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newsletter

Private Funds In Focus

Legal and Business News and Notes For the Private Investment Funds Community

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SUMMER 2013

Taking Stock: Year One of the JOBS Act

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The Jumpstart Our Business Startups (JOBS) Act became law just over one year ago. The JOBS Act seeks to encourage capital formation and reduce burdensome regulations on smaller issuers of securities. Since its enactment on April 5, 2012, we have seen significant changes across the public company landscape, but the JOBS Act's impact on fundraising for private companies and private investment funds has been more limited. The JOBS Act has streamlined the initial public offering process, and many soon-to-be public and newly public portfolio companies have taken advantage of its new rules and exemptions. At the same time, many of the more eagerly anticipated rule changes relating to private capital fundraising are not yet effective and await further action by the SEC.

Streamlining the IPO Process

The JOBS Act streamlines the process for certain issuers seeking to raise public capital. The JOBS Act amended the Securities Act of 1933 and the Securities Exchange Act of 1934 (Exchange Act) to create a new category of issuer referred to as an "emerging growth company" or "EGC." These issuers may take advantage of scaled-back disclosure requirements and transitional compliance rules in adapting to the full rigors of SEC reporting and compliance over an extended period.

events

Upcoming Events

Capital Dynamics webinar: "Co-investing Workshop" Robin Painter, Moderator
July 15, 2013, 11:00 a.m. ET. Register here.

Capital Creation 2013 | September 16-18, 2013. *Discount information:* Book online at www.capitalcreationeurope.com and benefit from an exclusive 25% discount available to Proskauer clients and contacts. Quote booking code PROSKAUER25 when you complete the online booking form to claim your discount. Alternatively, email capitalcreation@wbr.co.uk or call +44.0.207.368.9465 (again, please quote booking code PROSKAUER25)

SuperInvestor 2013 | November 19-22, 2013. *Discount information:* Book online and benefit from an exclusive 25% discount available to Proskauer clients and contacts: VIP Code: FKR2345PROSN.

To qualify as an emerging growth company, an issuer, during its most recently completed fiscal year at the time of SEC registration, must have had less than $1 billion in annual gross revenues and completed its initial registered offering of common equity after

December 8, 2011. An issuer loses its EGC status upon the earliest of:

- the last day of the fiscal year in which it has total annual gross revenues of $1 billion or more;
- the date on which it has issued more than $1 billion in nonconvertible debt during the prior three years;
- the date on which it becomes a "large accelerated filer" (at least 12 months of reporting history and $700 million in public float); and
- the last day of the fiscal year following the fifth anniversary of the date of its IPO.

Confidential Review Process

THE SEC OFFERS EGCs AN OPPORTUNITY TO SUBMIT A DRAFT REGISTRATION STATEMENT FOR CONFIDENTIAL REVIEW.

The SEC offers EGCs an opportunity to submit a draft registration statement for confidential review as long as the registration statement and amendments are publicly filed at least 21 days before the launch of the road show. Most EGCs are electing to take advantage of the confidential review process. Confidential review allows emerging growth companies to initiate their SEC review, but allows them to pull back without the stigma associated with withdrawing a registration statement in the event of a failed IPO attempt.

One of the effects of the confidential review process has been to alter visibility of the IPO pipeline. Previously, the market had a better view as to which companies were planning to go public in the near- and long-term. Now, however, visibility is often limited to the 21-day pipeline. This 21-day pipeline, however, is a better indicator of the deals that are likely to price in the near-term.

For fund managers and portfolio companies contemplating a "dual-track" process, the ability to confidentially submit a registration statement to the SEC for an IPO offers certain benefits. In the dual-track process, a portfolio company prepares to go public by filing an IPO registration statement and simultaneously runs a confidential private process to sell the company. A confidential SEC review process allows emerging growth companies to keep their progress along the IPO track, including any bumps in the road or a potential withdrawal from registration, out of the view of potential acquirers. An emerging growth company also could use its public filing as a way of indicating to potential acquirers that it is serious about going forward with the IPO, creating a "now or never" dynamic that may lead to higher sale premiums. At the opposite end of the spectrum, some EGCs have decided to file publicly at the beginning of their SEC process as a means to attract bidders.

