House Committee on Financial Services approved an amendment to the Small Company Capital Formation Act, which provided that "the Commission *shall* require an issuer to file audited financial

statements with the Commission annually" (our emphasis).[24] Title IV of the JOBS Act incorporates this reporting requirement in the context of the section 3(b)(2) exemption that it references. The legislation was met with strong bipartisan support. In November 2011, the House of Representatives overwhelmingly approved the Small Company Capital Formation Act of 2011 by a vote of 421 to one. Companion legislation was introduced in the Senate in September 2011 by Senators Jon Tester and Pat Toomey. But for a few minor differences, the Senate bill was substantially similar to the Small Company Capital Formation Act. Ultimately, the changes that were contemplated in these bills were incorporated into the JOBS Act, albeit with some modifications.

It is important to note that, throughout the preceding few years, when commentators were considering amending Regulation A to increase the dollar threshold and address state blue sky matters, the proposals had as their underlying premise that smaller issuers that were not SEC-reporting companies would be able to conduct one or more Regulation A offerings and elect either to remain non-reporting issuers, or voluntarily seek to have their securities listed and quoted on a national securities exchange (thereby becoming SEC-reporting companies) and use Regulation A as an alternative to a traditional IPO. The notion of an IPO on-ramp, or scaled approach to IPOs for emerging growth companies, had not yet been proposed.

Title IV of the JOBS Act

As noted above, Title IV of the JOBS Act does not amend existing Regulation A. Instead, section 401 of the JOBS Act amends section 3(b) of the Securities Act by adopting a new section (b).

Pursuant to the new section 3(b)(2), the SEC is authorised to promulgate rules or regulations creating an exemption that is substantially similar to the existing Regulation A. An issuer would be able to offer and sell up to $50 million in securities within a 12-month period in reliance on the exemption. The issuer may offer equity securities, debt securities, and debt securities convertible or exchangeable for equity interests, including any guarantees of such securities. The securities sold pursuant to the exemption will be offered and sold publicly (without restrictions on the use of general solicitation or general advertising) and will not be considered "restricted securities." The issuer may test the waters or solicit interest in the offering before filing any offering statement with the SEC, subject to any additional conditions or requirements that may be imposed by the SEC. The civil liability provision in section 12(a)(2) of the Securities Acts applies to any person offering or selling such securities.

The securities will be considered "covered securities" for purposes of the National Securities Market Improvement Act of 1996 (Nsmia), (and not subject to state securities review,) if: the securities are offered and sold on a national securities exchange; or the securities are offered or sold to a "qualified purchaser" as defined under the Securities Act.[25] These provisions are more limited than those originally contained in the standalone Regulation A legislation. During consideration of the Regulation A legislation, it became clear that perhaps the only significant source of controversy regarding modernising Regulation A related to state blue sky qualification. State securities regulators, through the North American Securities Administrators Association (Nasaa), expressed concerns about the potential for fraud and abuse related to offerings for small companies, including offerings completed pursuant to Regulation A. Nasaa opposed certain aspects of the proposals to modernise the regulation of these offerings that would involve broader state blue sky pre-emption.[26]

The SEC will require that the issuer file audited financial statements with the SEC annually. The SEC may impose other terms, conditions, or requirements deemed necessary for investor protection, including a requirement that the issuer prepare and file electronically with the SEC and distribute to prospective investors an offering statement and any related documents, including a description of the issuer's business and financial condition, its corporate governance principles, the intended uses of proceeds, and other appropriate matters. The SEC also may require an issuer that relies on the exemption to make available to investors and file with the SEC periodic disclosures. The bad actor disqualification provisions applicable for the exemption shall be substantially similar to the disqualification provisions contained in the regulations adopted pursuant to section 926 of the Dodd-Frank Act (which looks to the bad actor disqualification provisions in current Regulation A).

Not later than two years after enactment and every two years thereafter, the SEC shall review the offering threshold and report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on its reasons for not increasing the dollar amount.

Required study on blue sky laws

Section 402 of the JOBS Act requires that the Comptroller General must conduct a study of the impact of state blue sky laws on offerings made under Regulation A. Within three months of enactment of the Act, the Comptroller

General must deliver the report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate. The study titled "Factors that May Affect Trends in Regulation A Offerings" was delivered in July 2012.[27] The study notes that there are a number of factors that contributed to the lack of utility of the Regulation A exemption, and highlighted the time and expense associated with state blue sky compliance. The study concluded that without pre-emption of the state blue sky requirements, Regulation D would continue to be used in favour of Regulation A.

Proposed rules

On December 18, 2013, the SEC proposed rules to carry out the rulemaking mandate of Title IV of the JOBS Act. The proposed rules both retained and modernised the framework of current Regulation A by expanding it into two tiers based on offering amount. Generally, the proposed rules were well received and commentators focused principally on some of the financial statement and ongoing reporting requirements. In addition, the SEC's proposed rules fueled a debate among regulators, market participants, and commentators regarding the pre-emption of state blue sky requirements for Tier 2 Regulation A offerings, and whether such pre-emption would hurt investors or is necessary to ensure the widespread use of the offering exemption. On one side, commentators expressed concern that for Regulation A to be a workable exemption, it must attract issuers that might otherwise choose more opaque exemptions for their capital raising needs. This may include Rule 506 offerings to accredited investors where there are no disclosure requirements, no investment limits, and no ongoing reporting obligations. In contrast, Tier 2 Regulation A offerings provide enhanced investor protections.[28] Furthermore, even with coordinated state review, an issuer faced with a range of capital raising alternatives would not choose a Tier 2 Regulation A offering if state review were necessary.[29] On the other hand, consumer protection advocates noted that without state review of Tier 2 Regulation A offerings, investors will lose an important safeguard. In addition, Nasaa and certain other commentators asserted that such pre-emption arguably contravened the intent of Congress to have section 3(b)(2) apply to qualified purchasers (defined on the basis of sophistication and financial wherewithal and not simply the type of transaction being conducted) and securities offered and sold on a national securities exchange (which are already exempt from blue sky laws).[30] The comment period on the proposed rules closed on March 24, 2014.

Final rules

On March 25, 2015, the SEC voted unanimously to adopt final rules to implement the rulemaking mandate of Title IV of the JOBS Act by adopting amendments to Regulation A. The final rules provide an exemption for US and Canadian companies that are not required to file reports under the Exchange Act to raise up to $50 million in a 12-month period. The final rules create two tiers: Tier 1 for smaller offerings raising up to $20 million in any 12-month period; and Tier 2 for offerings raising up to $50 million. The rules also make the exemption available, subject to limitations on the amount, for the sale of securities by existing stockholders. The rules modernise the existing framework under Regulation A by, among other things, requiring that disclosure documents be filed on EDGAR, allowing an issuer to make a confidential submission with the SEC, permitting certain test-the-waters communications, and disqualifying bad actors. The final rules impose different disclosure requirements for Tier 1 and Tier 2 offerings, with more disclosure required for Tier 2 offerings, including audited financial statements. Tier 1 offerings will be subject to both SEC and state blue sky pre-sale review. Tier 2 offerings are subject to SEC, but not state blue sky pre-sale review; however, investors in Tier 2 offerings are subject to investment limits (except when securities are sold to accredited investors or are listed on a national securities exchange) and Tier 2 issuers are required to comply with periodic filing requirements, which include a requirement to file current reports upon the occurrence of certain events, semi-annual reports and annual reports. The final rules also provide a means for an issuer in a Tier 2 offering to concurrently list a class of securities on a national exchange through a short-form Form 8-A, without requiring the filing of a separate registration statement on Form 10. The final rules became effective on June 19, 2015.

Eligible issuers

Regulation A is available to issuers organised in and having their principal place of business in the United States or Canada. Certain issuers are "ineligible" to offer or sell securities under Regulation A, including: an issuer that is an SEC-reporting company; a blank check company; any investment company registered or required to be registered under the Investment Company Act (this includes business development companies); and any entity issuing fractional undivided interests in oil or gas rights, or similar interests in other mineral rights. The exemption also is not available to: issuers that have not filed with the SEC the ongoing reports required by Regulation A during the two years immediately preceding the filing of a new offering

statement; issuers that have had their registration revoked pursuant to an Exchange Act section 12(j) order that was entered into within five years before the filing of the offering statement; and certain bad actors.

Eligible securities
The securities that may be offered under Regulation A are limited to equity securities including warrants, debt securities, and debt securities convertible into or exchangeable into equity interests, including any guarantees of such securities. The final rule excludes asset-backed securities.

Offering limitations
As noted above, an issuer can choose a Tier 1 or a Tier 2 offering. Under Tier 1, an issuer may offer and sell up to $20 million in a 12-month period, of which up to $6 million may constitute secondary sales (except as noted below). Under Tier 2, an issuer may offer and sell up to $50 million in a 12-month period, of which up to $15 million may constitute secondary sales (except as noted below). In the issuer's initial Regulation A offering and any subsequent Regulation A offering in the following 12 months, the selling securityholder component cannot exceed 30% of the aggregate offering. In addition, the final rules distinguish between sales by affiliates and sales by non-affiliates. Following the expiration of the first year following an issuer's initial qualification of a Regulation A offering statement, the limit on secondary sales falls away for non-affiliates only.

Investment limitation
To address potential investor protection concerns, the final rules impose an investment limit for Tier 2 offerings. The investment limit does not apply to accredited investors and does not apply if the securities are to be listed on a national securities exchange at the consummation of the offering; otherwise a non-accredited natural person is subject to an investment limit and must limit purchases to no more than 10% of the greater of the investor's annual income and net worth, determined as provided in Rule 501 of Regulation D (for non-accredited, non-natural persons, the 10% limit is based on annual revenues and net assets).

Integration of offerings
A Regulation A offering will not be integrated with (1) prior offers or sales of securities, or (2) subsequent offers or sales of securities that are: registered under the Securities Act, except as provided in Rule 255(e); made in reliance on Rule 701; made pursuant to an employee benefit plan; made in reliance on Regulation S; made pursuant to section 4(a)(6) of the Securities Act (ie, crowdfunded offerings); or made more than six months after the completion of the Regulation A offering. The final rule also addresses abandoned offerings in much the same way that these are handled by Rule 155, with a 30-day cooling off period. The SEC also reaffirmed guidance that was included in the proposing release, which is consistent with the guidance regarding integration provided in SEC Release No. 33-8828 (August 3, 2007).

Exchange Act threshold
The final rule provides a limited exemption for securities issued in a Tier 2 offering from the section 12(g) "holder of record" threshold where the issuer is subject to, and current in its, Regulation A periodic reporting obligations. In order to benefit from this conditional exemption, an issuer must retain the services of a transfer agent and meet requirements similar to those in the "smaller reporting company" definition (public float of less than $75 million or, in the absence of a public float, revenues of less than $50 million, in the most recently completed fiscal year). An issuer that exceeds the section 12(g) threshold will have a two-year transition period.

Filing and delivery requirements
Regulation A offering statements must be filed on EDGAR. Form 1-A has been amended to consist of three parts: Part I, which will be an XML-based fillable form with basic issuer information; Part II, which will be a text file that will contain the disclosure document and financial statements; and Part III, which will be a text file that will contain exhibits and related materials. Periodic reports and any other documents required to be submitted to the SEC in connection with a Regulation A offering must be filed on EDGAR. The final rules adopt an access equals delivery model for Regulation A final offering statements. In the case where a preliminary offering statement is used to offer securities to potential investors and the issuer is not already subject to the Tier 2 periodic reporting requirements, an issuer and participating broker-dealer will be required to deliver the preliminary offering statement to prospective purchasers at least 48 hours in advance of sales.

Non-public review
An issuer may submit an offering statement for non-public review by the SEC. Consistent with the original Title I on-ramp provision available for EGCs, should an issuer opt for confidential review, the offering statement must be filed publicly not less than 21 calendar days before qualification of the offering statement. The timing, in the case of a Regulation A offering, is not tied to an issuer's

road show, but rather to the qualification of the offering statement.

Form 1-A

An issuer that seeks to rely on Regulation A must file and qualify an offering statement. The offering statement is intended to be a disclosure document that provides potential investors with information that will form the basis for their investment decision. A notice of "qualification" is similar to a notice of effectiveness in an SEC-registered offering. Part I of the offering statement requires certain basic information regarding the issuer, its eligibility, the offering details, the jurisdictions where the securities will be offered, and sales of unregistered securities. Part II contains the narrative portion of the offering statement and requires: disclosures of basic information about the issuer; material risks; use of proceeds; an overview of the issuer's business; an MD&A type discussion; disclosures about executive officers and directors and compensation; beneficial ownership information; related party transactions; and a description of the offered securities. This is similar to Part I of Form S-1, and an issuer can choose to comply with Part I of Form S-1 in connection with its offering statement. However, the disclosure requirements of Form 1-A are scaled.

Tier 1 and Tier 2 issuers must file balance sheets and other required financial statements as of the two most recently completed fiscal year ends (or for such shorter time as they have been in existence). US issuers are required to prepare financial statements in accordance with US GAAP. Canadian issuers may use US GAAP or IFRS as adopted by the IASB. As with EGCs, an issuer may elect to delay implementation of new accounting standards to the extent such standard permit delayed implementation by non-public business entities. The election is a one-time election and must be disclosed.

The financial statements for an issuer in a Tier 1 offering are not required to be audited. However, if a Tier 1 issuer already obtained an audit of its financial statement for other purposes and such audit was performed in accordance with US GAAS or the PCAOB standards and the auditors meet the independence standards, then the audited financial statements must be filed.

The financial statements for an issuer in a Tier 2 offering are required to be audited. The audit firm must satisfy the independence standard, but need not be PCAOB-registered. The financial statements may be audited in accordance with either US GAAS or PCAOB standards. An issuer in a Tier 2 offering that seeks to have a class of securities listed on a national securities exchange concurrent with the Regulation A offering must include financial statements prepared in accordance with PCAOB standards by a PCAOB-registered firm.

