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Client Alert

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SEC Releases Final “Regulation A+” Rules

On March 25, 2015, the Securities and Exchange Commission (“SEC”) adopted final rules under Title IV of the JOBS Act to amend Regulation A, which exempts certain smaller offerings from the SEC’s registration and prospectus delivery requirements. The final rules contemplate two tiers of offerings. Tier 1 offerings generally permit an eligible issuer to raise up to $20 million over a 12-month period in an unregistered, public offering. This offering amount is a surprising increase over the prior limitation of $5 million. Tier 2, which has been referred to informally as Regulation A+, permits an eligible issuer to raise up to $50 million in an unregistered, public offering in a 12-month period. Tier 1 offerings will remain subject to a requirement to qualify with state securities regulators, whereas Tier 2 offerings will not be similarly restricted. Tier 2 offerings, however, will impose additional ongoing reporting obligations on issuers that select that option. The rules become effective 60 days after publication in the Federal Register.

Overview

The final rules expand the current Regulation A framework found in Rules 251-263 under the Securities Act of 1933 (the “Securities Act”) by creating two tiers of Regulation A offerings. Tier 1 is based on the current Regulation A offering framework and permits eligible issuers to conduct unregistered, public offerings, provided that the total amount of securities sold does not exceed $20 million in any 12-month period. The $20 million limit is an increase over the $5 million cap that had previously been in effect. Tier 2, often referred to as “Regulation A+,” increases the dollar amount of the offering limitation and permits eligible issuers to conduct unregistered, public offerings, provided that the total amount of securities sold does not exceed $50 million in any 12-month period. An issuer of $20 million or less may elect to proceed under either Tier 1 or Tier 2.

Securities sold in Tier 1 and Tier 2 offerings will not be “restricted securities” under the Securities Act and will be freely tradable by non-affiliates. Tier 1 offerings will continue to be subject to the registration and qualification requirements in each state in which there are purchasers of the securities. For Tier 2 offerings, state registration is preempted, thereby removing one of the most significant obstacles for use of Regulation A as a viable capital-raising mechanism for smaller companies.

The new rules build on the current Regulation A framework and preserve, with some modifications, existing provisions regarding issuer eligibility, offering circular contents, testing-the-waters and “bad actor” disqualifications. The final rules also modernize the Regulation A filing process for Tier 1 and Tier 2 offerings and align practice in certain areas with prevailing practice for registered offerings. Issuers in Tier 2 offerings will be required to include audited financial statements in their offering documents and to file annual, semiannual and current reports with the SEC. In addition, purchasers in Tier 2 offerings will be subject to certain limitations on their investment. The changes to Regulation A are discussed in more detail below.

Eligible Issuers

The final rules preserve the existing issuer eligibility requirements set forth in prior Rule 251(a). Under new Rule 251(b), the exemption is available to non-reporting companies (i.e., companies that are not subject to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”)

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organized in, and with their principal place of business inside, the United States or Canada. The exemption continues to be unavailable to development stage companies, registered investment companies (including business development companies), issuers of fractional undivided interests in oil or gas rights (or similar interests in other mineral rights) and "bad actors" under Rule 262.

Rule 251(b) also makes Regulation A unavailable to two new classes of issuers:

- issuers that are required to, but have not, filed with the SEC the ongoing reports required by the final rules during the two years immediately preceding the filing of a new offering statement (or for such shorter period that the issuer was required to file such reports); and
- issuers that are or have been subject to an SEC order denying, suspending or revoking the registration of a class of securities under the Exchange Act.

Rule 262 contains certain bad actor provisions that will disqualify an issuer from relying on Rule 262. The final rules amend Rule 262 to include bad actor disqualification provisions in substantially the same form as recently adopted under Rule 506(d) of the Securities Act.

Eligible Securities

The final rules limit the type of securities that can be offered and sold in both Tier 1 and Tier 2 offerings to equity securities, debt securities and debt securities convertible or exchangeable into equity interests, including any guarantees of such securities. The final rules exclude asset-backed securities from the list of eligible securities under Regulation A.

