

SEC Proposes Rules to Increase Access to Capital for Smaller Companies

Hinshaw Alert | 4 min read

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Section 401 of the JOBS Act directed the SEC to adopt rules to exempt the following class of securities from the provisions of the Securities Act of 1933 (the “1933 Act”):

- The aggregate offering amount of all securities offered and sold on a registration statement filed with the SEC within the prior 12-month period in reliance on this exemption must not exceed \$50 million.
- The securities may be offered and sold publicly.
- The company may solicit interest in the offering prior to filing any offering statement with the SEC.
- The SEC will require the company to file audited financial statements with the SEC annually.

On December 18, 2013, the SEC proposed rules intended to implement Section 401. Set forth below is a brief overview of the proposed rules.

A more detailed discussion of these rules may be [found here](#).

Regulation A

A company selling securities to potential investors must register the offering under the 1933 Act – unless it can rely on an exemption.

Regulation A is a longstanding, little used, exemption which allows companies to sell securities and avoid complying with the 1933 Act registration rules. Reg A permits unregistered public offerings of up to \$5 million of securities in a 12-month period, including no more than \$1.5 million of securities offered by security-holders of the company.

Currently, companies relying on Reg A must submit an offering statement to the SEC for review. Reg A tailors those requirements for smaller companies and does not mandate ongoing reporting after the offering is completed. In addition, such offerings also are subject to state-level registration and qualification requirements.

Proposal

The SEC's proposed rules would expand and revise Reg A and create two tiers of Reg A offerings:

- Tier 1 offerings would consist of those offerings already covered by Reg A – namely securities offerings of up to \$5 million in a 12-month period, including up to \$1.5 million for the account of selling security-holders.
- Tier 2 offerings would consist of securities offerings of up to \$50 million in a 12-month period, including up to \$15 million for the account of selling security-holders.

For offerings up to \$5 million, a company could elect whether to proceed under Tier 1 or 2.

Basic Requirements

Whether relying on Tier 1 or Tier 2, a company would be subject to basic requirements, including ones addressing issuer eligibility and disclosure based on the existing provisions of Reg A. The regulation would also be updated to, among other things:

- Permit companies to submit draft offering statements for nonpublic SEC review prior to filing. If the offering proceeds, the drafts would have to be filed as an exhibit to the offering statement at least 21 days before the offering commences.
- Permit the use of “testing the waters” solicitation materials both before and after the filing of the offering statement, thereby allowing companies to determine if there is a market for the offering.
- Modernize the qualification, communications, and offering process in Reg A to reflect analogous provisions of the 1933 Act registration process, including requiring electronic filing of offering materials.

Additional Tier 2 Requirements

A Tier 2 offering would also be subject to the following requirements:

- An investor would be limited to purchasing no more than 10% of the greater of the investor's annual income or net worth. The company would be allowed to rely on the representations of the purchasers of the securities that they are not exceeding the limit.
- The financial statements included in the offering circular would have to be audited.
- The company would be required to file annual and semiannual ongoing reports and current event updates that are similar to the requirements for public companies. The annual report would be on a new form 1-K; the semiannual report would be made on new form 1-SA and the current event reports would be filed on form 1-U. A company could leave the Reg A reporting regime after completing its reporting obligations for the year in which the offering statement became effective provided it does not have more than 300 shareholders of record for the securities sold in the offering.

Eligibility

As currently is the case, the revised Reg A would be available to companies organized in and with their principal place of business in the United States or Canada.

The Reg A exemption would not be available to companies that:

- Are already SEC reporting companies and certain investment companies.
- Have no specific business plan or purpose or have indicated their business plan is to engage in a merger or acquisition with an unidentified company.
- Are seeking to offer and sell asset-backed securities or fractional undivided interests in oil, gas, or other mineral rights.
- Have not filed the ongoing reports required by the proposed rules during the preceding two years.
- Are or have been subject to an SEC order revoking the company's registration under the Exchange Act during the preceding five years.
- Are disqualified under the proposed "bad actor" disqualification rules.

Preemption of Blue Sky Law

Currently, Reg A offerings are subject to registration and qualification requirements in the states where the offering is conducted unless a state-level exemption is available.

Under the proposed rules, state securities law requirements would be preempted for Tier 2 offerings.

For further information on this issue, please contact [Tim Sullivan](#), or your regular [Hinshaw attorney](#).

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