THE REPUBLICAN STUDY COMMITTEE
Rep. Jim Jordan, Chairman
Paul Teller, Executive Director
RSC
202.226.9717
rsc.jordan.house.gov

Legislative Bulletin .....March 7, 2012

Contents:

H.R. 3606 – Reopening American Capital Markets to Emerging Growth Companies Act of 2011 (Fincher, R-CA)

Order of Business: H.R. 3606 is scheduled to be considered under a structured rule on Wednesday, March 7, 2012. The bill shall be considered as read and the bill shall be debatable for 1 hour equally divided and controlled by the chair and ranking minority member of the Committee on Financial Services. The rule makes in order only those amendments printed in the Rules Committee report accompanying the resolution. The rule waives all points of order against the amendments printed in the Rules Committee report and provides one motion to recommit with or without instructions. **The RSC legislative bulletin for these amendments will be sent out separately.**

Background: According to the Committee Report:

> "As the number of U.S. IPOs fell precipitously, fewer small companies have gone public. Small companies are critical to economic growth in the United States. In order to grow and create jobs, small companies must have access to capital. Unfortunately, the IPO Task Force found that fewer and fewer small companies have gone public: the share of IPOs smaller than $50 million fell from 80% in the 1990s to 20% in the 2000s. To encourage small companies to go public in the U.S., to spur economic growth, and to create jobs, Representatives Fincher and Carney introduced H.R. 3606 on December 8, 2011."

In addition to the Reopening American Capital Markets to Emerging Growth Companies Act, the legislation included the following bills that were voted out of the House: H.R.1070, H.R. 2940, H.R. 2930, and H.R. 1965.

Summary: H.R. 3606 increases American job creation and economic growth by improving access to the public capital markets for emerging growth companies. The legislation is intended to promote the growth and capitalization of small businesses by reducing reporting and registration requirements by the Securities Exchange Commission (SEC), and clarifying conditions under which issuers of securities may advertise to

potential investors. The legislation also defines the conditions under which businesses may use "crowdfunding" to raise capital from investors.

Highlights of the legislation are listed below which includes the texts of the five other bills.

Reopening American Capital Markets to Emerging Growth Companies

H.R. 3606 amends the Securities Act of 1933 and the Securities Exchange Act of 1934 to establish a new category of issuers known as "Emerging Growth Companies" (EGCs) which are issuers that have total annual gross revenues of less than $1 billion. An issuer that is an EGC as of the first day of a fiscal year shall continue to be deemed an EGC until: (1) the last day of the fiscal year during which the issuer had $1 billion in annual gross revenues or more; (2) the last day of the fiscal year following the fifth anniversary of the issuer's initial public offering date; or (3) the date in which the issuer is deemed to be a "large accelerated filer," defined by the U.S. Securities and Exchange Commission (SEC) as an issuer with more than $700 million in public float.

The legislation defines the "initial public offering date" as the date of the first sale of common equity securities of an issuer pursuant to an effective registration statement under the Securities Act of 1933. The legislation establishes the effective date for the bill as December 8, 2011, so a company could be classified as an emerging growth company only if its IPO occurred after that date. The legislation allows EGCs to defer compliance with Section 404(b) of the Sarbanes-Oxley Act of 2002 until the company is no longer considered an EGC. Instead, emerging growth companies must comply with the lesser standards currently applied to companies that have a market capitalization of no more than $75 million.

H.R. 3606 exempts EGCs from Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), which requires publicly-traded companies to hold a non-binding shareholder vote at least once every three years on executive compensation and a shareholder vote on executive severance payments known as "golden parachutes." The bill exempts EGCs from Section 953(b) of the Dodd-Frank Act, which requires publicly-traded companies to disclose in every SEC filing the ratio of the CEO's compensation to the median compensation of all other employees. This legislation also requires an issuer that loses its EGC status before its second anniversary as a public company to comply with the Dodd-Frank Act's executive compensation disclosure requirements described above starting in its third year of being a public company. Lastly, the bill requires an issuer that loses its EGC status after its second anniversary as a public company to comply with the Dodd-Frank Act's executive compensation disclosure requirements beginning in the fiscal year after losing its status.