Sales by Selling Security Holders

Consistent with the existing provisions of Regulation A, the final rules permit sales by selling security holders of up to 30 percent of the maximum amount permitted under the applicable offering limitation ($6 million in any 12-month period for Tier 1 offerings and $15 million in any 12-month period for Tier 2 offerings). Sales by selling security holders under either Tier 1 or Tier 2 will be aggregated with sales of Regulation A securities by the issuer and other selling security holders for purposes of calculating the maximum permissible amount of securities that may be sold during any 12-month period.

The final rules also limit secondary sales by affiliates that occur following the expiration of the first year after an issuer's initial qualification of an offering statement to no more than $6 million, in the case of Tier 1 offerings, or no more than $15 million, in the case of Tier 2 offerings, over a 12-month period. Secondary sales by non-affiliates that are made under a qualified offering statement following the expiration of the first year after an issuer's initial qualification of an offering statement will not be limited except by the maximum offering amount permitted by either Tier 1 or Tier 2. Although the secondary sales offering amount limitation will only apply to affiliates during this period, non-affiliate secondary sales will be aggregated with sales by the issuer and sales by affiliates for purposes of calculating compliance with the maximum offering amount permissible under the respective tiers. In addition, the final rules eliminate the last sentence of prior Rule 251(b), which previously prohibited affiliate resales unless the issuer had net income from continuing operations in at least one of its last two fiscal years.

Investment Limitation

There is no investment limitation for purchasers in a Tier 1 offering. For Tier 2 offerings, the final rules limit the amount of securities a non-accredited investor can purchase to:

- in the case of a non-accredited natural person, no more than 10 percent of the greater of its annual income and net worth, with annual income and net worth being calculated in the same manner as the "accredited investor" definition in Rule 501(a) under the Securities Act; and

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- in the case of a non-accredited entity such as a corporation or trust, no more than 10 percent of the greater of the purchaser's revenue or net assets (as of the purchaser's most recent fiscal year end).

The Tier 2 investment limitation does not apply to accredited investors. Moreover, investment limitations in a Tier 2 offering will not apply to the sale of securities that will be listed on a national securities exchange.

Integration of Offerings

Under final Rule 251(c) and SEC guidance, offerings made under Regulation A will not be integrated with:

- prior offers or sales of securities;
- contemporaneous offers or sales made under another exemption from registration, so long as each offering complies with the requirements of the particular exemption that is being relied upon for that offering; or
- subsequent offers and sales of securities that are:
    - registered under the Securities Act, except as provided in Rule 255(c);
    - made pursuant to Rule 701 under the Securities Act;
    - made pursuant to an employee benefit plan;
    - made pursuant to Regulation S;
    - made pursuant to Section 4(a)(6) of the Securities Act; or
    - made more than six months after completion of the Regulation A offering.

In addition, the final rules provide an integration safe harbor for abandoned Regulation A offerings. Under new Rule 255(e), if an issuer decides to register an offering after soliciting interest in a contemplated, but abandoned, Regulation A offering, any offers made pursuant to Regulation A will not be subject to integration with the registered offering, unless the issuer engaged in solicitations of interest in reliance on Regulation A to persons other than qualified institutional buyers and institutional accredited investors permitted by Section 5(d) of the Securities Act. If the issuer engaged in such solicitation, an abandoned Regulation A offering will not be subject to integration if the issuer and certain parties acting on its behalf wait at least 30 calendar days between the last solicitation and the filing of a registration statement. The final rules clarify, however, that waiting less than 30 calendar days before a subsequent registered offering will not necessarily result in integration and will instead depend on the particular facts and circumstances.

Treatment Under Section 12(g) of the Exchange Act

The rules as proposed would not have exempted Regulation A securities from the registration requirements of Section 12(g) of the Exchange Act. In a departure from the proposal, however, the final rules provide a limited exemption from Section 12(g) registration for securities issued in a Tier 2 offering, so long as the issuer:

- remains subject to, and is current in (as of its fiscal year end), its Regulation A periodic reporting obligations;

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- engages the services of a transfer agent registered with the SEC under Section 17A of the Exchange Act; and

- has a public float less than $75 million, determined as of the last business day of its most recently completed semiannual period, or, in the absence of public float, annual revenues of less than $50 million, as of the most recently completed fiscal year.

