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Understanding Recent Regulation A+ Changes

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Introduction

Regulation A has been around since the 1930s, almost since the Securities Act was adopted. As an offering exemption to the Securities Act, (as opposed to a private placement exemption), it effectively facilitates a cost-efficient means for small companies to raise capital in small amounts. Long before the JOBS Act was even contemplated, there were a number of initiatives designed to amend Regulation A. The principal issue with Regulation A had been the low dollar threshold of $5 million offering proceeds in a twelve-month period. With the passing of the JOBS Act, the dollar threshold for Regulation A+ was increased to $50 million.

Title IV of the JOBS Act

Title IV of the JOBS Act established certain fundamental provisions applicable to Regulation A offerings, including:

- Securities may be offered and sold publicly.
- Securities are not "restricted securities."
- Section 12(a)(2) liability will apply to the offering.
- Issuers can "test the waters."
- A limitation on eligible securities.

However, the SEC was given a fair bit of discretion in terms of many of the detailed requirements of the rule, including electronic filing requirements, bad actor provisions and ongoing disclosure requirements.

Title IV of the JOBS Act also required that a study be conducted by the U.S Government Accountability Office (U.S. GAO) to help understand what the principal impediments were that prevented broader usage of current Regulation A. The study revealed that, on a comparative basis, issuers that were trying to raise capital had Regulation D, specifically Rule 506, available to them, which permits companies to raise an unlimited amount of capital in a private offering made to private investors. The study showed that this was a considerably more attractive option to issuers compared with the limitations associated with Regulation A and its $5 million threshold. The GAO study also noted that blue sky requirements were an impediment to broader use of Regulation A.

With this information in hand the SEC adopted final rules that became effective during June 2015. The final

rules amend and modernize the existing Regulation A to become Reg A+ and create two tiers of offerings. Tier 1 is for companies that are in early stages of development and provides for offerings up to $20 million, and Tier 2 for offerings of up to $50 million.

However, any issuer of any size, provided it's not an SEC reporting company, can avail itself of Tier 1 or Tier 2 of Regulation A+. But Tier 2 should not be thought of as only raising an offering of between $20 and $50 million. Tier 2 can be used to raise anywhere from $1 to $50 million dollars.

The final rule set out the requirements in terms of issuers that were allowed to participate, the types of securities that one is allowed to sell, additional disclosure and ongoing reporting requirements, as well as an investment limit for Tier 2 offerings. Given these investor protection measures, Tier 2 offerings are exempt from certain blue sky requirements.

Regulation A+ Issuer Eligibility

Eligible issuers are those that are organized and have their principal place of business in the United States or Canada. Regulation A+ can be used in the context of a merger or acquisition and also includes Real Estate Investment Trusts (REITs) as well as Canadian issuers that already have a class of securities listed and traded on a securities exchange in Canada. A public company is also eligible to use Regulation A+ to raise capital through a subsidiary, as long as that subsidiary is not a separately reporting company. Also eligible would be a company that was once a reporting company, but subsequently has deregistered.

Ineligible issuers include:

- SEC reporting companies
- 1940 Act companies
- Blank check companies
- Issuers of fractional undivided interests in oil or gas (or similar interests in other mineral rights)
- Certain bad actors
- Issuers that have relied on Regulation A in the past
- Issuers that have not filed ongoing reports in a timely fashion, as required by Regulation A during the two-year period preceding the Regulation A offering
- Issuers that have had their Exchange Act registration revoked within five years before the filing of the offering statement.

Securities Eligibility

Securities that are eligible to be offered under Regulation A+ are limited to equity securities (including warrants), debt securities and debt securities that are convertible into or exchangeable into equity interests, including any guarantees of such securities.

Offering Limitations

The only securities that aren't permissible are asset-backed securities.

Tier 1—An issuer can offer and sell up to $20 million in a twelve-month period, of which up to $6 million can constitute secondary sales.

Tier 2—An issuer can offer and sell up to $50 million in a twelve-month period, of which up to $15 million may constitute secondary sales.

Note, however, that in the issuer's initial Regulation A+ offering and any Regulation A+-exempt offering in the twelve months following that offering, the selling security holder component cannot exceed 30% of the aggregate offering. After the first year following an issuer's initial qualification of a Regulation A+ offering statement, the limit on secondary sales falls away for non-affiliates.

