Here We Go Again: JOBS Act 2.0

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On April 5, 2012, President Barack Obama signed into law the Jumpstart Our Business Startups Act, or JOBS Act. The JOBS Act was designed to improve access to the U.S. capital markets for smaller businesses, and it instructed the U.S. Securities and Exchange Commission (SEC) to amend the securities laws and conduct studies on capital formation, disclosure and registration requirements.

In an effort to help reach this goal, the JOBS Act created a new category of issuer, the emerging growth company, or EGC, and eased the registration and disclosure requirements applicable to these issuers. The JOBS Act also created a number of new regulations applicable to EGCs, including the ability of EGCs to submit confidential draft registration statements to the SEC for review prior to making a public filing and providing scaled-down disclosure requirements for up to five years after an initial public offering (IPO) for these issuers.

To further ease existing requirements on capital raising, the JOBS Act also contained provisions that instructed the SEC to remove the prohibition on general solicitation and advertising in certain private offerings, created an exemption from registration for capital raises by way of crowdfunding, and called for revisions to Regulation A to, among other things, increase the amount of securities an issuer could offer. In addition, the JOBS Act raised the shareholder threshold required for registration under the Exchange Act of 1934, as amended (Exchange Act), easing the regulatory burden on smaller companies. Despite these accommodations, many practitioners were of the opinion that the JOBS Act did not go far enough and additional regulatory relief was necessary.

Since the inception of the JOBS Act, many companies have taken advantage of various accommodations provided to them under the act. In April 2014, the House Financial Services Committee introduced a number of legislative proposals with individual names that would make author Ayn Rand proud, but collectively were dubbed 'JOBS Act 2.0.' Currently, 11 bills are up for consideration as part of the JOBS Act 2.0 framework, with five of the bills having been approved by the House in July 2015 and, at the time this article was submitted for publication, referred to the Senate Committee on Banking, Housing and Urban Affairs. This

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article will focus on certain pending bills under the JOBS Act 2.0 the authors believe contain some of the most interesting developments that could further ease disclosure and reporting obligations facing smaller issuers and encourage access to the capital markets.

The summer of 2015 also saw activity from the SEC in responding to certain mandates of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This article also includes a discussion of the recently proposed rule on clawback policies on executive compensation and the final rule regarding pay ratio disclosure adopted by the SEC.

JOBS Act 2.0

Disclosure Modernization and Simplification Act of 2015 (H.R. 1525)

The Disclosure Modernization and Simplification Act of 2015 mandates certain updates to Form 10-K, the annual report public companies are required to file with the SEC. The bill directs the SEC to issue regulations that would permit issuers to file a summary page on Form 10-K, provided each item on the summary page includes a cross-reference to materials that are responsive to the disclosure requirements of Form 10-K.

Arguably more interesting, the bill, as proposed, also instructs the SEC to revise Regulation S-K, a compendium of disclosure rules that apply, to varying extents, to periodic reports, proxy statements and registration statements filed with the SEC. The bill would require the SEC to scale down or eliminate requirements in Regulation S-K to: 1) reduce disclosure burdens on EGCs, smaller reporting companies and accelerated filers, and to 2) eliminate provisions of Regulation S-K that are duplicative, overlapping, outdated or unnecessary. While the bill does not enumerate specific revisions to Regulation S-K that would ease the disclosure burdens faced by the relevant issuers, the requirement to eliminate provisions of Regulation S-K that require duplicative or unnecessary information would ease the regulatory burden on all reporting companies, the impact of which would likely be felt most strongly by EGCs and smaller reporting companies that typically have more limited resources than larger issuers to expend on public reporting.

In addition to mandating the aforementioned revisions to Regulation S-K, the bill would also require the SEC to commission a broad study, in consultation with the Investor Advisory Committee and the Advisory Committee on Small and Emerging Companies, to determine how best to modernize and simplify disclosure requirements in Regulation S-K in order to decrease the costs of disclosure faced by subject issuers. The study would emphasize a company-by-company approach to disclosure that would move away from the use of boilerplate language and static disclosure requirements. The study would evaluate the ways in which information is currently presented and consider whether alternative presentation methods are available that would discourage repetition and the disclosure of immaterial information.

