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House Passes More Securities Legislation

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

In what must be the most active period of securities legislation in recent history, the US House of Representatives has passed three more bills that would make changes to the federal securities laws. The three bills, which have not been passed into law as of yet, come in the wake of the Fixing American's Surface Transportation Act (the "FAST Act"), which was signed into law on December 4, 2015.

The 3 bills include: (i) H.R. 1675 – the Capital Markets Improvement Act of 2016, which has 5 smaller acts imbedded therein; (ii) H.R. 3784, establishing the Advocate for Small Business Capital Formation and Small Business Capital Formation Advisory Committee within the SEC; and (iii) H.R. 2187, proposing an amendment to the definition of accredited investor. None of the bills have been passed by the Senate as of yet.

Meanwhile, the SEC continues to finalize rulemaking under both the JOBS Act, which was passed into law on April 5, 2012, and the Dodd-Frank Act, which was passed into law on July 21, 2010. The SEC provides comprehensive information on its progress under each of the Acts on its website. For Dodd-Frank see HERE and for the JOBS Act see HERE.

H.R. 1675 – Capital Markets Improvement Act of 2016

On February 3, 2016, the House passed H.R. 1675, the Capital Markets Improvement Act of 2016, comprising 5 titles including (i) Title I – Encouraging Employee Ownership Act of 2015; (ii) Title II – Fair Access to Investment Research; (iii) Title III – Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification; (iv) Title IV – Small Company Disclosure Simplification; and (v) Title V – Streamlining Excessive and Costly Regulations Review.

The Executive Office strongly opposes H.R. 1675 and has issued a Statement of Administration Policy voicing its objections. The Executive Office points out that the bill has many flaws, imposes risks to investors, is overly broad, allows financial institutions to avoid appropriate oversight and is duplicative of existing administration authorities. I will continue to monitor progress and provide updates.

Title I – Encouraging Employee Ownership Act of 2015

The bill requires the SEC to amend Securities Act Rule 701 to require an issuer to provide certain delineated disclosures to employee investors regarding compensatory benefit plans if the aggregate sales price or aggregate amount of securities sold in any 12-month period exceeds $10 million, indexed for inflation every 5 years. The current regulations have a threshold of $5 million.

The Executive Branch strongly opposes the bill and even issued an official Statement of Administration Policy expressing its opposition.

Brief Summary of Rule 701

Rule 701 provides an exemption from the registration requirements under Section 5 of the Securities Act for offers and sales of securities pursuant to certain compensatory benefit plans and contracts related to compensation. The exemption only applies to issuers that are not subject to the reporting requirements of the Securities Exchange Act and is generally used by private companies.

The aggregate amount of sales under Rule 701 is limited to the greater of: (i) $1,000,000; (ii) 15% of the total assets of the issuer (or of the parent if the parent is a co-issuer or guarantor); or (iii) 15% of the total outstanding of the class of securities being offered. Rule 701 currently requires the delivery of the compensatory benefit plan or contract as applicable and additional disclosure if the aggregate sales exceed $5 million. Those additional disclosure include risk factors, a summary of the plan and financial statements prepared in accordance with U.S. GAAP.

Although securities issued under Rule 701 are restricted under Rule 144, they become freely tradable 90 days after the issuer becomes subject to the reporting requirements of the Securities Exchange Act without regard to the current information and holding period requirements under Rule 144 for non-affiliates and without regard to the holding period requirements for affiliates.

Like other exemptions, Rule 701 transactions are still subject to the anti-fraud provisions of the federal securities laws. Rule 701 does not pre-empt state law and accordingly, state securities laws must be complied with in any issuance under the Rule.

Title II – Fair Access to Investment Research

Title II requires the SEC to adopt rules providing that research issued by investment funds will not be deemed to be an offer for the sale of securities regardless of whether the report covers an issuer that is going to or has embarked on a registered offering and regardless of whether a broker-dealer associated with the fund will participate in the offering. The Act contains strong language, including prohibiting an SRO (FINRA) from maintaining or enforcing any rules conditioning the ability of a member to publish or distribute research on whether the member is participating in a registered offering.

Title III – Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification

Title III attempts to codify a broker-dealer registration exemption for mergers and acquisition brokers. The Executive Office Statement of Administration Policy points out that Title III as written is overly broad and would eliminate the registration requirements for M&A brokers engaged in a transaction for any privately held company with gross revenues up to $250 million. The Executive Office thinks this exemption amount is too high, among other issues. Moreover, the Executive Office notes that the SEC has already recognized an exemption for M&A brokers though a no action letter (see my blog HERE).

