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First Issuer Completes NASAA Coordinated Review For Regulation A Offering

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

The first issuer has completed the NASAA coordinated review process to qualify to sell securities in multiple states under Regulation A. As the first and only issuer to complete this process, the issuer (Groundfloor Finance, Inc.) took the time to write a comment letter to the SEC with respect to its Regulation A+ rulemaking and in particular to discuss its experience with the NASAA coordinated review process. The issuer's comment letter was followed by a letter to SEC Chair Mary Jo White from the House Financial Services Committee requesting that the SEC study the NASAA Coordinated Review Program.

The Coordinated Review Process

The NASAA coordinated review process is well put together and seems to have a focus on both investor protection and supportive assistance for the issuer. An issuer elects to complete the coordinated review process by completing a Form CR-3b and submitting the application together with a copy of the completed Form 1-A and audited financial statements to Washington state by e-mail. The application contains a "check the box" for the states in which the issuer desires to qualify. Filing fees are mailed separately to each of the states.

A lead merit and a lead disclosure examiner are then appointed to manage the review process. If the issuer is not applying in any state with merit review, only a lead disclosure examiner is appointed. The filing goes through a review, comment and amendment process with the lead examiner issuing comment letters on behalf of all states.

The review process timing is relatively quick. Within three days of filing, an issuer receives a written receipt for the filing and a letter detailing the review process. Within ten days of the filing confirm, the lead examiner drafts a proposed comment letter for the individual states to review and add to. The first comment letter must be delivered to the issuer within 21 days of filing.

The lead examiner schedules conference calls to discuss the comments and how the issuer can address the concerns. Moreover, the examiners make themselves available for discussion of comments and responses throughout the process, allowing for a type of cooperative relationship between the examiner and issuer. Issuers' comment responses are reviewed within five business days of receipt. If there are no comments, the offering will be cleared within 21 business days of filing.

The review standard itself is based on the NASAA Statements of Policy, which cover a wide array of topics—including, for example, impoundment of proceeds, loans and other material affiliated transactions, options and warrants, preferred stocks, promoter's equity investment, promotional shares, specificity in use of proceeds, underwriting expenses, unsound financial condition and voting rights. A detail of these policies will be a topic for a future blog.

Groundfloor's Letter Regarding the Coordinated Review Program

Groundfloor, the first and only issuer to complete the NASAA's new coordinated review program for the concurrent multi-state review of a Regulation A offering, strongly opposes state law preemption for Regulation A offerings. Groundfloor clearly had a positive experience with the program. The letter states, "[F]or us, the value of receiving comments in a timely fashion outweighs the marginal costs of filing in multiple states. The legal certainty this affords is substantial, and does not exist in federal review." Groundfloor continues, "[T]he uniform application of NASAA's Statements of Policy has been very helpful, and we have been able to comply with these policies despite the presence of certain conditions within our company which pertain to these policies. Communication with state examiners has been excellent, and direction on comment responses has been very clear."

In support of its position for both federal and state review, Groundfloor states, "[A]s a small issuer, we worry about bad actors destroying investor trust and appetite for offerings in this market. Combined state and federal registration along with the new

Coordinated Review program presents a threshold that legitimate businesses can meet, while creating a disincentive for speculative and unscrupulous issuers. We believe investors will benefit from registration statements that undergo two levels of scrutiny…" Finally Groundfloor notes, "[W]ith the Coordinated Review program in place, there is no basis for preempting state registration given the practical effects of registering through the program."

In the case of Groundfloor, its state review process was completed prior to the federal review process, presumably bolstering its support of the program. A review of Groundfloor's description of the NASAA coordinated review describes an efficient and helpful process. Groundfloor found that the NASAA Statement of Policy was uniformly applied and easy to understand. Despite the fact that they had affiliated transactions, limited operating history and were not profitable, Groundfloor was able to clear the merit review standards.

