JACKO LAW GROUP, PC
SECURITIES & CORPORATE COUNSEL

Legal Risk Management Tip
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HOW THE JOBS ACT OF 2012 WILL IMPACT FINANCIAL INSTITUTIONS

Introduction

The Jumpstart Our Business Startups Act ("JOBS Act"), which was signed into law by the President on April 5, 2012, is designed to assist companies and individuals raise capital. The Act is divided into six (6) titles, each of which is summarized below:

- Title I loosens the registration and disclosure requirements for companies filing their IPO if they can qualify as an "Emerging Growth Company;"
- Title II provides relief from the prohibition on general solicitation and general advertising for the sale of securities under Rules 506 and 144A of the Securities Act of 1933;
- Title III allows for "CROWDFUNDING" through funding portals for offerings up to $1 million;
- Title IV creates a new exemption for private offerings up to $50 million; and
- Titles V and VI offer private companies flexibility by increasing the total number of assets a company may have prior to registering its securities from $1 million to $10 million and also increases the number of investors private companies may have prior to registering its securities from 750 to 2000 people (as long as no more than 500 investors are non-accredited).

This month's Risk Management Tip will focus on Titles I and II, both of which are summarized below and are of particular interest to our clientele.

Title I – Focus on Emerging Growth Companies

Title I creates a new category of IPO issuer - an "Emerging Growth Company" ("EGC").

A company is classified as an EGC if total gross revenues are less than $1 billion. A company will remain classified as an EGC until one of the following occurs:

- The company has total annual gross revenues of $1 billion or more (adjusted every five (5) years for inflation);
- It has been five (5) years since the company's IPO;
- The company has issued more than $1 billion in non-convertible debt during the previous three (3) year period; or
- The company is deemed to be a "large accelerated filer."[1]

[1] A "large accelerated filer" is defined in 17 CFR 240.12b-2 as an issuer after it first meets the following conditions as of the end of its fiscal year: (i) The issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) The issuer has been subject to the requirements of section 13(a) or 15(d) of the Act for a period of at least twelve calendar months; (iii) The issuer has filed at least one annual report

Classification as an EGC provides several forms of relief from disclosure, compliance and governance obligations, which may help to make the IPO process more affordable. Companies that qualify as an EGC benefit from the following:

- No Compensation Disclosure. They will not be required to gain shareholder approval for executive compensation and golden parachute compensation;
- Only Two Years of Financial Statements. The IPO registration statement will only need audited financial statements for the two prior fiscal years (rather than three). Subsequent reports to be filed with the Commission need not include selected financial data prior to the earliest audited period presented with its first registration statement.
- No New U.S. GAAP Standards. The EGC is not required to comply with any new or revised financial accounting standards that are not applicable to non-registered companies.
- Exempt From Some New PCAOB Rules. An EGC will not be required to comply with some potential new rules under consideration by the Public Company Accounting Oversight Board ("PCAOB"). For example, the EGC will not be required to comply with mandatory audit firm rotations nor will they be required to have the auditing firm include a discussion and analysis in its reports from the audit (both of which are being considered right now).[2] Moreover, any additional rules by the PCAOB shall not apply to an EGC unless the Commission determines they are necessary or appropriate.
- Increased Availability of Research to Investors. The publication or distribution of "research reports" by a broker-dealer will not constitute an offer for sale or offer to sell, even if the broker-dealer is participating or will participate in the IPO. In addition, broker-dealers will not be required to comply with restrictions relating to post-offering research blackout periods of EGCs.
- Confidential Draft Registration. The EGC may confidentially submit a draft registration statement to the SEC for confidential non-public review by the staff prior to public filing, as long as the initial confidential submission will be publicly filed not later than 21 days before the issuer conducts a "road show." This requirement allows for public comparisons between the initial filed documents and later revisions.
- No Auditor Attestation Report on Internal Controls. The EGC is not required to comply with the auditor attestation requirements in Section 404(b) of the Sarbanes-Oxley Act as long as it remains an EGC, unless the Commission determines that such additional requirements are necessary or appropriate.
- Modernization of the S-K registration. Notably, within 180 days of the signing of the JOBS Act, the SEC shall review and determine how to simplify and modernize the S-K registration process to reduce the costs and other burdens for EGCs.

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pursuant to section 13(a) or 15(d) of the Act; and (iv) The issuer is not eligible to use Forms 10KSB and 10QSB for its annual and quarterly reports.

[2] http://www.journalofaccountancy.com/Issues/2012/Mar/Auditing.htm.

Title II – Access to Capital for Job Creators

Title II provides relief from the ban on general solicitation and general advertising for:

- Securities offered under Rule 506 of the Securities Act of 1933 so long as all purchasers are accredited and the issuer takes reasonable steps to verify the purchaser is an accredited investor; and
- Securities offered under Rule 144A of the Securities Act of 1933, provided all purchasers are "reasonably believed" to be Qualified Institutional Buyers ("QIBs").

The SEC has 90 days from the date of Title II's enactment to promulgate new rules on these provisions.

Currently a company that wishes to raise funds through Rule 506 of Regulation D cannot offer its securities through general solicitation or advertising. For the exemption to apply the company must have a pre-existing business or personal relationship with the investor. The JOBS Act requires the SEC to remove this prohibition on general solicitation and advertising, and adopt regulations that provide (1) all purchasers of the securities must be accredited investors, and (2) the issuer must take reasonable steps to verify the purchasers of the securities are accredited.

Consequently, the JOBS Act expands the methods by which securities can be sold under Rule 506. Once the rule is in effect, an individual who offers and sells securities in compliance with Rule 506 will not be subject to registration as a broker-dealer *solely because* they:

- Maintain a platform or mechanism that permits the offer, sale, purchase, negotiation, general solicitation, general advertisements or other similar activities, whether online or other means;
- Co-invest in such securities; or
- Provide ancillary services[3] with respect to such securities.

This flexibility will have substantial impact on the way private funds conduct business today.

Conclusion

While the JOBS Act is designed to spur investment activity in various forms, ongoing evaluation of regulatory guidance and interpretation will be required to ensure compliance with the rules' requirements. For more information on the JOBS Act and how it may impact your company, please contact Andrew Deddeh at andrew.deddeh@jackolg.com or (619) 298-2880.

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[3] Ancillary services allowed include due diligence services (so long as no investment advice is given for separate compensation) and providing standardized transaction documents to both issuers and investors.