Title IV – Small Company Disclosure Simplification

Title IV creates an exemption from the XBRL requirements for small and emerging growth companies. The Executive Office also opposes this change on the grounds that “[o]pen data disclosure systems benefit investors, issuers, and the public, increasing transparency of publicly traded companies by making their filings more easily accessible.

Impeding regulators' ability to use 21st century technological tools to regulate markets and protect investors is contrary to the SEC's mission."

I support Title IV and the exemption from the XBRL requirements.

Title V – Streamlining Excessive and Costly Regulations Review

Title V may be herculean in nature. Title V requires the SEC to review each significant regulation issued by the SEC to determine by vote of the SEC if such regulation is (i) outmoded, ineffective, insufficient or excessively burdensome; or (ii) is no longer necessary in the public interest or consistent with the SEC's mandate to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. Title V requires the immediate review and a 10-year periodic review. The Executive Office statement of opposition states that "[T]hese requirements are unnecessarily duplicative, wasteful and costly. The SEC already complies with the Regulatory Flexibility Act and is encouraged, under Executive Order 13579, to review rules to assess whether they are outdated or excessively burdensome. Requiring a review and full Commission vote on every major rule every 10 years under full Administrative Procedure Act-style requirements would severely hinder the SEC's ability to monitor markets and protect investors."

H.R. 3784 – Establishing Advocate for Small Business Capital Formation and Small Business Capital Formation Advisory Committee

On February 1, 2016, the House passed H.R. 3784, the SEC Small Business Advocate Act. The Act proposes to amend the Securities Exchange Act to establish the Advocate for Small Business Capital Formation within the SEC. The office would be charged with (i) assisting small businesses and their investors in resolving significant problems with the SEC and other SROs; (ii) identifying areas where small businesses and their investors would benefit from changes in SEC and other SRO regulation; (iii) identifying problems small businesses have with security access to capital; (iv) analyzing the potential impact of proposed rules and regulations on small businesses; (v) conduct outreach programs with small businesses and their investors; and (vi) work to propose these changes to the SEC and Congress.

In addition, the Act would create the Small Business Capital Formation Advisory Committee. The committee would provide the SEC with advice on SEC rules, regulations, and policies relating to (i) capital raising by emerging, privately held small businesses and publicly traded companies with less than $250 million in public market capitalization through securities offerings; (i) trading in the securities of such businesses and companies; and (3) public reporting and corporate governance requirements of such businesses and companies.

The new proposed committee seems duplicative of the existing SEC Advisory Committee on Small and Emerging Companies, which was organized by the SEC to provide advice on SEC rules, regulations and policies regarding "its mission of protecting investors, maintaining fair, orderly and efficient markets and facilitating capital formation" as related to (i) capital raising by emerging privately held small businesses and publicly traded companies with less than $250 million in public market capitalization; (ii) trading in the securities of such businesses and companies; and (iii) public reporting and corporate governance requirements to which such businesses and companies are subject.

H.R. 2187 – Amendment to the Definition of Accredited Investor

Also on February 1, 2016, the House passed H.R. 2187, the Fair Investment Opportunities for Professional Experts Act, proposing an amendment to the definition of accredited investor as to natural persons. In particular, the bill proposes to add provisions to the definition of accredited investor to include (i) any natural person who is currently licensed or registered as a broker or investment adviser by the SEC, FINRA or a state securities regulator and (ii) any natural person the SEC determines by regulation to have demonstrable education or job experience to qualify such person as having professional knowledge of a subject related to a particular investment, and whose education or job experience is verified by FINRA.

In addition, the bill tweaks other aspects of the definition related to natural persons. The bill proposes to adjust the current $1,000,000 net worth accredited investor eligibility standard every 5 years for inflation. The bill tweaks the exclusion of a person's primary residence from the calculation such that any indebtedness secured by the residence (i.e., a mortgage) that is in excess of the fair market value of the home, will be included as a liability in determining net worth. I think this creates ongoing calculation issues as the value of homes can vary widely in a short period of time.

I doubt the bill in its current form will gain any traction or ultimately become law, but we will, no doubt, see changes to the accredited investor definition in the near future. For further discussion, see my blog HERE.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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