



SEC Proposes Changing Rules for Exempt Offerings under Regulation A

The SEC recently proposed revisions to Regulation A that would raise the limit on exempt offerings from \$5 million to \$50 million within a 12-month period.¹ The proposed revisions required by the Jumpstart Our Business Startups Act are designed to make it easier for small companies to raise capital while providing meaningful investor protection.²

Key Facts

The proposed rules also would:

- Create a two-tier system with easier requirements for small offerings (up to \$5 million annually) compared to stricter requirements for larger offerings (up to \$50 million annually); and
- Modernize the Regulation A filing process to be consistent with current practice for registered offerings.³

Key Impact

- Nonpublic issuers would be allowed to raise up to \$50 million from non-accredited investors in a public offering.⁴

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¹ SEC Release Nos. 33-9497, 34-71120, and 39-2493, Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act; the Securities Act of 1933 and the Securities Exchange Act of 1934, all available at www.sec.gov.

² The Jumpstart Our Business Startups Act became law in April 2012.

³ Securities Act of 1933, Regulation A, Conditional Small Issues Exemption, available at www.sec.gov.

⁴ Accredited investors include individuals with a net worth of at least \$1 million excluding the value of their primary residence, and with annual income of at least \$200,000 in each of the two most recent years.

Current Regulation A Requirements

Regulation A offerings are public offerings with no prohibition on general solicitation and general advertising that are exempt from the filing requirements of the Securities Acts of 1933 and 1934. Currently, Regulation A permits unregistered public offerings of up to \$5 million of securities in any 12-month period by non-SEC reporting U.S. and Canadian issuers. The Regulation A exemption requires issuers to file an offering statement, which is similar to an abbreviated version of a prospectus in a registered offering, in paper format with the SEC.

SEC Objectives

From 2009 to 2012, Regulation A offerings occurred infrequently. During that time, \$73 million was raised through 19 qualified Regulation A offerings. In contrast, in offerings under the \$5 million threshold, \$25 billion was raised through 27,500 Regulation D offerings and \$840 million was raised through 373 registered offerings.⁵

The SEC states in its release that the proposed revisions are intended to increase the use of Regulation A and therefore help small companies raise capital.

Proposed Amendments to Regulation A

The proposed revisions to Regulation A create two tiers of offerings. These offerings would be exempt from existing registration requirements if certain requirements are met, including those listed in the following table.

Tier 1	Tier 2
Limit on Aggregate Offering Amount within the Prior 12 Months	
\$5 million, including up to \$1.5 million by selling security holders	\$50 million, including up to \$15 million by selling security holders
Investment Limitation (on a per Offering Basis)	
None	No more than 10% of the greater of the investor's annual income and net worth
Compliance with Blue Sky Laws	
Required	Exempt from state securities law requirements

⁵ Securities Act of 1933, Regulation D, Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933.

Eligible Securities. Exemption under Regulation A is limited to equity securities, debt securities, and convertible debt securities. The proposed revisions to Regulation A would exclude asset-backed securities, as defined in Regulation AB, from eligibility under Regulation A.⁶

Ineligible Issuers. Exemption under Regulation A is unavailable for:

- Issuers organized with their principal place of business outside the United States or Canada;
- Issuers with existing SEC reporting requirements;
- Investment companies as defined under the Investment Company Act of 1940;
- Issuers with no specific business plan or a business plan to engage in a merger or acquisition with unidentified companies;
- Issuers disqualified under *bad actor* provisions if they or other relevant persons, such as underwriters, directors, officers, or significant shareholders have been convicted of, or are subject to court or administrative sanctions for securities fraud or other violations of specified laws; and
- Issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights.

The proposed revisions to Regulation A also would disqualify issuers that have:

- Not fulfilled their obligation to file ongoing reports under the proposed revised rules during the two years preceding the filing of a new offering statement; and
- Been ordered by the Commission to deny, suspend, or revoke the registration of securities during the five years preceding the filing of a new offering statement.

Disclosure Requirements for Issuers

Issuers will be required to file the forms required by the proposed revisions on EDGAR. The filings will be subject to SEC staff review and subject to anti-fraud and civil liability provisions under the Securities Act of 1933.

Offering Statement Disclosure Requirements

The proposed rules would require issuers to provide the following information in the offering document:

- General information about the issuer, its officers and directors, and the offering;
- Executive compensation data for the three highest paid officers or directors during the most recent year;
- A description of the business for the prior three years;
- Offering price and planned use of proceeds;

⁶ Securities Act of 1933, Regulation AB, Asset-backed Securities, available at www.sec.gov.