Groundfloor, however, seems to gloss over some of the bigger differences that currently exist between the state and federal Regulation A processes. For instance, although the federal government does not require audited financial statements as part of a Form 1-A filing, many states do. In Groundfloor's letter it states that in completing the Form 1-A it had met nearly all of the state filing requirements, and continues that it "did not find audit and financial reporting requirements to be financially burdensome." It also did not complain about the state filing fees themselves.

Groundfloor makes good points in favor of the NASAA process. An issuer knows when to expect comments, and state comments are centralized from a single source. It would be ridiculous for an issuer to argue that answering comments and completing a review process through ten different states is better than a single source.

That still begs the question as to the efficacy of having state review at all. The argument, by Groundfloor and others, is that the SEC cannot be trusted with the process. Their position seems to be that the SEC is under-budgeted, overworked and/or incompetent and that the states are necessary gatekeepers for these relatively smaller offerings. I disagree. I believe that the SEC is more than capable of reviewing these offerings and ensuring that disclosures rise to the level necessary to provide investors with the information necessary to assess the risk of an investment and render an informed investment decision.

Regardless, the states retain jurisdiction over anti-fraud protections and the right and ability to investigate and prosecute fraud in any offering. I support allowing the federal government to control the disclosure process, including forms and review process, and continuing the combined efforts of both the states and federal authorities in policing, preventing and prosecuting fraud.

However, clearly, if state law is not ultimately pre-empted, the NASAA process should be bolstered.

House Financial Services Committee Letter to SEC Chair Mary Jo White

Upon learning of Groundfloor's comment letter, the House Financial Services Committee sent a letter to SEC Chair Mary Jo White noting that "[I]n passing Title IV of the Jumpstart Our Business Startups Act of 2012, Congress balanced the need to promote small business capital formation by tailoring the public offering process, while preserving strong investor protections, including state regulator oversight for securities sold to retail investors. The state regulators have now done the same, by streamlining their own registration processes."

The letter concludes by strongly urging the SEC to "closely examine the NASAA's Coordinated Review program, and not undermine crucial investor protections by preempting the states' regulators."

Background on the NASAA Position on Regulation A+

The North American Securities Administrators Association (NASAA), a group whose members are comprised of state securities regulators, while supportive of the Regulation A+ concept as a whole, has been vocal of its opposition of the proposed state law pre-emption provisions.

Notably, on April 8, 2014, Commissioner Luis A. Aguilar, the NASAA liaison, gave a speech at the North American Securities Administrators Association commenting on the NASAA's position. In the speech Mr. Aguilar praised the concept of the rule itself, including the two-tier structure, offering amount limits and, importantly, ongoing reporting requirements. He expressed agreement with many of the same provisions that have garnered support in the investment community, including Regulation A/A+ permit general solicitation and advertising, allowing test-the-waters communications and permit sales to both accredited and unaccredited investors. However, he also noted

that the NASAA was not supportive of the proposed federal pre-emption of state law for Regulation A+ offerings.

The NASAA site cites the usual investor protection and costs of blue sky compliance arguments in support of their overall position. Mr. Aguilar's speech summarizes a Government Accounting Office report on the issue:

"According to the GAO report, although states employ a limited number of methods for registering securities offerings, the specific requirements and processes vary. Thus, an issuer seeking to offer Regulation A securities in multiple states would traditionally have needed to make multiple state filings. To that end, the issuer's counsel would have needed to research the filing requirements for each state in which the offering was conducted. Each state in which the issuer chose to file would then provide its own comments, based on its own standard of review, and each state would have to separately declare the offering effective, before the offering could be conducted in that jurisdiction. As a result, complying with the registration provisions of multiple states was seen as expensive and time-consuming."

However, it is their view that the rules should be and can be better policed on a local level. The NASAA praised merit review states. Merit review generally includes rules related to, and a review of, such items as valuation, offering amount and general business plan. Moreover, some states require independent directors and other corporate governance standards.

