Welcome to America. Again

The Jobs Act gives is an excellent way to attract foreign issuers back to the US capital markets

A casual observer considering the prevailing attitudes in the US over the last few years toward foreign issuers might have sensed heightened concern on the part of US regulators.

In fact, the US Securities and Exchange Commission has been criticised by legislators for not having imposed additional safeguards to prevent foreign issuers from accessing the US capital markets through reverse mergers and not having scrutinised more carefully the filings of certain Asian-based issuers later found to have deficient disclosures.

In addition, in the aftermath of the financial crisis, US regulators were focused on imposing additional corporate governance and executive compensation requirements on public reporting companies, domestic and foreign, through adoption of the Dodd-Frank Act. It might, therefore, come as a bit of a surprise to learn that recently enacted legislation, the Jumpstart Our Business Startups (Jobs) Act, will make it easier for foreign issuers to raise capital in the US.

In fact, the Jobs Act was the culmination of about two years of national debate about the right balance to strike between protecting investors and promoting capital formation and encouraging entrepreneurial activity that would lead to job creation in the US. There is nothing like a serious financial crisis when it comes to getting people talking and thinking.

Although it would be inaccurate to say that concerns regarding the disclosures required of foreign issuers have fallen away, foreign issuers do stand to benefit from many Jobs Act provisions. The Jobs Act represents a significant change to the US securities offering framework. The legislation creates a transitional on-ramp for emerging growth companies to encourage them to pursue IPOs by phasing in compliance measures over time following their IPOs.

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Beyond creation of this new emerging growth category of issuer, the Jobs Act permits the use of general solicitation in Rule 144A offerings and in certain private placements and updates the thresholds for mandatory registration under Section 12(g) of the Exchange Act. Foreign private issuers are permitted to take advantage of almost all the Jobs Act provisions (the only provision not applicable to foreign private issuers relates to crowdfunding).

Welcome, foreign issuers

The changes brought about by the Jobs Act should make an initial public offering in the US more appealing to foreign issuers. As noted above, the Jobs Act creates a category of issuer, an emerging growth company (EGC), that can take advantage of certain newly created accommodations under the securities laws.

An EGC is defined as an issuer that had total annual gross revenues of less than $1 billion (or the US dollar equivalent, calculated on a US GAAP or IFRS basis) during its most recently completed fiscal year. An issuer does not qualify as an EGC if its IPO occurred on or before December 8 2011.

An EGC would continue to be considered an EGC until the earliest of: the last day of the fiscal year during which it had total annual gross revenues of at least $1 billion; the last day of the fiscal year following the fifth anniversary of the initial public offering of its equity; the date on which it has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or the date on which it is considered to be a large accelerated filer under the Exchange Act.

The Jobs Act liberalises the IPO process for EGCs by allowing EGCs to make confidential submissions of draft IPO registration statements, permitting increased communications with qualified institutional buyers (QIBs) and institutional accredited investors (as defined by rules under the Securities Act) during the IPO process, promoting research analyst coverage of EGCs by relaxing restrictions on analyst communications, and phasing in certain disclosure and corporate governance requirements.

Confidential submissions

An EGC is permitted to submit a draft IPO registration statement for confidential review by SEC staff prior to making a public filing, provided that the initial confidential submission and all amendments are publicly filed with the SEC not later than 21 days before the EGC commences a road show.

This may not sound new to foreign issuers. For years, foreign issuers were permitted to make confidential submissions of their IPO registration statements.

However, in December 2011, the SEC reversed this policy and announced it would only review initial registration statements on a confidential basis where the issuer is: a foreign government registering its debt securities; a foreign private issuer that is listed or is concurrently listing its securities on a non-US securities exchange; a foreign private issuer that is being privatised by a foreign government; or a foreign private issuer that can demonstrate that the public filing of an initial registration statement would conflict with the law of an applicable foreign jurisdiction.

Now, however, foreign issuers that qualify as EGCs will be able to submit their registration statements confidentially to the SEC.

Reduced disclosure

An EGC may elect to provide only two (rather than three) years of audited financial statements and a correspondingly reduced management's discussion and analysis of financial condition and results of operations (MD&A) in a registration statement related to a common equity IPO.

Going forward, an EGC may elect to omit selected financial data and MD&A information for any period prior to the earliest period for which audited financial statements were presented in the IPO registration statement.

While the exemptions described above for selected financial data and MD&A disclosures reference the Regulation S-K provisions that govern filings by registrants that are not foreign private issuers, EGCs that are foreign private issuers (whose disclosures are not governed by those provisions of

Regulation S-K) will be able to benefit from such relief according to recently released SEC guidance.

