Morgan Lewis

The Jumpstart Our Business Startups (JOBS) Act

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Provisions Relating to Emerging Growth Companies

- In effect now.
- Definition of an “Emerging Growth Company” (“EGC”):
  - An issuer that had total annual gross revenues of less than $1 billion during its most recently completed fiscal year.
    - *The $1 billion threshold is to be indexed for inflation by the SEC every five years to reflect the change in the Consumer Price Index for All Urban Consumers, published by the Bureau of Labor Statistics (“CPI”).*
  - An issuer cannot be an EGC if the first sale of common equity securities of the issuer under an effective Securities Act registration statement (the “IPO date”) occurred prior to December 8, 2011.

Provisions Relating to Emerging Growth Companies
Termination of EGC Status

- An EGC will no longer be deemed on EGC upon the earliest to occur of the following:
  - the last day of the EGC's fiscal year in which it had total annual gross revenues of at least $1 billion (as indexed for inflation based on the CPI);
  - the last day of the EGC's fiscal year following the fifth anniversary of the IPO date;
  - the date on which, during the previous 3-year period, the EGC has issued more than $1 billion in non-convertible debt; or
    - *On April 16, 2012, the Division of Corporation Finance (sometimes referred to as the "Division") issued Frequently Asked Questions on provisions of the JOBS Act relating to EGCs (the "April 16 FAQs"), stating that:*
      - the 3-year period is a rolling 3-year period and
      - "non-convertible debt" means any non-convertible security that constitutes indebtedness, whether issued in a registered offering or not.
  - the date the EGC is deemed a "large accelerated filer," as defined in Exchange Act Rule 12b-2.

Provisions Relating to Emerging Growth Companies
Executive Compensation Disclosures

- An EGC is exempt from the requirement under Exchange Act Section 14A to hold "say on pay," "say on frequency" and "say on golden parachute" votes.

- An issuer that is no longer an EGC will be subject to the Section 14A advisory voting requirements no later than:
  - For issuers that were EGCs for less than 2 years after the IPO date - 2 years from the IPO date.
  - For all other issuers – 1 year from the date the issuer is no longer an EGC.

Provisions Relating to Emerging Growth Companies
Executive Compensation Disclosures
(cont'd)

- EGCs need not provide "pay for performance" and "pay ratio" disclosures required under Section 953(b)(1) of the Dodd-Frank Act.
  - The SEC has not yet proposed rules implementing these requirements.
- EGCs may comply with Item 402 of Regulation S-K (executive compensation disclosure requirements) as it applies to "smaller reporting companies" (generally, an issuer with less than a $75 million public float).

Provisions Relating to Emerging Growth Companies
Financial Disclosures

- An EGC need not present more than two years of audited financial statements in a Securities Act registration statement for its IPO of common equity securities.
  - In the April 16 FAQs, the Division stated the following:
    - *The provision in the JOBS Act permitting the filing of only two years of audited financial statements is limited to the registration statement for the EGC's IPO of common equity securities.*
    - *Nevertheless, the Division will not object if, in other registration statements, an EGC does not present audited financial statements for any period prior to the earliest audited period presented in connection with its IPO of common equity securities.*
    - *If an EGC that presents two years of financial statements is required to include financial statements of another entity, the Division will not object if the EGC provides only two years of financial statements of the other entity, even though application of the significance test would result in a requirement to file three years of financial statements.*

Provisions Relating to Emerging Growth Companies
Financial Disclosures *(cont'd)*

- In any other Securities Act registration statement or any Exchange Act registration statement or report, the EGC need not present selected financial data for any period earlier than the earliest audited period presented in connection with the EGC's IPO.
  - Despite the reference to "other" Securities Act registration statements, the April 16 FAQs state that the Division will not object if an EGC presenting two years of audited financial statements in its IPO registration statement limits the number of years of selected financial data to two years.
- An EGC's MD&A need only provide information covering the abbreviated financial statement period.
  - Because the JOBS Act selected financial data and MD&A provisions specifically address Regulation S-K requirements, the provisions do not appear to apply to foreign private issuers. Nevertheless, in the April 16 FAQs, the Division stated that it will not object if a foreign private issuer that qualifies as an EGC complies with the scaled disclosure provisions available to EGCs to the extent relevant to the form requirements for foreign private issuers.

Provisions Relating to Emerging Growth Companies
Limitation of Application of Financial Standards

- In any Securities Act registration statement or Exchange Act registration statement or report:
  - An EGC will not be required to comply with any new financial reporting standard until the standard applies to non-issuers.
    - *For this purpose, the term "issuer" has the meaning as defined in Section 2(a) of the Sarbanes-Oxley Act (generally, entities that have a class of securities registered under Exchange Act Section 12, are subject to reporting requirements under Exchange Act Section 15(d), or have filed a Securities Act registration statement with the SEC).*
    - *In the April 16 FAQs, the Division stated that, in providing information on recently issued accounting standards, an EGC should disclose the date on which adoption is required for non-EGCs and the date on which the EGC will adopt the accounting standard.*

Provisions Relating to Emerging Growth Companies
Exemption from Internal Control Audit

- EGCs are exempt from the internal control auditor attestation requirement of Section 404(b) of the Sarbanes-Oxley Act.

