

SEC Adopts Rules to Increase Access to Capital for Smaller Companies

Hinshaw Alert | 8 min read

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On March 25, 2015, the SEC, as directed by Section 401 of the JOBS Act, adopted rules which significantly amend Regulation A.

On December 18, 2013, the SEC proposed amendments to Regulation A intended to implement Section 401. Generally speaking, the final rules follow the approach set forth in the proposed rules. The final rules should be effective in late May or early June.

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

Regulation A

Regulation A is a longstanding, little-used, exemption. Currently, 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. Reg A has been little used due to its limited offering size and disclosure burdens relative to other private placement exemptions, such as those offered by Regulation D.

Reg A+

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

- Tier 1 offerings will consist of securities of up to \$20 million in a 12-month period, including sales for the account of selling security-holders equal to the lesser of \$6 million or 30% of the aggregate offering price (including sales by the issuer).
- Tier 2 offerings will consist of securities of up to \$50 million in a 12-month period, including sales for the account of selling security-holders equal to the lesser of \$15 million or 30% of aggregate offering price (including sales by the issuer).

For offerings up to \$20 million, a company could elect to proceed under either Tier 1 or 2.

The new rules permit “test-the-waters” communications for Tier 1 and 2 offerings and disqualify issuers involved with bad actors.

The new rules will require issuers to electronically file disclosure documents with the SEC but impose different disclosure requirements for issuers involved in Tier 1 and Tier 2 offerings. In addition, the rules will allow issuers to submit offerings to the SEC on a confidential basis. An issuer completing a Tier 2 offering will be required to comply with periodic reporting rules.

Tier 2 offerings will be subject to investment limits as discussed below. Tier 2 offerings will be exempt from the state registration and qualification rules.

The rules permit brokers to rely on reports filed by a Reg A issuer making a Tier 2 offering to satisfy the broker’s obligations under Rule 15c2-11 and impose restrictions on secondary sales by security-holders following the completion of a Tier 1 or 2 offering.

Companies relying on Tier 2 of Reg A would not become subject to the reporting and most other requirements of the Securities Exchange Act of 1934 (the “1934 Act”). As a result, Reg A companies will not be subject to, among other rules, Sarbanes-Oxley, insider trading and reporting rules, or SEC proxy rules.

Eligible Securities

The Reg A exemption will only apply to offerings of equity securities, warrants, convertible equity securities, debt securities, and debt securities convertible or exchangeable into equity interests, including any guarantees of such securities. Asset-backed securities may not be sold in a Reg A offering.

Eligible Issuers

The revised Reg A would be available to issuers organized in and with their principal place of business in the United States or Canada.

The Reg A exemption would not be available to the following issuers:

- SEC reporting companies;
- Companies registered or required to be registered under the Investment Company Act of 1940 and business development companies (“BDCs”);
- Blank check companies;
- Companies seeking to offer and sell or fractional undivided interests in oil, gas, or other mineral rights;
- Companies that have not filed the ongoing reports required by the final Reg A rules during the preceding two years;
- Companies subject to an SEC order revoking registration under the 1934 Act during the preceding five years; and
- Companies disqualified under the “bad actor” disqualification rules.

Communications During an Offering

Companies may “test the waters” in order to solicit interest in a potential offering with the general public either before or after the filing of the offering statement. This allows a company to determine if there is sufficient interest in the offering.

Filing and Delivery Requirements

Whether relying on Tier 1 or Tier 2, a company will be subject to the following filing and delivery requirements, including ones which provide that:

- Companies must electronically file offering statements.
- Companies may submit electronic 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 qualification of the offering statement.

Offering Statement on Form 1-A

Under the final rules, companies would continue to file an offering statement on Form 1-A as revised. The rules update and clarify the Model B (Narrative) disclosure format under Part II of Form 1-A (renaming it as Offering Circular), while continuing to permit the use of Part I of Form S-1 narrative disclosure as an alternative.

Tier 1 and Tier 2 issuers must file balance sheets and related financial statements for the two previous fiscal year ends (or for such shorter time that they have been in existence).