Continuous offerings

The final rule continues to permit continuous or delayed offerings in certain instances, such as: securities offered or sold on behalf of selling security holders; securities offered under employee benefit plans; securities pledged as collateral; securities issued upon conversion of other outstanding securities or upon the exercise of options, warrants, or rights, etc.; and securities that are part of an offering that commences within two calendar days after the qualification date, will be offered on an continuous basis, may continue to be offered for a period in excess of 30 days from the date of initial qualification, and will be offered in an amount that, at the time the offering statement is qualified, is reasonably expected to be offered and sold within a period of two years from the initial qualification date. The offerings permitted under Regulation A are limited in the same manner as under Rule 415 under the Securities Act; as such, delayed offerings would not be permitted under Regulation A.

Offering communications

An issuer engaged in a Regulation A offering has substantial flexibility regarding offering communications. An issuer must file solicitation materials with the SEC. Solicitation materials used after an offering statement is filed must be accompanied by the offering circular or include a link to the offering statement. Solicitation materials will be subject to certain legends.

Ongoing reporting requirements

The final rules impose new ongoing reporting obligations for certain offerings. Tier 1 issuers will be required to provide certain information about their Regulation A offerings on a new form, Form 1-Z. Issuers in Tier 2 offerings will be subject to an ongoing reporting regime. Similar to the ongoing reporting regime that the SEC proposed in connection with issuers that conduct crowdfunded offerings, Tier 2 issuers would be required to file:

- annual reports on Form 1-K;
- semi-annual reports on Form 1-SA;
- current reports on Form 1-U;
- special financial reports on Form 1-K and Form 1-SA; and
- exit reports on Form 1-Z.

Form 1-K requires: disclosures relating to the issuer's business and operations for the preceding three fiscal years (or since inception if in existence for less than three years),

related party transactions, beneficial ownership, executive officers and directors, and executive compensation; MD&A; and, two years of audited financial statements. Form 1-K is required to be filed within 120 calendar days of the issuer's fiscal year-end. The semi-annual report on Form 1-SA is similar to a Form 10-Q, although it would be subject to scaled disclosure requirements. Form 1-SA is required to be filed within 90 days after the end of the first six months of the issuer's fiscal year-end, commencing immediately following the most recent fiscal year for which full financial statements were included in the offering statement or, if the offering statement included six-month interim financial statements for the most recent full fiscal year, then for the first six months of the following fiscal year. A current report on Form 1-U is required to announce: fundamental changes in the issuer's business; entry into bankruptcy or receivership proceedings; material modifications to the rights of securityholders; changes in accountants; non-reliance on audited financial statements; changes in control; changes in key executive officers; and sales of 10% or more of outstanding equity securities in exempt offerings. Form 1-U must be filed within four business days of the triggering event. An exit report on Form 1-Z is required to be filed within 30 days after the termination or completion of a Regulation A offering.

Rule 15c2-11, Rule 144, and Rule 144A

A Tier 2 issuer's periodic reports will satisfy Exchange Act Rule 15c2-11 broker-dealer requirements relating to the obligation to review information about an issuer in connection with publishing quotations on any facility other than a national securities exchange. However, contrary to commenters' requests, the final rule does not establish that these reports would constitute "current information" for purposes of Rule 144 and Rule 144A under the Securities Act. A Tier 2 issuer that voluntarily submits quarterly information in a form consistent with that required for semi-annual information would be able to satisfy the "reasonably current information" and "adequate current public information" requirements.

Tier 2 offering with concurrent Exchange Act registration

The final rules facilitate the ability of a Tier 2 issuer to voluntarily register a class of Regulation A securities under the Exchange Act. In the absence of the relief provided in the final rules, an issuer that completed a Regulation A offering and sought to list a class of securities on a national securities exchange would have had to incur the costs and the timing delays associated with preparing and filing a separate registration statement on Form 10. The final rule permits a Tier 2 issuer that has provided disclosure in Part II of Form 1-A that follows Part 1 of Form S-1 (or for Reits, Form S-11) to file a Form 8-A to list its securities on a national securities exchange. Of course, thereafter, the issuer would be subject to Exchange Act reporting requirements. An issuer that enters the Exchange Act reporting regime in this manner will be an EGC.

Termination or suspension of Tier 2 disclosure obligations

Tier 2 issuers are permitted to terminate or suspend their ongoing reporting obligations on a basis similar to the provisions for suspension or termination of reporting requirements for SEC-reporting companies. A Tier 2 issuer that has filed all required ongoing reports for the shorter of (1) the period since the issuer became subject to such reporting obligations or (2) its most recent three fiscal years and the portion of the current year preceding the date of filing Form 1-Z (termination or exit form) will be permitted to suspend its reporting obligations at any time after completing reporting for the fiscal year in which the offering statement was qualified. This suspension will be permitted if the securities of each class to which the offering statement relates are held of record by fewer than 300 persons and offers or sales made in reliance on a qualified offering statement are not ongoing. Further, the Regulation A ongoing reporting requirements would be automatically suspended if an issuer registers a class of securities under section 12 of the Exchange Act.

Bad actor disqualification provisions

The final rule includes bad actor disqualification provisions that are largely consistent with those included in Rule 506(d) of Regulation D.

State securities law requirements

As discussed above, one of the most significant concerns regarding the use of the Regulation A exemption has been the requirement to comply with state securities or blue sky laws. At the time the new rules were proposed, there was no coordinated review process by the states for Regulation A offerings. Although Nasaa has introduced a coordinated review process for Regulation A offerings, the SEC noted that the coordinated review process is relatively new and it remains largely untested. The final rules provide that Tier 1 offerings will remain subject to state securities law requirements. Consistent with the proposed rules, Tier 2 offerings will not be subject to state review if the securities are sold to "qualified purchasers" or, as provided by statute in the JOBS Act, listed on a national securities exchange.

The final rule defines the term "qualified purchaser" in a Regulation A offering to include all offerees and purchasers in a Tier 2 offering. States will, of course, continue to have authority to require filing of offering materials and enforce anti-fraud provisions in connection with a Tier 2 offering.

Securities Act liability

Sellers of Regulation A securities would have liability under section 12(a)(2) of the Securities Act in respect of offers or sales made by means of an offering statement or oral communications that include a material misleading statement or omission. While an exempt offering pursuant to Regulation A is excluded from the operation of section 11 of the Securities Act, those offerings are subject to the anti-fraud provisions under the federal securities laws.

Character of the securities sold in a Regulation A offering

The securities sold in a Regulation A offering are not considered "restricted securities" under Securities Act Rule 144. As a result, sales of the securities by persons who are not affiliates of the issuer would not be subject to any transfer restrictions under Rule 144. Affiliates, of course, would continue to be subject to the limitations of Rule 144, other than the holding period requirement. This is important to an issuer that would like an active trading market to develop for its securities following completion of a Regulation A offering. However, the issuer's securities may not be listed or quoted on a national securities exchange without registration under section 12 of the Exchange Act, and, as a result, there may not be a liquid market for the securities.

Finra review

For any public offering of securities, Finra Rule 5110 prohibits Finra members and their associated persons from participating in any manner unless they comply with the filing requirements of the rule.[31] Finra Rule 5110 also contains rules regarding underwriting compensation. Rule 5110(b) requires that certain documents and information be filed with and reviewed by Finra, and these filing and review requirements apply to securities offered under Regulation A.[32] In September 2015, Finra issued Notice to Members 15-32 providing guidance regarding the Finra filing requirements and review process for Regulation A offerings.

Considerations in conducting a Regulation A offering

Advantages

An exempt offering, including, for example, a Regulation D offering, is subject to several limitations, and a registered public offering may be too time-consuming and costly for an issuer. Using Regulation A to offer securities may provide an issuer with an offering format that is similar to a registered offering, but is more efficient. While there are many similarities between an offering statement and a prospectus, the preparation of an offering statement is generally simpler. An offering statement is less detailed than a prospectus for a registered offering. As a result, it is typically less costly for an issuer to conduct a Regulation A offering. The costs associated with external advisers, such as counsel and auditors, also will be lower in connection with a Regulation A offering. Also, management time devoted to the preparation of the offering statement will be less.[33] The review process undertaken by SEC staff may be somewhat shorter than the review and comment process in connection with a full registration. A registration statement on Form S-1 would always be subject to complete review by the SEC staff in connection with an issuer's initial public offering. Timing is often the most important determinant of success for an offering. Inability to initiate an offering during a favourable market window may result in the issuer not being able to conduct an offering at all. Regulation A may provide flexibility to the issuer in this respect.

No limitation on offerees

Regulation A does not impose any limitations on offerees. In contrast to Rules 505 and 506 of Regulation D, Regulation A does not limit the number of offerees or investors that can participate in an offering, nor does it impose any requirement that offerees be accredited or sophisticated investors.

Nature of securities

Securities offered and sold pursuant to Regulation A are offered publicly and are not "restricted securities." The securities may be traded in the secondary market (assuming that there is a secondary market) after the offering. As a practical matter, the securities likely will trade in the over-the-counter (OTC) market unless the issuer has taken steps to list the class of securities on an exchange. No holding period applies to the holder of securities purchased in a Regulation A offering. Because an issuer may remain a non-reporting company after completion of a Regulation A offering, there may not be an active secondary market. If a smaller company chooses to list a class of securities on a major exchange, it will become subject to Exchange Act reporting.[34] Certain institutional investors have limitations on the amount that they may invest in "restricted securities." These restrictions generally would not apply to investments in securities issued pursuant to Regulation A.

Testing the waters, advertising, and general solicitation
The ability to test the waters in connection with a Regulation A offering may make a Regulation A offering more appealing (if the dollar threshold is increased) than a Regulation D offering, even with the relaxation of the prohibition on general solicitation for certain offerings made pursuant to Rule 506 of Regulation D.

Disadvantages
Dollar threshold
Although there are many significant benefits associated with a Regulation A offering, the $50 million threshold undermines the benefits and reduces the utility of the exemption when compared to Rule 506.[35] Often, an issuer will look to engage an underwriter to assist with structuring and marketing the offering. Similar to a registered offering, the underwriting effort may be on a best-efforts or a firm commitment basis. The recent history of Regulation A shows that it is unlikely that a large well-established broker dealer will underwrite a Regulation A offering. With the current offering threshold of $50 million, participating in a Regulation A offering may not provide most broker-dealers with sufficient financial incentive.

Requirement of state registration
Offerings made pursuant to Tier 1 of Regulation A must satisfy state blue sky laws in each state where the offering is to take place. An offering likely will trigger a merit review in those states that are merit review states (unless waivers can be obtained), which may cause delays in qualifying Regulation A offerings. By comparison, offerings of securities listed on major exchanges (NASDAQ and NYSE) have been exempt from state review since 1996 pursuant to the Nsmia.[36] Similarly, securities offered pursuant to Rule 506 of Regulation D are exempt from state securities registration requirements.[37]

Considering the alternatives
Many clients have asked us why an issuer might choose to rely on Regulation A if the issuer could rely on Rule 506 of Regulation D. An exempt offering, including, for example, a Regulation D offering, may still be subject to several limitations that may not be appealing to an issuer, and a registered public offering may still be too time-consuming and costly. Using the new Regulation A to offer securities can provide an issuer with an offering format that is similar to a registered offering with certain accompanying advantages. It might be especially appealing for an issuer to consider this type of offering as a precursor to an IPO. An issuer will be required to prepare and furnish certain offering disclosures in connection with a Regulation A offering, while there are no information requirements associated with a Rule 506 offering. In practice, however, most issuers will prepare some disclosure materials to share with prospective investors, even in a Rule 506 offering. An issuer may want to preserve the opportunity to approach investors that are not accredited, and may do so in connection with a Regulation A offering.

A non-reporting company may choose to undertake a Regulation A offering or a Regulation D offering and remain below the shareholder threshold for required Exchange Act reporting. If it were to do so, a market for its securities may or may not develop. A non-reporting company that undertakes a Regulation A offering may also use the offering as an IPO.

Further guidance on Regulation A
Shortly following the effective date of the final rules, the SEC published a Small Entity Compliance Guide to provide market participants with an overview of the regulation. The staff of the SEC also published C&DIs on various aspects of the regulation. Among other things, these C&DIs noted that Regulation A could be applied in the context of merger transactions involving stock consideration. In July 2015, the SEC's Office of Investor Education and Advocacy issued an Investor Bulletin that highlights the differences from an investor's perspective between a Tier 1 and a Tier 2 offering, including the disclosure and ongoing reporting requirements and the investment limitation for Tier 2 offerings.

Regulation A litigation
The states of Montana and Massachusetts filed litigation challenging the SEC's definition of "qualified purchaser" in the context of Tier 2 Regulation A offerings. The states contend that the legislative history of Nsmia suggests that state pre-emption was intended to be limited to qualified purchasers, which were understood to be investors with certain levels of wealth, income, and financial sophistication. The states allege that the SEC exceeded its authority by pre-empting state regulation of Tier 2 offerings. As of the date of this writing, the litigation is proceeding, but the litigation has not interrupted or deterred issuers from undertaking Regulation A offerings in reliance on the final rules.

ENDNOTES

1 Securities Act Release No. 66, 1933 WL 28878 (November 1, 1933).

2 Regulation A consists of Rules 251 through 263. 17 CFR sections 230.251–.263, hereinafter cited by rule number.

3 *See* Pub. L. No. 96-477, section 301, 94 Stat. 2275, 2291 (1980).

4 *See* Small Business Initiatives, Securities Act Release No. 6949, 1992 WL 188930 (July 30, 1992).

5 President Bush announced: "[the] goal . . . is to . . . eliminate or revise those [securities laws] that clearly impose costs that exceed their benefits, and [to] ensure that other regulations are implemented in a cost-effective manner." Council of Economic Advisers, *The Annual Report of the Council of Economic Advisers, in* Economic Report of the President, 191 (1992).

6 The SEC highlighted in the proposing release the decline in the number of small business IPOs between 1986 and 1991 as well as the declining number of Regulation A filings between 1981 and 1991. *See* Securities Act Release No. 6,924, 1992 WL 52840 (March 11, 1992) ("Since 1986, equity IPOs have declined each year until the turnaround in 1991. Forty-four Regulation A financings were filed in FY 1991 with the Commission, representing financings of $41.5 million, in contrast with 439 filings covering financings of $408 million in FY 1981.").

7 *See id.* ("Small businesses are the cornerstone of the U.S. economy. The approximately 20 million small businesses in the United States employ more than half of the domestic labor force, produce nearly half of the gross domestic product and created the vast preponderance of new jobs during the period from 1988 through 1990.").