- Transactions with related-parties; and
- Management's discussion and analysis (MD&A) of the issuer's liquidity, capital resources, and results of operations for the two most recent years.

SEC Objectives

The SEC states in its release that the proposed MD&A disclosure would clarify existing requirements and save issuers time by providing more explicit guidance about the type of information and analysis that should be included. The clearer requirements for Regulation A offerings would result in more consistent disclosures with registered offerings and lead to improved MD&A disclosure, which would provide investors with better visibility into management's perspective on the issuer's financial condition and operations.

Financial Reporting Requirements. The proposed revisions to Regulation A would establish different financial reporting requirements for Tier 1 and Tier 2 offerings. Issuers conducting an eligible offering of up to \$5 million could elect to conduct the offering under either Tier 1 or Tier 2.

The following table summarizes the current and proposed financial statement requirements under Regulation A.

Current Requirements	Tier 1	Tier 2
Balance Sheets		
One year		Two years
Statements of Income, Cash Flows, and Stockholder's Equity		
Two years and interim periods (if required)		Two years and interim periods (if required)
Basis of Accounting		
U.S. GAAP	U.S. GAAP for U.S.-domiciled issuers Either U.S. GAAP or IFRS as issued by the IASB for Canadian issuers	
Annual Audit Requirements		
Unaudited, unless the issuer has audited financial statements	Unaudited, unless the issuer has audited financial statements	Audited

Current Requirements	Tier 1	Tier 2
Applicable Auditing Standards		
U.S. GAAS or PCAOB	U.S. GAAS or PCAOB	PCAOB
Auditors Required to Be Registered with the PCAOB		
No		No
Auditors Required to Comply with SEC Independence Rules		
Yes		Yes

Age of Financial Statements. For filings made more than three months after the end of issuers' most recently completed year, the balance sheet would be required to be dated as of the end of the most recently completed year. For filings made more than nine months after the end of issuers' most recently completed year, the balance sheet would be required to be dated no earlier than as of six months after the end of the most recent fiscal year. If interim financial statements are required, they must cover a period of at least six months.

Non-Public Submission of Draft Offering Statements. The proposed revisions to Regulation A would allow issuers to submit draft offering statements to the SEC for non-public review prior to filing.

Solicitation Materials. The proposed revisions to Regulation A would permit issuers to solicit interest in a potential offering with the general public before or after the offering statement is filed as long as any solicitation materials are filed with the SEC.

Ongoing Reporting Requirements

Currently, Regulation A requires issuers to file with the SEC every six months to report sales under Regulation A, with a final filing due within 30-calendar days after the termination, completion, or final sale of securities in the offering.

Tier 1 issuers would no longer be required to file periodic reports under the proposed revisions to Regulation A, but would be required to file a new Form 1-Z within 30 calendar days after completion or termination of the offering. This form would provide summary information on the recently completed offering and update certain issuer information.

Tier 2 issuers would be required to file periodic reports on newly created forms as summarized in the following table.

Reporting Requirements	
Annual Reports on Form 1-K	Financial statements prepared on the same basis, and subject to the same requirements for audit standards and auditor independence, as the financial statements required for the offering to be filed within 120 calendar days after the issuer's year-end.
Semiannual Reports on Form 1-SA	Unaudited financial statements filed within 90 days after the end of the issuers' second fiscal quarter.
Current Reports on Form 1-U	Filed within four business days after the occurrence of certain events, similar to 8-K reporting requirements (e.g., non-reliance on previous financial statements, departure of certain executive officers, etc.).
Termination Reports on Form 1-Z	Consistent with Tier 1 issuers, to be provided within 30 calendar days after completion or termination of the offering.

SEC Objectives

The SEC states that the proposed approach to ongoing reporting is expected to support a regular flow of information about issuers conducting Tier 2 offerings, which would benefit investors and foster the development of a market in such securities without imposing unnecessary costs on issuers that elect to conduct Tier 1 offerings. The SEC also states that it believes the proposed reporting requirements strike an appropriate balance between investor protection and the goal of facilitating capital formation for smaller companies.

Next Steps

The SEC has requested comments on the proposed rules, including whether the requirements for financial statements in an issuer's offering statement and ongoing reporting requirements are appropriate. The SEC has also requested comments on whether Tier 2 issuers should be required to provide their financial statements using eXtensible Business Reporting Language (XBRL).

Comments on the proposed rules are due March 24, 2014. The SEC will review the comments and determine whether to adopt the proposed rules.

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