The NASAA pointed to the new Coordinated Review Program for multi-state Regulation A and A+ offerings, which program has been adopted by 48 states. The program allowed an issuer to submit its SEC-qualified Regulation A/A+ for a single qualification process for all the participating states. A complete set of proposed rules have been prepared for the process, including the filing requirements, response time, and overall procedures.

In reality, very few Regulation A offerings are filed in merit review states due to time and expense associated with the intense regulatory review.

Background on the US Senate View of Regulation A+

On August 1, 2014, the U.S. Senate wrote a letter to the SEC expressing its opposition to the pre-emption provisions in the proposed Regulation A/A+ rules. The Senate letter

is strong in its position, starting out saying plainly that the SEC lacks statutory authority under Title IV of the JOBS Act to “ignore investor protections mandated by the plain letter of the statute” by having “proposed to broadly preempt state Blue Sky laws.” The letter continues with “it must be withdrawn.” No guesswork on the Senate’s position is necessary.

The text of Title IV of the JOBS Act provides, among other items (see refresher discussion below), a provision that Regulation A securities should be treated as covered securities for purposes of the National Securities Markets Improvement Act (NSMIA). Although an in-depth discussion of the NSMIA will be saved for a future blog, in general the NSMIA was an attempt to unify securities regulations by enumerating classes of securities that are considered federally “covered securities.” Federally covered securities are exempt from state registration and overview. For example, securities traded on a national exchange, securities issued pursuant to an effective registration statement (such as on Form S-1) and securities issued pursuant to Rule 506(b) or (c) under Regulation D are all covered securities.

Federally covered securities are still subject to state anti-fraud provisions, and states may require certain notice filings, such as a copy of a Form D filed with the SEC.

Title IV of the JOBS Act related to the revamp of Regulation A provides that “(b) Treatment as covered securities for purposes of NSMIA… Section 18(b)(4) of the Securities Act of 1933… is further amended by inserting… (D) a rule or regulation adopted pursuant to section 3(b)(2) and such security is (i) offered or sold on a national securities exchange; or (ii) offered or sold to a qualified purchaser, as defined by the Commission pursuant to paragraph (3) with respect to that purchase or sale.”

In other words, Title IV of the JOBS Act provides that the Regulation A/A+ securities will be considered covered securities and therefore not subject to state registration or overview as long as they are sold on a national securities exchange or sold to qualified purchasers. “Qualified purchaser” is another way to describe an “accredited investor.”

Since Title IV did not eliminate the pre-existing prohibition against its use by entities subject to the reporting requirements of the Securities Exchange Act of 1934 ("Exchange Act") before the offering, and since only securities subject to the reporting requirements may trade on a national securities exchange, that portion of the statute has little significance. It is possible that a national exchange would develop or an

existing exchange would add a tier that allowed an issuer to complete a Regulation A+ offering onto the exchange and thereafter permit the scaled-down Regulation A+ ongoing disclosure requirements while maintaining a listing; however, that option does not exist today. The US Senate letter missed this nuance and spent some time discussing the protections of selling onto a national securities exchange while criticizing the SEC for not including this as a requirement in Regulation A/A+ in order to be considered a covered security.

However, looking past the Senate's lack of comprehensive knowledge of the securities laws, the portion of their objection centered on the SEC's proposal that would include the allowance of sales under Regulation A/A+ to unaccredited investors (i.e., non-qualified investors) while concurrently pre-empting state law, if not overly exacting, is valid from a statutory constructive perspective. The SEC's proposal does clearly extend beyond the plain language of Title IV of the JOBS Act and is being met with significant, and likely fatal, objections.

The US Senate letter contains five pages of harsh reproach against the SEC, including such language as "... [t]he proposed rules expand the meaning of qualified purchaser to an exorbitant class of people – indeed 'all offerees of securities in a Regulation A offering and all purchasers in a Tier 2 offering.' This approach effectively defines a qualified purchaser in an entirely circular manner as anyone who purchases a Regulation A+ security offering. This stunning evasion of the statutory intent not only eviscerates the meaning of 'qualified purchaser' in the text of the JOBS Act but also eviscerates the requirement for listing on a national securities exchange…"

Regardless of the approach taken by the opposition, the message is clear and I believe the SEC will have no choice but to remove the broad preemption provisions from the proposed Regulation A/A+ rules. Of course, a statutory fix via an amendment to Title IV to treat all Regulation A/A+ issued securities as "covered securities" would be helpful, although I am unaware of any such pending proposal. Short of that, issuers should consider lobbying behind a process such as the proposed Coordinated Review Program, or it is likely that Regulation A will continue to be a rarely used capital raising option.

