News Bulletin

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Bank Shot: JOBS Act Facilitates Capital Raising by Banks

Although the recently enacted Jumpstart Our Business Startups (JOBS) Act was introduced to the American public as legislation aimed at creating jobs, it also has the potential to take us in other directions that may prove to be every bit as important. If we were describing billiards, we'd call that a bank shot. But, as we are not, this discussion will focus on the potential benefits for banks and bank holding companies that will result from the enactment of the JOBS Act.

Among other things, the JOBS Act establishes a new category of issuer called an emerging growth company ("EGC"). Companies, including banks and bank holding companies, may qualify as EGCs if they have annual gross revenues of under $1 billion in their most recently completed fiscal year.[1] A company may remain an EGC until the earlier of five years from completion of its initial public offering, or until it has achieved certain other milestones.[2] In an effort to promote capital formation, the JOBS Act provides an "on-ramp" for EGCs, easing EGCs into the disclosure and compliance obligations of being a public company. An EGC may benefit from certain reduced disclosure requirements in connection with its SEC filings. After an EGC completes its IPO, it will continue to benefit from a phase-in of various executive compensation and corporate governance requirements. In addition, the JOBS Act relaxes the prohibition on general solicitation and general advertising in connection with certain private offerings. The JOBS Act also establishes various new capital raising alternatives, including Regulation A+ offerings. Finally, the JOBS Act amends the threshold for registration and modifies the deregistration threshold under the Securities Exchange Act of 1934 (the "Exchange Act") for banks and bank holding companies. We describe the changes brought about by the JOBS Act in more detail in our client alert at www.mofo.com/jumpstart/.

Capital Raising by Banks and Bank Holding Companies

Private Offerings at the Bank Level

A bank may issue securities in reliance on the Section 3(a)(2) exemption. Section 3(a)(2) of the Securities Act of 1933 (the "Securities Act") exempts from registration any security issued or guaranteed by a national bank, or any banking institution organized under the law of any state, territory, or the District of Columbia, the business of which is substantially confined to banking and is supervised by the state or territorial banking commission or

[1] Presumably, for a bank or bank holding company, this will be net revenues.
[2] A company remains an "emerging growth company" until the earliest of: (a) the last day of the fiscal year during which the issuer has total annual gross revenues in excess of $1 billion (subject to inflationary indexing); (b) the last day of the issuer's fiscal year following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act; (c) the date on which such issuer has, during the prior three-year period, issued more than $1 billion in non-convertible debt; or (d) the date on which the issuer is deemed a "large accelerated filer."

similar official. To qualify for the exemption under Section 3(a)(2), the institution must meet two requirements: (i) it must be a national bank or any institution supervised by a state banking commission or similar authority and (ii) its business must be substantially confined to banking. Securities issued by bank holding companies are not exempt from registration under Section 3(a)(2). A national bank generally relies on Part 16 of the Officer of the Comptroller of the Currency's (the "OCC") regulations in connection with offerings pursuant to Section 3(a)(2). The Part 16 regulations generally require that a national bank offer and sell its securities pursuant to a registration statement filed with the OCC, unless there is an available exemption. An exemption from the registration requirement is available if the national bank offers and sells its securities in transactions that comply with the Regulation D safe harbor or in Rule 144A qualifying transactions. Generally, banks have structured their offerings of securities to comply with the Regulation D safe harbor in order to avoid the registration statement requirement.

Title II of the JOBS Act, titled "Access to Capital Markets for Job Creators," 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 Act requires that the SEC undertake rulemaking to relax the prohibition against general solicitation contained in Rule 144A. In connection with a Rule 506 offering or a Rule 144A offering, the issuer must take "reasonable steps" to verify that all purchasers in the offering are "accredited investors" in the case of Rule 506 offerings and "qualified institutional buyers" ("QIBs") in the case of Rule 144A offerings. Effectively, this provision of the Act has the effect of deregulating offers. The provisions of the JOBS Act do not address changes to Section 4(2) (now renumbered Section 4(a)(2)) of the Securities Act, which is the exemption for private offerings by an issuer. Given that the banking regulations, such as those contained in Part 16, have historically referenced the applicable rules and regulations promulgated under the Securities Act, it is reasonable to assume that the exemption available under Part 16 will be available to a national bank for an offering made under Section 3(a)(2), so long as the bank verifies that the purchasers of its securities are accredited investors or QIBs, as the case may be.

Private Offerings at the Bank Holding Company Level

Securities issued by a bank holding company are not eligible for the exemption from registration provided by Section 3(a)(2) discussed above. A bank holding company must find another available exemption from registration. A bank holding company may rely on a Rule 506 offering made to accredited investors or a Rule 144A offering to QIBs. As noted above, the JOBS Act requires that the SEC promulgate rules to relax the prohibition against general solicitation and general advertising in connection with these types of private offerings. During the financial crisis, there were a number of bank holding companies that were able to engage in acquisitions of loan portfolios or of banks, some completed with FDIC assistance or other loss-sharing arrangements. Many of these institutions that are privately or closely held may look to raise additional capital to fund their continued growth or for general corporate purposes. They will now have greater flexibility to engage in capital raising through private offerings. In addition, during the financial crisis a number of private equity investors formed private vehicles to purchase bank assets. These entities also may benefit from the additional flexibility available in connection with private offerings.

