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SEC Further Enhances the IPO On-Ramp

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THE SEC'S RULE CHANGES FURTHER STREAMLINE THE PATHWAY FOR MANY COMPANIES TO CONDUCT THEIR INITIAL PUBLIC OFFERINGS AND REDUCE THE BURDENS ASSOCIATED WITH THEIR SUBSEQUENT SEC PERIODIC REPORTING OBLIGATIONS.

On January 13, the Securities and Exchange Commission (SEC) adopted implementing regulations mandated by the Fixing America's Surface Transportation Act (FAST Act). These regulations further streamline the pathway for many companies to conduct their initial public offerings and reduce the burdens associated with their subsequent SEC periodic reporting obligations. The FAST Act, enacted in December 2015, primarily relates to new highway and transit projects, but one portion of the law was devoted to enhancements of the federal securities laws, adding a number of accommodations for emerging growth companies under the Jumpstart Our Business Startups Act (JOBS Act) and a

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codification of a long-standing exemption for resales of securities to financially sophisticated investors.

Accommodations for Emerging Growth Companies

An “emerging growth company,” a concept created by the JOBS Act in 2012, is generally defined as an issuer with less than $1 billion in total annual gross revenues during its most recently completed fiscal year. Among other things, the JOBS Act created a so-called “IPO on-ramp” by facilitating the initial public offerings of emerging growth companies. But the JOBS Act also left in place certain traps for the unwary, which the FAST Act and the recent SEC rule changes are intended to fix.

Omission of Unnecessary Audited Financial Statements. As mandated by the FAST Act, the SEC issued two interim final rules implementing certain changes, and these changes became effective on January 19, 2016. One of these new rules permits an emerging growth company to omit certain financial statements from the registration statement for its initial public offering, if it reasonably believes the omitted information will not be required to be included in the registration statement at the time of the offering, so long as the registration statement is amended prior to distributing a preliminary prospectus to include all financial information required by SEC rules at the time of the amendment. Before this change, IPO issuers were required to audit their financial statements for prior fiscal year periods that wound up not being required in the final IPO registration statements because of the passage of time between the initial submission and the time of the eventual marketing of the IPO. This change should significantly reduce IPO costs for many emerging growth companies.

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As an illustration of the impact of this change, assume an emerging growth company with a December 31 fiscal year files an IPO registration statement with the SEC on February 1, 2016, expecting to conduct its IPO in April 2016. Before the latest SEC rule change, the issuer would have had to include audited financial statements for 2013 and 2014 in its initial IPO registration statement submission. As a result of the rule change, the company will now only be required to include audited financial statements for 2014 in its initial IPO registration statement submission. Prior to commencing the marketing of the IPO in April, the company would amend the registration statement to include its audited financial statements for 2015. Effectively, the new rule allows the company to avoid filing the unnecessary audited financial statements for an older year that will not be required to be included in the final IPO prospectus, in this case the audited financial statements for 2013.

IPO Registration Statement and Amendments	Filing Dates	Audited Financials Included
Before the New Rule	February 1, 2016	2013 and 2014
	April 15, 2016	2014 and 2015
After the New Rule	February 1, 2016	2014
	April 15, 2016	2014 and 2015

Extension of Duration of Emerging Growth Company Status. As originally conceived, an issuer that qualifies as an emerging growth company maintains that status until the earliest of (i) the last day of the fiscal year of the issuer during which it has total annual gross revenues of $1 billion or more; (ii) the last day of its fiscal year following the fifth anniversary of the first sale of its common equity securities pursuant to an effective registration statement; (iii) the date on which the issuer has, during the previous three-year period, issued more than $1 billion in nonconvertible debt; or (iv) the date on which the issuer is deemed to be a "large accelerated filer" under applicable SEC rules.

The problem for a number of emerging growth companies was that they wound up falling out of emerging growth company status during the IPO process itself by unexpectedly exceeding $1 billion in annual revenues in the year of the IPO. As a result, these issuers lost the special benefits available to emerging growth companies and had to scramble to quickly comply with the more rigorous SEC disclosure requirements that were applicable to issuers other than emerging growth companies in order to complete their IPOs.

The FAST Act fixes this problem by providing that an issuer that qualifies as an emerging growth company at the time it initiates the registration process will continue to qualify as an emerging growth company until the earlier of the date on which the issuer consummates its initial public offering or the end of the one-year period beginning on the date the company ceases to be an emerging growth company. This provides emerging growth companies that lose emerging growth company status during the IPO process with sufficient breathing room — a full year — to complete their IPOs before they will need to comply with the more rigorous disclosure requirements applicable to companies that are not emerging growth companies.

Reduction of Pre-Marketing Public Filing Period. The JOBS Act enabled emerging growth companies to keep their IPO registration statements confidential until 21 days before they

commence the active marketing of their offering. The FAST Act reduces the 21-day requirement to 15 days, enabling emerging growth companies to more quickly take advantage of perceived opportune marketing timing for their initial public offerings.