- Management's report on internal control over financial reporting will be required.

Provisions Relating to Emerging Growth Companies:
Limitation on Application of New Auditing Standards

- Any PCAOB rule requiring
  - mandatory audit firm rotation or
  - auditor discussion and analysis

  will not apply to the audit of an EGC.
  - The PCAOB is considering, but has not adopted, these rules.
- Any additional PCAOB rules adopted after the JOBS Act is enacted will not apply to the audit of an EGC unless
  - the SEC determines that the application of such additional requirements is necessary or appropriate in the public interest after considering
    - *the protection of investors and*
    - *whether the action will promote efficiency, competition and capital formation.*

Provisions Relating to Emerging Growth Companies
Overriding Provisions Limiting the Use of Research Reports

- The JOBS Act amends Securities Act Section 2(a)(3) (definition of "sale") to limit the scope of Securities Act Section 2(a)(10) (definition of "prospectus") and Section 5(c) (prohibits offers to sell securities, through use of a prospectus or otherwise, prior to filing a registration statement) with respect to research reports relating to an EGC.
- The publication or distribution by a broker or dealer of a research report about an EGC that is the subject of a registered common equity offering that the issuer proposes to or has filed, or that is effective, will not constitute an offer to sell a security,
  - even if the broker is participating or will participate in the registered offering.
    - *Effectively overrides certain limitations in Securities Act Rules 137, 138 and 139 designed to prevent the use of research reports as selling tools in connection with registered offerings.*
    - *By stating that, for purposes of the definition of "prospectus," a research report does not constitute an offer to sell a security, the research report is not a prospectus and Securities Act Section 12(a)(2) will not apply to the research report.*

Provisions Relating to Emerging Growth Companies
Overriding Provisions Limiting the Use of Research Reports *(cont'd)*

- Neither the SEC nor any national securities association (i.e., FINRA) may adopt or maintain a rule prohibiting a broker, dealer or FINRA member from distributing a research report or making a public appearance, with respect to an EGC's securities:
  - within a prescribed period of time following the IPO date.
  - within any prescribed period of time prior to the expiration of a lock-up period under an agreement relating to sale of an EGC's securities after the IPO date.
    - *These JOBS Act provisions override certain provisions in FINRA Rule 2711.*

Provisions Relating to Emerging Growth Companies
Overriding Provisions Limiting Analyst Communications

- The SEC and FINRA may not adopt or maintain any rule in connection with an IPO for an EGC's common equity securities that:
  - restricts, based on functional rule, which associated persons of a broker, dealer or FINRA member may arrange for communications between a securities analyst and a potential investor.
  - restricts an analyst from participating in communications with management of the EGC that also is attended by other associated persons of the broker, dealer or FINRA member that is not an analyst.

Provisions Relating to Emerging Growth Companies
"Testing the Waters" in Securities Act Offerings

- The JOBS Act adds Section 5(d) of the Securities Act, which provides that: "Notwithstanding any other provision of this Section . . .":
  - An EGC (or a person acting on its behalf) may engage in oral or written communications with potential investors that are qualified institutional buyers (as defined in Securities Act Rule 144A) or institutions that are accredited investors (as defined under Securities Act Rule 501(a) in Regulation D) to determine if such investor may have an interest in a securities offering.
  - The communication may occur prior to or following the date of filing of the registration statement, "subject to the requirements of subsection 5(b)(2)" (prohibition on carrying a security for sale or delivery after sale unless accompanied or preceded by a Section 10(a) prospectus).

Provisions Relating to Emerging Growth Companies
Draft Registration Statements

- Under new Section 6(e) of the Securities Act, an EGC, prior to its IPO date, can submit a draft registration statement to the SEC for confidential, non-public review.
  - The confidential submission and all amendments must be publicly filed no later than 21 days before the issuer conducts a "road show" (as defined in Securities Act Rule 433(h)(4)).
    - *The 21 day requirement may prove to be a disincentive to use of draft registration statements.*
    - *Rule 433(h)(4) defines a "road show" as "an offer (other than a statutory prospectus or portion of a statutory prospectus filed as part of a registration statement) that contains a presentation regarding an offering by one or more members of the issuer's management . . . and includes a discussion of one or more of the issuer, such management and the securities being offered."*
  - The SEC cannot be compelled to disclose the confidential submissions.
    - *The confidential information will be exempt from disclosure under the Freedom of Information Act.*

Provisions Relating to Emerging Growth Companies
Draft Registration Statements *(cont'd)*

- On April 5, 2012 (the date the JOBS Act was enacted), the Division of Corporation Finance announced that EGCs may now confidentially submit draft registration statements for review.
  - Until a system for electronic submission is implemented, draft registration statements should be submitted as a text searchable PDF file on a CD/DVD or in paper format.
    - *The issuer should include a transmittal letter confirming EGC status.*
    - *No registration fee is required.*
    - *The submission will not be deemed "filed" for purposes of Section 5.*