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Refresher on Regulation A and Proposed Regulation A+

Below is a complete review of the proposed Regulation A/A+ rules. Although, as noted above, it is unlikely that the state preemption provisions will survive in a final rule, the remainder of the provisions have been met with more praise than opposition.

Background

Title IV of the JOBS Act amends Section 3(b) of the Securities Act, which up to now has been a general provision allowing the SEC to fashion exemptions from registration, up to a total offering amount of $5,000,000. Regulation A is, and has historically been, an exemption created under the powers afforded the SEC by Section 3(b).

Technically speaking, Regulation D, Rule 504 and 505 offerings and Regulation A offerings are promulgated under Section 3(b), and Rule 506 is promulgated under Section 4(a)(2). This is important because federal law does not pre-empt state law for Section 3(b) offerings, but it does so for Section 4(a)(2) offerings. The cost of compliance with the various and varied state laws can be prohibitive, especially with an offering limit of $5,000,000. Moreover, although Regulation A is technically an exemption from registration, it actually requires the filing of a registration statement with the SEC (Form 1-A), and such registration statement must clear comments. Accordingly, over the years, Rule 506 has become the private offering exemption of choice, and Rule 505 and Regulation A have rarely been used.

Title IV is expected to revamp Regulation A to encourage its use as a viable option for capital formation. On December 18, 2013, the SEC published proposed rules to implement the new Regulation A, which proposal would create two tiers of offerings: Tier 1 for offerings up to $5 million and Tier 2 for offerings of up to $50 million. Both tiers would be subject to certain requirements including issuer eligibility, disclosure and SEC qualification. Under the proposed rules, Tier 2 – Regulation A+ offerings – would pre-empt state law “blue sky” requirements.

The New Regulation A+ – The JOBS Act Provisions

Section 401 of the JOBS Act amended Section 3(b) of the Securities Act to renumber the current Regulation A as Section 3(b)(1) and add new Section 3(b)(2), which requires the SEC to adopt a new exemption that includes the following terms and conditions:

A. The aggregate offering amount of all securities offered and sold within the prior 12-month period in reliance on the exemption shall not exceed $50,000,000.
B. The securities may be offered and sold publicly.
C. The securities shall not be restricted.
D. The civil liability provisions in Section 12(a)(2) shall apply to any person offering or selling the securities.
E. The issuer may solicit interest in the offering prior to filing any offering statement in accordance with rules to be written by the SEC.
F. The SEC shall require the issuer to file annual financial statements with the SEC.
G. A suggestion that the SEC require the issuer to prepare and file an offering document and prospectus with the SEC, and that the SEC enact disqualifying bad boy provisions (Regulation A already has such provisions).
H. The new exemption provided under Section 401 is limited to equity, debt and convertible debt securities, including any guarantees of such securities.
I. The JOBS Act allows the SEC to make Regulation A+ issuers file periodic reports analogous to current 10-Q and 10-K reports by issuers subject to the reporting requirements of the Exchange Act. (Currently, Regulation A issuers are not required to file periodic reports with the SEC.)
J. Securities sold under Section 401(b) of the Jobs Act are “covered securities” for purposes of exempting those securities from state securities registration and offering requirements. That is, the new Regulation A+ pre-empts state law.