Scaled-Back Disclosures

In order to ease the transition to being a public company, the JOBS Act permits emerging growth companies initially to provide less disclosure than otherwise would be required. Over the past year, the market has strongly adopted some of these scaled-back disclosures, while others have had moderate or only limited adoption.

EGCs SEE MANY BENEFITS IN PROVIDING SCALED-BACK EXECUTIVE COMPENSATION DISCLOSURE AS PERMITTED BY THE JOBS ACT.

Strong Adoption	Moderate Adoption	Limited Adoption
> Reduced executive compensation disclosure > Exemption from auditor attestation requirements of Sarbanes-Oxley 404(b)	> Reduced historical financial information	> Noncompliance with new GAAP standards

In recent years, the SEC has required increasing amounts of executive compensation disclosure for issuers. Many have found this to be one of the more burdensome and complex disclosure requirements for public companies. Issuers see many benefits, in terms of saved time and reduced cost, in providing scaled-back disclosure in this area. IPO investors, aware that newly public companies are adopting and adjusting to new compensation policies and practices as part of the IPO process, seem accepting of this more limited disclosure.

The JOBS Act exemption from the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act also has been widely adopted by emerging growth companies. Section 404(b) requires each registered public accounting firm that prepares an audit report for a company to attest to and report on the assessment of internal controls over a company's financials made by the chief executive officer and chief financial officer. Emerging growth companies that elect this exemption realize significant cost savings. Management is still responsible for providing its opinion on internal controls, and the market seems comfortable with the delayed auditor attestation for as long as the issuer maintains its emerging growth company status.

THERE HAS BEEN MIXED ADOPTION OF SCALED-BACK HISTORICAL FINANCIALS BY EGCs.

There has been mixed adoption of scaled-back historical financials by EGCs. Emerging growth companies need only provide two years of audited financials, selected financial information, and management's discussion and analysis of financial condition and results of operations, rather than the usual three years (five years in the case of selected financial information). Most IPO prospectuses continue to include three years of audited financial statements. Typically the choice to go public with reduced financial disclosures depends on how important the third earlier year is to the investors' understanding of the company and the marketing of the new issue. Other important factors include what financials may be available in connection with acquired businesses, a desire to demonstrate trends and/or growth, and industry practice.

EGCs ARE PERMITTED TO USE "TESTING-THE-WATERS" COMMUNICATIONS TO CERTAIN INSTITUTIONAL INVESTORS TO GAUGE THEIR INTEREST IN AN IPO.

Under the JOBS Act, EGCs may use private company phase-in periods for adoption of new or revised accounting standards. A significant majority (almost 80%) of EGCs have irrevocably opted out of this accommodation. This has been the least used exemption provided by the JOBS Act, as EGCs seek to assure investors that their financial statements will be comparable to those of other companies that follow public company accounting standards.

Testing the Waters

EGCs are permitted to use "testing-the-waters" communications to certain institutional investors to gauge their interest in an IPO prior to submitting a registration statement with the SEC. Initially, many securities professionals expected that testing-the-waters communications would create a new dynamic in bringing IPOs to the market. However, we have seen limited use and mixed adoption of these communications. Issuers and underwriters are hesitant to use these communications, which are typically required to be shared with the SEC, due to confidentiality and liability concerns. Instead, testing-the-waters communications are used in deal-specific situations, such as for issuers with no true comparable companies, with new technologies or in new industries and generally where the level of potential investor interest is hard to gauge.

Research Reports – Continuing to Evolve

Provisions of the JOBS Act permit broader analyst coverage of emerging growth companies by allowing publication of research reports prior to, during, and after an offering. Underwriters are being cautious, however, and have, on the whole, not changed their practices. Typically, investment banks are not conducting pre-IPO research and are restricting research publication until 25 days after an EGC IPO. These provisions also eliminated the research quiet periods before and after the expiration or waiver of a company or shareholder lock-up agreement with EGC underwriters.

