SEC Releases Final Rule Amendments to Regulation A

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The Securities and Exchange Commission (SEC) recently adopted final rules that are designed to enable smaller companies to offer and sell up to US$50 million of unrestricted securities in a consecutive 12-month period without registration under the U.S. Securities Act of 1933 (U.S. Securities Act), subject to eligibility, disclosure and ongoing reporting requirements. The new rules modernize and expand Regulation A under the U.S. Securities Act in response to the rulemaking mandate of Title IV of the JOBS Act. While the new rules provide an additional capital raising option for eligible U.S. and Canadian companies, related SEC filing, review and disclosure requirements may limit their actual use.

Summary

The amended Regulation A (sometimes referred to as Regulation A+) creates two tiers of exemptions: Tier 1 for smaller offerings raising up to US$20 million in any consecutive 12-month period, including no more than US$6 million in sales by selling security holders that are affiliates of the issuer; and Tier 2 for offerings raising up to US$50 million in any consecutive 12-month period, including no more than US$15 million in sales by selling security holders that are affiliates of the issuer. The new rules require that an offering statement on new Form 1-A and, in the case of Tier 2 offerings, ongoing reporting documents be filed with the SEC, permit certain test-the-waters communications, and contain a “bad actor” disqualification similar to that in Regulation D under the U.S. Securities Act. The new rules impose different disclosure requirements for Tier 1 and Tier 2 offerings, with more detailed disclosure being required for Tier 2 offerings, including audited financial statements. Tier 1 offerings will be subject to both SEC and state blue sky pre-sale review. Tier 2 offerings will be subject to SEC review only (state securities laws will be preempted for Tier 2). Investors in a Tier 2 offering that do not qualify as “accredited investors” under Regulation D will be subject to investment limits (except when the securities to be sold are listed on a national securities exchange) and Tier 2 issuers will be required to file new annual (Form 1-K) and semi-annual reports (Form 1-SA), as well as current event reports (Form 1-U) as further discussed below.

Eligible Issuers and Securities

Both the Tier 1 and Tier 2 exemption will be available to issuers organized in and having their principal place of business in the United States or Canada that are not: (i) already subject to the reporting requirements of Section 13 or 15(d) of the U.S. Securities Exchange Act of 1934 (U.S. Exchange Act); (ii)
an investment company registered or required to be registered under the *Investment Company Act of 1940* or (ii) a blank check company. In addition, the exemption will not be made available to (i) issuers that have not filed with the SEC the ongoing reports required by amended Regulation A during the two years immediately preceding the filing of a new offering statement; (ii) issuers that have had their registration under Section 12 of the U.S. Exchange Act revoked pursuant to an order under Section 12(j) of that Act that was made within five years before the filing of the offering statement and (iii) offerings involving certain “bad actors” that have committed specific market-related offenses.

The securities that may be offered under Regulation A are limited to equity securities (including warrants), debt securities and debt securities convertible into or exchangeable into equity interests, including any guarantees of such securities. Securities sold in a Regulation A offering which are then resold by persons who are not affiliates of the issuer would not be subject to any transfer restrictions under Rule 144 under the U.S. Securities Act, as securities initially sold under Regulation A will not be restricted securities. However, secondary trading market trading for securities originally sold under Regulation A may be very limited in light of the requirement that Regulation A issuers not be public companies in the United States. Affiliates would continue to be subject to the affiliate resale limitations of Rule 144.

**Exchange Act Registration Exemption**

The new rules exempt securities in a Tier 2 offering from counting toward the mandatory registration requirements of Exchange Act Section 12(g) that would otherwise apply as a result of having more than 2,000 shareholders or more than 500 shareholders that are not accredited investors if the issuer meets all of the following conditions:

- engages services from a transfer agent registered with the SEC;
- remains subject to a Tier 2 reporting obligation;
- is current in its annual and semiannual reporting at fiscal year-end; and
- has a public float of less than US$75 million as of the last business day of its most recently completed semiannual period, or, in the absence of a public float, had annual revenues of less than US$50 million as of its most recently completed fiscal year.

An issuer that exceeds the dollar thresholds above and has enough shareholders to trigger a Section 12(g) registration requirement (including shares issued under Tier 2 of Regulation A) would have a two-year transition period before it must register its class of securities, provided it timely files all of its ongoing reports required under Regulation A.