This bill seeks to address the tension between improving the nature of disclosure and reducing the economic burdens associated with such disclosure. It is relatively inexpensive for issuers to provide the rote types of disclosures the SEC abhors (“revenue increased by $x.x million or y.y%”) and far more difficult/expensive for issuers to provide the substantive types of disclosures that the SEC champions (“the y.y% increase in revenues resulted from the factors described below which are likely to also impact next year’s revenues to the extent described below”). The bill seeks to eliminate unnecessary and repetitive disclosure obligations so companies can devote their limited resources to high-priority disclosures.

Small Company Disclosure Simplification Act (H.R. 1965)

While the Disclosure Modernization and Simplification Act of 2015 focuses on Regulation S-K, the Small Company Disclosure Simplification Act instructs the SEC to take a similar look at the current requirements surrounding the use of extensible business reporting language (XBLR).

In Jan. 2009, the SEC adopted final rules requiring reporting companies to provide certain financial information in XBRL format as a means to provide better information to investors. However, because the costs associated with preparing an issuer’s financial statements using XBRL are high, the obligation to do so may deter certain companies from going public, may encourage other companies to go private and may substantially increase a public company’s compliance costs. Critics of XBRL cite the likelihood that XBRL errors will occur and go undetected, and cite the opportunities for individuals to abuse the system with the information they garner from XBRL disclosures. In reaction to the criticisms lodged against XBRL, the Small Company Disclosure Simplification Act provides that EGCs and issuers with annual gross revenues less than $250 million would be exempt from the requirement to use XBRL for financial statements and other periodic reporting required to be filed with the SEC.

In addition, the bill directs the SEC to conduct an analysis of the costs and benefits to issuers with annual gross revenues less than $250 million of the requirement to use XBRL for their financial reporting. The analysis would include an assessment of whether the costs and benefits of using XBRL may differ for these issuers based on their size. It would also look at the effect on efficiency, competition, capital formation, financing and analyst coverage of such issuers (including any such effects resulting from use of XBRL by

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investors). Finally, the study would evaluate the costs incurred by issuers in complying with the XBRL reporting requirements, including costs associated with submitting XBRL data to the SEC, posting XBRL data to company websites and any additional software, and consulting or filing agent fees associated with the XBRL preparation. The study would weigh these factors against the benefits XBRL reporting provides to the SEC and the effectiveness of standards in the U.S. regarding interactive filing data as compared with standards of their international counterparts.

Both the Disclosure Modernization and Simplification Act of 2015 and the Small Company Disclosure Simplification Act would require the SEC to deliver a report detailing the findings of the studies on Regulation S-K and the use of XBRL, respectively. The report on Regulation S-K would contain: 1) specific recommendations on how to update and simplify the disclosure requirements of Regulation S-K in order to minimize disclosure costs, and 2) specific recommendations regarding how to: a) improve the readability and navigability of disclosure documents, and b) discourage repetition and the disclosure of immaterial information. The XBRL report would detail the results of the XBRL study and include findings related to progress in implementing XBRL reporting within the SEC and the use of XBRL data by SEC officials and investors.

Accelerating Access to Capital Act of 2015 (H.R. 2357)

The Accelerating Access to Capital Act of 2015 directs the SEC to revise certain instructions to Form S-3 to ease some of the form's eligibility requirements. Often, issuers who want to quickly access the capital markets do so through the use of an effective shelf registration statement on Form S-3. A registration statement on Form S-3 is a short form registration statement that allows an issuer to register its securities for sale, even when there is no immediate plan to sell the securities being registered. In order to use Form S-3 for this purpose, an issuer needs to comply with certain restrictive registrant requirements and transaction requirements, typically including but not limited to having a public float of $75 million or more (the value of an issuers publicly traded shares held by non-affiliates) and having been publicly reporting under the Exchange Act for at least 12 months. Under the current Form S-3 rules, an issuer with a public float of less than $75 million and whose securities are listed and registered on a national securities exchange (the New York Stock Exchange or the Nasdaq Stock Market) is limited as to the value of securities registered under Form S-3 that it can sell in any 12-month period. This rule is called the baby shelf rule.

Under the proposed bill, the SEC would be required to revise general instruction I.B.1. to Form S-3 so issuers would be eligible to use Form S-3 if they either met the public float requirement (and all other applicable eligibility requirements) *or* if they had at least one class of common equity securities listed and registered on a national securities exchange.

The bill also directs the SEC to revise general instruction I.B.6. to Form S-3, or the baby shelf rule, which applies to limited primary offerings by certain issuers and currently provides that an issuer must have a class of common equity securities listed and registered on a national securities exchange to be able to use Form S-3 for those transactions. The bill would remove the listing and registration requirements under this instruction and would allow issuers with securities trading on the over-the-counter markets to utilize the baby shelf rule.

