

# To the Point

SEC – final rule

## SEC adopts 'Regulation A+' to expand exempt offerings

'These new rules provide an effective, workable path to raising capital that also provides strong investor protections.'

– SEC Chair Mary Jo White

### What you need to know

- ▶ The SEC adopted rules, known as "Regulation A+," that will allow private companies to make exempt public offerings of up to \$50 million of securities within a 12-month period, as required by the Jumpstart Our Business Startups Act.
- ▶ The rules establish two tiers of offerings under Regulation A: Tier 1 offerings of up to \$20 million (up from \$5 million previously) within a 12-month period and new Tier 2 offerings of up to \$50 million within a 12-month period.
- ▶ Companies that make Tier 2 offerings will have significantly more reporting requirements than under Tier 1, but they will be exempt from state law registration and qualification requirements that have been cited as reasons for the limited use of Regulation A.
- ▶ The rules will be effective 60 days after they are published in the Federal Register.

### Overview

The Securities and Exchange Commission (SEC or the Commission) adopted [amendments](#) to Regulation A that allow private companies to make exempt public offerings of up to \$50 million in securities, as required by the Jumpstart Our Business Startups Act (JOBS Act).

The new rules, known as "Regulation A+," establish two tiers under Regulation A. Tier 1, which covers offerings of up to \$20 million within a 12-month period, retains many of the existing requirements of Regulation A. Tier 2 allows offerings of up to \$50 million within 12 months but requires more robust initial and ongoing reporting. For offerings up to \$20 million within 12 months, companies can elect to follow either the Tier 1 or Tier 2 requirements. Selling shareholders can sell up to 30% of the annual offering limit of the chosen Tier.



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## Background

Under Regulation A, private companies can make public offerings of securities without registering under the Securities Act of 1933. However, the SEC noted that companies rarely use today's Regulation A exemption.

The JOBS Act required the Comptroller General of the Government Accountability Office (GAO) to study the effect of state securities laws on Regulation A offerings. In its report to Congress, the GAO discussed factors that contribute to the limited use of Regulation A, including the small size of the offerings, the significant time and cost of complying with both federal and state securities laws, and the availability of other offering exemptions (e.g., Regulation D).

Tier 2 offerings are intended to address several factors raised by the GAO by preempting state securities laws known as Blue Sky laws. Tier 1 offerings will continue to be subject to state securities law registration and qualification requirements. However, Tier 1 issuers may be able to benefit from the multistate review program the North American Securities Administrators Association Inc. recently implemented to accelerate the review of Regulation A filings subject to Blue Sky laws.

As required by the JOBS Act, the SEC will review the new offering limits every two years. The first review is expected to be completed by April 2016. SEC Chair Mary Jo White also directed the SEC staff to report to the Commission within five years its findings about the effects of the new rules on capital formation.

## Key considerations

### Issuer eligibility requirements

Certain issuers continue to be ineligible to use Regulation A. These include existing SEC registrants; foreign companies other than Canadian companies; certain investment companies; certain issuers of interests in oil, gas or mineral rights; and development stage companies that do not have a specific business plan.

The rules disqualify offerings that involve "bad actors" to make the provisions of Regulation A consistent with those of Regulation D. Companies also are ineligible if they failed to comply with the new ongoing SEC reporting requirements in the preceding two years or were subject to an SEC order revoking a registration under the Exchange Act during the last five years.

The rules apply to offerings of equity, debt and convertible securities, including any guarantees of such securities. However, the rules do not apply to asset-backed securities.

### Filing requirements

All offerings under Regulation A will continue to require an offering statement on Form 1-A, which is subject to SEC staff review. The rules eliminate today's automatic "qualification" process and require an explicit notice of qualification by the SEC's Division of Corporation Finance. Qualification of an offering statement under Regulation A is similar to a declaration that a registration statement is effective.

An issuer that has not previously filed a qualified offering statement under Regulation A or a registration statement under the Securities Act can submit draft offering statements for nonpublic review by the SEC staff, provided a public filing is made at least 21 days before qualification. All offering statements (and other required reports for Tier 2 issuers) have to be filed electronically via EDGAR.

An issuer also may solicit investors both before and after an offering statement is filed (i.e., "test the waters") subject to the issuer's compliance with certain rules on the filing of solicitation materials and disclaimers.

Tier 2 offerings do not require compliance with state registration laws, but issuers will be subject to ongoing disclosure requirements.

### **Exchange Act registration considerations**

An issuer with more than \$10 million of assets and 2,000 or more holders of a class of securities (or 500 holders who do not meet the SEC's definition of an accredited investor) must register under Section 12(g) of the Exchange Act of 1934. However, holders of securities issued in a Tier 2 offering can be excluded from the number of holders for purposes of this requirement if certain criteria are met.