An issuer that exceeds the float or revenue tests, and otherwise exceeds the Section 12(g) thresholds (i.e., total assets of more than $10 million and a class of equity securities held by more than 2,000 persons or more than 500 non-accredited investors) becomes subject to a two-year transition period before it will be required to register its securities under Section 12(g), provided it timely files all ongoing reports under Rule 257.

Securities Act Liability

A Regulation A offering is a public offering that is exempt from Securities Act registration requirements. Because Regulation A offerings are exempt from the registration requirements of the Securities Act, issuers and other offering participants are not subject to the liability provisions of Section 11 of the Securities Act. Consistent with current Regulation A, other anti-fraud and civil liability provisions of the securities laws, including Section 12(a)(2) and Section 17 of the Securities Act and Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, apply to the offer and sale of securities in reliance on Regulation A.

Offering Statements

In its current form, Regulation A requires the filing and qualification of an offering statement on Form 1-A. Currently, Form 1-A is filed in paper form, rather than electronically via EDGAR, and consists of three parts: Part I (Notification); Part II (Offering Circular); and Part III (Exhibits). Part I of Form 1-A calls for certain basic information about the issuer and proposed offering that is necessary to determine the availability of the exemption. Part II of the offering statement consists of an offering circular — similar to the prospectus in a registration statement — that serves as the primary disclosure document to investors of the material facts about the issuer, its securities and the offering. Corporate issuers are given the option of following any one of three disclosure formats in Part II: Model A (Question-and-Answer Format); Model B (a scaled version of Form S-1 that largely follows the SEC's disclosure standards in effect for registration statements when Model B was adopted in 1981); and Part I of Form S-1. All other issuers have the option of using either Model B or Part I of Form S-1.

The final rules make significant changes to the current filing and qualification system. In particular, the final rules:

- require issuers to file offering statements with the SEC electronically (i.e., via EDGAR);

- similar to the rules for "emerging growth companies," permit the non-public submission of offering statements and amendments for review by the SEC staff before filing such documents with the SEC, so long as all such documents are publicly filed not later than 21 calendar days before qualification (the timing of the public filing is generally not tied to the commencement of a "road show");

- eliminate the Model A (Question-and-Answer) disclosure format under Part II (Offering Circular) of Form 1-A;

- update and clarify the Model B (Narrative) disclosure format under Part II of Form 1-A, while continuing to permit the use of Part I of Form S-1 (or Form S-11 for REITs and similar issuers) narrative disclosure as an alternative;

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- permit an offering statement to be qualified only by order of the SEC rather than, in the absence of a delaying notation on the offering statement, without SEC action on the 20th calendar day after filing, as is currently the case;

- require issuers in a Tier 2 offering to include audited financial statements in their offering circulars (issuers in a Tier 1 offering will not be required to include audited financial statements unless such financial statements have been prepared for another purpose);

- require all issuers to file balance sheets for the two most recent fiscal year ends (or for such shorter time that an issuer has been in existence); and

- permit issuers to provide financial statements in Form 1-A that are dated not more than nine months before the date of non-public submission or filing, and require issuers to include financial statements in Form 1-A that are dated not more than nine months before qualification, with the most recent annual or interim balance sheet not older than nine months.

Under the final rules, the financial statements included in a Regulation A offering statement will be required to be prepared in accordance with US GAAP, except that Canadian issuers could follow either US GAAP or International Financial Reporting Standards issued by the International Accounting Standards Board. Furthermore, issuers will be required to include interim financial statements for at least six months if the latest year-end balance sheet is dated more than nine months before the date of qualification. Interim financial statements will not be required to be audited or reviewed. In general, issuers will be required to follow the financial statement requirements for smaller reporting companies under Article 8 of Regulation S-X.

