Observers expect the Securities and Exchange Commission to issue final regulations under Titles III and IV of the JOBS Act soon, with many anticipating action in 2015. As companies contemplate taking advantage of these avenues for raising capital, they should carefully consider how their directors and officers liability insurance policy would respond to claims arising from such an offering. Insurers have taken note of the changes brought on by the JOBS Act and how it is blurring the lines between private and public securities offerings.

Differences Between Private and Public Company Directors and Officers Coverage

Most private company D&O policies contain an exclusion for claims arising out of a public offering of securities and the purchase or sale of publicly traded securities. Typically the terms “public offering of securities” and “publicly traded securities” are not defined. The exclusion normally goes on to provide that it “shall not apply to claims arising from an offer, sale, or purchase of securities in a transaction that is exempt from registration under the Securities Act of 1933.” Thus, there is coverage for claims arising out of private offerings but not public offerings. Insurers have separate public company D&O forms to address the unique exposures faced by public companies.

Insurers treat—and underwrite—private and public companies differently for a variety of reasons. Private company D&O policies often provide broad entity coverage (“Side C”) for a variety of claims beyond just securities claims, whereas entity coverage under most public company D&O policies is limited to securities claims. Ownership structure, regulation, and disclosure requirements vary widely between public and private companies. Public company claims tend to have a higher severity exposure and, as a result, those companies typically purchase higher limits of insurance. Conversely, private companies usually purchase lower limits of liability and frequently share D&O limits with other liability coverages in a package management liability policy. While many insurers write both private and public company D&O policies, their appetites for each can be markedly different. Finally, and importantly, private company D&O coverage is typically far less expensive than public company coverage.
The JOBS Act primarily affects securities offerings that are exempt from registration under the Securities Act of 1933. Therefore, as private company policies are usually constructed, most JOBS Act claims would fall under the carve-back for claims arising from exempt offerings and be covered under a private company D&O policy.

**The JOBS Act**

Title III of the JOBS Act allows companies to raise up to $1 million per year from the general public (both accredited and nonaccredited investors). These offerings are exempt from registration, but they may only be offered through strictly regulated crowdfunding platforms. Title IV, referred to as “Regulation A+,” allows companies to raise up to $50 million from both accredited and nonaccredited investors in an exempt offering. The SEC proposed regulations under both titles in late 2013, but final rules have not been issued as of the date of this paper.

Some insurers believe these changes have further blurred the lines between private and public offerings. Sometimes referred to as mini-IPOs, Title IV offerings are much larger than any currently available exemption and share many characteristics with a traditional IPO:

- Companies can raise up to $50 million within a 12-month period.
- Securities can be offered to both accredited and nonaccredited investors. Most exemptions available today, including Regulation A, permit offerings only to accredited investors.
- Companies can issue nonrestricted securities, which can be traded on public exchanges after the offering.

Many observers have noted the substantial changes that these provisions of the JOBS Act have made to private offerings of securities. Insurance companies have noted these changes too.

**Insurance Companies React**

Private company D&O insurers have begun to modify their policies in response to the proposed (and expected) JOBS Act regulations. Specifically, insurers have begun to introduce “JOBS Act Endorsements” to private company policies to “clarify” the types of claims they intend to cover for companies undertaking a JOBS Act offering. There are two major coverage implications in the endorsements currently in the market:

- Coverage is explicitly provided for offerings made under Titles II, III, and IV of the JOBS Act. Although coverage for a claim arising out of an offering pursuant to these titles should not have been in question (because they remain “exempt” offerings), the endorsements clarify this in the face of a new law by providing an express coverage grant instead of relying on the “exemption carve-back.”

- Coverage for claims arising from a Title IV offering is either excluded or sublimited to, for example, $250,000 of coverage. This is a significant coverage restriction for Title IV offerings, which previously would have enjoyed full limits as “exempt” offerings.

At least two leading insurers have introduced JOBS Act endorsements, and others are expected to follow suit once final regulations are issued. Insurers view Title IV offerings as closer to a “public offering of securities” rather than traditional private company offerings.

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1 Insurers may have argued that their policy forms were written before the JOBS Act was proposed and their intent was never to cover claims arising from exempt offerings of the size and scope allowed by the JOBS Act.
What to Do Now

Companies considering raising capital by taking advantage of these new exemptions (once the final regulations are passed) must assess their D&O coverage and be aware of any JOBS Act endorsement that is included in your current policy or expected to be added in the coming years. If a company is considering a Title IV offering, and its policy contains one of these JOBS Act endorsements, the bottom line is that a private company form, in all likelihood, does not provide satisfactory coverage. Further, the risks of an offering, particularly under Title IV, closely resemble the risks of a traditional public offering of registered securities. As such, the risks and potential severity of claims should be fully analyzed and addressed under a comprehensive program and coverage design that reflect the actual risks.

As insurers continue to react to JOBS Act offerings and any resulting claims, companies will need to assess what coverage the market is willing to offer. Even if a company raising $50 million under Title IV can obtain a broad scope of entity coverage under a private company policy, there are a number of considerations that may lead it to conclude that a public company policy is the preferred structure. And some insurers may simply be unwilling to offer a private company policy option for those companies.

It is imperative to engage an experienced D&O broker familiar with these issues as early as possible in the fund-raising process. Because coverage under a private company D&O policy for claims arising from JOBS Act offerings is a moving target, it is crucial for any company considering a Title III or IV offering to have a comprehensive understanding of what your policy currently covers and options going forward.