8 *See* Small Business Initiatives, Securities Act Release No. 6949, 1992 WL 188930 (July 30, 1992).

9 *See id.* at *2.

10 *See generally* Rules 251–63. 17 CFR sections 230.251–.263.

11 *See* 2009 Annual SEC Government-Business Forum on Small Business Capital Formation 17 (2009).

12 *See* 29th Annual SEC Government-Business Forum on Small Business Capital Formation, Record of Proceedings (November 18, 2010) (statement of David Hirschmann, President and CEO of the Center for Capital Markets Competitiveness at the US Chamber of Commerce).

13 *See* Statement of William R. Hambrecht, Chairman & Chief Exec. Officer, WR Hambrecht + Co.) ("According to public records, since 2005 there have only been 153 Reg A filings and of those 153, an astoundingly low number of 13 have actually priced.").

14 *See* A Proposal to Increase the Offering Limit Under SEC Regulation A: Hearing Before the H. Comm. on Fin. Servs., 111th Cong. 32 (2010) (prepared statement of William R. Hambrecht, Chairman & Chief Exec. Officer, WR Hambrecht + Co.).

15 *See* Small Company Capital Formation Act of 2011, HR 1070, 112th Cong. (1st Sess. 2011).

16 *See* Press Release, Fin. Servs. Comm., Administration Could Help Small Business Gain Access to Capital by Helping Pass the Small Company Capital Formation Act (March 22, 2011), *available at* http://archives.financialservices.house.gov/press/PRArticle.aspx?NewsID=1817.

17 *See* press release issued by the House Financial Services Committee, *available at* http://archives.financialservices.house.gov/press/PRArticle.aspx?NewsID=1817.

18 Pub. L. No. 111-203, 124 Stat. 1376 (21 July 2010) [hereinafter Dodd-Frank].

19 *See* Press Release, Fin. Servs. Comm., Administration Could Help Small Business Gain Access to Capital by Helping Pass the Small Company Capital Formation Act (March 22, 2011), *available at* http://archives.financialservices.house.gov/press/PRArticle.aspx?NewsID=1817.

20 *See generally* Legislative Proposals to Promote Job Creation, Capital Formation, and Market Certainty Before the Subcomm. on Capital Markets and Gov. Sponsored Enterprise of the H. Comm. on Fin. Servs., 112 Cong. 24 (2011).

21 Legislative Proposals to Promote Job Creation, Capital Formation, and Market Certainty Before the Subcomm. on Capital Markets and Gov. Sponsored Enterprise of the H. Comm. on Fin. Servs., 112 Cong. 24 (2011) (prepared statement of David Weild, Senior Advisor, Grant Thornton LLP).

22 *See* Amendment in the nature of a substitute to HR 1070 offered by Mr. Schweikert, no. 1, *available at* http://financialservices.house.gov/uploadedfiles/062211hr1070schweikertam.pdf.

23 As originally proposed, the legislation did not provide for a state blue sky law exemption.

24 Amendment to the Amendment in the Nature of a Substitute to HR 1070 Offered by Mr. Ackerman, no. 1a (emphasis added), *available at* http://financialservices.house.gov/uploadedfiles/062211hr1070ackermanam.pdf. As originally proposed, the legislation provided that the SEC *may* require an issuer to file audited financial statements with the SEC and distribute such statements to prospective investors.

25 National Securities Market Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3435 (October 11, 1996). NSMIA pre-empts state qualification and registration requirements for "covered securities," which includes issuer offerings of securities listed on NASDAQ or the NYSE and securities exempt from registration under federal securities law, including pursuant to rules promulgated under section4(a)(2) of the Securities Act. Currently, there is no definition under the Securities Act of a "qualified purchaser." The SEC would be required to adopt a definition.

26 *See* Letter from David S. Massey, North Carolina Deputy Securities Administrator, NASAA President, to Spencer H. Bachus, Chair., House Financial Services Committee, *et al.* (June 15, 2011), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/6-15-11-NASAA_Comment_Letter_HR1070_HR1082.pdf.

27 *See* study, *available at* http://www.gao.gov/assets/600/592113.pdf.

28 *See* speech of Commissioner Luis A. Aguilar titled "NASAA and the SEC: Presenting a United Front to Protect Investors" (April 8, 2014), *available at* https://www.sec.gov/News/Speech/Detail/Speech/1370541436767.

29 Tier 2 Regulation A offerings also are unlikely to be "local" in nature and Statements of Policy applied by state regulators have not been updated in a meaningful way, may slow down the offering process without providing meaningful investor protections, and are inconsistent with practices in "public offerings," which Tier 2 Regulation A offerings are more similar to than private placements. For example, many states require that each investor in their state sign a subscription agreement, which is not used in a registered offering that clears and settles through The Depository Trust Company (DTC) and is sold by a broker-dealer. A recent state review also triggered comments from examiners inquiring about the rules of DTC and requested more information about Cede & Co, DTC's nominee, as well as about the officers, directors, and purpose/role of Cede & Co.

30 *See* letter from William F. Galvin, Secretary of the Commonwealth of Massachusetts, to the SEC (December 18, 2013), *available at* https://www.sec.gov/comments/s7-11-13/s71113-1.pdf.

31 *See* FINRA Rule 5110.

32 *See* NASD Notice to Members 92-28 (May 1992); *see also* NASD Notice to Members 86-27 (April 1986).

33 The SEC has emphasised this advantage in the past. *See, e.g.*, Securities Act Release No. 5977, 1978 WL 196028, at *2 (September 11, 1978).

34 An issuer may choose to prepare and file a Form 10 to register one or more classes of securities under section 12 of the Exchange Act with the SEC.

35 *See* A Proposal to Increase the Offering Limit Under SEC Regulation A: Hearing Before the H. Comm. on Fin. Servs., 111th Cong. 10 (2010) (statement of Michael Lempres, Asst. Gen. Counsel, SVB Financial Group) ("The impetus behind the creation of regulation A was very good one. Unfortunately, in recent years, as you've been hearing, regulation A has not proved to be a useful capital raising vehicle for small issuers. It was used only a total of 78 times during the 10-year period between 1995 and 2004. An average of eight filings a year with the maximum amount of $5 million each really proves the irrelevance of regulation A in today's economy. It's simply not a viable vehicle as currently structured.").

36 *See* supra note 25.

37 Rules 504 and 505 of Regulation D were promulgated under section 3(b) of the Securities Act and do not pre-empt state securities law requirements. However, most states have adopted changes to their state securities laws that essentially duplicate the provisions of Regulation D.

CHAPTER 7

Exchange Act registration thresholds

Before the enactment of the JOBS Act, Exchange Act section 12(g) required registration of a class of an issuer's equity securities if, as of the last day of the issuer's fiscal year, the issuer had more than $10 million in assets and the class of equity securities was held of record by 500 or more persons.[1] Once these thresholds were crossed, an issuer would have to register the class of equity securities within 120 days of the end of the fiscal year, and then begin filing current and periodic reports with the SEC.[2] The definition of "held of record" for these purposes counts as holders of record only persons identified as owners on records of security holders maintained by the company, or on its behalf, in accordance with accepted practice. An issuer could only deregister a class of equity securities under section 12(g) when such class of equity securities is held of record by fewer than 300 persons, or by fewer than 500 persons and the total assets of the issuer has not exceeded $10 million on the last day of each of the issuer's three most recent fiscal years. Exchange Act section 12(g) was originally enacted out of concern that issuers who were not listed on a national securities exchange could nonetheless be widely held and traded over the counter, and therefore disclosure should be available to investors in such issuers through SEC registration and reporting.

Leading up to the JOBS Act changes to the Exchange Act registration/deregistration thresholds, concerns were raised about the fact that the 500-person held of record threshold had not been revisited since 1964. These concerns focused on the fact that issuers sometimes had to go public sooner than they might have otherwise by virtue of the mandatory registration provisions in section 12(g), and the possibility of SEC registration and reporting could serve to discourage private companies from raising capital and using equity awards to compensate employees. At the same time, concerns were expressed about issuers going dark and ceasing their SEC reporting by bringing the number of holders of record below the deregistration threshold. As a result of these concerns, a variety of proposals were advanced relating to possible amendments to section 12(g) registration thresholds. Some of these proposals sought to reduce the number of issuers required to report pursuant to the Exchange Act, for example, by raising the shareholder threshold,[3] by excluding employees or by excluding accredited investors, QIBs or other sophisticated investors from the calculation.[4] The SEC also received a rulemaking petition requesting that the SEC revise the "held of record" definition to look through record holders to the underlying beneficial owners of securities in order to prevent issuers from ceasing to report in certain circumstances.[5] Before April 5, 2012, the SEC was conducting a comprehensive study of these issues and was actively considering the various proposals.

Raising the registration and deregistration thresholds in Titles V and VI

As amended by Titles V and VI, Exchange Act section 12(g) now requires registration of a class of equity securities if, at the end of its fiscal year, an issuer has at least $10 million in assets and a class of equity securities held of record by either 2,000 persons, or 500 persons who are not accredited investors. Banks[6] and bank holding companies[7] are not required to register unless they have, at the end of the fiscal year, at least $10 million in assets and a class of equity securities held of record by 2,000 or more persons. The FAST Act further amended Exchange Act section 12(g) so that savings and loan holding companies are treated similarly to banks and bank holding companies. Under Exchange Act section 12(g)(4) before the enactment of the JOBS Act, an issuer could deregister a class of equity securities when either the issuer had $10 million or less in assets and the class of equity securities was held by fewer than 500 holders of record, or the class of equity securities was held by fewer than 300 holders of record. The JOBS Act increased the 300-persons held of record threshold in Exchange Act section 12(g)(4) only with respect to banks and bank holding companies, raising that threshold from 300 to 1,200 persons. The JOBS Act did not increase the 300-persons held of record threshold for deregistration for issuers that are not banks, bank holding companies, or savings and loan holding companies.

Under the JOBS Act, Exchange Act section 12(g)(5) was amended to provide that the term "held of record" does not include "securities 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 Securities Act." The SEC is directed to amend its Rule

12g5-1 definition of "held of record" to reflect this amendment to the statute. The SEC also is directed to adopt safe harbour rules for issuers to follow in 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 of 1933," and securities sold in exempt crowdfunding offerings will also not be included in determining whether registration is required under section 12(g).

On April 11, 2012, the Division of Corporation Finance issued "Frequently Asked Questions on Changes to the Requirements for Exchange Act Registration and Deregistration," which confirmed that the Title V and Title VI provisions raising the Exchange Act registration/deregistration thresholds were, for the most part, immediately effective, thereby providing issuers with the ability to avoid registration in 2012 and going forward and, specifically with regard to bank holding companies, to terminate their registration/reporting obligation.[8]

In Frequently Asked Question 4, the SEC noted that if a bank holding company with a class of equity securities held of record by fewer than 1,200 persons as of the first day of the current fiscal year has a registration statement that is updated during the current fiscal year pursuant to Securities Act section 10(a)(3), but under which no sales have been made during the current fiscal year, then the bank holding company may be eligible to seek no-action relief to suspend its section 15(d) reporting obligation. The staff has now been granting these no-action letters.[9]

As mentioned above, section 503 of the JOBS Act requires the SEC to revise the definition of "held of record" to exclude, from the section 12(g)(1) holder of record calculation, persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of section 5 of the Securities Act; however, the SEC has not yet proposed or adopted any implementing rules. In Frequently Asked Question 5, the SEC noted that an issuer (including a bank holding company) may exclude persons who received securities pursuant to an employee compensation plan in Securities Act–exempt transactions, whether or not the person is a current employee of the issuer. While section 503 of the JOBS Act directs the Commission to adopt "safe harbor provisions that issuers 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 of 1933," in the SEC's view the lack of a safe harbour does not affect the application of Exchange Act section 12(g)(5).

Required study

The SEC was required to examine its authority to enforce Rule 12g5-1 to determine if new enforcement tools are required to enforce the anti-evasion provision contained in (b)(3) of the rule, and to provide recommendations to Congress within 120 days of the enactment of the JOBS Act. On October 16, 2012, the SEC staff published the results of this mandated study, concluding that the statutes, rules and procedures as currently formulated provide the Division of Enforcement with sufficient tools to investigate and bring a case for section 12(g) violations based on section 12g5-1(b)(3).[10]

Treatment of savings and loan holding companies

On November 28, 2012, Representatives Steve Womack (R-AR) and Jim Himes (D-CT) asked former SEC chair Mary Schapiro to extend to savings and loan holding companies (SLHCs) the benefits of the JOBS Act increase in the section 12(g) registration threshold from 500 to 2,000 holders of record for banks and bank holding companies. Similarly, these members of Congress believed that the JOBS Act–mandated increase in the deregistration threshold for banks and bank holding companies from 300 to 1,200 should also be made available to SLHCs. They noted that, as sponsors of the original bill, they had not intended to treat SLHCs differently from banks and bank holding companies. While the Title V and VI changes were effective on enactment, the letter stated the hope that the SEC, when it updated its rules to reflect the JOBS Act changes, would treat SLHCs in the same manner as bank holding companies.

On May 8, 2013, Senator Patrick Toomey (R-PA) introduced a bill (S. 872) in the Senate to amend section 12(g) to make the shareholder threshold for registration of SLHCs the same as for bank holding companies; however, it was not passed. On January 13, 2014, Womack, Himes, Representative John Delaney (D-MD) and Representative Ann Wagner (R-MO) introduced to the House of Representatives for consideration similar legislation, i.e. the Holding Company Registration Threshold Equalization Act (H.R. 801).

As discussed earlier, the recently enacted FAST Act amends section 12(g)(1)(B) of the Exchange Act to include "savings and loan holding companies" (as defined in section 10 of the Home Owners' Loan Act). This provision serves to put SHLCs on equal footing for purposes of the section 12(g) threshold with banks and bank holding companies.