Small Company Simple Registration Act of 2015 (H.R. 1723)

While the Accelerating Access to Capital Act of 2015 would potentially ease certain eligibility requirements to use Form S-3, the Small Company Simple Registration Act of 2015 mandates revisions to Form S-1 that would provide further relief to some smaller issuers that are still unable to use Form S-3. Many smaller issuers do not meet the various eligibility requirements to use Form S-3 (a fact that will likely remain true even if the Accelerating Access to Capital Act of 2015 becomes law) and are instead limited to the use of Form S-1 to carry out a registered offering. Unlike Form S-3, issuers who file registration statements on Form S-1 are not able to use forward incorporation by reference to incorporate their Exchange Act reports into their prospectus. This means that annual reports, quarterly reports, proxy statements and other reports filed after the S-1 registration statement is declared effective do not automatically become part of the registration statement, even though the information contained in these Exchange Act reports is publicly available on the SEC website and on the issuer's website. In order to include those statements in an S-1 under current law, the issuers must incorporate these reports into a prospectus by way of a post-effective amendment or a prospectus supplement, which results in much higher costs of registration to these issuers.

The Small Company Simple Registration Act of 2015 directs the SEC to revise Form S-1 to permit smaller reporting companies to incorporate by reference in a registration statement filed on Form S-1 any documents the issuer files with the SEC after the effective date of the registration statement. For the smaller reporting companies that would remain ineligible to use Form S-3, this would be an important development that would alleviate potentially prohibitive addi-

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tional costs and burden associated with registered offerings without adversely impacting investor protection.

On July 14, 2015, the House passed the Small Company Simple Registration Act of 2015 and recommended the bill to the Senate Committee on Banking, Housing and Urban Affairs.

Improving Access to Capital for Emerging Growth Companies Act (H.R. 2064)

The Improving Access to Capital for Emerging Growth Companies Act contains mandates that would further alleviate burdens faced by EGCs in accessing the capital markets. Under current regulations, an EGC must wait 21 days from the date the EGC has first publicly filed a registration statement (and all amendments) before commencing a road show. Under the bill, EGCs would be permitted to commence a road show as early as 15 days from the date of the public filing.

Further, to provide for the extended use of the simplified disclosure requirements available to EGCs, the bill would extend the grace period for a change of status for EGCs. As proposed, an issuer that was an EGC at the time it submitted a confidential registration statement or a publicly filed registration statement, but ceases to be an EGC thereafter, will continue to be treated as an EGC through the earlier of: 1) the date on which the issuer consummates its initial public offering pursuant to such registration statement, or 2) the end of the one-year period beginning on the date the issuer ceases to be an EGC.

The bill would also revise the general instructions under Form S-1 and Form F-1 to provide that a registration statement filed (or submitted for confidential review) by an issuer prior to an IPO may omit financial information for historical periods that would otherwise be required by Regulation S-X as of the time of filing (or confidential submission) in the registration statement, provided that: 1) the financial information relates to a historical period the issuer reasonably believes will not be required to be included in the Form S-1 or Form F-1 at the time of the contemplated offering, and 2) prior to the issuer's distributing a preliminary prospectus to investors, the registration statement is amended to include all financial information required by Regulation S-X at the date of the amendment. The bill includes a reliance provision indicating issuers could begin to omit the aforementioned financial information within 30 days of the bill's enactment.

On July 14, 2015, the House passed the Improving Access to Capital for Emerging Growth Companies Act and recommended the bill to the Senate Committee on Banking, Housing and Urban Affairs.

Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015 (H.R. 686)

The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015 aims to clarify, simplify and reduce the regulatory costs associated with the sale or purchase of securities of smaller privately held companies. Under Section 15(b) of the Exchange Act, broker-dealers performing services in connection with the transfer of ownership of smaller privately held companies are required to register with the SEC, the Financial Industry Regulatory Authority (FINRA) and any applicable states. These registration requirements can come at substantial costs, which brokers typically pass on to buyers and sellers.

The bill would add a new Section 15(b)(13) to the Exchange Act, which (subject to a few exceptions) would exempt from registration broker-dealers performing services in connection with the transfer of ownership of eligible smaller privately held companies when the transaction involved is the sale of a privately owned business with annual earnings of less than $25 million and/or annual gross revenues of less than $250 million, and where the buyer would control and, directly or indirectly, actively manage the business after the transaction close.