Provisions Relating to Emerging Growth Companies
Draft Registration Statements *(cont'd)*

On April 10, 2012, the Division of Corporation Finance issued Frequently Asked Questions relating to the confidential submission process for EGCs. Among the matters addressed were the following:

- Because the term "initial public offering date" ["IPO date" in this presentation] is defined as the "date of the first sale of common equity securities of an issuer pursuant to an effective registration statement under the Securities Act of 1933," it can refer to an offering of stock under a Form S-8 registration statement or a selling shareholder's registered secondary offering.
- The confidential submission process is not available for Form 10 or Form 20-F Exchange Act registration statements.
- Foreign private issuers that are EGCs can use the confidential submission process (or, if it meets the requirements, can continue to make a non-public submission under the Division's policy on Non-Public Submissions from Foreign Private Issuers).

Provisions Relating to Emerging Growth Companies
Draft Registration Statements *(cont'd)*

- The Securities Act filing fee is due when the registration statement is first filed publicly on EDGAR.
- The draft registration statement need not be signed or include consents.
- The Division expects draft registration statements to be substantially complete, including a signed audit report.
- The Division will not object if an EGC does not treat "test the waters" communications under new Section 5(d) (which are limited to QIBs and institutional accredited investors) as a road show for purposes of the 21 day requirement under Section 6(e).
- If the EGC does not conduct a traditional road show or other activities that would come within the definition of "road show" (other than permissible "test the waters" activity), the registration statement and confidential submissions should be filed publicly on EDGAR at least 21 days before the anticipated effective date of the registration statement.

Provisions Relating to Emerging Growth Companies
Draft Registration Statements *(cont'd)*

- To accomplish the public filing of the confidential submission and all amendments at least 21 days before the road show (or, if applicable, the anticipated effective date), each confidential submission should be filed as a separate exhibit 99 to the first publicly filed registration statement.

- An EGC that filed a registration statement prior to enactment of the JOBS Act but is eligible to submit its registration statement on a confidential basis may switch to the confidential submission process for future amendments.

- The Securities Act Rule 134 safe harbor (for limited public notices about an offering) will not be available until the issuer files (i.e., on EDGAR) a registration statement that meets the requirements of Rule 134.

Provisions Relating to Emerging Growth Companies
Opt-In Right for EGCs

- An EGC may choose to forgo any exemption provided under the JOBS Act.
- However, with regard to the extension of time to comply with new financial accounting standards,
  - the EGC must make its opt-in election at the time it is first required to file a registration statement or periodic or other report under Exchange Act Section 13, and notify the SEC of its choice.
    - *In the April 16 FAQs, the Division stated that, although not required under the JOBS Act, EGCs submitting their draft registration statements on a confidential basis should notify the staff of their choice in their initial confidential submission, "as that choice will inform the staff's review of the financial statements in the draft registration statement."*
  - the EGC cannot selectively opt-in with regard to the financial accounting standards.
    - *The opt-in election relating to financial accounting standards is irrevocable.*

Provisions Relating to Emerging Growth Companies
Tick Size Study

- The SEC is required to conduct a study and submit a report within 90 days following the enactment of the JOBS Act (July 4, 2012):
  - The study must examine the impact that decimalization (trading in $0.01 increments) has had on the number of IPOs and on liquidity for small and middle capitalization company securities and
  - whether there is sufficient economic incentive to support trading operations in these securities in penny increments.
- If the SEC determines that EGC securities should be quoted and traded in more than $0.01 increments, it may adopt rules, no later than 180 days after the enactment of the JOBS Act (October 2, 2012), to designate a greater minimum increment, up to $0.10.

Provisions Relating to Emerging Growth Companies
Regulation S-K Study

- Not later than 180 days after enactment of the JOBS Act (October 2, 2012), the SEC must report to Congress on a review of Regulation S-K.
- The review must:
  - "comprehensively analyze the current registration requirements for such regulations" and
  - determine how the requirements can be updated to modernize and simplify the registration process and reduce costs and other burdens associated with the requirements for EGCs.

General Solicitation in Rule 506 and Rule 144A Offerings

- Not later than 90 days after enactment of the JOBS Act (July 4, 2012), the SEC must revise Securities Act Rules 506 and 144A(d)(1) as follows:
  - Rule 506 – The Rule 502(c) prohibition on general solicitation and general advertising will not apply to Rule 506 offerings, provided that all purchasers of securities are accredited investors.
    - *The rules must require the issuer to take "reasonable steps" to verify that purchasers are accredited investors, using such methods as determined by the SEC.*
    - *Rule 506 will continue to be treated as a regulation issued under Section 4(2).*
  - Rule 144A(d)(1) - Securities sold under Rule 144A may be offered, including by means of general solicitation or general advertising, to persons other than qualified institutional buyers (QIBs), provided that securities are sold only to persons the seller and any person acting on its behalf reasonably believe are QIBs.