Offering Process

The final rules require issuers and intermediaries in the prequalification period to deliver a preliminary offering circular to prospective purchasers at least 48 hours in advance of sale. In addition, the final rules modernize the qualification, communications and offering process in Regulation A offerings to reflect analogous provisions of the Securities Act registration process and will:

- permit issuers and intermediaries to satisfy their delivery requirements as to the final offering circular under an “access equals delivery” model when the final offering circular is filed and available on EDGAR;

- permit continuous or delayed offerings under certain circumstances;

- require issuers that sell to prospective purchasers in reliance on the delivery of a preliminary offering circular to provide purchasers, not later than two business days after completion of the sale, with a copy of the final offering circular or a notice that the sale occurred pursuant to a qualified offering statement that includes the URL where the final offering circular, or the offering statement of which such final offering circular is part, may be obtained and contact information sufficient to notify a purchaser where a request for a final offering circular can be sent and a final offering circular will be received in response; and

- permit issuers to file offering circular supplements after qualification of the offering statement in certain circumstances in lieu of post-qualification amendments, including to provide the types of information that may be excluded from a prospectus under Rule 430A.

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Testing-the-Waters

Under the final rules, issuers are permitted to test-the-waters or solicit interest in a potential offering from the general public either before or after the filing of the offering statement, so long as any solicitation materials used after publicly filing the offering statement are preceded or accompanied by a preliminary offering circular or contain a notice informing potential investors where and how the most current preliminary offering circular can be obtained. This requirement could be satisfied by providing the URL to the preliminary offering circular or the offering statement on EDGAR.

State Qualification

Consistent with current Regulation A, Tier 1 offerings will remain subject to state registration and qualification requirements. As a result, Tier 1 issuers may not be able to engage in test-the-waters communications if applicable state law does not permit this activity. In an effort to streamline the review process, most (but not all) state securities regulators have signed on to a central coordinated review program so that a Tier 1 issuer need only interact with a single disclosure examiner and, as applicable, a single merit examiner on behalf of all participating states.[1] Tier 1 issuers conducting offerings in jurisdictions that are not participants in the coordinated review program will be required to separately comply with the registration and qualification requirements of those non-participating jurisdictions. Tier 1 offerings are also subject to state anti-fraud jurisdiction.

Tier 2 offerings will not be subject to any state registration or qualification requirements. The states retain anti-fraud authority over Tier 2 offerings, however, and may pursue anti-fraud charges against issuers, promoters and broker-dealers who are alleged to violate applicable provisions of state law in connection with an offering. A state may also require that Tier 2 offering materials be filed with the state prior to completion of an offering, and the state may collect filing or registration fees in connection with the offering.

Ongoing Reporting Obligations

The final rules do not require Tier 1 issuers to file ongoing reports with the SEC after the completion of an offering. However, the final rules do require Tier 2 issuers to file ongoing periodic reports with the SEC via EDGAR. These ongoing reporting obligations do not constitute Exchange Act reporting and will not require a Tier 2 issuer to register under the Exchange Act unless registration is otherwise required under Section 12 of the Exchange Act. Annual reports on new 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 final rules also require semiannual reports to be filed on new Form 1-SA within 90 days after the end of an issuer’s second fiscal quarter. Among other things, Form 1-SA will include interim financial statements and certain MD&A disclosures. An audit or review of the interim financial statements is not required. Tier 2 issuers will also be required to report certain current events on new Form 1-U, similar to those that registrants are required to 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.

Issuers would exit the Regulation A ongoing reporting regime when they become subject to the ongoing reporting requirements of Section 13 of the Exchange Act, and may exit the Regulation A reporting regime at any time by filing an exit report after completing reporting for the fiscal year in which the offering statement was qualified, so long as the securities of each class to which the offering statement relates are held of record by fewer than 300 persons and offers or sales made in reliance on a qualified Regulation A

[1] At this time, 46 states, the District of Columbia, Puerto Rico and the US Virgin Islands participate in the coordinated review program. Arizona, Florida, Georgia, Guam and New York do not currently participate.

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offering statement are not ongoing. Regulation A reporting companies are not otherwise subject to the full range of compliance and reporting regulations faced by full-fledged public companies, such as the Sarbanes-Oxley Act, Section 16 short-swing profit reporting or Regulation FD.