Regulation A+ or Section 3(b)(2) of the Securities Act

Section 3(b) of the Securities Act permits the SEC to adopt rules and regulations exempting securities from registration if it finds that registration "is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering...." Current Regulation A was promulgated pursuant to Section 3(b) and it now provides an exemption from registration for public offerings of up to $5 million in a twelve-month period by U.S. or Canadian non-reporting companies. In order for an issuer to avail itself of the Regulation A exemption, it must prepare and file with the SEC an offering statement for the SEC's review and qualification, deliver an offering circular to prospective investors, and file periodic reports of

sales after completion of the offering. In addition, the issuer must meet certain substantive and procedural requirements.

Regulation A was intended to allow smaller businesses, including banks and bank-holding companies, access to the capital markets without subjecting them to the high costs associated with registered public offerings. However, the relatively low $5 million threshold and potential need to comply with state blue sky laws has made Regulation A unappealing. Title IV of the JOBS Act amends Section 3(b) of the Securities Act, by increasing the dollar threshold for a Regulation A-style offering (referred to as Reg A+ offerings). Pursuant to Section 3(b)(2), an issuer will be able to offer and sell up to $50 million in securities within a 12-month period in reliance on the exemption. The issuer may offer equity securities, debt securities, and debt securities convertible or exchangeable for equity interests, including any guarantees of such securities. The securities sold pursuant to the exemption will be offered and sold publicly (without restrictions on the use of general solicitation or general advertising) and will not be "restricted securities." The issuer may "test the waters" or solicit interest in the offering prior to filing any offering statement with the SEC, subject to any additional conditions or requirements that may be imposed by the SEC. The securities will be considered "covered securities" for NSMIA purposes (and not subject to state securities review) if the securities are offered and sold on a national securities exchange, or the securities are offered or sold to a "qualified purchaser" as defined under the JOBS Act. The civil liability provision in Section 12(a)(2) shall apply to any person offering or selling such securities.

The SEC will require that the issuer file audited financial statements with the SEC annually. The SEC may impose other terms, conditions, or requirements deemed necessary for investor protection, including a requirement that the issuer prepare and file electronically with the SEC and distribute to prospective investors an offering statement and any related documents, including a description of the issuer's business and financial condition, its corporate governance principles, the intended uses of proceeds, and other appropriate matters. The SEC also may require an issuer that relies on the exemption to make available to investors and file with the SEC periodic disclosures. The bad actor disqualification provisions applicable for the exemption shall be substantially similar to the disqualification provisions contained in the regulations adopted pursuant to Section 926 of the Dodd-Frank Act (which looks to the bad actor disqualification provisions in current Regulation A).

Bank holding companies may find Reg A+ offerings a compelling capital raising alternative. Bank holding companies generally need to access the capital markets frequently. For a bank holding company that is not subject to SEC reporting requirements, a Reg A+ offering may be more useful than a Rule 506 offering under Regulation D. Regulation A does not impose any limitations on offerees. In contrast to Rules 505 and 506 of Regulation D, and Section 4(2) of the Securities Act, Regulation A does not limit the number of offerees or investors that can participate in the offering, nor does it impose any requirement that offerees be accredited investors. A bank holding company issuer and its underwriter may have greater flexibility in structuring a Reg A+ offering. Securities offered and sold pursuant to Regulation A are offered publicly and are not "restricted securities." The securities are freely tradeable in the secondary market (assuming that there is a secondary market) after the offering. No holding period applies to the securities purchased in this type of offering. This may be important to certain institutional investors that are subject to limitations on investments in "restricted securities." Also, in connectizon with a Regulation A offering, an issuer may test the waters to gauge investor interest. A bank holding company also may consider conducting a Regulation D offering, or a Regulation S offering, after it has completed a Regulation A type offering. A bank holding company may choose to list its securities and become a reporting company contemporaneous with undertaking a Regulation A type offering, or it may choose to remain a non-reporting company even after it completes the Regulation A type offering. As we discuss below, the JOBS Act also raises the holder of record threshold for mandatory SEC reporting. As a result, a bank or bank holding company will be able to engage in many more rounds of private financings prior to becoming subject to costly reporting requirements.