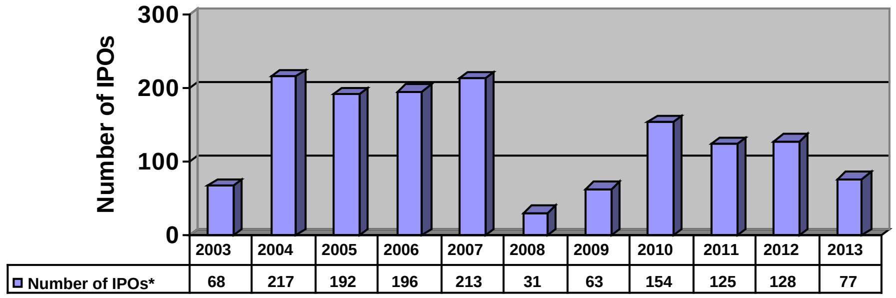
IT IS NOT CLEAR THAT THE IPO MARKET WOULD LOOK MUCH DIFFERENT WITHOUT THE JOBS ACT'S ENACTMENT.

The IPO Market – Is the JOBS Act Fueling Growth?

Over the JOBS Act's first year, almost 85% of all IPOs that went into effect were filed by emerging growth companies. The largest industry sectors represented were technology, life sciences, real estate, energy and financial services. An estimated 85 EGCs exist in the confidential submission pipeline, and approximately 65 EGCs that are in registration have publicly filed registration statements. In the first five months of 2013, 60% of the initial public offerings were made by US domestic issuers self-identified as EGCs. These offerings have ranged in size between $12 million and $312 million. In addition, there have been more priced IPOs in the first five months of 2013 as compared to the first six months of any year since 2007.

While this data indicates that issuers are electing to take advantage of the benefits of the JOBS Act, it is not clear that IPO market volume would look much different without its enactment. The IPO market still has a long way to go to reach pre-recession levels. From 2004 to 2007, the average number of IPOs was over 200 per year. There is a strong case to be made that a recovering US economy and other macroeconomic factors are jumpstarting the equity capital markets, rather than provisions of the JOBS Act.

IPO Pricings



**Data for 2013 includes first five months only.*

Source: Renaissance Capital (www.renaissancecapital.com), as of June 10, 2013. Excludes SPACs, closed-end funds and trusts.

Exchange Act Registration Threshold Lifted – Easier for Companies to Stay Private Longer

Previously under Section 12(g) of the Exchange Act, an issuer had to register a class of securities once such class was held by 500 or more shareholders of record and the issuer had more than $10 million in assets. The JOBS Act significantly increased this threshold to 2,000 shareholders of record or 500 persons who are not "accredited investors" as defined in Regulation D. The new rule excludes from the calculations employees who obtained equity under employee compensation plans in reliance on exemptions from registration.

In the past, many private portfolio companies have restricted offering activity for fear that a growing shareholder base would trigger public registration requirements. This fear also applied to private investment funds with large investor bases. The JOBS Act allows private funds to accept more investors and private portfolio companies to continue to increase their shareholder base without being required to register under the Exchange Act.

Waiting for Action: General Solicitation and Advertising

On August 29, 2012, the SEC proposed amendments to Rule 506 of Regulation D and Rule 144A. The proposed amendments implement the JOBS Act mandate to permit general solicitation in offerings to accredited investors under Regulation D and to qualified institutional buyers (QIBs) under Rule 144A. These amendments will benefit both operating companies and private investment funds. Currently, private companies and investment funds must scrupulously avoid press releases, press statements and other communications that reference fundraising activities, except when such communications are limited to investors with which the issuer has a substantial preexisting business relationship.

As of the date of publication of this article, these amendments have not yet become effective. The proposed amendments have been one of the most discussed, and politically-charged, components of the JOBS Act. We expect that with the appointment of new leadership at the SEC, there is a good chance that some action will be taken on these proposed amendments by the end of the year.

Please see our previous client alert on this topic:
http://www.proskauer.com/publications/client-alert/sec-proposes-rule-amendments-to-permit-general-solicitation-in-private-offerings/

THE SEC HAS NOT PROPOSED ANY CROWDFUNDING RULES AND DOES NOT SEEM INCLINED TO DO SO IN THE NEAR FUTURE.