The SEC Proposed Rules

In drafting the proposed rules, the SEC reworked the entire Regulation A by bifurcating Regulation A into two tiers: Tier 1 for offerings up to $5 million in any 12-month period including up to $1.5 million for the account of selling security holders (the pre-existing Regulation A); and Tier 2 for offerings up to $50 million in any 12-month period including up to $15 million for the account of selling security holders. The proposed rules both add the new Section 3(b)(2) (i.e., Regulation A+) provisions and modify the existing Regulation A.

The following is a summary of the proposed rules as set forth in the SEC rule release.

Eligible Issuers

As proposed, Regulation A+, like the existing Regulation A, would be available for any company organized in, and with their principal place of business in, U.S. or Canada. Regulation A+ is unavailable to any entity that is subject to the reporting requirements of the Securities Exchange Act of 1934 ("Exchange Act") before the offering, investment companies, blank check companies, entities disqualified under bad actor provisions, issuers of fractional undivided interests in oil or gas rights, or similar interests in mineral rights. Also disqualified are Regulation A+ issuers who are delinquent with their ongoing Regulation A+ reporting requirements for over two years.

Notably, the SEC release confirms that shell companies (other than blank check shell companies) are not excluded from Regulation A+ offerings. However, the SEC does seek comment on this point and could make a change in the final rule release.

Eligible Securities

The proposed rules limit securities that may be issued under Regulation A+ to equity securities, including common and preferred stock and options, warrants and other rights convertible into equity securities, debt securities and debt securities convertible or exchangeable into equity securities, including guarantees. However, the proposed rules exclude asset-backed securities.

Offering Limitations and Secondary Sales

As noted above, the proposed rules divide Regulation A into two tiers: Tier 1 for offerings up to $5 million in any 12-month period including up to 30% of the offering (i.e., up to $1.5 million) for the account of selling security holders (the pre-existing Regulation A); and Tier 2 for offerings up to $50 million in any 12-month period including up to 30% of the offering (i.e., up to $15 million) for the account of selling security holders.

Sales for the account of security holders (secondary sales) will not be limited to affiliates or non-affiliates, but rather only limited to 30% of the overall offering.

Investment Limitation

The proposed rules would limit the investment amount for an individual investor in a Regulation A+ offering to no more than the greater of 10% of annual income or net worth. Calculation of income and net worth is as provided for accredited investors under

Rule 501 of Regulation D. Issuers will be required to notify the investor of the investment limitation. However, issuers will be able to rely on the investor's representation of compliance, unless the issuer knows such representation is untrue.

Integration

The proposed rules maintain current Regulation A integration standards. In particular, a Regulation A offering will not be integrated with any of the following: (i) prior offers or sales of securities; (ii) subsequent offers and sales of securities that are (a) registered under the Securities Act (subject to limitations where there has been solicitation of interest under the "test the waters" provisions; (b) made in reliance on Rule 701 (employee offerings) of the Securities Act; (c) made pursuant to an employee benefit plan; (d) Regulation S offerings (e) offerings made more than 6 months after completion of the Regulation A+ offering; or (f) crowdfunding offerings made under Regulation Crowdfunding.

Treatment under Section 12(g)

Exchange Act Section 12(g) requires that an issuer with total assets exceeding $10,000,000 and a class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited register with the SEC, generally on Form 10, and thereafter be subject to the reporting requirements of the Exchange Act. The proposed Regulation A+ rules specifically do not provide for any exclusions to the Section 12(g) requirements for Regulation A investors.

Liability under Section 12(a)(2)

Sellers of Regulation A+ securities have liability under Section 12(a)(2) to investors for any offer or sale by means of an offering circular or an oral communication that includes a material misleading statement or material misstatement of fact.

Offering Statement – Electronic Delivery

A company intending to conduct a Regulation A+ offering must file an offering statement with, and have it qualified by, the SEC. The offering statement will be filed with the SEC using the EDGAR database filing system. Investors must be provided with the final qualified offering statement prior to a sale of securities. Like current registration statements, the proposed Regulation A+ rules provide for an "access equals delivery"

model, whereby access to the offering statement via the internet and EDGAR database will satisfy the delivery requirements.