In December 2015, the staff of the SEC provided guidance in the form of various C&DIs relating to the application of the provision.[11]

Appendix A SHAREHOLDER TRIGGERS		
	Companies other than banks, BHCs and SLHCs	**Banks, BHCs and SLHCs**
Total assets at fiscal year-end that trigger reporting requirement if shareholder trigger is breached	$10 million	$10 million
Total number of holders of record that triggers reporting	2,000 holders of record OR 500 non-accredited holders of record	2,000 holders of record
Total number of holders of record to exit reporting	300 or fewer holders of record	1,200 or fewer holders of record
Effectiveness	Immediately effective	For banks and BHCs, at the end of the issuer's first fiscal year following enactment of the JOBS Act and, in the case of SLHCs, following enactment of the FAST Act

ENDNOTES

1 These thresholds were set forth in Exchange Act section 12(g)(1) and Exchange Act Rule 12g-1. When section 12(g) was enacted in 1964, the asset threshold was set at $1 million. The asset threshold was most recently increased to $10 million in 1996. SEC Release No. 34-37157 (May 1, 1996), *available at* http://www.sec.gov/rules/final/34-37157.txt.

2 In addition, section 16 reporting and short-swing liability apply to insiders; beneficial ownership reporting applies to significant stockholders; the SEC's proxy rules apply to the issuer; and the various Sarbanes-Oxley Act and Dodd-Frank Act provisions apply as a result of Exchange Act section 12(g) registration.

3 *See, e.g.,* Comment Letter from American Bankers Association to SEC (November 12, 2008), *available at* http://www.sec.gov/rules/petitions/4-483/4483-21.pdf.

4 *See, e.g.*, 2009 Annual SEC Government-Business Forum on Small Business Capital Formation Final Report (May 2010), *available at* http://www.sec.gov/info/smallbus/gbfor28.pdf.

5 Petition from Lawrence Goldstein to SEC (February 24, 2009), *available at* http://www.sec.gov/rules/petitions/2009/petn4-483-add.pdf. *See also* Petition for Commission Action to Require Exchange Act Registration of Over-the-Counter Equity Securities (July 3, 2003), *available at* http://www.sec.gov/rules/petitions/petn4-483.htm.

6 Under Exchange Act section 12(i), banks do not register their securities or file reports with the SEC.

7 The term "bank holding company" is defined in the Bank Holding Company Act of 1956.

8 "Frequently Asked Questions on Changes to the Requirements for Exchange Act Registration and Deregistration" (April 11, 2012), *available at* http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-12g.htm.

9 *See, e.g.*, Peoples Financial Services Corp. (August 16, 2012); Central Virginia Bankshares, Inc. (August 8, 2012); AB&T Financial Corporation (July 27, 2012); Botetourt Bankshares, Inc. (July 24, 2012); First Ottawa Bankshares (July 23, 2012); Potomac Bancshares, Inc. (July 23, 2012); Skagit State Bancorp, Inc. (July 20, 2012); Touchmark Bancshares, Inc. (July 17, 2012).

10 *Report on Authority to Enforce Exchange Act Rule 12g5-1 and Subsection (b)(3)* (October 15, 2012), *available at* http://www.sec.gov/news/studies/2012/authority-to-enforce-rule-12g5-1.pdf.

11 Fixing America's Surface Transportation (FAST) Act Compliance and Disclosure Interpretations (December 21, 2015), *available at* https://www.sec.gov/divisions/corpfin/guidance/fast-act-interps.htm.

CHAPTER 8

Research

As discussed in the Introduction, the capital markets have undergone significant changes in the last decade. In 2003, as a result of legal and regulatory developments, the business of research coverage changed quickly and fundamentally. These changes were brought about as a result of the entry by a number of investment banking firms into the Global Research Analyst Settlement (the Global Settlement), the adoption of SRO rules relating to research, and the promulgation by the SEC of Regulation AC. The Global Settlement addressed the most serious perceived conflicts between investment banking and research departments during the dot-com boom and required implementation of various prophylactic measures by investment banking firms that provided research coverage, including separating banking and research structurally and physically, requiring a chaperone to monitor communications between the two, and requiring analyst compensation be determined independently and not be based on banking revenues. Regulation AC was designed to ensure research analyst independence and integrity by requiring that research analysts certify the truthfulness of the views expressed in research reports and public appearances. The rules adopted by the NASD (Finra's predecessor) and NYSE followed along the same lines and also addressed the timing of research reports in connection with offerings. In addition to imposing significant compliance burdens, together, the Global Settlement and the rules and regulations relating to research also brought about a significant cultural shift and changed fundamentally the role of research analysts and the business of research coverage. In part, as a result of these changes, research coverage for smaller companies declined. As noted in the IPO Task Force Report, the lack of research coverage adversely impacts trading volumes, company market capitalisations, and the total mix of information available to market participants.[1] In order to promote capital formation by emerging growth companies, the IPO Task Force Report recommended that policymakers consider the existing restrictions on research and adopt measures to encourage additional research coverage of emerging growth companies in order to improve the flow of information. Title I of the JOBS Act addresses certain of the concerns raised by the IPO Task Force Report by implementing a number of changes to the restrictions on the timing of, and on the publication of, research reports relating to emerging growth companies. As discussed below, however, the JOBS Act does not address the research safe harbours contained in the Securities Act, nor does it address the regulations that mandate the separation of research and investment banking functions. In order to put the JOBS Act research-related changes in context, below we have provided a summary of the rules and regulations governing the research function and the release of research reports.

The regulatory framework applicable to research

The rules and regulations that apply to the relationship between the research and investment banking departments of an investment banking firm include: Finra Rule 2241 (which supersedes Finra Rule 2711 as well as NYSE Rule 472); SEC Regulation AC (Analyst Certification); and Rules 137, 138, and 139 under the Securities Act. In addition, certain firms are bound by the terms of the Global Settlement.

During the dot-com boom, research analysts published reports recommending investments in the securities of many companies with which their firms had an advisory or investment banking relationship. In 1999, the SEC began a review of industry practices regarding the disclosure of research analysts' conflicts of interest. Committees of the US House of Representatives and the Senate also held hearings on research analysts' conflicts of interests. In April 2002, the SEC announced a formal inquiry into industry practices concerning research analysts, their conflicts of interest and their relationships with the investment banking departments within their firms. Civil complaints were filed by the SEC and other federal and state regulatory and law enforcement authorities against these firms. The Global Settlement is an enforcement agreement first announced in December 2002 and finalised on April 28, 2003, among the SEC, NASD (now Finra), the NYSE, the New York State Attorney General, and 10 of the then-largest investment banking firms in the United States

(referred to here as the settling firms). As part of the Global Settlement, the settling firms agreed to several measures designed to prevent abuse stemming from pressure by investment bankers on research analysts to provide favourable coverage of specific issuers or securities. The settling firms were required to separate their investment banking and research departments from each other both physically and with information firewalls. Additionally, the budget allocation for research was to be independent of investment banking. Research analysts were also prohibited from attending IPO pitches and road shows with investment bankers. Finally, research analysts' previously issued ratings about issuers had to be disclosed and made available. In addition to these regulatory actions, each settling firm was enjoined from violating the statutes and rules that it was alleged to have violated and were also required to pay fines to their investors, fund investor education, and pay for independent third-party market research. The Global Settlement remains in effect, although its terms have been modified from time to time.

The Sarbanes-Oxley Act required the SEC to address conflicts of interest involving research analysts and investment bankers. In response to Sarbanes-Oxley, the NASD and the NYSE established rules and safeguards to separate research analysts from the review, pressure, and oversight of investment banking personnel. These rules are intended to ensure the integrity of research and to protect investors from being misled as a result of a failure to disclose potential conflicts of interest. On July 29, 2003, the SEC announced the approval of a series of changes to the rules affecting research analysts, generally embodied in Finra Rule 2711 and NYSE Rule 472 and referred to as the SRO rules. The SRO rules have since been amended many times, but the most significant amendments were approved by the SEC last fall. A new consolidated rule relating to equity research, which supersedes and replaces Finra Rule 2711 and NYSE Rule 472, became effective in December 2015.[2] The new rule, Finra Rule 2241, retains many of the principal provisions of the predecessor rule, including provisions requiring the maintenance of separations between research and banking, but adopts a more principles-based approach.[3]

The Global Settlement and SRO rules address reporting lines, requiring that research and investment banking be separate units and research not report to banking. Research must be physically separated from investment banking. This physical separation must be reasonably designed to ensure that there will not be any intentional or unintentional flow of information between research and investment banking. Research must have its own resources for compliance and legal services. In addition, the research budget may not be controlled by investment banking, and compensation for research personnel cannot be tied to investment banking business or revenues.[4]

Both the SRO rules and Regulation AC mandate that research reports include certain disclosures. Research reports must include disclosures relating to any actual or potential conflicts of interest. For example, a research report must disclose whether a firm does or seeks to do business with the company covered by the report; whether it has received, or expects to receive, compensation from the subject company within a specified time period; and whether analysts or other persons own securities of the subject company. Regulation AC requires that reports contain prominent certifications regarding the views expressed in the research report and attesting that the analyst's compensation was not tied to or related to specific recommendations or views expressed by the research analyst in the research report.

The Global Settlement also limits the participation of research personnel in offering related activities. Research personnel may not participate in efforts to solicit business for investment banking, including, among other things, participating in any pitches or otherwise communicating with a company or prospective client for the purpose of soliciting investment banking business. Further, SEC interpretive guidance states that it would be inconsistent with section I.9 of Addendum A to the Global Settlement to allow investment banking personnel to include any information regarding any research analyst employed by the firm in a pitch book or any other presentation materials used to solicit investment banking business.[5] Research personnel are not allowed to participate in any road shows sponsored by the company or investment banking related to a public offering or other investment banking transaction. However, SEC interpretive guidance provides that research personnel may listen (in listen-only mode) or view a live webcast of these road shows. Research personnel may also access other widely attended presentations to investors from a remote location, but, if the presentation is in the firm's building, they must be in a separate room.

The Global Settlement permits certain communications between a research analyst and an issuer in connection with an offering. At an issuer's request, investment banking personnel may arrange for a department of the firm other than research to provide the issuer access to previously published reports regarding that issuer that would be available from other sources. Should an issuer request investment banking personnel to arrange a meeting between the issuer and a research analyst, the investment bankers must instruct the issuer to contact research directly

and may not notify research in advance. A research analyst is permitted to attend a meeting with an issuer and answer questions regarding the analyst's views on the company but may not use it as an opportunity to solicit investment banking business, and investment banking personnel may not be present or participate in any of these meetings.

The SRO rules subject member firms to quiet periods during which they may not publish research and during which analysts may not make public appearances following initial and secondary offerings and around the termination, waiver, or expiration of lock-up agreements, subject to certain exceptions.

Restrictions on communications affecting research

In addition to these rules and regulations that affect the structure and business of research coverage, the Securities Act imposes restrictions on offering related communications that impact the dissemination of research reports.

A research report[6] may be considered an offer or a non-conforming prospectus under the Securities Act. Information, opinions, or recommendations by a broker-dealer about securities of an issuer proposing to register securities under the Securities Act may constitute an offer to sell such securities, particularly when the broker-dealer participates in the distribution as an underwriter or member of the selling group.[7] The issuance of a research report in advance of a public offering could also technically constitute gun jumping (the illegal solicitation of an offer before a registered offering) and, as a result, a section 5 violation.

Until relatively recently, the nature and content of communications made around the time of a securities offering were generally very limited, because the SEC took an expansive view of the concept of an offer. Under section 2(a)(3) of the Securities Act, an offer is defined broadly and includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.[8] Before an issuer filed a registration statement, all offers in any form were prohibited.[9] Between the filing of the registration statement and its effectiveness, the only written offers that were permitted were those filed with the SEC and that conformed to the requirements applicable to a statutory prospectus under section 10 of the Securities Act.[10] After the registration statement was declared effective, written materials still were required to meet the section 10 prospectus requirements. Additional offering-related materials were permitted only if a final prospectus (conforming to the section 10(a) requirements) was delivered before or along with the additional materials.[11] These limitations did not relate to the accuracy or content of the communications. Any violation of these rules was considered gun jumping.[12] The SEC's restrictive position was founded on the belief that "the means of communications were limited and restricting communications (without regard to accuracy) to the statutory prospectus appropriately balanced available communications and investor protection."[13]

In 2004, the SEC decided to revamp the securities offering communications regime. In its release proposing the Securities Offering Reform the SEC stated:

> *The capital markets, in the United States and around the world, have changed significantly since those limitations were enacted. Today, issuers engage in all types of communications on an ongoing basis, including, importantly, communications mandated or encouraged by our rules under the Exchange Act. Modern communications technology, including the Internet, provides a powerful, versatile, and cost-effective medium to communicate quickly and broadly. [footnote omitted] The changes in the Exchange Act disclosure regime and the tremendous growth in communications technology are resulting in more information being provided to the market on a more non-discriminatory, current and ongoing basis. Thus, while the investor protection concerns remain, the gun jumping provisions of the Securities Act impose substantial and increasingly unworkable restrictions on communications that would be beneficial to investors and markets and consistent with investor protection.*[14]

As a result, as part of its 2005 Securities Offering Reform, the SEC redesigned the regulation of communications in order to limit the types of communications that would be deemed offers for purposes of section 5 of the Securities Act or prospectuses for purposes of section 12(a)(2) of the Securities Act. In connection with Securities Offering Reform, the SEC broadened the existing safe harbours under the Securities Act for certain research reports, which are contained in Rules 137, 138, and 139. These safe harbours for certain research reports apply to all types of issuers (as opposed to the JOBS Act's provisions which apply only to emerging growth companies or EGCs) who meet the requirements of Rules 137, 138 and 139. The safe harbours expressly exclude research reports from the definition of offers, offers for sale, and offers to sell[15] under section 5.[16] Note that the safe harbours only apply to research reports distributed in advance of or during a public offering, a Rule 144A offering or a Regulation S offering.[17] It is unlikely, however, that a research report that meets the requirements set forth in the safe harbours would be

considered a "general solicitation" in the context of a private placement.

