

Beyond The Jobs Act Crowdfunding Provisions - Significant New Opportunities to Raise Private Capital and Do Small Public Offerings.

By: Thomas A. Cifelli

Background

Privately-held companies have long encountered a litany of regulatory challenges in raising capital in the United States, both in the private markets and through an initial public offering (an "IPO"). These regulatory challenges arise primarily from the provisions of the Securities Act of 1933 (the "Securities Act"), which generally regulates public and private offerings, and the Securities Exchange Act of 1934 (the "Exchange Act"), which in large part deals with the ongoing reporting and proxy solicitation obligations of public companies and also with the regulation of broker-dealers.

Game Changing 2012 Legislation

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the "JOBS Act"), bipartisan legislation aimed at easing regulatory burdens on small companies and facilitating capital formation.

This is far more important than people think to keep innovation alive in the US and help the economy turn the corner and start to again create meaningful new jobs to help soften the coming second wave of job losses as the US government eventually faces reality and implements further budget cuts.

What few people understand is that the increased regulation of stock brokerage firms since the 1990s, combined with far too generous arbitration and litigation awards to investors against investment advisers, has caused a shift from most stock brokers recommending individual stock and bond investments to clients to now nearly all investment professionals recommending mutual funds, ETFs, annuities and other managed investment products. This has caused a shift from individual stock investing for long-term holding to institutional traders dominating the volume in stock and bond trading today.

Most stock brokers no longer do individual stock and bond research. They no longer look for undervalued stocks or special opportunities. Firms have shifted to charging management fees based on a percentage of the value of assets managed. While this has eliminated the conflict brokers used to have because they could make more money only by changing client portfolio positions (churning), this also has eliminated the opportunity for investors to be introduced to amazing undervalued stocks by their brokers (if they even still have one as so many investors do their own portfolio management today).

Sadly this change in how stock brokerage firms operate combined with increased regulation and litigation risks has caused small firm investment banking divisions to become an endangered species. They simply no longer hardly exist. It is these smaller broker-dealer firm investment banking divisions that used to help companies raise private capital and create syndicates among small firms to underwrite small public offerings.

The JOBS Act sweeping changes to the U.S. federal securities laws may help bring individual investors and small companies looking to raise money together again by (i) streamlining the IPO process and relaxing post-IPO reporting obligations and (ii) easing regulatory restrictions on private capital

formation. These recently relaxed restrictions against public solicitation even for all accredited offerings may help bring qualified professionals at broker-dealer firms back in the game of helping raise capital for small business.

The “Jobs Act” Provisions

The JOBS Act (Title 1) makes the IPO process less burdensome for certain smaller companies and creates an "on-ramp" of post-IPO regulation for these same companies.

The JOBS Act (contained in Titles 2 and 4) creates new opportunities, in addition to the highly publicized crowdfunding exemption contained in the JOBS Act, to raise private capital by removing the prohibition on general solicitation and advertising when securities are sold solely to accredited investors pursuant to Rule 506 of Regulation D and by increasing the amount of securities that may be offered and sold in Regulation A type offerings from \$5 million to \$50 million.

Rule 506 of Regulation D

Rule 506 of Regulation D is an exemption from the registration requirements of the Securities Act which can be utilized by both public and private companies. In a Rule 506 offering, an unlimited amount of securities can be offered and sold to an unlimited number of accredited investors and up to 35 non-accredited investors. However, Rule 502 of Regulation D currently prohibits the general solicitation or advertisement of securities in Rule 506 offerings. This prohibition on general solicitation and advertising means that issuers need to have some pre-existing relationship with offerees in a Rule 506 offering, resulting in significant limitations on the ability of issuers to raise private capital in a Rule 506 offering. Among other things, Title 2 of the JOBS Act removes this prohibition to permit general solicitation and advertising in Rule 506 offerings sold to accredited investors only.

Regulation A+

Pursuant to authority granted in Section 3(b) of the Securities Act to exempt certain securities from the registration requirements of the Securities Act, the SEC adopted Regulation A to provide a mechanism for issuers to publicly raise a limited amount of capital (currently up to \$5 million) without having to go through the full blown registration process and with the ability to remain a private company without public company reporting obligations. Regulation A offerings are similar to public offerings in that a document, an offering circular, is prepared, filed with the SEC and subject to SEC review and comment, however, the offering circular provides scaled down disclosure from what would be required in a registration statement. Due in part to the limited offering amount and the relative advantages of utilizing Rule 506 of Regulation D for exempt offerings, Regulation A has been used only infrequently. Title 4 of the JOBS Act increases the utility of Regulation A type offerings by adding a new exemption which is being informally referred to as Regulation A+.

Conclusion

The Jobs Act will soon make a real difference in matching investors with small companies looking for capital. This is most definitely needed due nearly all broker-dealer firms no longer allowing their brokers to inform clients of private offering opportunities or small public offerings. Getting individual investors back in the game of making risk investments in pre-public or small public companies is desperately needed as private equity and venture capital firms have failed to fill the gap caused by investment

brokers and financial advisers around the country turning into managed product salespeople verses stock researchers and intermediaries willing to introduce wealthy clients to more risky non-public privately placed security investments.

© Thomas A. Cifelli, 2012. All Rights Reserved. Visit www.MicroCapIPO.com for more information.