The legislation amends the Securities Act of 1933 to permit the publication or distribution by a broker or dealer of a research report about an EGC that is the subject of a proposed public offering, even if the broker or dealer is participating or will participate in the offering. The legislation also would amend the Securities Act of 1933 to expand

the range of permissible pre-filing communications to sophisticated institutional investors to allow EGCs to determine whether qualified institutional or accredited investors might have an interest in a contemplated securities offering. Companies that meet the criteria for being an emerging growth company could opt for compliance with full SEC registration requirements for a regular company. However, the company must make this choice when filing for registration.

The legislation amends the Securities Exchange Act of 1934 to permit members of the investment banking team for a broker or dealer participating in an offering to arrange for communications between securities analysts and potential investors in EGCs, and to permit research analysts to participate in communications with management of the issuer that are also attended by other members of the broker or dealer.

Access to Capital for Job Creators (Based on H.R. 2940)

H.R 3606 directs SEC to eliminate the prohibition against general solicitation as a requirement for a certain exemption under Regulation D Rule 506. The legislation authorizes that (not later than 90 days after enactment) the SEC to revise the Securities Act of 1933 to remove the prohibition against general solicitation or advertising on sales of non-publicly traded securities, provided that all purchasers of the securities are "accredited investors." The legislation requires the securities issuer to verify that the purchasers are accredited investors. Under current law, accredited investors are defined to include banks, insurance companies, registered investment companies, corporations and charitable organizations with more that $5 million in assets, and wealthy individuals. In total, the bill makes the exemption under the SEC's Regulation D Rule 506 available to issuers even if the securities are marketed through a general solicitation or advertising so long as the purchasers are "accredited investors."

Entrepreneur Access to Capital (Based on H.R. 2930)

H.R. 3606 would amend the securities laws to provide for registration exemptions for certain crowdfunded securities, and for other purposes. The legislation amends section 4 of the Securities Act of 1933 by exempting transactions involving the issuances of securities for which:

- the aggregate annual amount raised through the issue of the securities is $1,000,000 or less, or if the issuer provides potential investors with audited financial statements, $2,000,000 or less;

- individual investments in the securities are limited to an aggregate annual amount equal to the lesser of $10,000, and 10 percent of the investor's annual income;

- in the case of a transaction involving an intermediary between the issuer and the investor, the intermediary complies with the requirements under section 4A(a) of the Securities Act of 1933;

- in the case of a transaction not involving an intermediary between the issuer and the investor, the issuer complies with the requirements under section 4A(b*)* of the Securities Act of 1933.

H.R. 3606 also does the following:

4A. Requirements with Certain Small Transaction:

The legislation requires a person acting as an intermediary in a transaction involving the issuance of securities to comply with the following requirements if the intermediary:

- warns investors, including on the intermediary's website, of the speculative nature generally applicable to investments in startups, emerging businesses, and small issuers, including risks in the secondary market related to illiquidity;

- warns investors that they are subject to the restriction on sales requirement described under subsection;

- takes reasonable measures to reduce the risk of fraud with respect to such transaction;

- provides the SEC with the intermediary's physical address, website address, and the names of the intermediary and employees of the person, and keep such information up-to-date;

- provides the SEC with continuous investor-level access to the intermediary's website;

- requires each potential investor to answer questions demonstrating competency in—

    - recognition of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;

    - risk of illiquidity; and

    - such other areas as the SEC may determine appropriate.

- requires the issuer to state a target offering amount and withhold capital formation proceeds until aggregate capital raised from investors other than the issuer is no less than 60 percent of the target offering amount;

- carries out a background check on the issuer's principals;

- provides the SEC with basic notice of the offering, not later than the first day funds are solicited from potential investors, including—

- the issuer's name, legal status, physical address, and website address;
- the names of the issuer's principals;
- the stated purpose and intended use of the capital formation funds sought by the issuer; and
- the target offering amount.

- outsources cash-management functions to a qualified third party custodian, such as a traditional broker or dealer or insured depository institution;
- maintains such books and records as the SEC determines appropriate;
- makes available on the intermediary's website a method of communication that permits the issuer and investors to communicate with one another; and
- does not offer investment advice.

