Capital Markets Alert

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SEC Adopts Final Rules to Allow Exchange Act Reporting Companies to Use Regulation A

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The Securities and Exchange Commission (SEC) adopted final rules to allow reporting companies to rely on the Regulation A exemption to conduct securities offerings of up to $50 million in a 12-month period without Securities Act registration. The amendments to Regulation A, which satisfy a congressional mandate under the Economic Growth, Regulatory Relief, and Consumer Protection Act, will become effective upon publication in the Federal Register, which can be expected in the next several weeks.[1]

Background

Regulation A provides an exemption from Securities Act registration for offerings of securities up to $50 million in a 12-month period. Issuers may elect to conduct a Regulation A offering pursuant to the requirements of either Tier 1 or Tier 2. Tier 1 is available for offerings of up to $20 million in a 12-month period, including no more than $6 million on behalf of selling security holders that are affiliates of the issuer. Tier 2 is available for offerings of up to $50 million in a 12-month period, including no more than $15 million on behalf of selling security holders that are affiliates of the issuer. Securities sold under Regulation A are deemed sold in a public offering and therefore are not "restricted securities" subject to Securities Act resale limitations.

State "Blue Sky" registration requirements are not pre-empted for Tier 1 offerings. As such, Tier 1 offerings are subject to both federal and state registration and qualification requirements. Blue Sky requirements for Tier 2 offerings, on the other hand, are pre-empted.

Currently, Regulation A is not available to companies that are subject to the ongoing reporting requirements of Exchange Act Sections 13 or 15(d). Rather, as expanded in 2015, Regulation A offers non-reporting companies an alternative path to access the public capital markets without incurring the costs and burdens of being a fully fledged publicly reporting company.

[1] In an unusual departure from typical administrative practice, the SEC did not publish a notice of proposed rulemaking in the Federal Register and solicit public comment on the proposed rulemaking because it concluded the amendments are necessary to conform Regulation A to the requirements of the Economic Growth, Regulatory Relief, and Consumer Protection Act and involve a limited exercise of agency discretion.

Final Rule Amendments

The final rules amend Securities Act Rule 251 to permit companies subject to the Exchange Act reporting requirements to use Regulation A. The final rules also revise Securities Act Rule 257 to provide that companies that have filed all reports required to be filed by Exchange Act Sections 13 or 15(d) during the prior 12 months (or such shorter period that the company was required to file such reports) will be deemed to have met the reporting requirements of Regulation A. In connection with these amendments, the SEC also made other narrow conforming changes to Regulation A and Form 1-A.

Except for the changes above, the procedural and substantive aspects of the Regulation A exemption otherwise remain unchanged. For example, the Regulation A exemption remains available only to a company organized in, and with its principal place of business inside, the United States or Canada. It remains unavailable to investment companies, special purpose acquisition companies (SPACs), business development companies (BDCs), blank check companies, companies subject to "bad boy" disqualification, and issuers of fractional undivided interests in oil or gas rights.

Implementation Guidance

Because the final rule amendments are limited to only those necessary to satisfy the narrow congressional mandate, the SEC included certain implementation guidance in the adopting release that seeks to clarify the operation of the rules in the context of a Regulation A offering by an Exchange Act reporting company.

Key Takeaways

Eligible Exchange Act reporting companies now will be able to access the public markets via an alternative offering process. Certain benefits available under Regulation A may be attractive to some issuers. For example, issuers are permitted to "test the waters" before or after the filing of the offering circular, and these investor outreach efforts are not limited to qualified institutional buyers and institutional accredited investors, as is the case for emerging growth companies. Also, as noted above, securities sold under Regulation A are not "restricted securities" subject to Securities Act resale limitations, as is the case with securities sold in traditional private placements under Section 4(a)(2), Rule 506 of Regulation D and Rule 144A.[2]

However, similar to the review and effectiveness of a traditional registration statement, an issuer offering circular would be subject to potential SEC review and comment and must be qualified (analogous to a notice of effectiveness) by the Staff before any sales could be made. Also, underwriters participating in a Regulation A offering can be expected to require diligence and disclosure comparable to that required in a registered offering due to application of the liability provisions under Securities Act Sections 12(a)(2) and 17 and Exchange Act Section 10(b) and Rule 10b-5 thereunder.[3]

On balance, we do not think the amendments will have a significant impact on the traditional public markets. We believe public companies listed on a national securities exchange that elect to access the public markets will continue to do so via offerings registered under the Securities Act. We believe an SEC registered offering generally will be faster, less expensive and offer better pricing.

[2] The term "Rule 144A offering" refers to an offering in which the issuer sells securities to a broker-dealer on a firm commitment basis in reliance on Section 4(a)(2) or Rule 506 of Regulation D, and then the broker-dealer resells the securities to qualified institutional buyers, or QIBs, pursuant to Rule 144A. These QIBs may rely on Rule 144A for subsequent resales to other QIBs

[3] Securities Act Section 11 liability is limited to registration statements and thus would not apply.

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