Increase in Registration and Deregistration Threshold under Section 12(g)

Prior to enactment of the JOBS Act, Section 12(g) of the Exchange Act required issuers to register a class of equity securities with the SEC if, on the last day of the issuer's fiscal year, such class of securities was held of record by 500 or more record holders and the company had total assets of more than $10 million.[3] After a company registers under Section 12(g), all of the reporting requirements under the Exchange Act apply; therefore, a company would need to file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and proxy statements on Schedule 14A, and certain persons would be required to report transactions on Forms 3, 4, and 5 and Schedules 13D and 13G.[4] Historically, a company could deregister a class of equity securities under Section 12(g) when such class of equity securities was held of record by fewer than 300 persons, or by fewer than 500 persons and the total assets of the issuer had not exceeded $10 million on the last day of each of the issuer's three most recent fiscal years. The JOBS Act seeks to provide greater capital-raising flexibility for banks and bank holding companies by allowing them to delay becoming subject to SEC reporting obligations as their shareholder base grows.

Title VI of the JOBS Act, "Capital Expansion," amends Section 12(g)(1)(B) of the Exchange Act, and requires that a bank holding company register under the Exchange Act not later than 120 days after the last day of its first fiscal year ended on which its total assets exceed $10 million and on which it has a class of equity securities (other than exempted securities) held of record by 2,000 or more persons. The JOBS Act revises the definition of "holder of record" to exclude persons who receive securities pursuant to an employee compensation plan in transactions exempt from the registration requirements of Section 5 of the Securities Act, and to exclude securities acquired in certain crowdfunding offerings. The immediate impact of increasing the registration threshold is that banks and bank holding companies may conduct additional private financings without triggering SEC registration. In the past, bank holding companies frequently engaged in share repurchases in order to control the number of holders of record precisely to avoid triggering the mandatory reporting provisions. Now, bank holding companies will be able to enjoy greater flexibility. Title VI the JOBS Act also permits banks and bank holding companies to suspend registration under Section 12(g) if the number of holders of record falls below 1,200 persons. As a result, some banks and bank holding companies may consider the benefits of deregistering to avoid potentially burdensome SEC reporting costs. The amendments increasing the threshold to permit deregistration are effective immediately, and the SEC is required to issue final regulations to implement these amendments within one year of enactment of the JOBS Act.

Bank Holding Companies Conducting IPOs under the JOBS Act

The JOBS Act also seeks to ease many of the regulatory burdens imposed on small companies that intend to, or are in the process of, go public through an IPO. For bank-holding companies that are EGCs, the JOBS Act allows for a streamlined IPO "on-ramp" process in order to phase-in some of the more comprehensive and costly disclosure requirements. For instance, EGCs now have the option to:

- File a registration statement with the SEC on a confidential basis: EGCs are permitted to submit a draft registration statement, as well as amendments, to the SEC for confidential, nonpublic review prior to making a public filing, provided that the initial confidential submission and all amendments are filed with the SEC no later than 21 days prior to the issuer's commencement of a road show.[5]

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[3] While Section 12(g) provides for a $1 million threshold, Rule 12g-1 provides an exemption from the mandatory registration provisions of Section 12(g) for companies with assets of $10 million or less.

[4] Foreign private issuers are subject to less burdensome disclosure requirements. A foreign private issuer is required to file annual reports on Form 20-F, and quarterly and current reports on Form 6-K if such information is required to be made public in its home jurisdiction. A foreign private issuer is also exempt from the proxy solicitation requirements and its insiders are not required to report transactions on Forms 3, 4, and 5.

[5] For more information on confidential IPO submissions, see our alert at http://www.mofo.com/files/Uploads/Images/120412-SEC-IPO-JOBS-act.pdf.

- Test the waters: EGCs are permitted to engage in oral or written communications with QIBs and institutional accredited investors in order to gauge their interest in a proposed IPO, either prior to or following the first filing of the IPO registration statement.
- Benefit from reduced disclosure requirements: EGCs are required to present only two years of audited financial statements (as opposed to three years) in connection with their IPO registration statements. In any other registration statement or periodic report, an EGC need not include financial information within its selected financial data or in its MD&A disclosure for periods prior to those presented in its IPO registration statement.

The JOBS Act also permits EGCs to phase into some of the requirements imposed under the Dodd-Frank Wall Street Reform and Consumer Protection Act, including: (1) the say-on-pay vote requirement; (2) the advisory vote on golden parachute payments requirement; (3) the requirement to disclose the relationship between executive compensation and the financial performance of the company; and (4) the CEO pay-ratio disclosure requirement. Further, EGCs are not subject to any rules requiring mandatory audit firm rotation or a supplement to the auditor's report that would provide additional information regarding the audit of the EGC's financial statements.

The JOBS Act also promotes research coverage of EGCs. Broker-dealers are permitted to publish or distribute a research reports about an EGC that proposes to register or is in registration. The research report will not be deemed an "offer" under the Securities Act regardless of whether the broker-dealer will participate or is participating in the offering.

Conclusion

It will take quite a while before there can be a thorough assessment of the various directions in which the JOBS Act will take the American economy. For smaller banks and bank holding companies, it does appear that it will provide their capital raising activities with a shot in the arm. You might say that Congress has provided the American people with a much needed bank shot in the arm.

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