The SEC's intent was to provide liquidity opportunities for existing security holders without creating potential conflicts with interested stockholders or affiliates. The final rules eliminate the previous prohibition on resales by affiliates in reliance on the exemption, unless the issuer had net income from continuing operations in at least one of the two previous years. This flexibility relating to secondary sales for non-affiliates may prove important in enabling investors, including venture and private equity investors, to see Regulation A as a liquidity opportunity.

Investment Limitations

Under Tier 1 of Regulation A+, a non-accredited natural person is limited to purchase no more than 10% of the investor's annual income or net worth, whichever is greater. This investment limit only applies to non-accredited investors, not institutions, and will not apply if the securities are to be listed on a national securities exchange, such as the NASDAQ, at the consummation of the offering. The investment limit does not apply to Tier 2 Regulation A+ offerings.

Exchange Act Holder of Record

The final rules for Regulation A+ provide a limited exemption for securities that are issued in Tier 2 offerings from the Exchange Act section 12(g) "holder of record" threshold where the issuer is subject to, and current in, its Regulation A+ periodic reporting obligations.

There are two ways that companies can become subject to SEC reporting requirements under the Exchange Act. One is if they affirmatively undertake an IPO and choose to list their securities. The other is if they trip the holder of record threshold, as defined in Section 12(g), which was amended in Title V and Title VI of the JOBS Act. In order to have this limited exemption from the holder of record threshold, the issuer must retain the services of a transfer agent and meet requirements similar to those in the "smaller reporting company" definition (public float of less than $75 million or, in the absence of a float, revenues of less than $50 million, in the most recently completed fiscal year).

An issuer that exceeds the Section 12(g) threshold will have a two-year transition period.

This can be very helpful if a company undertakes a number of Regulation A+ offerings over a period of years, or if the company is undertaking Regulation A+ offerings, but also issues some Rule 506 offerings and conducts a series of private or exempt transactions. However, in this situation it is important to be mindful of the number of record holders, as well as of when and how it trips the 12(g) threshold.

Investor Protection & Liability

Sellers of Regulation A+ securities have Section 12(a)(2) liability in respect of offers or sales made by means of an offering circular or oral communications. So, while preparing an offering circular, or any "test the waters" materials, it is imperative to avoid material misleading statements or omissions.

Disclosure Requirements & Offering Process

Among the steps the SEC took to modernize Regulation A was requiring participants in a Regulation A+ offering to file registration offering statements, periodic reports and other forms using the EDGAR filing system.

The final rules adopt an "access equals delivery" model for Regulation A+ offering circulars that apply rules 172 and 173 for a public offering. When a preliminary offering circular is used to offer securities to potential investors by a non-reporting issuer, the issuer and participating broker-dealer will be required to deliver the preliminary offering circular to prospective purchasers at least 48 hours in advance of sales.

Offering Circular (Form 1-A) Content

Part I (Notification) is a simple form that requires very basic information regarding the issuer, such as issuer eligibility, some offering details, basic information about the jurisdictions where the securities are going to be offered and information on sales of unregistered securities.

Part II of the Offering Circular is much more time consuming and expensive. It is very similar to a Form S-1 registration statement and will be very familiar to securities lawyers and issuers who have engaged in multiple rounds of financing. Part II contains the narrative portion of the Offering Circular and requires disclosures of basic information about the issuer including:

- Material risks
- Use of proceeds
- An overview of the issuer's business
- An MD&A type discussion
- Disclosures about executive officers and directors, including compensation
- Beneficial ownership information
- Related party transactions
- A description of the offered securities

Issuers can choose to comply with Part I of Form S-1 in connection with its Offering Circular. In fact, an issuer that chooses to list its securities concurrent with the completion of a Regulation A+ offering will be required to use Part I of Form S-1 in connection with the Offering Circular.

Because the majority of companies using Regulation A+ are smaller companies or companies in early states of development, all of the disclosure requirements are scaled, meaning that smaller companies can take advantage of reduced disclosure requirements.

For an issuer in a particular industry—oil and gas, real estate, financial services—where SEC industry guides

are applicable, such as, in the case of a REIT, Guide 5, those guides are applicable in terms of informing disclosure requirements.

Financial Statements

There are some important differences in financial statement requirements between Tier 1 and Tier 2. Both Tier 1 and Tier 2 issuers must file balance sheets and other required financial statements for the two most recently completed fiscal year ends, or for any shorter time they've been in existence.

The financial statements for an issuer in a Tier 2 offering are required to be audited by an independent auditor that need not be PCAOB-registered. However, if an issuer of a Tier I offering seeks to have a class of securities listed on a national securities exchange concurrent with the Regulation A offering, the financial statements must be audited in accordance with PCAOB standards by a PCAOB-registered firm.