Testing the waters

For years, we have struggled to explain to foreign issuers contemplating an IPO in the US, the logic underlying US securities laws regulation of communications that could be made by an issuer and others acting on its behalf prior to the filing of an IPO registration statement, during the registration process, and immediately following completion of an IPO.

These restrictions have been reconsidered and, now, relaxed. The Jobs Act has put into place a more liberalised and contemporary regime for communications by or about EGCs. The Jobs Act expands the range of permissible communications to permit an EGC, or a person authorised to act on its behalf, whether before or after the filing of a registration statement, to test the waters and gauge market interest in a potential offering by engaging in oral or written communications with potential investors that are QIBs or institutional accredited investors.

These test-the-waters communications may yield important insights for an EGC and its advisers, and also enable an issuer to complete a private placement to these investors while proceeding with its IPO.

Research reports

The Jobs Act promotes research coverage of EGCs by relaxing many prohibitions relating to research that were adopted in the aftermath of the tech bubble. The Jobs Act permits investment banks to publish and distribute research report about an EGC the common equity securities of which are the subject of an IPO pursuant to a registration statement that the EGC proposes to file, has filed or that is effective.

The research report will not be deemed to constitute a regulated offer, even if the broker or dealer is participating or will participate in the IPO.

The Jobs Act also amends the Exchange Act to prohibit the SEC and any registered national securities association from adopting or maintaining any rule or regulation prohibiting any broker, dealer or member of a national securities association from publishing or distributing any research report or making a public appearance with respect to the securities of an EGC during post-IPO quiet and lock-up periods and imposing any rule or regulation in connection with an EGC's IPO that restricts which associated persons of a broker, dealer or member of a national securities association may arrange for communications between a securities analyst and a potential investor or a securities analyst from participating in any communications with the management of an EGC that is also attended by any other associated person of a broker, dealer or member of a national securities association whose functional role is other than as a securities analyst.

Phase-in of governance

An EGC that is a US domestic issuer will be entitled to defer compliance with certain provisions of the Dodd-Frank Act relating to shareholder voting and executive compensation. In addition, a domestic or foreign EGC will not be subject to the requirement for an auditor attestation of internal controls pursuant to Section 404(b) of the Sarbanes-Oxley Act; however, it will be subject to the requirement that management establish, maintain, and assess internal control over financial reporting.

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Also, the CEO and CFO of an EGC will be required to provide Sarbanes-Oxley-compliant certifications. An EGC will not be required to comply with any new or revised financial accounting standard until the date that such accounting standard becomes broadly applicable to private companies.

An EGC will be subject to a transition period for any required PCAOB mandatory audit firm rotation and any supplemental audit report information requirement, unless the SEC determines that such requirement is necessary and appropriate for investor protection.

Exempt offerings

Issuers of all sizes and levels of sophistication, both domestic and foreign, rely on exempt offerings as part of their capital-raising efforts. A foreign issuer often relies on the private placement exemption, and in particular on Regulation D, to raise capital from US persons without having to subject itself to US reporting requirements. Regulation D was intended to facilitate capital formation by providing issuers with a safe harbor from the Securities Act registration requirements.

Rule 506 of Regulation D permits an issuer to sell securities in a private placement to an unlimited number of accredited investors, provided that the issuer complies with the general requirements of Regulation D. Rule 502(c) of Regulation D prohibits the issuer or any person acting on its behalf to offer or sell securities by any form of general solicitation or general advertising.

This prohibition against general solicitation has been criticised because there is often confusion regarding whether a particular communication constitutes a general solicitation. The Jobs Act requires that the SEC undertake rulemaking to relax the prohibition against general solicitation and general advertising for offerings made under Rule 506, provided that the securities are sold only to purchasers that are verified by the issuer to be accredited investors.

Similarly, the Jobs Act requires that the SEC undertake rulemaking to relax the prohibition against general solicitation contained in Rule 144A provided that the issuer take reasonable steps to verify that all purchasers in the offering are qualified institutional buyers (QIBs).

A foreign issuer, including a foreign private issuer that has a class of its securities listed on a US securities exchange, will be able to benefit from this enhanced flexibility. However, unlike the changes relating to EGCs which are immediately effective, the provisions relating to exempt offerings will require additional SEC rulemaking.

Also, for foreign issuers that may rely on contemporaneous Rule 144A and Regulation S offerings, it will be important to monitor whether the SEC provides additional guidance regarding the prohibition contained in Regulation S against directed selling efforts, which was not addressed by the Jobs Act.

Work ahead

A great deal of work lies ahead before the US capital markets are likely, once again, to be thought of as the most compelling and obvious capital raising choice for small and mid-cap foreign issuers. The Jobs Act appears to be an excellent start, or more aptly stated, restart.

Given the historic depth and durability of the US capital markets, there is no reason why the welcome sign should not be easy to read in any language.

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