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SEC Proposes Expansion of the Securities Registration Exemption Under Schedule A

On Dec. 18, 2013, the Securities and Exchange Commission (SEC) proposed new rules intended to increase access to capital for smaller companies. This rulemaking implements Title IV of the Jumpstart Our Business Startup Act (JOBS), which mandated that the SEC implement new rules that exempt annual offerings of up to \$50 million from the registration requirements of the Securities Act of 1933. Significantly, the SEC's proposed rules pre-empt state-level registration and qualification requirements for these larger offerings. This represents a significant expansion of the SEC's exemptive authority under Regulation A, which currently covers offerings of up to \$5 million. Regulation A is rarely used, in part because these offerings are still subject to state-level securities laws.

Two Tiers of Exemptions

Currently, Regulation A requires companies to submit an offering statement that is then reviewed by the staff of the SEC. The proposed amendment to Regulation A, dubbed Regulation A+, creates two tiers of exemptions¹. Tier 1 maintains the annual offering limit of \$5 million, or \$1.5 million for securities offered by the company's security holders. Tier 2 covers offerings up to \$50 million, including up to \$15 million for the account of selling security holders. State-level securities laws would be pre-empted for Tier 2 offerings, but not for Tier 1 offerings. If an offering qualifies for the Tier 1 exemption, the company may instead elect to proceed under Tier 2, in which case it would be subject to all Tier 2 obligations.

Offerings under Tier 1 and Tier 2 must comply with the basic reporting requirements under the current version of Regulation A, such as issuer eligibility and disclosure provisions. Tier 1 offerings require only an

electronically filed exit report with the SEC on new Form 1-Z. In addition, the new rules will:

Allow companies to submit draft, nonpublic offering statements to the SEC to be reviewed prior to public filing.

Allow the use of “testing the waters” solicitation materials before and after filing the offering statement.

Update the qualification, communications and offering process, including a requirement for electronic filing.

Tier 2 offerings will be subject to additional conditions:

Issuers must include audited financial statements in their offering circulars.

Issuers must electronically file with the SEC less-extensive annual and semiannual reports and current event updates, similar to the way issuers are required to file periodic reports, so long as the securities are held of record by at least 300 investors.

Issuers may file a Form 1-Z to terminate or suspend their reporting obligations if total securities are held of record by fewer than 300 investors.

Where applicable, issuers must file special financial reports between the time financial statements are included in the Form 1-A offering statement and the issuer’s first “periodic report” due after qualification of the offering statement.

The amount of securities an investor can purchase is limited to no more than 10 percent of the greater of annual income and net worth.

¹ Regulation A is codified as Section 3(b) of the Securities Act. Section 401 of the JOBS Act designates Section 3(b) as 3(b)(1) and adds section 3(b)(2), which mandates the creation of an exemption for offerings of up to \$50 million.

Eligibility Requirements

The proposed amendments to Regulation A preserve its issuer eligibility provisions. The current Regulation A exemption is available to companies organized in – and with their principal place of business in – the U.S. and Canada, but is unavailable to companies that:

Are subject to reporting obligations under Section 13 or 15(d) of the Securities Exchange Act of 1934.

Are registered or required to be registered under the Investment Company Act of 1940.

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Have no specific business plan or purpose or have indicated their business plan is to engage in mergers and acquisitions with unidentified companies.

Are issuers of fractional undivided interests in oil or gas rights or similar interests in other mineral rights.

In addition, the proposed rules will:

Apply only to equity securities, debt securities and debt securities convertible into or exchangeable for equity interests.

Exclude offerings of asset-backed securities.

Exclude issuers that have not filed with the SEC the ongoing reports required by the proposed rules during the two years immediately preceding the filing of an offering statement.

Exclude issuers subject to an SEC order revoking their registration under the Exchange Act during the preceding five years.

Exclude certain issuers and their affiliates that have been disqualified under the “bad actor” rules.

What This Means to You

This rulemaking could breathe new life into the small initial public offering (IPO) market by reducing the cost and complexity of regulatory compliance. From 2009 through 2012, there were only 19 Regulation A offerings out of a total of approximately 27,500 offerings at or below the \$5 million threshold. The new rules address this failure by creating an exemption that may actually prove useful to small companies. Though Tier 2 does require audits and additional ongoing reporting requirements, it will reduce the overall burden of state and federal securities law and provide a more attractive option for smaller companies seeking to raise capital. Any securities issued under Regulation A+ will be freely transferable by nonaffiliates of the issuer.

The SEC proposal is available online at sec.gov. The comment period will run for 60 days after its publication in the federal register.

Contact Information

For additional information about this or any securities or corporate governance issue, please contact your Husch Blackwell attorney or any attorney in our Securities & Corporate Governance group.