Rules 137, 138, and 139 are designed to protect analysts, brokers, and dealers from general solicitation and gun jumping violations in connection with their regularly disseminated research reports. In the Securities Offering Reform release, the SEC recognised that certain events, including passage of Sarbanes-Oxley, Regulation AC, revisions to the self-regulatory organisation rules governing broker-dealers, and the global research analyst settlement,[18] had addressed the "veracity and reliability" of research reports, as well as other potential abuses associated with these reports.[19] In particular, the SEC stated that it expects research reports "will better disclose conflicts of interest relating to research of which investors should be aware."[20] In light of these developments, the SEC decided it was "appropriate to make measured revisions to the research rules that are consistent with investor protection but that will permit dissemination of research around the time of an offering under a broader range of circumstances."[21] Rule 137 applies to broker-dealers not participating in a registered offering and therefore not classed as underwriters. In order not to violate the gun jumping provisions and solicitation prohibitions, the broker-dealer must publish the report in the ordinary course of its business and may not receive any consideration from, or act under any direct or indirect arrangement with, the issuer of the securities, a selling security holder, any participant in the distribution of the securities, or any other person interested in the securities. Furthermore, the issuer may not be, nor have been in the past three years: a blank cheque company,[22] a shell company,[23] or a penny stock issuer.[24]

Rule 138 applies to broker-dealers participating in the distribution of a different security from that being discussed in the research reports. Rule 138 permits a broker-dealer that is participating in the distribution of an issuer's securities to publish and distribute research reports that either: relate solely to the issuer's common stock, debt securities, or preferred stock convertible into common stock, where the offering involves solely the issuer's non-convertible debt securities or non-convertible non-participating preferred stock; or relate solely to the issuer's non-convertible debt securities or non-convertible, non-participating preferred stock, where the offering involves the issuer's common stock, debt securities, or preferred stock convertible into common stock. In order to take advantage of Rule 138, the broker-dealer must regularly report on the types of securities that are the subject of the research report. The issuer involved must not be a blank cheque company, shell company, or penny stock issuer and be either:

- a reporting company (foreign or domestic) and current in its Exchange Act filings; or
- a foreign private issuer that meets all of the registrant requirements of the revised Form F-3[25] (other than the reporting history provisions of General Instructions IA1 and IA2(a) to Form F-3) and either:
  - satisfies the $75 million minimum public float threshold in General Instruction I.B.1. of Form F-3, or
  - is issuing non-convertible securities other than common equity, and meets the provisions of General Instruction IB2 of Form F-3; and either:
    - has its equity securities trading on a "designated offshore securities market" as defined in Rule 902(b) of the Securities Act, and has had them trading for at least 12 months, or
    - has a worldwide public float of $700 million or more.

Rule 139 applies to broker-dealers participating in the registered distribution of the same security as that discussed in their disseminated research reports. The broker-dealer must publish or distribute research reports in the regular course of its business, and such publication or distribution cannot represent either the initiation of publication or the re-initiation of publication. The issuer may not be a blank cheque, shell company or penny stock issuer and must:

- have filed all required Exchange Act reports during the preceding 12 months;
- meet all the registrant requirements of the revised Form S-3/F-3 (other than the reporting history provisions of General Instructions IA1 and IA2(a) to Form F-3); and either:
  - satisfies the minimum public float threshold in General Instruction IB1 of Forms S-3/F-3,
  - is or will be offering non-convertible securities other than common equity and meet the threshold pursuant to General Instruction IB2 of Form S-3/F-3,[26] or is
    - a WKSI as defined in Rule 405 of the Securities Act, or
    - a foreign private issuer that satisfies the same requirements as for Rule 138.

Over time, commentators have noted that the SEC's communications rules are outmoded and need to be revised, because they have the effect of inhibiting more information from being made available to the investing public. The IPO Task Force Report recommended that the SEC expand the existing safe harbours in order to permit broker-dealers to initiate coverage and distribute research

on IPO issuers without being deemed to have offered securities through the research reports and include oral (in addition to written) communications within the scope of the safe harbours.

JOBS Act Title I changes
Recognising the contribution of research coverage to the market for emerging companies, the JOBS Act attempted to address some logistical issues relating to the diligence activities undertaken in connection with IPOs; however, it did not supersede the Global Settlement. The JOBS Act also eliminated certain quiet period restrictions on publication of research reports in offerings by emerging growth companies.

Research reports and offers
Section 105 of the JOBS Act permits a broker-dealer to publish or distribute a research report about an EGC that proposes to register an offering of common stock under the Securities Act or has a registration statement pending, and the research report will not be deemed an offer under section 2(a)(3) of the Securities Act, even if the broker-dealer will participate or is participating in the offering. Section 105(a) of the JOBS Act defines a research report as "a written, electronic, or oral communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, *whether or not* it provides information reasonably sufficient upon which to base an investment decision" (our emphasis). This differs from the definition of a research report in the SRO rules and Global Settlement, where the information contained in the report must be reasonably sufficient to form the basis for an investor's decision. Accordingly, the definition of research report for purposes of the JOBS Act would encompass nearly any written or oral communication relating to an EGC or its securities made by a broker-dealer.

Section 105(a) of the JOBS Act provides that a research report published by a broker-dealer about an EGC that is planning a public offering of common equity securities will not be considered an offer for purposes of section 2(a)(10) and section 5(c) of the Securities Act. As a result, the issuance of a written research report by a broker-dealer will not trigger a section 5 violation and would not constitute a written offer "by means of a prospectus" for purposes of potential liability under section 12(a)(2). By contrast, the JOBS Act does not provide an exemption from section 12(a)(2) liability for testing-the-waters communications under the JOBS Act but only from section 5. Therefore, a research report would have greater protection from liability under the JOBS Act than testing-the-waters materials. Whether an oral research report may be subject to section 12(a)(2) liability is more complicated. The JOBS Act does not provide a safe harbour under section 12(a)(2) with respect to oral research reports. Consequently, an oral research report could still result in section 12(a)(2) liability if it is deemed to constitute an offer of a security. As a general matter, it is worth noting that the JOBS Act has no impact on liability under Rule 10b-5 or state anti-fraud laws.

Research participation in certain meetings
Section 105(b) prohibits any SRO and the SEC from adopting any rule or regulation that would restrict a broker-dealer from participating in certain meetings relating to EGCs. The JOBS Act also removes restrictions on who within an investment bank can arrange for communications between research analysts and prospective investors in connection with an EGC IPO, permitting investment bankers to be involved in those arrangements. Further, a research analyst would be permitted to engage in any communications with an EGC's management when other employees of the investment bank, including the investment bankers, are present.

Under section 105(b) of the JOBS Act, an associated person of a broker-dealer, including investment banking personnel, may arrange communications between research analysts and investors. This activity would include, for example, an investment banker forwarding a list of clients to the research analyst that the analyst could, at his or her own discretion and with appropriate controls, contact. In turn, a research analyst could forward a list of potential clients it intends to communicate with to investment banking personnel as a means to facilitate scheduling. Investment bankers can also arrange, but not participate in, calls between analysts and clients. In August 22, 2012, the SEC's Division of Trading and Markets published a highly anticipated series of JOBS Act Frequently Asked Questions entitled 'About Research Analysts and Underwriters,' which addressed various research-related matters.[27] In the SEC FAQs, the SEC has stated that such arranging activity, without more, would not violate Finra Rule 2711 or NYSE Rule 472 (now, Finra rule 2241), although it notes that firms should be mindful of other provisions of the Exchange Act and the SRO Rules as well as the applicability of the Global Settlement.[28]

The JOBS Act prohibits a national securities association or the SEC from maintaining rules restricting research analysts from participating in meetings with investment banking personnel and an EGC in connection with an EGC's IPO. Before the enactment of the JOBS Act,

research personnel were prohibited from attending meetings with issuer management that were also attended by investment banking personnel in connection with an IPO, including pitch meetings. Section 105(b) of the JOBS Act permits research personnel to participate in any communication with the management of an EGC concerning an IPO that is also attended by any other associated person of a broker, dealer, or member of a national securities association whose functional role is other than as an analyst, including investment banking personnel. The SEC has interpreted this section as primarily reflecting a Congressional intent to allow research personnel to participate in EGC management presentations with sales force personnel so that the issuer's management would not need to make separate and duplicative presentations to research personnel at a time when resources of the EGC may be limited.

The SEC stated in the SEC FAQs that research personnel must limit their participation in such meetings to introducing themselves, outlining their research programme and the types of factors that they would consider in their analysis of a company, and asking follow-up questions to better understand a factual statement made by the EGC's management. In addition, after the firm is formally retained to underwrite the offering, research personnel could, for example, participate in presentations by the management of an EGC to educate a firm's sales force about the company and discuss industry trends, provide information obtained from investing customers, and communicate their views.[29]

In their October 11, 2012 amendments (which became effective retroactive to April 5, 2012, the date the JOBS Act was enacted), Finra amended then Rule 2711(c)(4) to conform to the provisions of the JOBS Act, specifically to provide that, while research analysts are prohibited from soliciting business for investment banking, they are not prevented from attending a pitch meeting in connection with an initial public offering of an EGC that is also attended by investment banking personnel; provided, however, that a research analyst may not engage in otherwise prohibited conduct in such meetings.[30]

In the SEC's view, section 105(b)(2) of the JOBS Act allows a firm to avoid the ministerial burdens of organising separate and potentially duplicative meetings and presentations among an EGC's management team, investment banking personnel, and research analysts. Section 105(b)(2) did not address communications where investors are present together with company management, analysts and investment banking personnel. Therefore, the SEC has taken the view that this provision of the JOBS Act does not affect the SRO rules prohibiting analysts from participating in road shows or otherwise engaging in communications with customers about an investment banking transaction in the presence of investment bankers or the company's management. These rules apply to communications with customers and other investors and do not depend on whether analysts, investment bankers, and management are participating jointly in such communications.[31]

The SEC FAQs confirm that Regulation AC is not affected by the JOBS Act.

In May 2015, Finra provided guidance on research participation in certain meetings through its Research Rules Frequently Asked Questions.[32] In these Frequently Asked Questions, Finra makes clear that it regards the participation of research personnel in meetings including investment banking personnel that relate to offerings as presenting certain risks. These risks are heightened if research personnel participate in meetings before the investment bank has been awarded a mandate to take part in the offering. To this end, in its guidance, Finra notes it views an IPO in three stages, with a sliding scale of attendant risks where an analyst communicates with an issuer: (1) a pre-IPO period; (2) a solicitation period; and (3) a post-mandate period. Given the heightened risks that may be presented in the solicitation period, wherein a research analyst may feel pressured to promise favourable research or to share its views with the issuer regarding valuation, Finra member firms should consider carefully whether research personnel should join meetings during such period. Communications with research, and any potential conflicts of interest, can be more effectively managed in the pre-IPO and in the post-mandate periods.

In the Finra Research Rules Frequently Asked Questions, Finra also provides its views regarding the SEC FAQs, and, specifically, Question 4 with respect to the permissible communications by a research analyst attending an EGC IPO pitch meeting or other meetings during the solicitation period for an EGC IPO mandate. Finra emphasises that analysts attending such meetings are not permitted to engage in otherwise prohibited conduct or communications and cannot, for example, solicit investment banking business, or share views on valuations during the IPO pitch process. Given the sensitivity of many of these issues, most investment banks have chosen not to have research personnel present in pitch meetings.

Quiet periods

A broker-dealer participating in an issuer's IPO is generally subject to certain blackout periods with respect to publishing of research reports about such issuer. The publication of research is prohibited in advance of the IPO

and, once the IPO has been priced, no research can be published until 40 days following the offering. Additionally, the publication of any research must be suspended for the 15 days before and after the release or expiration of any lock-up agreement.

The JOBS Act now prohibits any national securities association (which includes Finra) or the SEC from adopting any rule or regulation prohibiting a broker-dealer from publishing or distributing a research report or making a public appearance with respect to the securities of an EGC within any prescribed period of time following the EGC's IPO or the expiration date of any lock-up agreement. This eliminates the traditional post-IPO quiet period for EGCs.

On October 11, 2012, the SEC granted accelerated approval for amendments to the SRO rules, effective immediately, that conform to the requirements of the JOBS Act related to research analysts and research reports in certain offerings by EGCs. In addition, the amendments eliminated the quiet periods in connection with IPOs and secondary offerings of EGCs by the adoption of then Finra Rule 2711(5), which states that the lock up periods discussed in paragraphs (f)(1), (f)(2) and (f)(4) of Finra Rule 2711, "shall not apply to the publication or distribution of a research report or a public appearance following an initial public offering or secondary offering of the securities of an Emerging Growth Company".[33]

The JOBS Act also did not explicitly permit publication or distribution of a research report relating to an EGC after the expiration, termination, or waiver of a lock-up agreement or prohibit quiet periods after a follow-on offering of an EGC's securities. The adoption of the amendments to the SRO Rules have made clear that both the SEC and Finra interpret the JOBS Act to apply equally to permit publication of research reports on an EGC's securities, no matter how the lock-up period ends – by termination, expiration, or waiver – both before and after the termination, expiration, or waiver of the agreement, eliminating all quiet periods for EGCs.

Section 105(d) of the JOBS Act provides that neither an SRO nor the SEC may adopt or maintain any rule or regulation prohibiting a broker-dealer from publishing or distributing a research report or making a public appearance with respect to the securities of an EGC following an offering or in a period before (although notably not after) expiration of a lock-up.

The FAQs explain that the Staff views the prohibition on quiet period rules contained in section 105(d)(2) as applying to the quiet periods on research at the termination, waiver, modification, etc. of a lock-up agreement (in connection with an emerging growth company IPO or a follow-on offering) regardless of the means by which the lock-up period comes to a close.

As noted above, the new Finra research rule, Finra Rule 2241, retains the principal provisions of the predecessor rule. Perhaps having seen that the relaxation of the quiet periods for EGCs has not raised any regulatory concerns, Finra Rule 2241 relaxes the research quiet periods following offerings by non-EGCs, as well as around lock-up expirations, waivers, or terminations.

Other restrictions on research

The JOBS Act does not affect or amend most of the existing rules and regulations dealing with the separation of research and investment banking, even in relation to EGCs. The JOBS Act does not address or amend Regulation AC. The JOBS Act does not directly address the Global Settlement, and, as the Global Settlement is a judicial order and not an SEC or Finra rule, it is technically not affected by the enactment of the JOBS Act. It is important to remember, however, that the Global Settlement only affects the eight remaining settling firms. All other broker-dealers not party to the Global Settlement are able to take advantage of the self-effectuating provisions of the JOBS Act described above. It remains to be seen whether the settling firms will petition the court for another amendment to the Global Settlement to conform to the provisions of the JOBS Act. The JOBS Act also does not address the existing research safe harbours, and it is unclear when the SEC will amend Rules 137, 138, and 139 to address the effects of the JOBS Act.