Secondary Liquidity

The final rules amend Exchange Act Rule 15c2-11(a) so that an issuer's ongoing reports filed under Tier 2 will satisfy the specified information about an issuer and its security that a broker-dealer must review before publishing a quotation for a security (or submitting a quotation for publication) in a quotation medium. Rule 15c2-11 permits broker-dealers to facilitate over-the-counter trading by publishing a quotation for a security (or submitting a quotation for publication) in a quotation medium so long as certain information about that security is available. The final rules also permit issuers conducting offerings under Tier 2 that seek to list their securities on a national securities exchange or otherwise register a class of securities under the Exchange Act to do so by using the Form 8-A short-form registration statement (instead of the longer Form 10) if the issuer includes Part 1 of Form S-1 or Form S-11 narrative disclosure in its Form 1-A. An issuer registering a class of securities under the Exchange Act concurrently with the qualification of a Regulation A offering statement will become an Exchange Act reporting company upon effectiveness of the Form 8-A and, if applicable, its obligation to file ongoing reports under Regulation A will be suspended for the duration of the resulting reporting obligation under Section 13 of the Exchange Act.

Preliminary Observations

The SEC should be applauded for adopting a new and expansive private offering regime, particularly in light of intense lobbying by some parties who sought to curtail significantly the scope of new Regulation A at the time of its proposal. The new regulation has tremendous potential for development-stage companies in a wide range of capital-intensive industries, including biotechnology, banking and real estate.

Some commentators have in the past criticized the blue-sky qualification process as being unwieldy and unpredictable. That burden, coupled with the low offering limit under prior Regulation A, contributed to its very infrequent use by issuers. It remains to be seen if the new coordinated review process will alleviate those concerns and induce more issuers to choose the Tier 1 option. Blue-sky preemption is certainly a welcome feature of the Tier 2 option.

As compared with a traditional IPO, new Regulation A reduces disclosure requirements but may not provide the same level of robust secondary market liquidity. As compared with a traditional Regulation D private placement under Rule 506(b), new Regulation A allows issuers access to a broader investor base, including non-accredited retail investors, potentially allowing issuers access to capital at a lower cost, but would impose additional reporting requirements and accompanying costs, particularly for Tier 2 issuers. On the other hand, the relatively new Rule 506(c) exemption, which permits general solicitation, has many of the features of a Tier 2 offering without a limitation on offering size or an ongoing SEC reporting requirement. New Regulation A may also create an alternate method for issuers seeking to engage in crowdfunding. Ultimately, issuers will need to weigh these and other considerations to determine which offering method is best suited to their needs.

Impact on Private Investment Funds

The new Regulation A is likely to have less of an impact on the private investment fund community than it will with respect to other smaller issuers. A key limitation on the utility of Regulation A to private fund sponsors is the opening of offerings to the general public and not just to "qualified investors." While private funds could offer their securities to the general public under Regulation A without being required to register the offering under the Securities Act, such funds could not admit investors who are not

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"accredited investors" and still maintain a valid exemption from registration under the Investment Company Act of 1940.

Since many private fund investment strategies could not effectively operate under the restrictions imposed by the Investment Company Act, and the costs associated with registration as an investment company are often prohibitive for small issuers, private funds would not be able to take advantage of the broader offering avenue available under Regulation A. Further, the ability to generally solicit the public under Regulation A but only admit sophisticated investors does not seem to offer any additional benefit over what has been made available to private funds under new Rule 506(c) under Regulation D, which itself has not resulted in widespread use of Rule 506(c) by both emerging and established private fund managers to date.

Even where Regulation A does offer private funds some lessening of certain regulatory burdens, the lessened burden does not appear to outweigh the added obligations under a Regulation A offering. Private fund managers are unlikely to view the pre-emption of state law on the offerings as a worthwhile tradeoff for having to file their offering memoranda and financial statements with the SEC or the states, as the case may be. Lastly, the exemption appears to be unavailable to private fund sponsors that utilize offshore jurisdictions such as the Cayman Islands, the British Virgin Islands, Bermuda and Ireland.

Contacts

S. Gregory Cope
gcope@hunton.com

David S. Freed
dfreed@hunton.com

Scott H. Kimpel
skimpel@hunton.com

Evan C. Williams
ewilliams@hunton.com

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