JOBS Act Expands Fund-Raising Options

The Jumpstart Our Business Startups Act (JOBS Act) was enacted in April 2012 and opened the door to additional fundraising options for small to mid-sized companies. One major result of the Act is the creation of a virtual "IPO on-ramp." This technique encourages emerging growth companies to make initial public offerings (IPOs) of equity shares to raise the funds needed to hire workers and scale up their operations. The law also expands the use of "crowdfunding," private offerings, and direct communications to investors to inform them of investment opportunities. Some provisions are effective now; others are awaiting additional interpretive guidance. This article explains the new options available to companies and the timetables for issuance of related rules.

The IPO on-ramp

The IPO on-ramp is established by Title I of the Act, and it is available immediately. This concept has its roots in a report on "Rebuilding the IPO On-Ramp" issued by an IPO Task Force following an Access to Capital Conference hosted by the US Treasury Department in 2011. The report cites three reasons for the significant declines in the number of IPOs in recent years: increased costs of going and staying public, restrictions on the information available to investors, and a shift in trading from long-term investing to high-frequency trading of large-cap stocks. Together, these factors constitute a significant entry barrier — and an IPO on-ramp is seen as a platform to help companies gain access in a gradual way. Here are the highlights in Q&A format.

What benefits does the IPO on-ramp provide, and who can use it?
The IPO on-ramp provides a transitionary period that temporarily lowers the cost of accessing the capital markets for up to five years for any company that qualifies as an "emerging growth company."

To enter the ramp, a company must meet the criteria for an emerging growth company, meaning:

a) a company's annual gross revenue must be less than $1 billion in its prior fiscal year, and
b) the company cannot have first sold common equity in a registered offering on or before Dec. 8, 2011.

A company exits the ramp when it no longer qualifies as an emerging growth company, meaning:

a) it completes the five-year transitionary period,
b) it has more than $1 billion in gross revenue,
c) it issues more than $1 billion in non-convertible debt in a three-year period, or
d) it becomes classified as a large accelerated filer (e.g., due to market capitalization of $700 million or more).

The SEC Staff has published FAQs with guidance on the general applicability of Title I at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm.

How does the IPO on-ramp lower costs for companies?

The IPO on-ramp reduces the costs to an emerging growth company of filing the IPO registration statement and up to five years of periodic reports in the following ways:

- The initial registration statement for an equity IPO requires only two years of audited financial statements instead of the usual three years.
- The company is not required to adopt any new or revised accounting standards earlier than the effective date for private companies.
- The company is not required to comply with the requirement to obtain an attestation report on internal control over financial reporting from its independent auditor.
- The periods required for selected financial data do not need to extend to periods before the earliest audited financial statements included in the initial registration statement.
- The company can submit a draft IPO registration statement for a confidential nonpublic review by the SEC staff in accordance with guidance available on the SEC's website at http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm and http://www.sec.gov/divisions/corpfin/cfannouncements/secureemail.htm.
- The company must generally comply with the disclosure requirements for smaller reporting companies (i.e., those with market capitalizations less than $75 million) but it is temporarily exempted from selected laws and rules, including disclosures about say-on-pay votes, say-on-golden-parachute rules, and pay-for-performance.

How does the IPO on-ramp expand the information available to investors?

To make more information available to investors, the IPO on-ramp legislation permits the following:

- A broker or dealer for an emerging growth company may distribute research reports about the issuer's equity securities (i.e., oral or written communications containing information, recommendations or opinions), even if the reports don't meet the criteria for "reasonably sufficient upon which to base an investment decision."
- The emerging growth company or its representative may engage in communications designed to "test the waters" and gauge the level of interest in the IPO by qualified institutional investors or accredited investors.

Why is the on-ramp controversial and how can companies deal with the controversy?

Some of the changes are controversial because they represent exceptions to laws intended to protect investors, including the Sarbanes-Oxley Act and the Dodd-Frank Act, and because they inhibit the standard-setting flexibility of the Financial Accounting Standards Board with regard to setting different effective dates for public and nonpublic companies. Each company must assess the risks and weigh the options. For example:

- The JOBS Act provides an opt-in right that allows an emerging growth company to choose to forego an exemption and instead comply with the requirements that apply to an issuer that is not an emerging growth company.
- If a company elects to use this option, its choices regarding accounting standards must be made for all standards and must be applied consistently as long as it remains an emerging growth company.

