NEW AND IMPROVED REGGAE: SEC ADOPTS REGULATION "A+"

Smarter Way to Cross Blog Archives
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Regulation A under the U.S. Securities Act of 1933 was enacted back in 1936 to provide smaller issuers with a simplified procedure to raise capital. For many reasons, however, it has been, to date, the SEC's forgotten stepchild. For example, an offering under the original Regulation A required the filing of an "offering statement" with the SEC at least 10 days before the commencement of the offering. Although Regulation A offerings did not incur continuous reporting obligations under the Securities Exchange Act of 1934 (i.e., the continuous public filing of annual, quarterly, and special reports by the issuer with the SEC), the rules governing the offering statement demanded a level of disclosure that often approached the level of a registered prospectus. Moreover, the total amount of all offerings by a Regulation A issuer during any 12-month period was capped at a mere US$5 million. These factors conspired to keep Regulation A in an awkward no-man's land. An issuer seeking an exemption from registration would often turn to Rule 506 under Regulation D, which has no cap on offering size and does not narrowly prescribe the method of disclosure to potential investors—so long as they are all accredited investors. In 2012, there were just eight qualified Regulation A offerings raising approximately US$34.5 million. During that same period, there were approximately 7,700 Regulation D offerings under $5 million that raised an aggregate of approximately US$7 billion.

Recognizing these infirmities, the SEC recently adopted major updates to Regulation A, commonly known as "Regulation A+," that are designed to significantly boost the attractiveness of this pathway to capital. Crucially, Regulation A is available only to companies organized in, and with their principal place of business located in, **either the United States or Canada**, but not to companies that are already SEC-reporting. Regulation A+ significantly raises the US$5 million threshold pursuant to two offering tiers with varying criteria. The chart below provides a quick summary of the Regulation A+ tiers:

Tier 1

Tier 2

Offering size

Up to US$20 million in a 12-month period

Up to US$50 million in a 12-month period

Audited financials required?

No

Yes

Ongoing reporting requirements?

No

Annual, semiannual and current event reports to be made with the SEC

Accredited investor requirements?

None

Non-accredited investors may purchase no more than 10 percent of the greater of such investor's annual income or net worth.

Blue sky pre-emption?

No

Yes

Offerings proceeding under either tier are subject to basic requirements as to issuer eligibility, disclosure and "bad actor" disqualification, drawn from current Regulation A criteria. Both tiers would also permit companies to submit draft offering statements for non-public review by SEC staff prior to filing and permit the continued use of solicitation materials after filing the offering statement (although the solicitation materials would be filed with the SEC).

It is anticipated that with the A+ updates, Regulation A will return to prominence as a pathway for capital raising by emerging companies, including Canadian companies looking to attract U.S. investment. From an issuer's perspective, the cost-benefit analysis between Regulation A and Regulation D may come down to weighing whether the higher disclosure threshold (and the limited reporting requirements in a Tier-2 offering) under the new and improved Regulation A justifies the upside of marketing a freely trading security to a wide range of prospective U.S. purchasers (recall that Regulation D securities are legended, subject to transfer restrictions and generally only offered to accredited investors).

Although the disclosure requirements may appear daunting at first blush, Regulation A may also present good trial run for a company looking to raise capital in the near term, but with an eye on going public in the U.S. in the not too distant future.