Offering Statement – Non-Public (Confidential) Submission

As is allowed for Emerging Growth Companies, the proposed rules would permit an issuer to submit an offering statement to the SEC on a confidential basis. Confidential submissions will allow a Regulation A+ issuer to get the process under way while soliciting interest of investors using the "test the waters" provisions without negative publicity risk if it alters or withdraws the offering before qualification by the SEC. The confidential filing, SEC comments, and all amendments must be publicly filed as exhibits to the offering statement at least 21 calendar days before qualification.

Offering Statement – Form and Content

The proposed rules require use of new modified Form 1-A. Form 1-A consists of three parts: Part I – Notification, Part II – Offering Circular and Part III – Exhibits. Part I calls for certain basic information about the issuer and the offering, and is primarily designed to confirm and determine eligibility for the use of the Form and a Regulation A offering in general. Part I will include issuer information; issuer eligibility, application of the bad actor disqualification and disclosure; and jurisdictions in which securities are to be offered and unregistered securities issued or sold within one year.

Part II is the offering circular and is similar to the prospectus in a registration statement and in fact, an issuer can choose to use Part I of Form S-1 as the offering circular in a Form 1-A offering statement. Part II requires disclosure of basic information about the issuer and the offering; material risks; dilution, plan of distribution, and use of proceeds; description of the business operations; description of physical properties; discussion of financial condition and results of operations (MD&A); identification of and disclosure about directors, executives and key employees; executive compensation; beneficial security ownership information; related party transactions; description of offered securities; and two years of financial information.

The required information in Part II of Form 1-A is scaled down from the requirements in Regulation S-K applicable to Form S-1. Moreover, issuers that had previously completed a Regulation A offering and had thereafter been subject to and filed reports with the SEC could incorporate by reference from these reports in future Regulation A offering circulars.

Form 1-A requires two years of financial information. All financial statements for Regulation A offerings must be prepared in accordance with GAAP. Financial statements of a Tier 1 issuer are not required to be audited unless the issuer has obtained an audit for other purposes. Audited financial statements are required for Tier 2 issuers. For Tier 1, the accountants must meet independence standards but are not required to be registered with the Public Company Accounting Oversight Board. Audit firms for Tier 2 issuers must be independent and PCAOB-registered.

Part III requires an exhibits index and a description of exhibits required to be filed as part of the offering statement.

Continuous or Delayed Offerings and Offering Circular Supplements

The proposed rules allow for continuous or delayed offerings (i.e., shelf offerings) using Regulation A+ (Tier 2 offerings). The proposed rule would provide for continuous or delayed offering for the following types of offerings: (i) securities offered or sold by or on behalf of a person other than the issuer or its subsidiary (resale offerings); (ii) securities offered and sold pursuant to a dividend or interest reinvestment plan or an employee benefit plan; (iii) securities issued upon the exercise of outstanding options, warrants, or rights; (iv) securities issued upon conversion of other securities; (v) securities pledged as collateral or (vi) securities which are offered beginning within two calendar days of the registration qualification date and which will be offered on a continuous basis and which will be offered for in excess of 30 days.

Amendments to the offering circular would be necessary for fundamental changes to the facts presented in the offering circular and to update the financial statements at least annually. Issuers will be required to remain current in their reporting with the SEC to maintain the qualification of the offering circular.

Currently S-1 is unavailable to an issuer conducting a direct primary offering on a continuous or delayed basis. The ability to do so in a Regulation A+ offering is an attractive option.

Offering Price

All Regulation A offerings must be at a fixed price. That is, no offerings may be made "at the market" or for other than a fixed price.

Qualification

As with an S-1, the SEC would review the offering statement for accuracy and completeness of disclosure, not the merits of the company or the offered securities. Similar to any registration process, the SEC will issue comments and, upon clearing comments, the offering circular will be declared "qualified." However, unlike other registration processes, a Regulation A or A+ offering circular will only be qualified by order of the commission, and not by the passing of any particular time period.