Statutory Interpretation
"Public Offering"

- New Securities Act Section 4(b) states that offers and sales under Rule 506 (as revised by the JOBS Act) will not be deemed public offerings as a result of general advertising or general solicitation.
  - Preserves Section 4(2) (now Section 4(a)(2)) exemption for Rule 506 offerings.

Rule 506
Activities That Will Not Require Broker-Dealer Registration
Securities Act Section 4(b)(1)

- In connection with a Rule 506 offering, and subject to specified conditions, a person will not be subject to registration as a broker or dealer solely because:
  - the person maintains a platform or mechanism that permits
    - *the offer, sale or purchase of, or negotiation with respect to securities,*
    - *general solicitation or general advertisements or*
    - *similar or related activities by issuers of such securities, whether online, in person or through other means, or*
  - the person or any person associated with the person
    - *co-invests in the securities or*
    - *provides "ancillary services" with respect to the securities*

Rule 506
Activities That Will Not Require Broker-Dealer Registration: Conditions to the Exemption – Securities Act Section 4(b)(2)

- The exemption is available only if
  - the person and each of its associated persons receives no compensation in connection with the purchase or sale of the security,
  - the person and each of its associated persons do not have possession of customer funds or securities in connection with the purchase or sale of the security, and
  - neither the person nor any of its associated persons is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act.
    - *The JOBS Act references Section 3(a)(39) "of this title," apparently intending to refer to Section 3(a)(39) of the Exchange Act.*

Rule 506
Activities That Will Not Require Broker-Dealer Registration: Definition of "Ancillary Services"

- "Ancillary Services" are:
  - due diligence services in connection with the offer, sale or purchase of, or negotiation with respect to, the security, if the services do not include "for separate compensation," investment advice or recommendations to issuers or investors and
  - The provision of standardized documents to issuers if:
    - *the person does not negotiate the terms of the issuance of the securities "for and on behalf of third parties," and*
    - *issuers are not required to use the standardized documents as a condition to using the service.*

Crowdfunding

- Title III of the JOBS Act, also called the **C**apital **R**aising **O**nline **W**hile **D**eterring **F**raud and **U**nethical **N**on-**D**isclosure (CROWDFUND) Act of 2012:
- Embodies the Senate amendment to the version of the JOBS Act initially passed by the House.
- Requires the SEC to adopt extensive regulations within 270 days following enactment of the JOBS Act (December 31, 2012).

Crowdfunding
Section 4(a)(6)

- The JOBS Act creates a new Section 4(a)(6) of the Securities Act, exempting from Securities Act registration requirements offers and sales of an issuer's securities in "crowdfunding" transactions.
  - Title III of the JOBS Act refers to amendments to Section 4(6) of the Securities Act. However, Section 201(b) of the JOBS Act divides Section 4 into subsections (a) and (b) so that the amendments to Section 4 relating to crowdfunding are incorporated in new Section 4(a)(6).

Crowdfunding
Section 4(a)(6) *(cont'd)*

- Aggregate Limit – The aggregate amount of securities of the issuer sold to all investors in reliance on the Section 4(a)(6) exemption together with all other sales in reliance on the Section 4(a)(6) exemption during the preceding 12 month period may not exceed $1,000,000.
  - This and all other dollar amounts in the JOBS Act crowdfunding provisions are to be adjusted by the SEC every five years to reflect changes in the CPI.

Crowdfunding
Section 4(a)(6) *(cont'd)*

- The Section 4(a)(6) exemption does not apply to
  - foreign issuers,
  - Exchange Act reporting companies,
  - investment companies (as defined in Section 3 of the Investment Company Act, or excluded from the definition by Section 3(b) or 3(c) of that Act) and
  - any other issuer excluded by SEC rule.

Crowdfunding
Section 4(a)(6) *(cont'd)*

- Individual Investor Limit – The aggregate amount of sales to any investor by an issuer, including any amount sold in reliance on the Section 4(a)(6) exemption during the preceding 12 months, may not exceed:
  - for individuals with either annual income or net worth of less than $100,000 – the greater of
    - *$2,000 or*
    - *5 percent of the annual income or net worth of the investor, as applicable.*
  - for individuals with either annual income or net worth equal to or more than $100,000,
    - *10 percent of the annual income or net worth of the investor, as applicable, not to exceed $100,000,*

Crowdfunding
Section 4(a)(6) *(cont'd)*

- For the purposes of Section 4(a)(6), an "issuer" includes all entities controlled by or under common control with the issuer.
- Under new Securities Act Section 4A(h),
  - the calculation of net income and net worth under Section 4(a)(6) will be made "in accordance with any rules of the Commission under [the Securities Act] regarding the calculation of the income and net worth respectively, of an accredited investor" and
  - dollar amounts in Section 4(a)(6) and in issuer information requirements under new Section 4A(b) will be adjusted no less frequently than once every 5 years to reflect changes in the CPI.