Requirements on Issuers if No Intermediary:

H.R. 3606 will require an issuer who offers securities without an intermediary to comply with the following requirements if the issuer:

- warns investors, including on the issuer's website, of the speculative nature generally applicable to investments in startups, emerging businesses, and small issuers, including risks in the secondary market related to illiquidity;
- warns investors that they are subject to the restriction on sales requirement;
- takes reasonable measures to reduce the risk of fraud with respect to such transaction;
- provides the SEC with the issuer's physical address, website address, and the names of the principals and employees of the issuers, and keeps such information up-to-date;
- provides the SEC with continuous investor-level access to the issuer's website;
- requires each potential investor to answer questions demonstrating competency in—
    - recognition of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;

- risk of illiquidity; and
- such other areas as the SEC may determine appropriate.

- states a target offering amount and withholds capital formation proceeds until the aggregate capital raised from investors other than the issuer is no less than 60 percent of the target offering amount;
- provides the SEC with basic notice of the offering, not later than the first day funds are solicited from potential investors, including—
  - the stated purpose and intended use of the capital formation funds sought by the issuer; and
  - the target offering amount.
- outsources cash-management functions to a qualified third party custodian, such as a traditional broker or dealer or insured depository institution;
- maintains such books and records as the SEC determines appropriate;
- makes available on the issuer's website a method of communication that permits the issuer and investors to communicate with one another;
- does not offer investment advice; and
- discloses to potential investors, on the issuer's website, that the issuer has an interest in the issuance.

H.R. 3606 will allows for an issuer or intermediary to rely on certifications provided by an investor to verify the investor's income. The legislation authorizes the SEC to make public the notices of*:*

- the intermediary's and issuer's physical address, website address, and the names of the intermediary and employees of the person, and keep such information up-to-date
- the offering, not later than the first day funds are solicited from potential investors, including—
  - the issuer's name, legal status, physical address, and website address;
  - the names of the issuer's principals;
  - the stated purpose and intended use of the capital formation funds sought by the issuer; and

- the target offering amount.

- of the offering, not later than the first day funds are solicited from potential investors, including—

  - the stated purpose and intended use of the capital formation funds sought by the issuer; and

  - the target offering amount.

Other Provisions:

H.R. 3606 prohibits investors from selling securities purchased through crowdfunding for one year, unless the securities are sold back to the issuer or to an accredited investor. The legislation requires that an intermediary not be treated as a broker under securities laws. The legislation also requires that if an issuer raises capital using the methods described under this bill, nothing in this bill will be construed as preventing an issuer from raising capital through other methods not described.

H.R. 3606 requires the SEC to issue rules as are necessary for implementing the crowdfunding transactions as listed above and provide cost benefit analysis within 90 days of enactment. Also within 90 days of enactment the SEC must issue rules that disqualify from crowdfunding any issuers who have in the past been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC.

Lastly, H.R. 3606 directs the SEC to make available to the states the information disclosed to it regarding the notice of crowdfunding offerings and the contact information for the intermediary or the issuer, as is relevant. The legislation also pre-empts state law by adding securities issued under crowdfunding agreements to the list of covered securities exempt from state law.

Small Company Capital Formation (Based on H.R. 1070)

H.R. 3606 would authorize the Securities and Exchange Commission (SEC) to exempt a certain class of securities from the 1933 Act. The legislation gives the SEC the authority to add by rule or regulation a class of securities to the securities exempted. The legislation would exempt these securities with the following terms and conditions*:*

- The aggregate offering amount of all securities sold within the prior 12-month period in reliance on the exemption added in accordance with this paragraph will not exceed $50,000,000.

- The securities may be offered and sold publicly.

- The securities will not be restricted securities within the meaning of the federal securities laws and the regulations.

- The civil liability provision in section 12(a)(2) will apply to any person offering or selling those securities.

- The issuer may solicit interest in the offering prior to filing any offering statement, on these terms and conditions as the SEC may prescribe in the public interest or for the protection of investors.