Solicitation of Interest ("Testing the Waters")

Regulation A allows for pre-qualification solicitations of interest in an offering commonly referred to as "testing the waters." All solicitation material must be submitted to the SEC as an Exhibit under Part III of Form 1-A. Issuers can use "test the waters" solicitation materials both before and after the initial filing of the offering statement. In the event that materials are issued after the filing of an offering circular, the materials must include a current preliminary circular or information on where one can be obtained. "Test the waters" solicitations may be made both orally and in writing.

Unlike the "testing of the waters" by emerging growth companies that are limited to QIBs and accredited investors, a Regulation A+ company could reach out to retail and non-accredited investors. After the public filing but before SEC qualification, a company may use its preliminary offering circular to make written offers.

Of course, all "test the waters" materials are subject to the antifraud provisions of federal securities laws.

Ongoing Reporting

Unlike current Regulation A, which does not require ongoing reporting with the SEC other than to report sales or termination of the offering, the proposed rules contemplate two levels of reporting for the two levels of offering (Tier 1 and Tier 2). A Tier 1 company will need to file certain information about the Regulation A offering, including information on sales and the termination of sales, on new Form 1-Z no later than 30 calendar days after termination or completion of the offering. Tier 1 issuers will not have any ongoing reporting requirements.

Tier 2 companies are also required to file certain offering termination information and would have the choice of using Form 1-Z or including the information in their first annual report on new Form 1-K. In addition to the offering summary information, Tier 2 issuers would be required to submit ongoing reports including: an annual report on Form 1-K, semiannual reports on Form 1-SA, current event reports on Form 1-U and notice of suspension of ongoing reporting obligations on Form 1-Z (all filed electronically on EDGAR).

The ongoing reporting for Tier 2 companies is less demanding than the reporting requirements under the Securities Exchange Act of 1934. In particular, there are fewer 1-K items and only semiannual 1-SA (rather than the quarterly 10-Q) and fewer events triggering Form 1-U (compared to Form 8-K). The SEC anticipates that companies would use their Regulation A offering circular as the groundwork for the ongoing reports, and they may incorporate by reference text from previous filings.

The proposed rules also provide for a suspension of reporting obligations for a Regulation A issuer that desires to suspend or terminate its reporting requirements. Termination is accomplished by filing a Form 1-Z and requires that a company be current over stated periods in its reporting, have fewer than 300 shareholders of record, and have no ongoing offers or sales in reliance on a Regulation A+ offering statement. Of course, a company may file a Form 10 to become subject to the full Exchange Act reporting requirements.

In addition to the reduced reporting noted above, a Tier 2 issuer would not be subject to other Exchange Act compliance, including among others: SEC proxy statement rules; Section 16 reporting by directors, officers and 10% stockholders of ownership and transactions in issuer securities; Section 13 disclosure by 5% stockholders; Regulation FD compliance to prevent selective disclosure of material information; internal financial and disclosure effectiveness controls under the Sarbanes-Oxley Act; and CEO/CFO certifications required by Sarbanes-Oxley for periodic reports.

Exchange Act Rule 15c2-11 and Rule 144

The ongoing reporting obligations of a Tier 2 issuer will be deemed to satisfy a broker-dealer's obligation to review specific information about an issuer before publishing a quotation. The ongoing reporting obligations of a Tier 2 issuer will also satisfy the current information requirements under Rule 144.

Freely Tradable Securities

Securities sold in a Regulation A+ offering, like those under current Regulation A, are not subject to transfer restrictions and are not restricted under Rule 144. Accordingly, it is contemplated that Regulation A issuers could have a market maker file a 15c2-11 application on their behalf and establish a secondary trading market in their securities.

Relationship with State Securities Law

Under the proposed rules, Tier 2 offerings would pre-empt state law entirely. In addition, under the proposed rules, an issuer would be able to "test the waters" for Tier 1 (up to $5 million), but would require federal and state review and qualification if, after determining investor interest, the issuer files an offering statement.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the Producer and host of LawCast.com, The Securities Law Network.

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