Confidential Review

If a company wants to explore the possibility of doing a Regulation A+ offering, an issuer can submit an offering statement for non-public review by the SEC, which is very similar to the process for emerging growth companies under Title I of the JOBS Act, and request that the SEC comment on the offering statement, respond to the comments, etc. Should an issuer opt for confidential review, the offering statement must be filed publicly no less than twenty-one calendar days before qualification of the offering statement.

"Testing the Waters"

One of the great advantages of a Regulation A+ transaction is that an issuer can "test the waters." This means an issuer can use marketing materials with appropriate disclaimers and attempt to solicit interest to see if there is investor appetite for an offering. Prior to confidentially submitting its offering statement there's a great opportunity for communication that might not exist with some of the other securities exemptions.

Ultimately, materials that are used after an offering statement is publicly filed will have to be filed with the SEC and made publicly available. Therefore, when preparing "test the waters" materials it's important to ensure that those materials are fair and accurate in their presentation of the company, the investment opportunity, the risk, etc.

Ongoing Reporting

Another key difference between Tier 1 and Tier 2 offerings is what happens after the transaction. An issuer that completes a Tier 1 offering has a very limited post-closing or ongoing reporting obligation other than to file an exit report (Form 1-Z) within thirty days of the completion or termination of the offering.

In contrast, Tier 2 issuers are subject to ongoing reporting. As a result, an issuer considering a Tier 2 offering should engage in a careful cost/benefit analysis to determine the likelihood of raising the full $50 million.

Tier 2 issuers are required to file:

- Annual reports on Form 1-K (120 calendar days after the issuer's fiscal year end)
- Semi-annual reports on Form 1-SA (90 calendar days after the end of the first six months of the issuer's fiscal year)
- Current reports on Form 1-U
- Special financial reports on Form 1-K and Form 1-SA
- Exit reports on Form 1-Z

Additional reports are required to be filed for specified events, including:

- Fundamental changes
- Bankruptcy proceedings
- Material modifications of the rights of security holders
- Changes in accountant

- Non-reliance on previously issued financial statements
- A change in control
- Departure of principal executive officer or principal financial officer
- Unregistered sale of 10% or more of outstanding equity securities

Ongoing reports filed by Tier 2 issuers must satisfy a broker-dealer's Rule 15c2-11 obligations. The final rule does not require that reports constitute "current information" according to the obligations of Rule 144 and 144A. However, in order for a holder to be able to resell securities and rely on Rule 144 for another exemption a Tier 2 issuer could voluntarily submit quarterly information in a form consistent with that required for semi-annual information and thus satisfy the conditions for "reasonably current information" and "adequate current public information" required by Rule 144.

The other alternative for liquidity would be for the issuer to regularly provide a liquidity opportunity for existing security holders through NASDAQ's private secondary market, through issuer repurchases or by facilitating transactions among existing stockholders.

Termination or Suspension of Tier 2 Disclosure Obligations

Tier 2 issuers don't have to continue with their reporting forever. However, the decision to suspend reporting obligations will depend on the issuer's principal purpose for the financing and how it affects security holders' opportunity for liquidity. Tier 2 issuers are permitted to terminate or suspend their ongoing reporting obligations on a basis similar to the provisions for suspension or termination of reporting requirements for Exchange Act filers. If a Tier 2 issuer has filed all required ongoing reports for the shorter of (1) the period since the issuer became subject to such reporting obligations or its most recent three fiscal years, or (2) the portion of the current year preceding the date of filing Form 1-Z (termination or exit form), that issuer will be permitted to suspend its reporting obligations at any time after completing reporting for the fiscal year in which the offering statement was qualified.

Offering Process, Clearing and Settlement

When an issuer enlists the help of a financial intermediary that acts as a placement agent or underwriter in the Regulation A transaction, that placement agent or broker must submit the offering terms to FINRA for review. To facilitate clearing and settlement, an issuer and their advisors may arrange for:

- A CUSIP number for the securities
- Book-entry arrangements through the issuer's transfer agent
- DTC settlement (like 3(a)(2) securities)

However, it's not required that an issuer enlist a broker dealer to assist with a Regulation A+ offering. An issuer could conduct a Regulation A+ on its own by employing the internet, using its network of friends and family or existing security holders. That decision, however, will depend on the issuer's intentions for the offering. For example, if the issuer is conducting the offering in order to gain exposure for the company, reach institutional and retail investors, and/or position the company for its next steps, it may well benefit by having a broker dealer or placement agent to help with the "testing the waters" materials, the offering statement disclosures (particularly the offering's business description), and arrange for investor meetings and road show presentations.