- The SEC will require the issuer to file audited financial statements with the Commission annually.

- Any other terms, conditions, or requirements as the SEC may determine necessary in the public interest and for the protection of investors, which may include—

    - a requirement that the issuer prepare and electronically file with the Commission and distribute to prospective investors an offering statement, and any related documents, in the same form and with same content as prescribed by the Commission, which will include a description of the issuer's business operations, its financial condition, its corporate governance principles, its use of investor funds, and other appropriate matters; and
    - disqualification provisions under which the exemption will not be available based upon the disciplinary history of the issuer or its predecessors, affiliates, officers, directors, underwriters, or other related persons, which will be substantially similar to the disqualification provisions contained in the regulations adopted in accordance with section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 U.S.C. 77d note).

H.R. 3606 would enact a limitation that only the following types of securities may be exempted under the proposed rule or regulation: equity securities, debt securities, and debt securities convertible or exchangeable to equity interests, including any guarantees of such securities.

The legislation also require that upon the SEC enacting the terms and conditions, as the Commission determines necessary in the public interest and for the protection of investors, the Commission by rule or regulation may require an issuer of a class of securities exempted under this bill to make available to investors periodic disclosures regarding the issuer, its business operations, its financial condition, its corporate governance principles, its use of investor funds, and other appropriate matters, and also may provide for the suspension and termination of a requirement with respect to that issuer.

The bill requires that not later than 2 years after the date of enactment of the Small Company Capital Formation Act of 2011 and every 2 years thereafter, the Commission will review the offering amount limitation and will increase this amount as the Commission determines appropriate. If the Commission determines not to increase the amount, it will report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on its reasons for not increasing the amount.

Lastly, H.R. 3606 requires the added class of securities is to be treated as covered securities for the purpose of the National Securities Markets Improvement Act

Private Company Flexibility and Growth (Based on H.R. 2167)

H.R. 3606 raises the threshold for mandatory registration under the Securities Exchange Act of 1934 from 500 shareholders to 1,000 shareholders for all companies and excludes securities held by shareholders who received such securities under employee compensation plans from the calculation. Raising the shareholder threshold would eliminate one impediment to capital formation for small companies.

Capital Expansion (Based on H.R. 4088 and H.R. 1965)

H.R. 3606 raises the threshold for mandatory registration under the Securities Exchange Act of 1934 from 500 shareholders to 2,000 shareholders for all banks and bank holding companies and raises the shareholder deregistration threshold from 300 shareholders to 1,200 shareholders. Raising the shareholder threshold for these small financial institutions will reduce their regulatory burdens and eliminate an impediment of raising equity capital from new shareholders without triggering SEC oversight in addition to prudential regulation.

Committee Action: H.R. 1965 was introduced on May 24, 2011 by Rep. Himes, and was referred to the House Financial Services. On the October 26, 2011 the bill was marked-up and reported by voice vote.

Administration Position: According to the SAP:

> "The Administration supports House passage of the Rules Committee Print of H.R. 3606. Helping startups and small businesses succeed and create jobs is fundamental to having an economy built to last. The President outlined a number of ways to help small businesses grow and become more competitive in his September 8, 2011, address to a Joint Session of Congress on jobs and the economy, as well as in the Startup America Legislative Agenda he sent to the Congress last month. In both the speech and the agenda, the President called for cutting the red tape that prevents many rapidly growing startup companies from raising needed capital. The President is encouraged to see that there is common ground between his approach and some of the proposals in H.R. 3606. The

Administration looks forward to continuing to work with the House and the Senate to craft legislation that facilitates capital formation and job growth for small businesses and provides appropriate investor protections."

Cost to Taxpayers: According to the Committee Report, "a cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974 was not made available in time for the filing of this report."

Does the Bill Expand the Size and Scope of the Federal Government?: No.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: No

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: H.R. 3606 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

Constitutional Authority: According Rep. Fincher's statement of constitutional authority, "Congress has the power to enact this legislation pursuant to the following: Article 1 Section 8."

RSC Staff Contact: Ja'Ron Smith, ja'ron.smith@mail.house.gov, (202) 226-2076.