### **Tier 1 information requirements**

The Form 1-A offering statement must include, among others items, the following information:

- ▶ Information about the offering and securities, including any underwriters, material risks, dilution disclosures, the plan of distribution and how the issuer will use the proceeds
- ▶ General information about the issuer, including the names of its directors and officers and their business experience during the past five years and the name and ownership level of each holder of more than 10% of its voting securities
- ▶ Executive compensation data for the most recent fiscal year for the three highest-paid officers or directors (as a group for Tier 1 offerings and individually for Tier 2 offerings)
- ▶ A description of the issuer's business operations for the prior three fiscal years
- ▶ Management's discussion and analysis (MD&A), including the issuer's liquidity, capital resources and results of operations covering the two most recent fiscal years
- ▶ Annual financial statements for the previous two fiscal years, which can be unaudited if audited financial statements aren't available
- ▶ Interim financial statements for at least a six-month period if the latest year-end balance sheet is dated more than nine months before the date of qualification
- ▶ Financial statements of significant probable or consummated business acquisitions (including real estate operations), which could be unaudited if audited financial statements aren't available, and related pro forma financial information
- ▶ Financial statements of guarantors and issuers of guaranteed securities (or other information under S-X Rule 3-10) and affiliates whose securities collateralize an issuance (S-X Rule 3-16), which could be unaudited if audited financial statements aren't available

Financial statements must be prepared in accordance with US GAAP, except Canadian issuers can follow either US GAAP or IFRS as issued by the International Accounting Standards Board. Like emerging growth companies under the JOBS Act, Regulation A issuers can use the extended transition periods for private companies to comply with new or revised accounting standards. However, an issuer must disclose this election when it first files an offering statement and must apply it to all new or revised accounting standards. Issuers that don't elect this accommodation in their first filing may not use it in any future filings. Tier 1 offerings do not require ongoing reporting by the issuer.

### **How we see it**

Tier 1 or Tier 2 issuers will meet the FASB's definition of a public business entity (PBE) and must follow US GAAP for PBEs in financial statements filed with the SEC in connection with Regulation A offerings. That means that companies that apply private company alternatives permitted under US GAAP (e.g., the goodwill accounting alternative) will need to reverse the effects of those alternatives in their historical financial statements prior to a Regulation A offering.

## **Tier 2 information requirements**

Tier 2 offerings are not subject to the state securities law registration and qualification requirements. However, they are subject to audit and ongoing SEC reporting requirements and purchaser limitations, in addition to the requirements summarized above.

### ***Audited financial statements in the offering statement***

Financial statements included in the offering statement must be audited in accordance with either the standards of the American Institute of Certified Public Accountants or the Public Company Accounting Oversight Board. Issuers are required to follow the financial statement requirements for smaller reporting companies under Article 8 of Regulation S-X, in most cases.

### ***Periodic reporting requirements***

Tier 2 issuers must file periodic reports with the SEC. Annual reports on Form 1-K must include audited financial statements and meet disclosure requirements similar to those of the offering statement. Form 1-K is due within 120 days after the issuer's fiscal year end.

The new rules also require semiannual reports to be filed on Form 1-SA within 90 days after the end of an issuer's second fiscal quarter and include interim financial statements and certain MD&A disclosures. An audit or review of the interim financial statements is not required.

Tier 2 issuers also must report certain current events on Form 1-U, similar to some that registrants report on Form 8-K. These events include fundamental changes in the business, changes in the issuer's certifying accountant, non-reliance on previous financial statements or related audit reports, and departures of key executives.

An issuer must continue to report under Regulation A until it becomes subject to periodic reporting under the Exchange Act or, after the issuer files its first Form 1-K, the securities sold under Regulation A are held by fewer than 300 holders and there are no longer offers or sales made in reliance on a qualified Tier 2 offering statement.

### ***Investor purchase limits***

Purchases by non-accredited investors in a Tier 2 offering are limited to no more than 10% of the greater of an investor's annual income or net worth (or 10% of the greater of the purchasing company's annual revenue or net assets at fiscal year end). There are no limitations if the securities will be listed on a national securities exchange upon qualification.

For companies that make Tier 2 offerings, the exemption requires disclosures that have some similarities to those of smaller reporting companies.

## **How we see it**

Companies interested in the Tier 2 exemption need to plan and set appropriate timelines to comply with the ongoing reporting requirements. These requirements are extensive and have some similarities to the current requirements for smaller reporting companies.

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