Continuous or Delayed Offerings

Regulation A+ does permit an issuer to conduct certain types of continuous offerings, also known as delayed offerings, including:

- Securities offered and sold pursuant to a DRIP or employee benefit plan
- Securities issuable upon the exercise of warrants, options or rights
- Securities issued upon conversion of other outstanding securities

An at-the-market offering, however, cannot be conducted using Regulation A.

State Law Requirements

The final rules of Regulation A+ provide that Tier 1 offerings remain subject to state securities law requirements. That means that in a Tier 1 offering the offering statement must be prepared for review and comment by the SEC, but also by state securities regulators.

By contrast, a Tier 2 offering is not subject to state review if the securities are sold to "qualified purchasers" or, as provided by statute in the JOBs Act, listed on a national securities exchange. In its final rules, the SEC defined "qualified purchasers" in a Regulation A+ offering as all offerees and purchasers in a Tier 2 offering.

There are many robust investor protection provisions built into the Tier 2 framework, as well as requirements for what has to be provided in an offering statement, so offerees in a Tier 2 offering have quite a lot of information about the Tier 2 company at their disposal when they are making an investment decision. Based on that, Tier 2 transactions are currently not subject to state review.

Coordinated Review

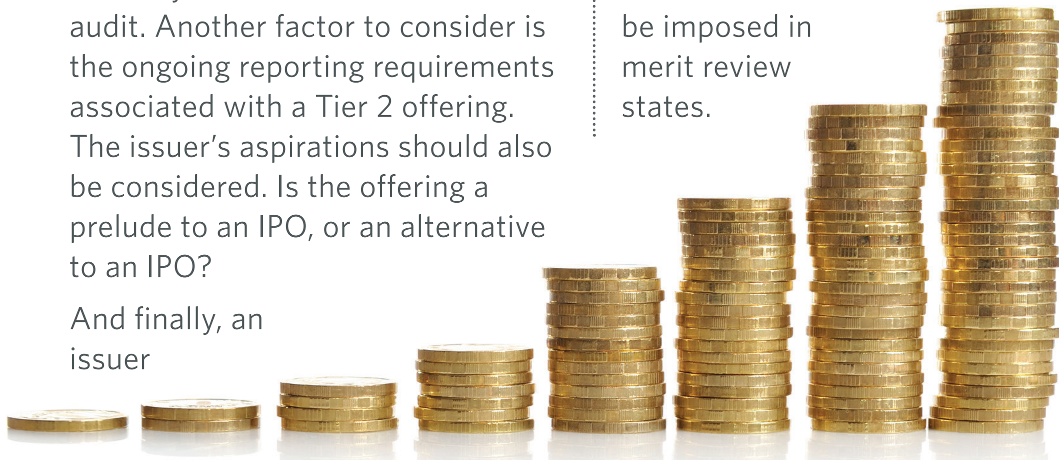
With the adoption of final Regulation A+ rules, the states, through NASAA, established a coordinated review program for Regulation A+ offerings designed to facilitate the filing of Regulation A offerings in multiple U.S. jurisdictions.

Pursuant to the review protocol, a lead merit and a lead disclosure examiner will be appointed by the state to manage the review of the offering and coordinate comments received from other states where the securities will be sold. If the issuer is not applying for registration in a state that applies merit standards, then only a lead disclosure examiner need be appointed. During the process the participating jurisdictions use the applicable NASAA statements of policy as modified by the review protocol.

Tier 1 Versus Tier 2

Offering participants often wonder if they should opt for a Tier 2 offering even if they don't intend to raise more than $20 million. During that decision process issuers should consider the difference in the financial statement disclosure requirements between the two. This may not be as significant an issue for issuers that have been in business for a relatively short period of time as it is for companies that have been in business for more than two years and may never have conducted an audit. Another factor to consider is the ongoing reporting requirements associated with a Tier 2 offering. The issuer's aspirations should also be considered. Is the offering a prelude to an IPO, or an alternative to an IPO?

And finally, an issuer should evaluate where it intends to offer the securities. Is it only in a few states? Is it principally through the internet? There are still a significant number of states that have a merit review approach and that apply a number of standards that are not so easy to comply with, so before making the Tier 1/Tier 2 decision, an issuer should consult closely with council. Understand where the securities will be sold and as well as the offering requirements and standards that will be imposed in merit review states.