**Investment Limitation**

The new amendments impose an investment limit for Tier 2 offerings. A non-accredited natural person is subject to an investment limit and must limit purchases to securities having an aggregate purchase price of no more than 10% of the greater of the investor’s annual income and net worth, calculated as provided in the accredited investor definition under Rule 501 of Regulation D. The investment limit will not apply to accredited investors and also will not apply to non-accredited investors if the securities are to be listed on a national securities exchange at the completion of the offering. Issuers are required to make investors aware of the investment limitations, but would otherwise be able to rely on an investor’s representation of compliance with the proposed investment limitation unless the issuer knew, at the
time of sale, that any such representation was untrue.

The Offering Statement

Regulation A offering statements on Form 1-A must be filed with the SEC and will be subject to SEC review and comments. A notice of “qualification” from the SEC must be obtained before the securities can be sold, which is similar to a notice of effectiveness in an SEC-registered offering. The offering statement will require certain basic information regarding the issuer, its eligibility, the offering details, the jurisdictions where the securities will be offered, and prior sales of unregistered securities. The offering statement will also require disclosure about the business of the issuer; material risks; use of proceeds; an overview of the issuer’s business; MD&A type discussion; executive officers and directors and their compensation; beneficial ownership information; related party transactions; and a description of the offered securities, but these disclosure requirements will be scaled back in comparison to registration statements filed with the SEC in connection with public offerings. Canadian issuers will be required to include financial statements prepared in accordance with either U.S. GAAP or IFRS, as adopted by the International Accounting Standards Board. The financial statements included in offering statements for Tier 2 offerings must be audited.

Ongoing Reporting Requirements

The amended Regulation A imposes new ongoing reporting obligations for Regulation A offerings. All reports to satisfy reporting obligations for Tier 1 and Tier 2 offerings are required to be filed electronically on EDGAR. Tier 1 and Tier 2 issuers are required to provide certain information about their Regulation A offerings on a new form, Form 1-Z, within 30 days after the termination or completion of a Regulation A-exempt offering.

Only Tier 2 issuers would be required to file: (i) annual reports on Form 1-K; (ii) semi-annual reports on Form 1-SA; (iii) current reports on Form 1-U; and (iv) exit reports on Form 1-Z. In its adopting release, the SEC noted “that adopting different ongoing reporting requirements for Canadian issuers would not be consistent with our goal to adopt a uniform reporting standard for Tier 2 issuers that provides investors with certainty as to the amount of information they can expect to receive from an issuer in a Tier 2 offering on an ongoing basis.”

The annual report on Form 1-K would require disclosures relating to the issuer’s business and operations for the preceding three fiscal years (or since inception if in existence for less than three years) and other similar disclosure covered in the Form 1-A offering statement. The form is required to be filed within 120 calendar days of the issuer’s fiscal year-end.

The semi-annual report on Form 1-SA would be similar to a Form 10-Q, consisting primarily of financial statements and MD&A. Unlike Form 10-Q, however, Form 1-SA does not require disclosure about quantitative and qualitative market risk, controls and procedures, updates to risk factors, or defaults on senior securities. The semi-annual report is required to be filed within 90 days after the end of the first six months of the issuer’s fiscal year end, commencing immediately following the most recent fiscal year for which full financial statements were included in the offering circular.

A current report on Form 1-U will be required to announce fundamental changes in the issuer’s business; entry into bankruptcy or receivership proceedings; material modifications to the rights of security holders; changes in accountants; non-reliance on audited financial statements; changes in control; changes in key executive officers; and unregistered sales of 10 percent or more of outstanding equity securities. The form must be filed within four business days of the triggering event.
FINRA Review

For any public offering of securities, FINRA Rule 5110 prohibits FINRA members and their associated persons from participating in any manner unless they comply with the filing requirements of the rule. Rule 5110(b) requires that certain documents and information be filed with and reviewed by FINRA, including underwriter compensation, and these filing and review requirements apply to securities offered under Regulation A.

Canada Implications

While the disclosure requirements under expanded Regulation A are not as extensive as those applying to an SEC-registered public offering of securities, other registration exemptions remain available to Canadian issuers that do not require the preparation of disclosure documents that must be filed with and reviewed by the SEC, such as Regulation D and Rule 144A under the U.S. Securities Act. In addition, eligible Canadian companies continue to be able to use the U.S.-Canada Multijurisdictional Disclosure System (MJDS) to gain access to the U.S public capital markets using primarily their Canadian disclosure documents and generally without undergoing the SEC’s review and comment process. We anticipate that Regulation D, Rule 144A and MJDS will continue to be the preferred route to the U.S. capital markets for Canadian companies.

The final rules will be effective 60 days following publication in the Federal Register.

For further details, the SEC Release No. 33-9741 is available here.

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