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Capital Tracker

Hess: New jobs act helping startups and emerging companies

Premium content from Business First by Paul Hess

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On April 5, after a remarkably fast journey through the House of Representatives and Senate, President Barack Obama signed into law the Jumpstart Our Business Startups (JOBS) Act. The Jobs Act is intended to help startups and facilitate emerging private companies' efforts to raise equity capital and stay private longer. The act also is designed to make the process of going public (and being a young public company) easier through significant changes in the regulatory scheme of the federal securities laws.

There are four key components of the Jobs Act:

The creation of new securities registration exemptions – highlighted by the new "crowdfunding" exemption;

The expansion of other existing securities registration exemptions;

The increase in the threshold number of shareholders that triggers public company registration; and

The creation of an "IPO On-Ramp" that eases the regulatory burden of going public and of being a public company during the early years following an IPO.

The new crowdfunding exemption, which refers to raising money from a variety of individual investors in a company, will permit a private company to issue up to $1 million of securities over a 12-month period to an unlimited number of investors.

It requires certain requirements be met. The exemption will relax existing rules that make it very difficult for private companies to raise capital from anyone other than "accredited investors." Accredited investors include certain institutional investors and individuals with a net worth of at least $1 million, exclusive of home equity, or with annual income of at least $200,000 (or $300,000 if joining with spouse).

In order to take advantage of the crowdfunding exemption, a company must sell its securities through an intermediary registered with the **Securities and Exchange Commission** as either a funding portal or a broker. The issuing company must file with the SEC and deliver to investors and intermediaries certain basic financial information, business information and risk disclosures.

Investors with an annual income or net worth of at least $100,000 can invest up to 10 percent of their annual income or net worth up to $100,000. Investors with an annual income and net worth less than $100,000 can invest the greater of $2,000 or up to 5 percent of their annual income or net worth. Securities acquired under the crowdfunding exemption may not be resold for one year, unless sold to either the issuing company or accredited investors.

Implementing SEC rules for this crowdfunding exemption are to be issued within 270 days.

The Jobs Act also expands Rule 506 of Regulation D. The revised rule allows issuers to publicly advertise private placements and use general solicitations of investors if all investors in the private placement are accredited investors. Previously, advertising and general solicitations were prohibited for private placements.

Following implementation of these changes, issuers will be able to promote private placements through a number of new methods, including email, social media, Internet advertising, blogs, investing communities, newspaper and radio ads. This new rule will not go into effect until the SEC promulgates implementing rules, which is required within 90 days of the act's passage.

The Jobs Act also increases the statutory cap for other private placements from $5 million to $50 million, provided that the company complies with certain rules, makes certain disclosures (most notably the preparation of an offering circular, which must be delivered to investors and filed with the SEC and must include certain required information, such as two years of audited financial statements), and files subsequent periodic reports.

The new exemption sent forth pursuant to the Jobs Act will look like a mini-public offering, and it has some similarities to the existing "Regulation A" exemption. The new exemption will permit general solicitations of investors, allow issuers to test the water with potential investors under certain conditions, and securities issued pursuant to the exemption will not be subject to resale restrictions. The exemption will not go into effect until the SEC sets new rules, for which no deadline exists.

The Jobs Act also will allow some private companies to stay private longer. Under the old law, a company would be subject to public reporting once it reached 500 shareholders.

Under the new law, a company will not be subject to public reporting until the earlier of (a) reaching 2,000 shareholders of record, or (b) reaching 500 shareholders of record who are not accredited investors. Persons who acquire their shares under the company's equity compensation plans and persons who purchase their shares under the new crowdfunding exemption will not be counted toward the number of record holders for this purpose. While this change became effective immediately, the definition of a "holder of record" will be revised under rules to be adopted by the SEC.

Perhaps the provision receiving the most attention is the one referred to as the "IPO On-Ramp." This reforms a number of securities requirements applicable to emerging growth companies, which generally are defined as a company with less than $1 billion in annual revenue, by simplifying the process of going public and by reducing disclosure and other compliance requirements for new public companies for a transitional period of up to five years.

The reforms to the federal securities laws should make it easier in Central Ohio and across the country for startup companies, growing companies and midsize companies to raise capital. However, many of the reforms are subject to future SEC rulemaking that could delay their implementation and limit their impact

Ultimately, a growing economy and strong financial markets are the key to the ability of private companies to raise capital in these challenging market conditions.

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