Crowdfunding
Section 4(a)(6) *(cont'd)*

- The transaction must be conducted through a broker or "funding portal" that complies with the requirements of new Securities Act Section 4A(a).
  - Under new Securities Act Sections 4A(a)(1) and (2), a person acting as an intermediary in a Section 4(a)(6) transaction must, among other things, register with the SEC and any applicable self-regulatory organization as a broker or funding portal.
- The issuer must comply with the requirements of new Securities Act Section 4A(b).

Crowdfunding
Definition of Funding Portal
Exchange Act Section 3(a)(80)

- What is a Funding Portal?
  - Any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely under Section 4(a)(6), that does not:
    - *offer investment advice or recommendations,*
    - *solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal,*
    - *compensate employees, agents or other persons*
      - for such solicitation or
      - based on the sale of securities displayed or referenced on its website or portal,
    - *hold, manage, possess or otherwise handle investor funds or securities or*
    - *engage in other activities specified by SEC rule.*

Crowdfunding
Actions Required of Intermediaries
Section 4A(a)(3)

- Intermediaries in Section 4(a)(6) offerings must provide disclosures required by SEC rules,
  - including disclosures relating to risks and other investor education materials.

Crowdfunding
Actions Required of Intermediaries – Section 4A(a)(4) *(cont'd)*

- Intermediaries must ensure that each investor
  - reviews investor education information in accordance with standards set forth in SEC rulemaking,
  - positively affirms that the investor:
    - *understands that he or she is risking loss of his or her entire investment, and*
    - *can bear such a loss, and*
  - answers questions demonstrating an understanding of
    - *the level of risk generally applicable to investments in startups, emerging businesses and small issuers,*
    - *the risk of illiquidity, and*
    - *such other matters as are set forth in SEC rules.*

Crowdfunding
Actions Required of Intermediaries
Section 4A(a)(5) – (6)

- Intermediaries must
  - take measures required by SEC rule to reduce the risk of fraud, including obtaining a background and securities enforcement regulatory history check on each of the issuer's
    - *officers,*
    - *directors and*
    - *20 percent equity holders, and*
  - make available to the SEC and potential investors the information required to be provided by issuers under new Section 4A(b) not later than 21 days prior to the first day on which securities are sold to any investor.
    - *The SEC may specify a different period.*

Crowdfunding
Actions Required of Intermediaries
Section 4A(a)(7) *(cont'd)*

- Intermediaries must
  - ensure that offering proceeds are not provided to the issuer until the aggregate capital raised from all investors is at least equal to the target offering amount and
  - allow investors to cancel their commitment to invest, as provided by SEC rule.

Crowdfunding
Actions Required of Intermediaries – Sections 4A(8) – (12)

- Intermediaries must
  - make such efforts as set forth in an SEC rule to ensure that "no investor in a 12-month period has purchased securities offered pursuant to [Section 4(a)(6)] that in the aggregate, from all issuers," exceeds the Section 4(a)(6) investment limits,
  - take steps to protect the privacy of information collected from investors, in accordance with SEC rules,
  - not compensate promoters, finders or lead generators for providing personal identifying information of any potential investor to a broker or funding portal,
  - prohibit its directors, officers or partners (or persons occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services and
  - meet other requirements prescribed by SEC rules.

Crowdfunding
Actions Required of Issuers
Information to be Provided – Section 4A(b)(1)

- An issuer that offers or sells a security in a Section 4(a)(6) transaction must:
  - file with the SEC,
  - provide to investors,
  - provide to the relevant broker or funding portal, and
  - make available to potential investors

  several categories of information.

Crowdfunding
Actions Required of Issuers
Information to be Provided – Section 4A(b)(1) (cont'd)

- The categories of information to be provided include:
  - The name, legal status, physical address and website address of the issuer,
  - The names of the directors and officers (and any persons occupying a similar status or performing a similar function) and each 20 percent holder of "the shares of the issuer."

Crowdfunding
Actions Required of Issuers
Information to be Provided – Section 4A(b)(1) (cont'd)

- A description of the financial condition of the issuer, including, for offerings that, together with all other Section 4(a)(6) offerings within the preceding 12 month period, have aggregate target offering amounts of
  - $100,000 or less,
    - *income tax returns filed by the issuer for the most recently completed fiscal year (if any); and*
      - (Effect on offerings early in the fiscal year?)
    - *financial statements of the issuer, certified by the principal executive officer to be "true and complete in all material respects."*
  - more than $100,000 to $500,000,
    - *financial statements reviewed by a public accountant independent of the issuer, using professional standards and procedures for such review or standards and procedures established by SEC rule for such purpose.*
  - more than $500,000, or such other amount set forth in an SEC rule,
    - *audited financial statements.*

Crowdfunding
Actions Required of Issuers
Information to be Provided – Section 4A(b)(1) (cont'd)

- A description of the stated purpose and intended use of proceeds of the offering with respect to the target offering amount.
- The target offering amount, the deadline to reach that amount, and regular updates regarding the issuer's progress in meeting the amount.
- The price to the public of the securities and method for determining the price,
  - provided that prior to sale, each investor must be provided:
    - *in writing, the final price and all required disclosures; and*
    - *"a reasonable opportunity to rescind the commitment to purchase the securities."*