Tier 2 issuers must include audited financial statements in their offering statements that are audited in accordance with either GAAS or the standards of the Public Company Accounting Oversight Board (PCAOB). The accountants must be independent but they do not have to be registered with the PCAOB.

Issuers in Tier 1 offerings do not have to provide audited financials. However, if the issuer has already obtained audited financials prepared in accordance with GAAP or PCAOB standards and the accountants satisfy the independence standards, then the audited financials must be filed. However, the accountants do not have to be registered with the PCAOB.

Ongoing Reporting

The ongoing reporting rules provide that:

- Issuers that conduct a Tier 1 offering must electronically file a Form 1-Z exit report with the SEC not later than 30 calendar days after termination or completion of a qualified Reg A offering containing information about sales in such offering and an update of certain information.
- Issuers relying on Tier 2 exemption will 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 will be on a new

Form 1-K; the semiannual report will be made on new Form 1-SA and the current event reports will be filed on Form 1-U.

- Form 1-K will require disclosures relating to the company's business and operations for the preceding three years (or since inception, if in existence for less than three years); related party transactions; beneficial ownership; executive officers and directors; executive compensation; MD&A; and two years of audited financial statements.
- Form 1-SA and Form 1-U are analogous to Form 10-Q and Form 8-K, respectively, but with scaled disclosure requirements.
- These reports will be filed via EDGAR: (i) Form 1-K – 120 days after the fiscal year end; (ii) Form 1-SA – 90 days after the end of the second fiscal quarter; and (iii) Form 1-U – within four business days of the relevant event.
- Companies that conduct a Tier 2 offering must include in their first annual report (on Form 1-K) after termination or completion of a qualified Reg A offering or in their Form 1-Z exit report containing information about sales in the terminated or completed offering.

Purchase Limits

There are no investment limitations for purchasers in Tier 2 offerings who qualify as accredited investors under Rule 501 of Regulation D.

In a Tier 2 offering, an investor who is not an accredited investor will be limited to purchasing no more than 10% of the greater of the investor's annual income or net worth. The annual income and net worth would be calculated for individuals as provided in the accredited investor definition in Regulation D. Non-natural persons are subject to the investment limitation and should calculate the limitation based on no more than 10% of the greater of the purchaser's revenue or net assets (as of the purchaser's most recent fiscal year end).

There are no investment limitations for a Tier 1 offering.

Registration with the SEC

The final rules provide that securities issued in Tier 2 offerings are exempt from the provisions of Section 12(g) for so long as:

- the issuer remains subject to, and is current in (as of its fiscal year end), its Regulation A periodic reporting obligations;
- the issuer engages the services of a transfer agent registered with the SEC pursuant to Section 17A of the 1934 Act; and
- the issuer meets requirements similar to those in the "smaller reporting company" definition under 1933 Act and 1934 Act rules. This conditional exemption is limited to issuers that have a public float of less than \$75 million, determined as of the last business day of its most recently completed semiannual period, or, in the absence of a public float, annual revenues of less than \$50 million, as of the most recently completed fiscal year.

Section 12(g) registration will be required if on the last day of a fiscal year: (i) the company exceeded the public float threshold or the annual revenue threshold, and (ii) the company has total assets of more than \$10 million and the class of equity securities is held by more than 2,000 persons or 500 persons who are not accredited investors (item (ii) being the “12(g) Threshold”).

An issuer that exceeds public float or annual revenue threshold and the Section 12(g) Threshold will be granted a two-year transition period before it would be required to register its class of securities pursuant to Section 12(g), provided it timely files all ongoing reports due pursuant to Rule 257 during such period.

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. Tier 1 offerings will be subject to state registration and qualification requirements.

Under the rules, state securities law requirements purchaser will be defined to be any person to whom securities are offered or sold in a Tier 2 offering.

For further information on the proposed Reg A rules, please contact [Tim Sullivan](#), or your regular [Hinshaw attorney](#).

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