The future of research

To date, following enactment of the JOBS Act, most firms have proceeded cautiously in respect of research relating to EGCs. In the United States, there has not been (given traditional restrictions on offering related communications) any history of pre-deal research. It is not clear that firms will become comfortable with pre-deal IPO research even following the JOBS Act. Firms have published research reports on EGCs that have completed their IPOs; however, generally, these research reports have been published at least 25 days following completion of the IPOs. Even firms that are not parties to the Global Settlement have not been quick to publish research reports immediately upon completion of the IPO. Over time, as practitioners become more comfortable with the new rules, and compliance departments of investment banking firms are able to adapt to these new rules, market practice may evolve. Commentators continue to emphasise the importance of availability to retail investors of information that is contained in research reports. The experiences in

recent offerings have led many to advocate for additional changes related to research reports and to calls to require that any research views shared with institutional investors or with a limited number of investors be shared more broadly. We discuss these issues further in Chapter 9.

ENDNOTES

1 *See* IPO Task Force Report, *available at* http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf, at 26.
2 Finra Regulatory Notice 15-30 (August 2015), *available at* http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-15-30.pdf
3 *See Id.*
4 *See* Global Settlement (I)(1): http://www.sec.gov/litigation/litreleases/finaljudgadda.pdf; Finra Rule 2241.
5 *See* Global Settlement Addendum A.
6 A research report is defined as a written communication that includes information, opinions or recommendations with respect to securities of an issuer or an analysis of an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision. Rule 137(e) of the Securities Act.
7 *See* Adoption of Rules Relating to Publication of Information and Delivery of Prospectus by Broker-Dealers Prior to or After the Filing of a Registration Statement Under the Securities Act of 1933, Securities Act Release No. 33-5101, 1970 WL 10585 (November 19, 1970).
8 *See, e.g., id.* at n.88 ("the publication of information and publicity efforts, made in advance of a proposed financing which have the effect of conditioning the public mind or arousing public interest in the issuer or in its securities constitutes an offer …") (citing Securities Act Release No. 33-5180, 1971 WL 120474 (August 20 1971)).
9 Section 5(c) of the Securities Act, 15 USC section 77e(c).
10 section 5(b) of the Securities Act, 15 USC section 77e(b).
11 *See* the definition of prospectus in section 2(a)(10) of the Securities Act, 15 USC section 77b.
12 Securities Offering Reform Release, No. 33-8591, 2005, WL 1692642 (July 19, 2005), at 39–40. Gun jumping refers to the illegal solicitation of an offer before a registered offering.
13 Reform Release, *supra* note 10, at 16.
14 *Id.* at n.55. *See also id.* at 41–42.
15 *See* section 2(3) of the Securities Act.
16 *See* Rules 137–39 of the Securities Act.
17 *See* Rule 139(b)–(c) of the Securities Act.
18 *See* SEC Litigation Release No. 18438 (October 31, 2003).
19 Reform Release, *supra* note 11, at 155.
20 *Id.*
21 *Id.* at 156. Research reports issued in reliance on Rule 137, 138, or 139 continue to be subject to the antifraud provisions of the federal securities laws, including liability under section 17(a) of the Securities Act, section 10(b) of the Exchange Act, and Rule 10b-5 of the Exchange Act.
22 A blank cheque company is a development stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, other entity, or person. *SEC Rule 419(a)(2).*
23 A shell corporation is a company that serves as a vehicle for business transactions without itself having any significant assets or operations. *SEC Rule 405.*
24 A penny stock issuer is a very small issuer of low-priced speculative securities. Since penny stocks are difficult to accurately price, there are specific SEC rules that must be satisfied before a broker-dealer can sell a penny stock, and the SEC does not allow the issuer to use certain exemptions from the registration requirements when selling their securities. *Exchange Act Rule 3a51-1.*
25 Effective as of September 2, 2011, the SEC amended Form S-3 and Form F-3 by revising General Instruction IB2 to eliminate the use of credit ratings as a transaction eligibility standard and replace it with an alternative set of standards. The new standards provide that an offering of non-convertible securities is eligible to be registered on Form S-3 or Form F-3 if the issuer meets the Registrant Requirements in General Instruction IA and either has issued at least $1 billion of non-convertible securities in transactions registered under the Securities Act, other than equity securities, for cash during the past three years, has outstanding at least $750 million of non-convertible securities, other than common equity, issued in primary offerings for cash registered under the Securities Act (each as measured from a date within 60 days of the filing of the registration statement); or is a wholly owned subsidiary of a WKSI.
26 *Id.*

27 Frequently Asked Questions about Research Analysts and Underwriters (August 22, 2012), *available at* https://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm
28 *See* SEC FAQs, *supra* note 3 at Question 3.
29 *See* SEC FAQs, *supra* note 3 at Question 4.
30 *See* http://www.sec.gov/rules/sro/Finra/2012/34-68037.pdf
31 *See* SEC FAQs, at Question 5.
32 Finra Research Rules Frequently Asked Questions (FAQ), *available at* http://www.finra.org/industry/faq-research-rules-frequently-asked-questions-faq.
33 *See* http://www.sec.gov/rules/sro/Finra/2012/34-68037.pdf

CHAPTER 9

Other capital formation discussions

As we noted in the Introduction, the JOBS Act was the continuation of a dialogue regarding the impact of increased regulation and increased disclosure requirements on capital formation, as well as on the IPO process more specifically. Largely as a result of improved economic conditions and, in part, as a result of some of the JOBS Act accommodations, the US IPO market has improved in recent years. However, discussions regarding measures intended to promote capital formation continue.

Below, we highlight what we believe to be a few of the areas that are likely to receive substantive attention in the near future. We have organised the discussion in two parts, focusing first on public offerings and second on exempt offerings.

The JOBS Act and initial public offerings

Three years have passed since the JOBS Act was signed into law to ease regulatory burdens on smaller companies and to facilitate public and private capital formation. The provisions related to IPOs, which have been effective since enactment, seek to encourage EGCs to pursue IPOs by codifying a number of changes to the IPO process and establishing a transitional "on-ramp" that provides for scaled-down public disclosures for EGCs. As we discuss in Chapter 2, the impact of the JOBS Act on the execution of IPOs has been significant, resulting in new market practices that issuers and their advisers should be aware of when planning an IPO.[1]

In 2013, a total of 222 IPOs generated $54.9 billion in gross proceeds. This is a significant increase compared to 2012, when 128 IPOs generated $42.7 billion ($26.9 billion, excluding Facebook). The IPO market was dominated by EGCs, which accounted for approximately 80% of all IPOs in 2013. Measured by total proceeds raised, the energy, financial and healthcare segments were the most active in 2013; however, the resurgence of the IPO market generally was broad-based. Financial sponsors also continue to play an important role in the IPO market. In 2013, a total of 70 private equity-backed IPOs generated $24.8 billion and 81 venture capital-backed IPOs generated $9.6 billion.

In 2014, a total of 275 IPOs generated $85.3 billion in gross proceeds ($63.3 billion, excluding Alibaba). This is a significant increase compared to 2013, when 222 IPOs generated $54.9 billion. The IPO market was again dominated by EGCs, which accounted for approximately 76% of all IPOs in 2014. Measured by total proceeds raised, the technology, financial and energy segments were the most active in 2014; however, the resurgence of the IPO market generally was broad-based. Financial sponsors also continue to play an important role in the IPO market. In 2014, a total of 71 private equity-backed IPOs generated $25.0 billion and 126 venture capital-backed IPOs generated $35.3 billion.

In 2015, a total of 170 IPOs generated $30.0 billion in gross proceeds. During this period, the IPO market was dominated by EGCs, which accounted for approximately 97% of all IPOs. Measured by total proceeds raised, the healthcare, consumer and energy segments were the most active during the first nine months of 2015. Financial sponsors also continue to play an important role in the IPO market. A total of 39 private equity-backed IPOs generated $11.3 billion and 85 venture capital-backed IPOs generated $8.9 billion in 2015.

JOBS Act 2.0?

Market participants and commenters identified a number of aspects of the JOBS Act IPO on-ramp process that should be streamlined or clarified. In recent years, various bills have been introduced, principally in the House of Representatives, which address aspects of the IPO on-ramp provisions. A number of these bills met with bipartisan support in the House, but failed to garner the support needed to advance beyond that into legislation. As we discuss in the Introduction, it was not until recently that several of the most popular measures found their way into the FAST Act. These included reducing the original 21-day public filing requirement for EGC IPO registration statements to a 15-day period, providing a grace period for EGCs that cease to qualify as EGCs while in the midst of pursuing IPOs, and making certain modest accommodations to the financial statement and financial information requirements for EGCs. We regard these as

enhancements to the JOBS Act's on-ramp provisions.

Other discussions relating to IPOs

Offering-related communications

In the Introduction, we discuss an exchange of correspondence in 2011 between Congressman Darrell Issa and SEC chair Schapiro relating to, among other things, capital formation. In those 2011 letters, Issa questioned whether the SEC's regulations relating to offering-related communications had a chilling effect on capital formation. The SEC committed to review its rules relating to offering related communications. The Issa-Schapiro dialogue had a second act in mid-2012. In June 2012, Issa wrote a letter to Schapiro inquiring about the regulations applicable to IPOs.[2] The letter specifically address "barriers to communicating with investors" during the IPO process. Issa referenced public reports that noted that during the Facebook IPO, certain of the underwriters may have provided institutional investors with information about revenue forecasts for Facebook, and questioned whether SEC regulations relating to offering communications had the effect of creating information disparities. Issa also questioned whether there were sufficient safe harbours for research reports such that research analysts would be encouraged to make reports available broadly, including to retail investors. This was not the first time that concerns had been raised regarding the dissemination of information in IPOs. Going as far back as 2003, a committee convened by the New York Stock Exchange and the NASD at the SEC's request, referred to as the IPO Advisory Committee, published a report that made a number of recommendations that were designed to restore investor confidence in IPOs.[3] The IPO Advisory Committee report included a section on levelling the playing field that suggested that issuers be required to make a version of their IPO roadshow available publicly on an unrestricted basis, as well as that underwriters disclose final IPO allocations to issuers. In her response letter dated June 19, 2012, Schapiro reiterated the SEC's views that the statutory prospectus should be the primary source of information for investors, but referred to various communications reforms, including Securities Offering Reform in 2005, which had relaxed restrictions on communications.[4] Schapiro also recognised the importance of research reports and observed that the SEC had modernised the safe harbours for research reports. As we discuss in Chapter 8, the JOBS Act provides greater flexibility to publish research reports relating to EGCs. Despite this enhanced flexibility, investment banks generally have chosen to disseminate broadly their research and may provide different research products to different types of investors.

Issa's letter also inquired whether there should be broader safe harbours to address the inclusion of forward-looking information and projections in prospectuses and in free writing prospectuses. It also asked the SEC to consider whether additional safe harbours should be adopted to protect communications, including forecasts, made in research reports. Schapiro noted the existence of safe harbours for certain forward-looking communications. She also pointed out that liability would not extend to a research analyst's failure to predict accurately an issuer's future performance.

During 2014 and 2015, the SEC remained quite focused on completing the rulemaking required in order to implement the JOBS Act mandate. These matters related to offering-related communications and research reports and have not received attention recently. It appears that although the SEC has not modified the rules relating to an issuer's post-IPO "quiet period," the quiet period has been anything but quiet. Many IPO issuers have chosen to engage in widespread communications immediately or shortly following their IPOs. Perhaps the framework governing offering-related communications should be reviewed in light of advances in communications.

The structure of IPOs

The Issa letter to Schapiro also raises some fundamental questions regarding the structure of IPOs in the United States, where the book building process has long been relied upon for public offerings. As part of the book building process, underwriters will meet with institutional investors and the issuer and the underwriter will conduct a road show that will include in-person meetings with groups of institutional investors. During the marketing process, the underwriters will gather informal indications of interest from institutional investors about the extent of their interest in an investment in the issuer's securities, along with their pricing sensitivities. Over the marketing period, the underwriters begin to form a book of interest based on these conversations.

Issa questions whether this traditional book building approach allows the underwriters to exercise too much discretion over the IPO process, and questions whether the approach may be fraught with conflicts that may lead to inaccurate pricing. Issa cites to the experience of the Facebook IPO. He also wonders whether the process has the effect of foreclosing opportunities for meaningful retail participation in IPOs. Finally, Issa asks the SEC to comment on whether it has considered whether alternatives, such as auctionbased pricing, would be more beneficial and potentially less subject to overpricing and

conflicts of interest. Again, this is another area that had been explored many times before Issa's letter. The IPO Advisory Committee, in 2003, considered whether alternatives to the book building approach should be advanced. In other jurisdictions, there are examples of modified book building approaches where specified percentages are reserved for retail investor orders, as well as examples of auction-based approaches. Academics have devoted substantial attention to considering whether book building or auction-based approaches are beneficial to issuers and investors. In fact, Schapiro, in her response to Issa, provides a very thorough survey of the leading academic literature on IPO under-pricing and the advantages and disadvantages associated with the book building and the auction-based models. More or less at the same time, the US Senate Banking Committee's Subcommittee on Securities, Insurance and Investment held hearings examining the IPO process. Legislators had as their objective considering whether the IPO process is fair and transparent, and whether the IPO market operates effectively for both institutional and retail investors. Dr Ann Sherman provided testimony regarding the IPO methods used in different countries and commented on the costs and benefits of various approaches, concluding that retail investors are unlikely to contribute to more accurate IPO pricing. Sherman and other participants in the hearing did conclude that there was unequal access to information regarding IPOs. Sherman suggested requiring issuers to make their road show materials publicly available. Others suggested extending the application of Regulation FD in order to make certain that retail investors had access to the same information that was provided to institutional investors. From time to time, the IPO process appears to undergo review. However, at present, it is not clear that there is any impetus to re-evaluate the book building approach.