Crowdfunding
Actions Required of Issuers
Information to be Provided – Section 4A(b)(1) (cont'd)

- A description of the ownership and capital structure of the issuer, including:
  - terms of the offered securities and other classes of the issuer's securities, including how such terms may be modified, and a summary of the differences between such securities, including how the rights of the offered securities may be materially limited, diluted or qualified by rights of another class of issuer securities;
  - a description of how the exercise of rights held by principal shareholders of the issuer could negatively impact the purchasers of the offered securities;

Crowdfunding
Actions Required of Issuers
Information to be Provided – Section 4A(b)(1) (cont'd)

- the name and ownership level of each existing shareholder who owns more than 20 percent of any class of issuer securities;
  - *Note that a separate information requirement calls for disclosure of each 20 percent holder of "the shares of the issuer."*
- how the offered securities are being valued "and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions";
- risks to purchasers related to minority ownership in the issuer and risks associated with corporate actions, including additional share issuances, a sale of the issuer or its assets, and related party transactions; and
- any other information required by SEC rule.

Crowdfunding
Actions Required of Issuers
Other Matters – Section 4A(b)(2) – (3)

- Limitations on issuer advertising – Issuers may not advertise the terms of the offering, except through notices directing investors to the funding portal or broker.

- Disclosure requirements relating to compensation for specified promotional activities – Issuers must refrain from compensating or committing to compensate any person for promoting the issuer's offerings through communication channels provided by a broker or funding portal without taking such steps as required by SEC rule to ensure that the person "clearly discloses the receipt, past or prospective" of such compensation "upon each instance of such promotional communication."

Crowdfunding
Actions Required of Issuers
Other Matters – Section 4A(b)(4) – (5)

- Issuer reporting requirements – File with the SEC and provide to investors, at least annually, "reports of the issuer's results of operations and financial statements," as specified by SEC rule,
  - subject to such exceptions and termination dates as specified by SEC rule.

- Issuers also must comply with any other requirements as the SEC may, by rule, prescribe, for the protection of investors and in the public interest.

Crowdfunding
Information to be Provided to State Securities Authorities – Section 4A(d)

- The SEC will make available or cause the relevant broker or funding portal to make available, to the state and U.S. territorial securities authorities, the information issuers are required to provide under Section 4A(b), and such other information required by SEC rule.

Crowdfunding
Liabilities – Right of Action – Section 4A(c)

- The JOBS Act provides for Section 12(a)(2) - type liability against the issuer in connection with a Section 4(a)(6) offering.

- A person who purchases of security in a Section 4(a)(6) offering may bring a civil action against an issuer:
  - to recover all consideration paid for the security plus interest (less any income received on the security) upon tender of the purchased security; or
  - for damages, if the person no longer owns the securities.

Crowdfunding
Liabilities – Right of Action – Section 4A(c) *(cont'd)*

- Any action brought under Section 4A(c)(1) will be subject to the provisions of Securities Act Sections 12(b) and Section 13, as if the liability were created under Section (12)(a)(2).
  - Section 12(b), in effect, limits liability to the extent the person who offered or sold the security can prove that any portion of the amount of loss otherwise recoverable under Section 12(a)(2) was not caused by a material misstatement or omission in connection with the offer or sale of securities.
  - Section 13 establishes a statute of limitations in Section 12(a)(2) actions - one year after discovery of the untrue statement or omission (or after such discovery should have been made by the exercise of reasonable diligence), but in no event more than three years after the sale.

Crowdfunding
Liabilities – Definition of "Issuer" for Purposes of Section 4(A)(c)

- The term "issuer" includes any person who is
  - a director or partner of the issuer,
  - the principal executive officer or officers,
  - the principal financial officer,
  - the controller or principal accounting officer, or
  - any person occupying a similar status or performing a similar function.

  that offers or sells a security in a Section 4(a)(6) transaction "and any person who offers or sells the security in such offering."

Crowdfunding
Liabilities – Standards of Liability – Section 4A(c)(2)

- An issuer will be liable in an action brought under Section 4A(c)(1) for material misstatements or omissions in oral or written communications (by use of any means or instruments of transportation or communication, in interstate commerce or of the mails) in connection with the offer or sale of securities in a Section 4(a)(6) transaction, provided that;
  - the purchaser did not know of the misstatement or omission, and
  - the issuer does not sustain the burden of proof that it did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.
    - *Section 4A(c)(2) essentially adopts the Section 12(a)(2) liability standard.*
      - "The standard of care under Section 12(a)(2) is less demanding than that prescribed by Section 11 or, put another way, . . . Section 11 requires a more diligent investigation than Section 12(a)(2)." Securities Offering Reform, Release No. 33-8591 (July 19, 2005), Section IV.C.