Crowdfunding Cools

One of the most talked about, but probably least significant in terms of economic impact, JOBS Act provision requires the SEC to adopt equity crowdfunding rules. Crowdfunding typically involves an entrepreneur raising money in relatively small amounts from a large number of people, through social media and other online platforms. The SEC has not proposed any crowdfunding rules and does not seem inclined to do so in the near future. In addition, there are significant challenges in the promulgation of any crowdfunding rules, including providing adequate protections for small investors and the risks and costs of compliance for small businesses.

Conclusion

The JOBS Act has clearly had an impact on the IPO process during its first year. However, the full, longer-term impact of the JOBS Act as a whole remains to be seen.

AIFMD July 22 Deadline Nears for Non-European Funds and Fund Managers

Key parts of the European Directive on Alternative Investment Fund Managers (AIFMD) will become effective on July 22, 2013. In particular, non-EEA (European Economic Area) managers who wish to market non-EEA funds to investors in Europe after July 22 will have to start complying with new rules and procedures under the AIFMD and relevant national implementing rules in each EEA country in which they wish to market.

Among the key recent developments relating to the implementation of the AIFMD for non-EEA managers and funds:

- ESMA (the European Securities and Markets Authority) recently entered into cooperation agreements with a number of key regulatory agencies in key jurisdictions, including the Securities and Exchange Commission in the US, as well as the relevant regulators in the Cayman Islands, the British Virgin Islands, Bermuda, Jersey, Guernsey, Australia, Canada, Hong Kong, Singapore and Switzerland. These agreements provide for the exchange of information among the relevant regulatory authorities, and are a necessary precondition that must occur before a manager from a particular non-EEA jurisdiction can market a fund from a particular non-EEA jurisdiction to EEA investors.

ABSENT AN EXTENSION IN A PARTICULAR EEA COUNTRY, NON-EEA FUNDS AND FUND MANAGERS MUST BE PREPARED TO PROVIDE ADDITIONAL INFORMATION ON A RANGE OF TOPICS TO PROSPECTIVE INVESTORS.

- Individual countries in the EEA must adopt legislation implementing the AIFMD by July 22, 2013. While a number of countries (such as the United Kingdom and Ireland) have made significant progress towards implementation, somce countries have not yet taken the necessary action.
- Among other things, each EEA country is supposed to establish new filing and reporting procedures that must be followed by non-EEA managers and non-EEA funds after July 22 in each EEA country in which they market to investors. If a particular EEA country has not adopted new filing and reporting procedures by July 22, then it generally should be assumed that any existing national private placement rules in effect in that country will apply, unless otherwise indicated by the relevant regulatory authorities in the country. As the July 22 deadline approaches, non-EEA funds and managers likely will need to consult with local counsel in each relevant country in order to determine what filing and reporting procedures must be followed in order to market a fund to investors in that country as each country is likely to take different approaches to implementing the AIFMD.
- Two key countries, the United Kingdom and Germany, recently proposed transition periods that extend the AIFMD compliance deadline for non-EEA managers and non-EEA funds marketing to investors in those countries until July 22, 2014. Conditions often attach to the ability to use the transition period, such as having commenced marketing into the EEA or the relevant country prior to July 22, so the precise requirements in each country should be checked to ensure that a transition period is available to a non-EEA manager.
- Some countries, such as Denmark, currently are proposing not to offer extensions. Absent an extension in a particular EEA country, non-EEA funds and fund managers must be prepared to provide additional information on a range of topics to prospective investors. For funds that already have begun marketing efforts, this most likely would be done by way of either updated offering materials or some form of supplemental disclosure statement that includes the additional required information.

Non-EEA fund managers who are currently marketing funds, or preparing to market funds, in the EEA will need to continue to monitor developments in connection with the July 22 implementation date.