Advertising and solicitation

Title II of the Act seeks to change some of the underlying market economics that favor trades of large-cap stocks by expanding the information available about private placements and lowering the cost of distributing that information. The changes are rooted in part in the expectation that Internet technology can be used to help protect investors by screening purchasers of securities to ensure that risky securities are being purchased by those who can afford to take the risk.

This section is not effective until the SEC revises Rules 506 and 144A covering private offerings. Currently, these rules prohibit persons who are not registered brokers or dealers from soliciting funds from the general public and require instead that the funds be solicited from accredited investors or qualified institutional investors. The Act gives the SEC 90 days to modify the rules to lift the bans on general solicitation and advertising and provide guidance that will require “reasonable steps” to verify that purchasers of the securities are accredited investors or qualified institutional investors. After this guidance is issued, companies will be permitted to distribute information to the public without incurring the cost of a broker.

It is not clear how the SEC will modify its rules. Some have speculated that the JOBS Act could open the door for the release of information on TV, billboards, and websites. In the meantime, 14 law firms have issued a joint consensus paper that provides an overview of the changes along with citations for documents containing current safe harbors and interpretive guidance. The paper is available at www.lw.com/upload/pubContent/_pdf/pub4743_1.pdf.

CrowdFunding

Title III, the “Capital Raising Online While Deferring Fraud and Unethical Non-Disclosure Act of 2012” (CROWDFUND Act), creates an exemption from the SEC’s registration requirements for crowdfunding transactions that meet certain criteria. This section is not effective until the SEC publishes guidance on topics, such as disqualifications, exclusions and regulations for funding portals. Here are the highlights in Q&A format.

What is crowdfunding and who can use it?
Crowdfunding involves the use of Internet technology to gain access to a large pool of investors who are willing to contribute small amounts of capital.

- Currently, funding portals can accept contributions, but they can’t sell shares of equity. Typically, a funding portal charges a fee for allowing a business to combine various technologies: a webpage to explain the benefits associated with various amounts of donations, PayPal to accept contributions and social media — such as Facebook and Twitter — to publicize the campaign.
- The Act gives the SEC 270 days to create rules that will expand the concept to allow companies to sell equity shares and raise up to $1 million, provided the issuer meets all the requirements, uses a broker or funding portal that complies with all the applicable requirements and ensures its sales of shares meet the applicable requirements. The SEC also has 270 days to issue other implementing rules, including one that will exclude crowdfunding investors from the total number of shareholders of record.

What are the reporting and attestation requirements for crowdfunding?
Companies that issue equity shares through crowdfunding will be subject to SEC reporting requirements. Some of the requirements are spelled out in the Act, and the SEC has the authority to set more. Examples of the requirements established by the Act include filing with the Commission and making available to potential investors the following: a description of the business and anticipated business plan, information about the directors and officers, a description of the financial condition and target offering amounts, a statement of the intended use of the proceeds and a description of the ownership and capital structure of the issuer. The attestation requirements vary depending on the target offering amounts:

- For offerings of $100,000 or less, all that is required are income tax returns for the most recently completed year and financial statements certified by the principal executive officer to be true and complete in all material respects.
- For offerings between $100,000 and $500,000 (or other amount to be set by the SEC), the issuer needs financial statements reviewed by an independent accountant.
- For offerings over $500,000 (or other amount to be set by the SEC), the issuer needs audited financial statements.

Other changes

Other sections of the JOBS Act introduce the following changes:

- Title IV will help more small businesses raise capital without going through the IPO process by raising the offering threshold for Regulation A from $5 million to $50 million. The SEC is expected to issue a rule or regulation to implement this change. The Act also requires the Comptroller General to conduct a study on the impact of state "blue sky" laws on offerings made under Regulation A within three months.
- Title V raises the threshold for mandatory Exchange Act registration for most non-listed companies from 500 shareholders of record to 2,000 shareholders of record, as long as there are less than 500 non-accredited investors, meaning those who purchase their shares through crowdfunding or employee compensation plans.
- Title VI changes the thresholds for non-listed banks or bank holding companies to terminate their Exchange Act registration from 300 shareholders to 1,200 shareholders of record. The SEC is required to adopt implementing regulations within one year.
- The SEC has provided additional guidance on Titles V and VI at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-12g.htm.

For more information

If you would like additional information about the JOBS Act and the options available to your company, please contact your CBIZ Tofias & Mayer Hoffman McCann advisor, or you may reach us at TheBottomLine@cbiztofias.com and 888.761.8835.