Crowdfunding
Restrictions on Resales – Section 4A(e)

- A purchaser of securities in a Section 4(a)(6) transaction may not transfer the purchased securities for one year after purchase, except for transfers
  - to the issuer,
  - to accredited investor,
  - in an offering registered with the SEC, or
  - to a family member "or the equivalent," in connection with the death or divorce of the purchaser, or "in other similar circumstances," in the discretion of the SEC.
- The SEC may, by rule, impose additional limitations on resale.

Crowdfunding
Disqualifications – JOBS Act Section 302(d)

- The SEC, by rule, must establish provisions for disqualification of issuers from offering securities in, and brokers or funding portals from effecting or participating in, Section 4(a)(6) offerings.

Crowdfunding
Disqualifications – JOBS Act Section 302(d) *(cont'd)*

- The disqualification provisions will:
  - be substantially similar to Securities Act Rule 262 (Regulation A disqualification provisions),
  - will disqualify the offer or sale of securities by a person
    - *who is subject to a final order of a state securities, banking or insurance authority, or a federal banking agency or the National Credit Union Association that:*
      - bars a person from associating with entities regulated by the authority, from engaging in the business of securities, insurance or banking, or from engaging in savings association or credit union activities,
      - constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct within the 10 years prior to the date of the "filing of the offer or sale," or
    - *who has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC.*

Crowdfunding
Investor Exclusion from Section 12(g)
Exchange Act Section 12(g)(6)

- The SEC must adopt a rule "conditionally or unconditionally" exempting securities acquired in a Section 4(a)(6) offering from the provisions of Section 12(g) of the Exchange Act.
    - As a result of this provision and other JOBS Act amendments to Exchange Act Section 12(g), subject to any conditions set forth in SEC rules, Section 12(g) registration will not be required for a class of equity securities if fewer than 2,000 holders of record and fewer than 500 holders of record who are not accredited investors hold securities issued in transactions other than Section 4(a)(6) offerings.

Crowdfunding
Regulation of Trading Portals
Exchange Act Section 3(h)

- Under new Exchange Act Section 3(h), the SEC must, by rule, exempt, "conditionally or unconditionally," a registered funding portal from broker-dealer registration, provided that the funding portal:
  - remains subject to the examination, enforcement and other SEC rulemaking authority;
  - is a member of a national securities association (FINRA); or
  - is subject to other requirements set forth in SEC rules.

Crowdfunding
Regulation of Trading Portals
Exchange Act Section 3(h) *(cont'd)*

- For the purposes of Exchange Act Sections 15(b)(8) (effectively requires most registered brokers and dealers to be members of FINRA) and 15A (governing national securities associations), the term "broker or dealer" includes a funding portal and the term "registered broker or dealer" includes a registered funding portal, except as otherwise determined by SEC rule.
  - FINRA can conduct examinations of or bring enforcement actions against a registered funding portal only under FINRA rules written specifically for registered funding portals.

Crowdfunding
Preemption of State Law

- Securities sold in Section 4(a)(6) offerings are "covered securities."
  - As a result, Section 4(a)(6) offerings are exempt from state registration, documentation and offering requirements.
  - In addition, no state may impose a fee on a notice filing in connection with securities offered and sold in a Section 4(a)(6) transaction except:
    - *the state of the issuer's principal place of business; or*
    - *the state in which purchasers of 50 percent or more of the aggregate amount of the issue are residents.*
- However, states will retain jurisdiction with respect to fraud or deceit or unlawful conduct by a broker, dealer, funding portal or issuer.

Crowdfunding
Preemption of State Law – Funding Portals

- No state may regulate a registered funding portal "with respect to its business as such," except:
  - The state in which the principal place of business of a registered funding portal is located may examine a funding portal or enforce any law, rule, regulation or administrative action against a funding portal,
    - *provided, the law, rule, regulation or administrative action is not "in addition to or different from the requirements for registered funding portals established by the [SEC]."*

Expansion of Section 3(b) Exemption
"Super" Regulation A

- Under amendments to Section 3(b) of the Securities Act, the SEC must adopt a rule (no deadline is set forth in the JOBS Act) adding a class of securities to the securities exempt under Section 3, subject to the following terms and conditions.
  - The aggregate offering price for all securities offered and sold within the prior 12 month period is $50 million.
    - *The SEC is required to review the dollar amount limitation every two years and increase the amount as it deems appropriate.*
      - If the SEC determines to not increase the amount, it must report the reasons for its determination to the House Committee on Financial Services and the Senate Committee on Banking, Housing and Urban Affairs.

Expansion of Section 3(b) Exemption
"Super" Regulation A *(cont'd)*

- The securities may be offered and sold publicly.
- The securities will not be restricted securities.
- Securities Act Section 12(a)(2) liability will apply to any person offering or selling the securities.
- The issuer may "test the waters" prior to filing any offering statement, subject to terms and conditions specified by the SEC.
- The issuer must file audited financial statements with the SEC annually.

