Regulation A+ White Paper

ABSTRACT
An in-depth look at the Regulation A+ system for equity offerings by private companies
Introducing Regulation A+ of the JOBS Act

Recently, the United States Securities and Exchange Commission (SEC) made a much-needed update to Regulation A, which is called Regulation A+ (Reg A+). This update has opened a new capital market, one in which companies can take investment funding from both accredited and non-accredited investors.

Non-accredited investors offer a fresh investment source for companies. This update allows non-accredited investors, or “main street investors,” the opportunity to utilize new investment strategies in equity securities with both established and startup companies.

Reg A+ solves a major problem for mid-sized companies—they have had very limited access to growth capital for decades. Now, companies in the $2 to $100 million range (sales per year) can raise up to $50 million per year of growth capital to expand their businesses.

This paper will go into the new legal details, explain the qualifications under the new rules, and outline the opportunities and potential challenges for investors looking to participate in the new ecosystem that Reg A+ of the JOBS act offers.
1. What Are Regulation A+ Tiers and Limits?

In addition to traditional high-wealth accredited investors, Reg A+ opens an entire capital market of non-accredited investors -- investors who are private entities and under no obligation to register with the SEC.

An Issuer selling equity securities under Reg A+ will admit investors directly into its own cap table with no intermediaries. An investor now has the opportunity to access an entire range of new investment opportunities in companies that wish to expand their access to capital.

There are two reasons for raising money from non-accredited investors.

One reason is that millions of non-accredited investors have money they are willing to invest for a decent return. In fact, Reg A+ will allow non-accredited, “main street investors” into the equity securities market which was previously unreachable without SEC accreditation and high-wealth.

The other reason is less tangible but sometimes even more important—non-accredited investors may be interested stakeholders in an endeavor.

Consider a few scenarios where stakeholders would want to invest—industries like community development projects and medical research. Opening up a development project to crowdfunding can help garner community support for development plans, or increase community patronage of an establishment. The same benefits could be inferred for investment in biotech research where investors might have valuable feedback and a vested interest in contributing to research and treatment. Reg A+ allows for non-accredited investors to access these investment opportunities as equity securities.

Regulation A+ allows Issuers to raise up to $50 million from both accredited and non-accredited investors at a reasonable cost.

Under Tier I, the offering limit maximum is $20 million per company in a 12-month period, with not more than 30% in offers by selling security holders that are affiliated with the Issuer.

Tier II has an offering limit of $50 million per company in a 12-month period with not more than $15 million in offers by selling security holders that are affiliated with the Issuer.

Tier II offerings have the distinct advantage of a state preemption clause, which provides preemption from state reporting laws and encourages funding to come from multiple states without additional reporting requirements.

The Issuer only needs to file once with the Securities and Exchange
Commission rather than each individual state, eliminating extraneous reporting.

This incentivizes companies to raise equity securities more easily across state lines, which opens up a broader swath of investment choices for both accredited and non-accredited investors.

Tier II does come with additional reporting requirements including audited financial statements, as well as annual, semiannual, and current event reports. All of these reports are public and provide investors with an inside look at the health of an issuer.

<table>
<thead>
<tr>
<th></th>
<th>Maximum Limits</th>
<th>State Preemption</th>
<th>Non-Accredited Investor Limits</th>
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</thead>
<tbody>
<tr>
<td>TIER I</td>
<td>$20 million</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>TIER II</td>
<td>$50 million</td>
<td>Yes</td>
<td>10% of income or net worth</td>
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2. Eligible Companies and Approval Process

Any Issuer whose principal headquarters are based in the United States or Canada can apply for a Reg A+ offering. This provides a large selection of companies for investors to consider. There are a few examples of companies not able to participate in Reg A+.

Some of these examples include:

- Foreign Issuers outside of the U.S. and Canada
- Investment companies as defined by the Investment Companies Act of 1940
- Reporting or Public companies
- A development stage company that has no business plan or purpose
- A company whose business plan is to merge or acquire companies
- A company issuing fractional undivided interests in oil, gas, or mineral rights
- Any company disqualified under the “bad actor rule”

An Issuer could be in for a costly and time-consuming process (see section 4 for a solution to this challenge) with many variables to consider.

One significant consideration is the complexity and scope of any financial audits that a company must undergo, in addition to the cost and length of the SEC approval process.

Given the new introduction of Reg A+ at the SEC, the review process itself is variable. So far, the time to qualify a completed Tier 2 filing averages about 76 days.

Legal fees to prepare and negotiate the disclosure package with the SEC cost from $42k to $150k. The cost of auditing a company’s financial statement will vary widely. A small startup may get an audit complete for $4,000 while a larger, more complex company structure audit could cost many times that amount.

In a conservative assessment, a Reg A+ Issuer would be safe budgeting $75,000 and three months to secure SEC approval. All filings will be electronic, via the SEC EDGAR system.
Generally speaking, documents filed with the SEC are public. However, an Issuer that has not previously sold securities under either Regulation A+ or a public registration statement is allowed to file a “draft” offering statement with the SEC, which will be reviewed confidentially. Issuers may choose to do this in order to protect patents or proprietary products.

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3. Eligible Investors: Types and Requirements

Non-accredited investors are now allowed to invest in crowdfunding under Reg A+. These investors must abide by the following limits and requirements when investing under Tier II.

A non-accredited investor is limited to investing the greater of 10% of one’s annual income or 10% of one’s net worth, excluding the principal residence. The investor simply “self verifies” his or her income and net worth by filling out a form. This is a per offering limit, not a per investor limit.

In the case of a non-accredited investor that is not a human being, the 10% limit is applied to revenue and net assets.

There are no investment limits under Tier I for any entity and no investment limits for accredited investors under either tier. Under Regulation A+ an Issuer is not required to verify investor accreditation.