Other Proposals Included with the JOBS Act 2.0

In addition to the proposed bills described above, there are five other bills currently included in the JOBS Act 2.0 framework: 1) the SBIC Advisers Relief Act of 2015 (H.R. 432), which would amend the Investment Advisers Act to reduce unnecessary regulatory costs and eliminate duplicative regulation of advisers to small business investment companies (passed by the House on July 14, 2015, and recommended to the Senate Committee on Banking, Housing and Urban Affairs); 2) the Holding Company Registration Threshold Equalization Act of 2015 (H.R. 1334), which would apply the shareholder registration and deregistration thresholds contained in the JOBS Act to savings and loan companies (passed by the House on July 14, 2015, and recommended to the Senate Committee on Banking, Housing and Urban Affairs); 3) the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2015 (H.R. 1847), which would repeal sections of the Dodd-Frank Act to increase market transparency and facilitate global regulatory cooperation (passed by the House on July 14, 2015, and recommended to the Senate Committee on Banking, Housing and Urban Affairs); 4) the Securities and Exchange Commission Overpayment Credit Act (H.R. 1975), which would allow self-regulating organizations to offset fee overpayments with future fee assessments; and 5) the Fair Access to Investment Research Act of 2015 (H.R. 2356), which would direct the SEC to provide

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a safe harbor for research reports that cover exchange traded funds.

Dodd-Frank Developments—Clawback Policies and Pay Ratio Disclosure

In the summer of 2015, as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC published a proposed rule regarding clawback policies on executive compensation and adopted a final rule regarding pay ratio disclosure.

On July 1, 2015, the SEC published a proposed rule directing national securities exchanges to establish listing standards that would require listed issuers to adopt policies that, in the event of a material restatement of the issuer's financial statements, would require executive officers to pay back incentive-based compensation they had erroneously received. The rule is intended to increase accountability and the quality of financial reporting. To accomplish this goal, the clawback would only apply to forms of incentive-based compensation that were earned or vested based on the attainment of a financial reporting measure (*i.e.,* a measure based on accounting principles used to prepare the company's financial statements, or the company's stock price or total shareholder return).

As proposed, the rule prohibits indemnification of the executive officers against the recovery of the incentive-based compensation, which means issuers should review their existing indemnification arrangements to ensure they are consistent with the proposed rule. The proposed rule also adds new responsibilities to the compensation committee.

Once the final rule is adopted, the exchanges will have 90 days to file their proposed listing standards, and issuers will be required to adopt rule-compliant clawback policies within 60 days of the listing standards becoming effective.

On Aug. 5, 2015, the SEC published a final rule that requires reporting issuers (excluding smaller reporting companies, EGCs, foreign private issuers, registered investment companies and multi-jurisdictional disclosure system filers) to disclose the ratio of compensation paid to its chief executive officer to that paid to its median employee. The rule, designed to provide shareholders with additional information by which to evaluate the compensation paid to the chief executive officer, amends item 402 of Regulation S-K to require disclosure of: 1) the median of the annual total compensation of all employees (excluding the CEO); 2) the annual total compensation of the CEO; and 3) the ratio of the two amounts. Such disclosure would be required in registration statements, proxy and information statements, and annual reports required to include executive compensation information.

The rule provides issuers with flexibility in identifying the median employee, and issuers would only be required to identify the median employee once every three years. Subject to a few limited exceptions, all employees of the issuer (including non-U.S., part-time, temporary and seasonal employees) would need to be included in the employee population. The annual total compensation for the median employee will be calculated using the same rules that apply when calculating the CEO's compensation, and issuers will be required to describe the methodology by which they identified the median employee and any adjustments of assumptions made in determining the median employee's annual total compensation. Issuers may supplement this disclosure with additional narrative disclosure or ratios, as long as the information is not misleading.

The pay ratio disclosure is required for fiscal years beginning on or after Jan. 1, 2017, which means calendar year issuers would need to include the disclosure in their proxy statements or Form 10-Ks filed in 2018.

Securities legislation and regulation tend to come in fits and spurts: 1933 (the Securities Act), 1934 (the Exchange Act), 2002 (Sarbanes Oxley), 2010 (Dodd-Frank) and 2012 (JOBS Act), followed by more technical bills that tend to fill in the spaces between the major pieces of legislation. The legislation that may become known as JOBS Act 2.0 has the feel of technical bills, but in the end may rival major legislation in its scope and impact, at least with respect to smaller issuers and emerging growth companies. ⚖

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