Expansion of Section 3(b) Exemption
"Super" Regulation A *(cont'd)*

- The SEC may impose other terms and conditions that it determines are necessary in the public interest and for the protection of investors, including:
  - a requirement that the issuer prepare and file electronically with the SEC and distribute to prospective investors an offering statement and related documents, in form and with content as prescribed by the SEC, including:
    - *audited financial statements,*
    - *a description of the issuer's business operations, its financial condition, its corporate governance principles, its use of investor funds and "other appropriate matters," and*
  - disqualification provisions substantially similar to those in regulations adopted under Section 926 of the Dodd-Frank Act.
    - *Section 926 of the Dodd-Frank Act requires the SEC to adopt rules ("bad actor" provisions) for disqualification of certain offerings from reliance on Rule 506. (Rule 506(e) was proposed by the SEC in Release No. 33-9211 (May 25, 2011).)*

Expansion of Section 3(b) Exemption
"Super" Regulation A (cont'd)

- The exemption may apply only to:
  - "equity securities";
  - debt securities;
  - debt securities convertible or exchangeable to equity interests; or
  - guarantees of the foregoing.

Expansion of Section 3(b) Exemption
"Super" Regulation A (cont'd)

- The SEC may enact rules requiring the issuer to provide periodic disclosures regarding:
  - the issuer,
  - its business operations,
  - its financial condition,
  - its corporate governance principles,
  - its use of investor funds, and
  - other appropriate matters.
    - *The SEC rules also may provide for suspension or termination of the periodic reporting requirement with respect to that issuer.*

Expansion of Section 3(b) Exemption
"Super" Regulation A:
State Preemption

- A security issued under the exemption is a "covered security" under Section 18 of the Securities Act (and, therefore, exempt from state registration, documentation and offering requirements) if the security is:
  - offered or sold on a national securities exchange; or
  - offered or sold to a "qualified purchaser" as defined by SEC rules.

Study of Impact of Blue Sky Laws on Regulation A Offerings

- The Comptroller General must conduct a study and provide a report on its findings on the impact of blue sky laws on Regulation A offerings not later than three months after enactment of the JOBS Act (July 5, 2012).

Change in Exchange Act Section 12(g) Registration Threshold
(For all companies except banks and bank holding companies)

- The 500 holders of record threshold for registration of a class of equity securities under Section 12(g)(1)(A) of the Exchange Act is changed to require Exchange Act registration if, on the last day of the preceding fiscal year, an issuer has total assets exceeding $10 million and a class of equity securities held of record by [at least]
  - 2,000 persons, or
  - 500 persons who are not "accredited investors" (as defined by the SEC).
    - *The criteria to exit Exchange Act reporting are not changed.*
    - *Determining which holders are not accredited investors may be challenging.*

Change in Exchange Act Section 12(g) Registration Threshold
Employee Compensation Plan Securities

- Under an amendment to Exchange Act Section 12(g)(5), the definition of "held of record" will not include securities held by persons who received the securities under an employee compensation plan in transactions exempted from Securities Act registration requirements.
  - Transferees of the employees?
  - The SEC must adopt rules revising the definition of "held of record" to implement the Section 12(g)(5) amendment and adopting safe harbor provisions for issuers to determine whether holders of their securities received the securities under an employee compensation plan in transactions exempted from Securities Act registration requirements.
    - *In Frequently Asked Questions issued by the Division of Corporation Finance on April 11, 2012, the Division stated that companies may exclude persons covered by the Section 12(g)(5) amendment (whether or not they are current employees) prior to the effective date of the revised definition.*
    - *As noted above, under the JOBS Act crowdfunding provisions, the SEC must exempt, by rule (within 270 days after enactment of the JOBS Act) – December 31, 2012), conditionally or unconditionally, securities acquired pursuant to a Securities Act Section 4(a)(6) transaction from the provisions of Section 12(g).*

Change in Section 12(g) Registration Threshold and Exit Threshold for Banks and Bank Holding Companies

- The holders of record threshold for Exchange Act Section 12(g) registration of a class of securities issued by a bank or bank holding company is increased to 2,000 or more persons.
- Termination of Section 12(g) registration of a class of securities issued by a bank or bank holding company under Section 12(g)(4) will occur 90 days, or such shorter period provided by SEC rule, after the bank or bank holding company files a certification with the SEC that there are fewer than 1,200 holders of record of such class.
  - The suspension of the duty to file reports under Section 15(d) also will be subject to the less than 1,200 holders of record requirement.
- The SEC must issue final regulations implementing these changes within one year after enactment of the JOBS Act.

Study or Enforcement Authority Under Rule 12g5-1

- The SEC is to conduct a study to determine if new enforcement tools are needed to enforce the anti-evasion provisions of Rule 12g5-1(b) (dealing with forms of holding securities designed to evade, by not treating the holder as a holder of record, Exchange Act reporting resulting from the requirements of Section 12(g) or 15(d) of the Exchange Act).
  - The SEC must transmit its recommendations to Congress within 120 days after enactment of the JOBS Act (August 3, 2012).

Outreach

- The SEC must provide online information and conduct outreach to inform small and medium sized businesses, women-owned business, veteran-owned businesses and minority-owned businesses of changes made in the JOBS Act.

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