Before the lawyers put pen to paper, or while the SEC is considering a securities application under Reg A+, prospective securities Issuers can begin to solicit expressions of interest from potential investors, a process often referred to as “TestingTheWaters™.” Soliciting expressions of interest early in the process is helpful in determining investor interest.

This is an opportunity for investors to express support in an equity securities offering with Issuers.

All expressions of interest from an investor are non-binding, until a sale has been made. Any materials used to solicit expressions of interest must be filed with the SEC if the Reg A+ offering goes forward.

One important point of consideration is that a Reg A+ offering is more costly than an Equity CrowdFunding Title II offering.

Title II offerings can cost between $5,000-$10,000 with no annual reporting fee, compared to a Reg A+ designation which could vary widely depending on the cost of the financial audit, and is conservatively estimated to cost $75,000 with an added cost of financial reporting every six months.

TestingTheWaters™ can help an Issuer determine if there is enough investor interest. If there isn’t, an Issuer can save the cost associated with an SEC filing and pursue other funding sources.

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5. Typical Legal and Accounting Support Required Under Regulation A+

In addition to the legal expertise needed to file with the SEC, Tier II Issuers (companies) are required to provide two years (or less if the company has a shorter life) of audited financial statements which must be prepared in accordance with the Generally Accepted Accounting Principles (GAAP).

For Canadian companies, either GAAP or the International Financial Reporting Standards (IFRS) must be followed.

Issuers filing under Tier I are allowed to use only reviewed statements. However, if those statements are audited for other purposes, the audited version must be used.

Audited statements are more expensive than unaudited statements and cost will vary based on the complexity of the financials.

For some start-ups, audits could cost as little as $2,000. Competition in the field may help bring down the prices as more Issuers apply for Reg A+ status.

Strict legal and accounting standards set forth by the SEC help protect investors and increase transparency in the offerings. As an investor, these reporting requirements, while adding to the expenses of the company, offer investors some protections and ability to inspect their investments.

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### Life cycle of an ‘IPO-Lite’ capital raise under SEC Reg A+ of the JOBS Act

<table>
<thead>
<tr>
<th>Stage 1</th>
<th>Stage 2</th>
<th>Stage 3</th>
<th>Stage 4</th>
<th>Stage 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Getting Ready</td>
<td>Testing the Waters</td>
<td>Filing with the SEC</td>
<td>Conducting the Offering</td>
<td>Filing Ongoing Reports</td>
</tr>
<tr>
<td>Consult with a trusted and specialized (securities) attorney, or related advisor, about getting your company structured and organized.</td>
<td>Publicize your potential offering, for instance via social media, to collect expressions of interest (non-binding). You can start doing this on June 19, 2015.</td>
<td>Select the type of offering (Tier 1 or 2) for your capital raise and submit materials through EDGAR, the SEC’s online filing system.</td>
<td>Once your filing has been “qualified” by the SEC, work with a licensed broker-dealer to offer your securities to accredited and non-accredited investors.</td>
<td>Depending on the type of offering (Tier 1 or 2), you may need to continue filing ongoing reports with the SEC, including financial and current event reports.</td>
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**Source:** [http://onforb.es/1NMKq3V](http://onforb.es/1NMKq3V)
6. Post-Investment Reporting and Follow-Up on Investments

Under Tier I, reporting requirements are minimal—Issuers must file Form 1-Z to report the completion of the offering.

Issuers under Tier II offerings must file annual reports. Issuers must use Form 1-K, including information on business operations, related party transactions, beneficial ownership of voting securities, identification of directors, executive officers and significant employees, executive compensation data for the three most highly paid officers, a management discussion, and two years of financial statements.

These public reports could provide investors with invaluable insight about the health of their investment.

Additionally, semiannual reports using Form 1-SA, including unaudited financial statements and a management discussion, must be filed. Under certain circumstances Tier II Issuers will be required to file a current events report using Form 1-U. These include fundamental changes, bankruptcy, receivership, material modifications of the rights of security holders, changes in accountants, changes in control or a departure of a principal executive, and other significant events.

“These public reports could provide investors with invaluable insight about the health of their investment.”
7. How to Obtain Investment Liquidity Without Company Acquisition or IPO

After completing a Reg A+ offering an Issuer has additional options to continue to raise money, including a private investment, a Title II round, another Reg A+ offering (after 12 months have passed, another Reg A+ offering can be made), or an IPO.

Reg A+ can be used as the vehicle to conduct an IPO. Or conduct a Mini IPO using Reg A+ as a less expensive route to liquidity on the OTCQB or OTCQX marketplaces.

Issuers can start a Reg A+ offering after a Title II offering is complete. Conversely, Issuers can start a Title II offering six months after a Reg A+ offering is complete.

Theoretically, it is possible to raise money using Reg A+ while simultaneously raising money using Title II but it raises tricky legal questions with limited additional benefits.

After an offering is complete an investor may choose to move the investment out of their Reg A+ shares into cash or some other investment.

Investors can do this because the SEC allows Reg A+ shares to be sold in the aftermarket.

However, it will take time for the financial markets to make these sales transparent and easy to transact.
Conclusion

The very extensive expansion of Reg A+ over the old Regulation A was a much needed advance by the SEC, which will give mid-sized companies a new way to potentially raise capital.

Reg A+ is a welcome addition to the capital market. Security Issuers now have access to up to $50 million dollars per company per year in investment capital under Reg A+.

It may be wise for companies to “Test The Waters” for investors before committing fully to funding the Regulation A+ filing process at the SEC which is costly and time consuming. TestingTheWaters™ will benefit investors, as it will allow them to know which investment opportunities may be arising, and reserve themselves investment space before they are oversubscribed.