Disclosure requirements and disclosure effectiveness

The JOBS Act's IPO on-ramp provisions attempt to streamline the disclosure requirements for EGCs undertaking an IPO. The SEC also was mandated by Title I of the JOBS Act to undertake a study of the disclosure requirements set forth in Regulation S-K in order to analyse current disclosure requirements and determine whether these requirements can be updated, modified or simplified in order to reduce costs and other burdens on EGCs. On December 23, 2013, the SEC delivered to Congress its report, which considers potential recommendations for revisiting disclosure requirements broadly.[5]

Many practitioners have noted that even with the scaled disclosure requirements applicable to smaller reporting companies and the disclosure accommodations made available to EGCs by the JOBS Act, the SEC disclosure requirements and disclosure practices still seem to result in incredibly detailed and lengthy IPO documents that are often hundreds of pages long. Commentators have noted that, for a retail investor, it may be difficult to wade through dense disclosures and to assess which risks are most critical to the issuer's future prospectus and business results. For this reason, some commentators have encouraged the SEC to review whether certain disclosure requirements may be modernised or simplified.

In various speeches, SEC representatives have discussed the SEC's disclosure effectiveness project.[6] The staff of the Division of Corporation Finance is reviewing specific sections of Regulation S-K and S-X in order to assess whether certain requirements are outdated or redundant and whether disclosure requirements might benefit from a principles-based approach.[7] The SEC's review first considers the disclosures included in periodic reports and evaluates whether Industry Guides and form-specific disclosures should be updated, taking into consideration whether disclosure requirements should be scaled for smaller reporting companies and EGCs.[8]

The SEC also has stated that it plans to consider how information is disclosed and whether disclosure documents could be made simpler and more user friendly through the introduction of hyperlinks or topical indices.[9] The SEC staff also intends to consider whether to recommend a "company disclosure" or "core disclosure" approach in which an issuer's basic business description and other company information would be disclosed in a "core" document and supplemented through periodic filings.[10] In the absence of rule changes, the SEC has noted that practitioners could improve disclosures by avoiding repetition, producing more tailored, less generic risk factors and other disclosures and eliminating outdated information.[11]

The SEC also has identified a number of areas that often lead to duplicative disclosures.[12] For example, discussion of share-based compensation, verbatim repetition from the notes to the financial statements in the MD&A section of an issuer's critical accounting policies, and the "follow the leader" phenomenon whereby issuers include disclosures made by other comparable companies in their own filings even if those disclosures may not be appropriate or as relevant.[13]

Although the staff of the SEC has been engaged in this disclosure effectiveness project for some time and has requested comment on certain requirements under Regulation S-X in this context, the FAST Act imposes

certain deadlines for the SEC's work. Specifically, the FAST Act directs the SEC to complete its work related to revising Regulation S-K for the purpose of eliminating duplicative, overlapping, outdated or unnecessary requirements by no later than 180 days after the FAST Act's enactment, or June 2016. The FAST Act also requires that the SEC complete a study of Regulation S-K within 360 days after enactment, or November 2016.

It is important to note that changes to the disclosure requirements of Regulation S-K and Regulation S-X likely will apply to all issuers and not just to EGCs.

Smaller reporting companies and the "in-betweeners"

As we have noted elsewhere, over time, the SEC has done much to modernise its regulations relating to offering communications, and also has adopted changes to improve the capital formation process. Securities Offering Reform in 2005 simplified the offering process for the largest and most sophisticated public companies, WKSIs, and provided these companies with greater flexibility for offering-related communications. Companies that are considered smaller reporting companies are entitled to rely on certain scaled disclosure requirements, but many of these scaled disclosure requirements have not been reviewed by the SEC in some time. Many mid-sized companies cannot benefit from EGC status (due to the timing of their initial offerings of equity securities) and are larger than smaller reporting companies and thus not entitled to scaled disclosure provisions. We refer to these companies as in-betweeners. Their disclosure and reporting concerns have not been addressed. In addition, these companies have capital raising needs that also have not been addressed by Securities Offering Reform or by the modifications made to the eligibility requirements for use of shelf registration statements for primary offerings.

Capital formation issues for smaller reporting companies, as well as other mid-sized companies, continues to be a topic of discussion among market participants. For example, an industry task force, the Equity Formation Task Force, issued a report to the US Treasury Department recommending a few additional measures to facilitate capital formation.[14] The Equity Formation Task Force appears to be a successor to the IPO Task Force whose October 2011 report to the US Treasury Department contained various recommendations that were eventually incorporated in the JOBS Act.[15] Several bills have been proposed in Congress to address certain of the issues concerning smaller reporting companies and mid-cap companies. For example, bills have been introduced that would amend the definition of "non-accelerated filer," revise the definition of WKSI to lower the threshold and amend the restrictions on the use of Form S-3 by smaller reporting companies for primary offerings. The FAST Act directs the SEC to revise Form S-1 in order to permit smaller reporting companies to forward incorporate, or incorporate by reference documents filed after the effective date of the registration statement. This measure will make it much more cost-efficient for smaller reporting companies to maintain a current resale registration statement (or other registration statement) on Form S-1, without the need to file post-effective amendments. In light of the legislative proposals and recommendations made by the SEC's Advisory Committee on Smaller and Emerging Companies at the SEC's Government Business Forum on Small Business Capital Formation, additional measures will be considered that are intended to address the needs of smaller reporting companies.

Accredited investor status

As we discuss in Chapter 4, Title II of the JOBS Act required that the SEC implement regulations relaxing the prohibition against general solicitation and general advertising in connection with certain private offerings conducted pursuant to Rule 506 under Regulation D. The JOBS Act also required an additional measure of verification of the investor's status as an accredited investor in connection with any Rule 506 offering employing general solicitation. Investor verification was required, given that for private placements where general solicitation was used, it was possible for an issuer or a financial intermediary working on the issuer's behalf to contact potential investors with whom neither the issuer nor the financial adviser had a pre-existing relationship. Congresswoman Maxine Waters was the sponsor of an amendment to HR 2940 that created the requirement of reasonable steps to verify, and her language was ultimately included in section 201(a)(1) of the JOBS Act. Waters explained the rationale for her amendment as follows:

> *… I am concerned about the process in which accredited investors verify that they are in fact accredited. As I understand it, it is currently a self-certification process. This obviously leaves room for fraud … If we are rolling back protections for our targeted audience of sophisticated individuals, we must take steps to ensure that those folks are in fact sophisticated.*[16]

Historically, in the United States, the statutory private placement exemption, or section 4(a)(2) exemption, was available for a "private offering," which was understood to be an offering made on a limited basis to a group of investors with whom the issuer, or the issuer's agent, had a pre-existing relationship, and who were in a position to

have or to obtain certain information about the issuer. An offering made under proposed Rule 506(c) would still be considered a private placement; however, it would involve an offering to investors with whom the issuer potentially had no pre-existing relationship, and who might not necessarily receive any specified information about the issuer before making their investment decision. As a result, many commentators have expressed investor protection concerns. Commentators have noted that there is enhanced opportunity for fraudulent practices where general solicitation is used. As a result of these concerns, many, including SEC Commissioner Aguilar, have suggested that the SEC should revisit the definition of accredited investor and consider whether the definition sufficiently identifies investors that have the requisite financial sophistication to fend for themselves and not have the protections associated with registered securities offerings.[17]

Changes to the definition of accredited investor

On December 21, 2011, the SEC amended the accredited investor standards in its rules under the Securities Act to implement section 413(a) of the Dodd-Frank Act.[18] The change to the net worth standard was effective upon enactment by operation of the Dodd-Frank Act on July 21, 2010; however, section 413(a) also required the SEC to revise its Securities Act rules to conform to the new standard.[19] Rules 215[20] and 501(a)(5)[21] under the Securities Act set forth the accredited investor standards.[22] Pursuant to section 413(a) of the Dodd-Frank Act, the SEC is required to adjust the net worth standard for natural persons individually or jointly with their spouses, to "more than $1,000,000 … excluding the value of the primary residence."[23] Before the adoption of section 413(a), the standard under Rules 215 and 501(a)(5) required a minimum net worth of more than $1 million, but permitted an individual investor and his or her spouse to include the net equity value of their primary residence in calculating whether they qualified for accredited investor status.[24]

In amending Rules 215 and 501(a)(5) to conform to the new standard under the Dodd-Frank Act, the SEC adopted identical language in the two rules,[25] defining individual accredited investor status to require net worth in excess of $1 million, provided that "[t]he person's primary residence shall not be included as an asset." The final accredited investor definition is consistent with the approach taken in the proposing release with respect to the basic treatment of the primary residence and indebtedness secured by the primary residence.[26] The final rules also provide a specific provision addressing the treatment of incremental debt secured by the primary residence that is incurred in the 60 days before the sale of securities to the individual in the exempt offering and certain new grandfather provisions.

The new standard discusses the treatment of mortgage debt in calculating net worth. "Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability …"[27] Thus, under the final rules, as in the proposing release, net worth is calculated by excluding positive equity that an investor may have in its primary residence.[28] The SEC believed this approach to be the most appropriate way to conform its rules to section 413(a) stating: "it reduces the net worth measure by the net amount that the primary residence contributed to net worth before enactment of section 413(a), which we believe is what is commonly meant by 'the value of a person's primary residence'."[29] The final rules also provide that any excess of indebtedness secured by the primary residence over the estimated fair market value of the residence is considered a liability for purposes of determining accredited investor status on the basis of net worth, whether or not the lender can seek repayment from other assets in default.[30] In the SEC's view, the full amount of the debt incurred by the investor is the most appropriate value to use in determining accredited investor status.[31]

Review and mandatory study

Section 413(b) of the Dodd-Frank Act provides that four years after enactment, and every four years thereafter, the SEC must review the accredited investor definition as applied to natural persons, including adjusting the threshold, although it may not be lowered below $1 million.[32] Section 415 of the Dodd-Frank Act requires the Comptroller General of the United States to conduct a Study and Report on Accredited Investors examining "the appropriate criteria for determining the financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds."[33] The study is expected to be taken into account by the SEC in future rulemakings in this area.[34] On July 18, 2013, the US Government Accountability Office (GAO), which is headed by the Comptroller General, released its report with respect to the accredited investor standard.[35] In addition to reviewing data in order to understand whether the existing criteria serves the intended purpose or whether alternative criteria should be considered, the GAO conducted interviews with market participants. In connection with its study, the GAO considered whether

there should be an investments-owned criterion added to the accredited investor standard, or a tiered approach that would limit investments to a fixed percentage of an individual's net worth (similar to the proposed investment limits for crowdfunding offerings under Title III of the JOBS Act). The GAO also considered whether the accredited investor standard should be modified to introduce a sophistication or financial literacy prong. In its report, the GAO notes that market participants seemed to consider a minimum investments-owned criterion as practicable.

These recent changes to the accredited investor standard did not fundamentally alter the basic premise of the definition – that is, net worth continues to be used as a proxy for financial sophistication, or, at least for the ability to bear a certain measure of investment risk. However, many commenters have advocated that standards other than or in addition to net worth and annual income be considered in connection with revisions to the definition of "accredited investor." Certain recommendations have been incorporated into proposed legislation.

On December 18, 2015, the staff of the SEC published its Report on the Review of the Definition of "Accredited Investor" as required by section 413(b)(2)(A) of the Dodd-Frank Act.[36] The study suggests that, among other things, the Commission consider: leaving the current income and net worth thresholds in place, but make these subject to investment limitations; creating thresholds subject to inflationary adjustments; revising the definition to allow certain individuals to qualify as accredited investors based on other measures of sophistication, such as education or professional certifications; and amending the entity definitions.

Information requirements and continuing reporting requirements

In the post-JOBS Act world, there may be some disparities in the information requirements that arise for an issuer depending on the securities offering exemption that the issuer chooses to rely on in connection with its capital raising efforts. For example, following enactment of the JOBS Act, an issuer may conduct a Rule 506 offering using general solicitation and make sales to investors that are verified to be accredited investors. The issuer is not subject to any information requirements. The securities sold in a Rule 506 offering will be covered securities. The securities also will be restricted securities. Conceivably, an issuer could conduct multiple Rule 506 offerings, and, if the issuer remains below the holder-of-record threshold, the issuer would remain exempt from any requirement to provide information to security-holders. By contrast, an issuer might choose to raise modest amounts of capital in crowdfunded offerings through a funding portal or a broker-dealer made to a broader universe of potential investors, provided that the issuer complies with certain limited information requirements and thereafter makes publicly available certain limited information. The securities sold in a crowdfunded offering will be restricted securities. Title IV of the JOBS Act contemplates that an issuer that is not an SEC-reporting company may rely on the new Regulation A exemption to offer securities publicly, which will not be restricted securities, provided that the issuer satisfies certain information requirements. Following a Regulation A offering, the issuer may choose to remain private, although it will have issued shares in a broad-based offering, and may be subject to certain SEC reporting requirements, though these are likely to be limited. In addition, given the growth of private secondary markets, the securities of a private company may be actively traded through the facilities of a private secondary market and, provided the issuer remains under the holder-of-record threshold, it will not be subject to information requirements. There also may be issuers that have securities that trade over-the-counter and there may not necessarily be robust publicly available disclosures for investors. Also, in recent years, the "unicorn" phenomenon has received significant public attention. Privately held companies may rely for years on successive rounds of financing and achieve significant market capitalisations while remaining private. These companies may have dispersed shareholder bases and be well known to customers and institutional investors. Employees, consultants and other stakeholders in these companies may from time to time have liquidity opportunities presented to them through sales on private secondary markets. Recognising that the dynamics of capital formation may have changed permanently and IPOs may continue to be deferred in favour of exempt offerings, many commenters, including certain SEC Commissioners, have noted that attention should be devoted to promoting private secondary markets. Commenters also have noted that information requirements should be reviewed for companies that have developed a market following. It is likely that this is an area on which the SEC will focus as part of its investor protection mission.

Intrastate and regional offerings

At the same time that the SEC adopted Regulation Crowdfunding, the SEC proposed rule changes that could potentially facilitate intrastate and regional offerings that are subject to state blue sky regulation. The SEC proposed to modernise Rule 147 under the Securities Act and

establish a new exemption to facilitate offerings relying upon recently adopted intrastate crowdfunding exemptions under state securities laws. The SEC also proposed amendments to Rule 504 of Regulation D to increase the aggregate amount of securities that may be offered and sold in any 12-month period from $1 million to $5 million and to disqualify certain bad actors from participating in Rule 504 offerings. The SEC indicated in the proposing release that these proposals are "part of the Commission's efforts to assist smaller companies with capital formation consistent with other public policy goals, including investor protection."[37] These amendments were not required by the JOBS Act or by any other legislation, but resulted simply from the SEC's own initiative to undertake changes intended to promote capital formation.