Forward Incorporation by Reference on Form S-1

A second interim final rule adopted by the SEC pursuant to the FAST Act permits smaller reporting companies (with some exceptions) to incorporate by reference in their Form S-1 registration statements any SEC filings made by the company in the future. A "smaller reporting company" is generally defined as a company with a public float (i.e., value of equity securities held by nonaffiliates) of less than $75 million. Historically, Form S-1 — the general public offering registration form for domestic smaller reporting companies and unseasoned issuers — has only permitted incorporation by reference of prior SEC filings, not future SEC filings. In order to be eligible to incorporate prior or future SEC filings by reference into Form S-1, the company must have filed an annual report (such as a Form 10-K) for its most recently completed fiscal year and must have filed all reports and other materials required under the Securities Exchange Act of 1934 (Exchange Act) during the preceding 12 months (or for the shorter period that the company has been subject to the SEC's periodic reporting requirements).

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The ability to incorporate future SEC filings by reference into Form S-1 will streamline the process for smaller issuers to maintain "resale shelf registration statements." Forward incorporation will eliminate the requirement for such issuers to file prospectus supplements to reflect material developments and to file annual post-effective amendments to include the most recent year's audited financial statements.

Resale Exemption for Sales to Financially Sophisticated Buyers

The FAST Act added a new section 4(a)(7) to the Securities Act of 1933 (Securities Act), codifying a securities offering exemption that has informally existed for a long time — the so-called "section 4(a)(1½) exemption". Unlike a private placement exemption under Regulation D or other exemptions used by issuers to offer and sell their securities without registration under the Securities Act, section 4(a)(7) creates a "resale exemption," that is, an exemption that can be used by existing securityholders to resell their securities. Securityholders that originally acquired their securities from issuers in a private placement hold "restricted securities" that cannot be freely resold, either on the stock market or otherwise. Similarly, company insiders and controlling shareholders, known as "affiliates," are similarly limited in their ability to resell securities they own. Restricted securityholders

and affiliates must either arrange for their resale to be registered on a resale registration statement or they must resell their securities pursuant to an exemption from registration.

Perhaps the most well-known resale exemption is Rule 144, which allows holders of restricted securities and affiliates to resell their shares publicly. But sometimes security-holders who may not freely resell their securities do not qualify for a Rule 144 sale, either because they have not held their restricted securities for a long enough holding period or because they are affiliates who desire to sell shares in a negotiated transaction or sell more shares than are permitted under the Rule 144 volume limitations.

To address such cases, an informal (noncodified) exemption known as the section 4(a)(1½) exemption developed, permitting resales of securities that could not otherwise qualify for another resale exemption to financially sophisticated purchasers that agreed to hold the securities for investment (without an intention to distribute the securities without registration).

Because of the absence of regulatory codification, sellers relying on the 4(a)(1½) exemption have historically faced uncertainty in determining whether the transaction will be exempt from registration under the Securities Act. New section 4(a)(7) of the Securities Act clarifies and expands on the existing informal section 4(a)(1½) exemption, laying out specific requirements for a qualifying resale, including:

- The purchaser must be an accredited investor
- Neither the seller nor any person acting on the seller's behalf offers or sells such securities by general solicitation or advertising
- If the issuer is not subject to the SEC's periodic reporting requirements, the seller and prospective purchaser must obtain certain reasonably current specified information from the issuer
- Neither the seller nor any compensated intermediary is subject to certain legal disqualifications (e.g., a bad actor)
- The issuer is engaged in business, is not in an organizational stage or in bankruptcy or receivership, and is not a blank check, blind pool or shell company with no specific business plan or purpose

- The transaction does not involve a security that constitutes the whole or part of an unsold allotment to, or a subscription or participation by, a broker or dealer as an underwriter of the security or a redistribution

- The transaction involves a security of a class authorized and outstanding for at least 90 days before the transaction.

In contrast to purchasers of securities sold under Rule 144 but consistent with purchasers of securities in a section 4(a)(1½) transaction, purchasers of securities under the new section 4(a)(7) exemption may not freely resell the securities — they receive restricted securities.

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Private equity or venture capital investors in public companies frequently find themselves being tagged as affiliates, either because they own more than 10 percent of the common stock or because they have a representative on the board of directors. New section 4(a)(7) provides such shareholders an alternative to Rule 144 for sales of their securities, thereby enhancing their liquidity.

Miscellaneous Provisions

The FAST Act includes several additional provisions affecting the SEC and securities regulations, requiring the SEC to:

- Eliminate duplicative, overlapping, outdated or otherwise unnecessary disclosure requirements

- Undertake a study to determine how to modernize and simplify SEC disclosure requirements to reduce the costs and burdens on issuers while still providing all material information and to submit a report to Congress regarding its detailed recommendations

- Permit issuers to include a summary page within Form 10-K, provided that each item on the summary page includes a cross-reference (by electronic link or otherwise) to the related material in Form 10-K.

In addition, the FAST Act extends to "savings and loan holding companies," the higher threshold triggering mandatory Exchange Act registration for "banks and bank holding companies" that had been affected by the JOBS ACT. As a result, savings and loan holding companies and banks will be treated the same and will not be required to register under the Exchange Act unless they have, at the end of the fiscal year, at least $10 million in assets and a class of equity securities held of record by at least 2,000 persons.

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