Integration

In the final Regulation A+ rules the SEC also adopted a number of integration safe harbors. A Regulation A+ offering will not be integrated with:

- Prior offers or sales of securities; or
- Subsequent offers or sales of securities that are:
- Registered under the Securities Act, except as provided in Rule 255(e)
- Made in reliance on Rule 701
- Made pursuant to an employee benefit plan
- Made in reliance on Regulation S
- Made pursuant to Section 4(a)(6) of the Securities Act
- Made more than six months after the completion of the Regulation A offering

The final rule also provides clarification of Rule 155 for Regulation A+ offerings that have been abandoned. If an issuer registers an offering under the Securities Act after soliciting interest in a contemplated, but subsequently abandoned, Regulation A+ offering, the abandoned Regulation A+ offering would not be subject to integration with the registered offering if the issuer engaged in solicitations of interest to QIBs and institutional accredited investors permitted by Section 506 of the Securities Act. This may impact a Regulation A+ issuer's approach to "test the waters" communications.

If the issuer engaged in solicitations of interest to persons other than QIBs and institutional accredited investors, an abandoned Regulation A+ offering would not be subject to integration if the issuer (and any underwriter, broker, dealer, or agent used by the issuer in connection with the proposed offering) waits at least thirty calendar days between the last such solicitation of interest in the Regulation A+ offering and the filing of the registration statement with the SEC. An issuer can integrate a Regulation A offering into a more comprehensive capital raising plan, which might include a Rule 506 offering, or a Regulation A+ offering as a first step before undertaking an IPO.

Concurrent Exchange Act Registration

The final rule also permits a Tier 2 issuer that has provided disclosure in Part II of Form 1-A that follows Part 1 of Form S-1 (or for REITs, Form S-11) to file a Form 8-A to list its securities on a national securities exchange.

An issuer that enters the Exchange Act reporting regime in this manner will be an EGC and will become subject to Sarbanes-Oxley requirements as well as to the corporate governance requirements of the securities exchange on which it lists its securities.

Regulation A+ as a Stepping Stone to an IPO

A Regulation A+ offering may also be a good choice for a company that doesn't feel ready to do an IPO. In this way, they are able to remain private but develop a market following. The "test the waters" process, as well as the public filing of the offering circular, serves to make information about the issuer broadly available.

An issuer might view a Tier 2 offering as an opportunity to build internal systems for reporting and to assemble a team accustomed to periodic reporting in advance of an IPO. Aside from cost, this affords the benefit of qualifying the company as an emerging growth company when it comes time to do its IPO.

Finally, by conducting a Tier 2 offering the issuer may attract the attention of potential acquirers, or may raise its profile within the financial community on its path to an IPO. It has become much more commonplace for an issuer that is contemplating an IPO to undertake a late-stage private placement. This "pre-IPO" private placement is a means of attracting known sector buyers and serves to validate the company before it begins the IPO process. It also serves to prepare the issuer for the more rigorous IPO process, as they will have to prepare an offering circular, satisfy reporting requirements and prepare financial statements.

Conclusion

The changes to Regulation A+ were designed to offer a cost-efficient means for small companies to raise capital in larger amounts. However, there is some doubt that these new rules will boost the use of Regulation A+ as much as the SEC is hoping. Particularly with regard to larger offerings using Tier 2, the enhanced reporting requirements—and the scrutiny they entail—may be too much of a negative, even with the ability to raise up to $50 million and to offer unrestricted securities. Companies may simply continue to rely on Rule 506 private placements (which have no dollar limit), even if the securities are "restricted," or conversely they may decide to just go all the way with a bona fide IPO.

About Anna Pinedo.

Anna Pinedo, partner and co-leader of Mayer Brown's global capital markets group, has concentrated her practice on securities and derivatives. She represents issuers, investment banks/financial intermediaries, and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products. Ms. Pinedo works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products.

Ms. Pinedo has been included in Best Lawyers in America, Euromoney's Expert Guide for Capital Markets and Expert Guide for Women in Business Law, Super Lawyers, Crain's New York Business "Forty Under 40," Investment Dealer's Digest "Forty Under 40" and Hispanic Business's "100 Most Influential Hispanics." Ms. Pinedo has been ranked by Chambers USA and recommended by The Legal 500 as one of America's leading capital markets-derivatives and capital markets-structured products lawyers. She has been recognized as a notable lawyer for financial services regulation-broker dealer (compliance) by Chambers USA. She was a recipient of the Lexology Client Choice Award for Capital Markets in 2016 and 2017 and for Derivatives in 2018.

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