Recent Experience with SEC Examinations

We have seen an increase in SEC examinations of registered investment advisers in the last few months. In particular, we have seen a number of so-called “presence” exams of recently-registered investment advisers, especially private equity fund managers, as promised by the SEC staff in various public announcements concerning its objective to contact and perform some level of review of at least 25% of newly-registered advisers. Among the issues that we have seen raised by SEC staff examiners in recent examinations are:

- ***Expenses charged to clients***, such as travel expenses and legal expenses (including expenses related to an adviser’s registration with the SEC).
- ***Presentation of past investment performance***, including portability issues (i.e., whether individuals at a new firm can use their track record developed at a prior firm), calculation methodology, and adequacy of back-up records.
- ***Potential conflicts of interest***, in particular issues related to trade allocations, “side-by-side” investments (especially when multiple funds advised by the same adviser invest at different times or in different securities of the same portfolio company), and co-investments by employees and principals in portfolio companies in which clients have invested.
- ***Valuation practices***, including variations from stated valuation policies, and variations in methodologies from one portfolio company to another portfolio company.
- ***Transaction fees*** or other similar types of fees charged by advisers to portfolio companies in which clients have invested.

Recently-registered advisers that have not yet had an SEC examination should be prepared for questions related to these topics that may arise when they are examined.

Changes to Form 13F

Investment managers that file Form 13F (generally applicable to managers with investment discretion over $100 million or more of securities included on the SEC’s list of exchange-traded Section 13F securities) should be aware that the SEC implemented a new online form on May 17. Starting with the filing in respect of the second quarter of 2013 which must be filed by August 14, Form 13F filers will be required to use the new online form, and may no longer file Form 13F in text format. In addition, the holdings table for the Form must be completed according to the EDGAR XML technical specification. Investment managers also should be aware that amendments to any previous filings of Form 13F must be completed using the new online form.

Recent Client Alerts

AIFMD Co-operation Arrangements Are Agreed with 34 Regulators (6/3/2013)

In an important step towards the implementation of the Alternative Investment Fund Managers Directive in the European Economic Area on July 22, 2013, the European Securities and Markets Authority announced on May 30, 2013 that it had reached agreement on co-operation arrangements with regulators in a number of countries outside of the EEA. This alert provides a list of the approved regulators as well as a concise overview of the co-operation agreements.

SEC and CFTC Adopt "Red Flag" Identity Theft Rules (5/31/13)

The SEC and the CFTC recently issued their final "red flag rules" requiring certain regulated entities that qualify as either "financial institutions" or "creditors" to adopt programs to identify and address the risk of identity theft. The final rules went into effect on May 20, 2013, and all affected SEC- and CFTC-regulated entities are required to be in compliance with them by November 20, 2013. This alert provides a brief analysis of Regulation S-ID (the SEC's new red flag rules) and Subpart C (the CFTC's new red flag rules) and their potential impact on private fund advisers.

SEC Staffer Cautions Private Funds Industry on Potential Broker Registration Issues (4/26/13)

David W. Blass, Chief Counsel of the SEC's Division of Trading and Markets, recently gave a speech focusing on a number of activities commonly conducted by private fund advisers that could raise potential broker registration issues under the Securities Exchange Act of 1934. This alert provides a summary of Mr. Blass' speech and the issues it raises for those in the private funds industry.

Upcoming Deadlines for Private Funds that Trade Swaps (4/9/13)

Key changes to the swaps markets, pursuant to the Dodd-Frank Act, are starting to take effect. This alert highlights significant deadlines affecting private investment funds.

ESMA Publishes Final AIFMD Remuneration Guidelines (2/14/13)

On February 11, 2013, the European Securities and Markets Authority published final guidelines on remuneration of alternative investment fund managers under the Alternative Investment Fund Managers Directive. The Guidelines, which clarify and expand on the remuneration requirements contained in the Directive, focus on introducing sound and prudent remuneration policies and organizational structures to avoid conflicts of interest that may lead to excessive risk taking. The rules will apply to European Economic Area-based managers of alternative investment funds, including hedge funds, private equity funds and real estate funds.

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Our Private Investment Funds Group is comprised of more than 100 lawyers and advises clients worldwide on all of the legal and business issues important to private equity, venture capital and hedge fund sponsors, including structuring investment vehicles of all types and portfolio company investments, as well as institutional investor representation and secondary purchases and sales.

This newsletter is for clients and friends of our Private Investment Funds Group and discusses business and legal issues and developments affecting the private investment funds community.

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