Going forward

The JOBS Act has been an important catalyst for discussions regarding the appropriate balance between regulation and disclosure requirements and efficient access to the capital markets. We hope that the lively dialogue that the JOBS Act has reignited will continue and that it will lead to a review of disclosure requirements and additional innovative approaches to capital raising.

ENDNOTES

1 For more information, *see* "Market trends relating to JOBS Act accommodations" in Chapter 2 (The IPO process).
2 Letter dated June 19, 2012, *available at* http://s3.documentcloud.org/documents/370607/issa-ipoletter-june2012.pdf.
3 *See* http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p010373.pdf.
4 *See* letter at http://online.wsj.com/public/resources/documents/secipoletter0826.pdf.
5 For more information regarding the SEC's study on Regulation S-K, *see* "Required studies – Regulation S-K" in Chapter 1 (The IPO on-ramp).
6 *See* speech of Keith F. Higgins, Director, Division of Corporation Finance, titled "Disclosure Effectiveness: Remarks Before the American Bar Association Business Law section Spring Meeting" (April 11, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370541479332#.U2fpdxnD-Hs.
7 *Id.*
8 *Id.*
9 *Id.*
10 *Id.*
11 *Id.*
12 *See* speech of Keith F. Higgins, Director, Division of Corporation Finance, titled "Keynote Address at PLI – Thirteenth Annual Institute on Securities Regulation in Europe" (March 20, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370541190424#.U2f0ARnD-Hs.
13 *Id.*
14 *See* report titled "From the On-Ramp to the Freeway: Refueling Job Creation and Growth by Reconnecting Investors with Small-Cap Companies" (November 11, 2013), *available at* http://www.securitytraders.org/wp-content/uploads/2013/11/ECF-From-the-On-Ramp-to-the-Freeway-vF.pdf.
15 For more information regarding the IPO Task Force, *see* "Legislative and other efforts" in Introduction.
16 House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises Holds Markup on HR 1965, HR 2167, HR 2930, HR 2940 and a Draft Bill Concerning Small Companies and Regulatory Relief, 112th Cong., 1st Sess. (Congressional Hearing held October 5, 2011), Congressional Quarterly Transcripts at 8-9.
17 *See, e.g.*, Commissioner Luis Aguilar's statements titled "Increasing the Vulnerability of Investors," *available at* http://www.sec.gov/news/speech/2012/spch082912laa.htm.
18 Net Worth Standard for Accredited Investors, Securities Act Release No. 9287, Investment Company Act Release No. 29891, 2011 WL 6415435 (December 21, 2011) (the Net Worth Standard Adopting Release).
19 On January 25, 2011, the SEC proposed amendments to the accredited investor standards. *See* Net Worth Standard for Accredited Investors, Securities Act Release No. 9177, Investment Company Act Release No. 29572, 2011 WL 231559 (January 25, 2011).
20 17 CFR section 230.215.
21 17 CFR section 230.501(a)(5).
22 Rule 501 defines the term "accredited investor" for purposes of exempt and limited offerings under Rules 504, 505, and 506 of Regulation D. Rule 215 defines the term "accredited investor" under section 2(a)(15) of the Securities Act, setting the standards for accredited investor status under section 4(5) of the Securities Act, formerly section 4(6), which permits offerings solely to accredited investors of up to $5 million, subject to certain conditions. 15 USC 77d(5). Former section 4(6) of the Securities Act was renumbered section 4(5) by section 944 of the Dodd-Frank Act.
23 Section 413(a) of the Dodd-Frank Act, Pub. L. No. 111-203, section 413(a) (2010), states: "The Commission shall adjust any net worth standard for an accredited investor, as set forth in the rules of the Commission under the Securities Act of 1933, so that the individual net worth of any natural person, or joint net worth with the spouse of that person, at the time of purchase, is more than $1,000,000 (as such amount is adjusted periodically by rule of the Commission), excluding the value of the primary residence of such natural person, except that during the 4-year period that begins on the date of enactment of this Act, any net worth standard shall

be $1,000,000, excluding the value of the primary residence of such natural person."

24 *See* 17 CFR section 230.215(e) and section 230.501(a)(5) (2010).

25 The SEC stated: "… so the two rules will implement section 413(a) of the Dodd-Frank Act in the same way." *See* Net Worth Standard Adopting Release at *4.

26 *See id.* at *5.

27 *See* Rule 501(a)(5)(i)(B) (as amended).

28 *Id.*

29 *Id.*

30 *See id.* at *7.

31 *Id.* The SEC further explained: "that is the basis on which interest accrues under the mortgage and the amount that third parties would look to in assessing creditworthiness." *Id.*

32 Dodd-Frank Act, section 413(b).

33 Dodd-Frank Act, section 415.

34 *See* Net Worth Standard Adopting Release at *3.

35 *See* Report to Congressional Committees titled "Securities and Exchange Commission -– Alternative Criteria for Qualifying as an Accredited Investor Should be Considered" (July 2013), *available at* http://gao.gov/assets/660/655963.pdf.

36 *See* http://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-1218 2015.pdf.

37 *See* SEC Release No. 33-9470 (October 23, 2013).

APPENDIX A: JOBS ACT: SUMMARY OVERVIEW

EMERGING GROWTH COMPANIES (EGCS)	
Qualifying as an EGC	EGC defined as an issuer with total gross revenues of less than $1 billion
Disqualification as an EGC	EGC until the earliest of: (A) last day of the fiscal year during which issuer's total gross revenues exceed $1 billion; or (B) five years from IPO; or (C) the date on which issuer has sold more than $1 billion in non-convertible debt; or (D) date on which issuer becomes a large accelerated filer (public float of $750 million).
IPOs by EGCs	• Confidential submission available • Must file publicly at least 15 days (previously 21 days) before roadshow[1] • Two years audited financials required (instead of three) • May elect to rely on certain scaled disclosures available to smaller public reporting companies (such as for executive compensation) • May engage in testing the waters with QIBs and IAIs
Ongoing disclosures/governance requirements	• May opt into voluntary disclosures • Subject to phase-in for say-on-pay and say-on-golden parachute requirements • Subject to phase-in for any PCAOB mandatory rotation or modified audit report requirement • Exempt from Sarbanes-Oxley section 404(b) attestation (but subject to requirement for management assessment of internal control requirement over financial reporting and to CEO/CFO certification requirement) • Not required to adopt FASB standards until broadly applicable to private companies
RESEARCH REPORTS	
Permitted communications	• Research report on EGC not an offer • Research report on EGC not subject to quiet period or lock-up period restrictions • Distribution participants may publish research before commencement of an offering, during an offering, or post offering
Conflicts, separation, disclosures	• Reports subject to required conflicts disclosures and certifications • Modifies separation/chaperoning requirements in connection with certain activities for EGCs
REGULATION D	
Rule 506 offerings	General advertising/general solicitation permitted in Rule 506(c) offerings provided that the issuer has a reasonable belief that purchasers are all AIs based on verifying AI status
BROKER-DEALER REGISTRATION	
Platforms/matching services	Not required to register as broker-dealers solely as a result of participation or involvement in Rule 506 offerings that use general solicitation or general advertisement, provided that platform does not receive transaction-based compensation, handle customer funds or securities, or participate in documentation
CROWDFUNDING	
Offering threshold	The aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, is not more than $1 million

Investment threshold	The aggregate amount sold to any investor by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, does not exceed: • the greater of $2,000 or 5% of the annual income or net worth of the investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; or • 10% of the lesser of annual income or net worth of an investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if both the annual income or net worth of the investor is equal to or more than $100,000
Manner of offering	Transaction must be conducted through a broker or funding portal
Information	Information filed and provided to investors regarding the issuer and offering, including financial information based on the target amount offered
Funding portals	Funding portals are subject to SEC and SRO regulation
Liability	Subject to Securities Act section 12(a)(2) liability
Status of securities	Covered securities for NSMIA
Other conditions	Issuers must file with the SEC and provide to investors, no less than annually, reports of the results of operations and financial statements of the issuers
REGULATION A	
Eligible issuer	Non-reporting issuer with principal place of business in Canada or the United States; not an investment company or a bad actor
Offering threshold	Tier 1 offerings: Up to $20 million within the prior 12-month period (with no more than $6 million sold on behalf of selling stockholders) Tier 2 offerings: Up to $50 million within the prior 12-month period (with no more than $15 million sold on behalf of selling stockholders) SEC required to review threshold and report on threshold to Congress
Status of securities	Securities sold in a Tier 2 offering are covered securities for NSMIA; however, securities sold in a Tier 1 offering are subject to blue sky requirements
Investment threshold	Non-accredited natural persons in Tier 2 offerings are subject to an investment limit and are required to limit purchases to no more than 10% of the greater of the investors's net worth or annual income (for non-accredited, non-natural persons, the 10% limit is based on annual revenues and net assets)
Liability	Subject to section 12(a)(2) liability
Other conditions	SEC empowered to impose additional conditions; Tier 2 issuers must include audited financial statements in the offering statement and file with the SEC annual audited financial statements; rule includes detailed ongoing reporting requirements
EXCHANGE ACT THRESHOLD	
Issuer not a bank or bank holding company[2]	Becomes subject to reporting within 120 days after last day of fiscal year ended in which issuer had: • total assets in excess of $10 million; and • a class of equity securities (other than exempted securities) held of record by either 2,000 persons, or 500 persons not AIs

Issuer is a bank or bank holding company	Becomes subject to reporting within 120 days after last day of fiscal year ended in which issuer had: • total assets in excess of $10 million; and • a class of equity securities (other than exempted securities) held of record by 2,000 persons May deregister if class of equity securities held of record by fewer than 1,200 persons
Held of record	Excludes: securities held by persons who received the securities pursuant to an employee compensation plan in transactions exempt from section 5 registration requirements and securities sold pursuant to crowdfunding exemption
REQUIRED STUDIES	
Decimalisation	SEC, within 90 days of enactment, must report to Congress on its study of the impact of decimalisation on IPOs and the impact of this change on liquidity for EGCs; SEC also must consider within 180 days of enactment any recommendations regarding the minimum trading increments for EGCs; on July 20, 2012, the SEC delivered to Congress its report
Regulation S-K	SEC, within 180 days of enactment, must report to Congress on its review of Regulation S-K and its recommendations concerning changes to Regulation S-K requirements for EGCs to simplify burdens; on December 23, 2013, the SEC delivered to Congress its report
Blue Sky laws and Regulation A	Comptroller General, within 3 months of enactment, must report to Congress on its study of the impact of blue sky laws on Regulation A offerings; on July 3, 2012, the Comptroller General delivered to Congress its report
Section 12 SEC enforcement authority	SEC, within 120 days of enactment, must report to Congress on its assessment regarding additional enforcement tools that may be needed for it to enforce anti-evasion provision in Securities Act section 12(b)(3); on October 16, 2012, the SEC delivered to Congress its report

ENDNOTES

1 The 21-day period was shortened to a 15-day period by the FAST Act.

2 The FAST Act amends the Exchange Act section 12(g) threshold for savings and loan holding companies to make it the same as the threshold for banks and bank holding companies.

APPENDIX B: SUMMARY CHART OF EXEMPT OFFERING ALTERNATIVES

Below we provide a summary comparison of various securities exemptions.

Type of Offering	Dollar Limit	Manner of Offering	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Exemption
Section 3(a)(11)	None.	No limitation other than to maintain intrastate character of offering.	Issuer and investors must be resident in state. No limitation on number.	None.	Rests within the state (generally a nine month period for resales within state pursuant to Rule 147).	Need to comply with state blue sky laws by registration or state exemption.
Section 4(a)(2)	None.	No general solicitation or general advertising.	Investors must meet sophistication and access to information test so as not to need protection of registration.	None.	Restricted securities.	Need to comply with state blue sky laws.
Rule 504 Regulation D	$1 million with-in prior 12 months.	No general solicitation or general advertising unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sales to accredited investors with general solicitation.	Available to non-reporting companies only that are not investment companies or blank check companies.	File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sale to accredited investors with general solicitation.	Need to comply with state blue sky laws by registration or state exemption.
Rule 505 Regulation D	$5 million with-in prior 12 months	No general solicitation or advertising.	Unlimited accredited investors and 35 non-accredited investors.	File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted securities.	Need to comply with state blue sky laws.
Rule 506(b)	None.	No general solicitation or general advertising under Rule 506(b).	Unlimited number of accredited investors and 35 non-accredited investors that are sophisticated.	File Form D with SEC not later than 15 days after first sale.	Restricted securities.	No need to comply with state blue sky laws.

Type of Offering	Dollar Limit	Manner of Offering	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Exemption
Rule 506(c)	None.	General solicitation permitted, provided that all purchasers are accredited investors.	Under Rule 506(c), all purchasers must be accredited investors. Issuer must take reasonable steps to verify accredited investor status.	File Form D with the SEC not later than 15 days after first sale.	Restricted securities.	No need to comply with state blue sky laws.
Tier 1 Regulation A	$20 million within prior 12 months, but no more than $6 million by selling security holders.	"Testing the waters" permitted before and after filing Form 1-A. Sales permitted after Form 1-A qualified.	Eligible issuer No investor requirement.	File test-the-waters documents, Form 1- A, any sales material and report of sales and use of proceeds with the SEC.	Not restricted securities.	Subject to state blue sky laws regarding pre-offering review, filing, and anti-fraud.
Tier 2 Regulation A	$50 million within the prior 12 months, but no more than $15 million by selling security holders.	'Testing the waters' permitted before and after filing Form 1-A. Sales permitted after Form 1-A qualified.	Eligible issuer No investor requirement; however, investors who are natural persons and are not accredited investors are subject to an investment limit.	File test-the-waters documents, Form 1- A, any sales material and report of sales and use of proceeds with the SEC.	Not restricted securities.	Not subject to state blue sky laws regarding pre-offering review; however, subject to state blue sky filing and anti-fraud requirements.
Regulation Crowdfunding	Up to $1 million in a 12-month period.	Offering must be made solely through a platform.	Issuers that are not reporting companies, not funds, and not subject to disqualification.	Issuer subject to ongoing reporting requirements. Requires the preparation of a Form C, which resembles a Form 1-A.	Securities sold in an offering are subject to certain transfer restrictions for one year.	No need to comply with state blue sky laws.

APPENDIX C: EGC IPO PROCESS