THE NATIONAL LAW REVIEW

Raising Capital from Individual Investors Using Regulation A+

Saturday, July 8, 2017

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Raising capital is essential to startups, and a new option to fundraising allows you to raise money from individual investors through the Securities and Exchange Commission's (SEC) Regulation A+. We'll explore the different aspects of Regulation A+ to see if it's right for you.

For decades, companies had two basic choices for capital raising: a full-blown initial public offering (IPO) or a private placement to accredited investors only. IPO's are a major undertaking, and private placements are limited to accredited investors who meet certain income or net worth standards (in general, accredited investors translates into people who are millionaires). But now there is a new option available to companies: SEC Regulation A+, which I describe as “IPO lite”.

Why Not Do a Full-Blown IPO?

Here is an interesting fact: there are only half as many public companies today as there were in 1996 (a drop from 7,400 public companies to 3,700 today). Twenty-plus years ago, many small companies aspired to go public because it showed that you had “made it” as a company. But things have changed. Many companies have merged into other companies or have “gone private” to avoid the cost and complexity of being a public company. You have to be pretty far along in your business to do an IPO; it requires extensive filings with the SEC and ongoing compliance.

What About Private Placement?

Instead of going public, many companies opt to raise money using private placements to accredited investors. Most angel investments, investment funds and venture capital investments are structured this way. Federal and state securities agencies take a hands-off approach to these offerings. The theory is that accredited (high net worth) investors can protect themselves. But private placements typically do not include people who do not qualify as “accredited” (most people in America). *(See our previous post on accredited investors for more information.)*

Regulation A+

But now there is a third path to raising money. The SEC revamped Regulation A (Reg A) two years ago. Often referred to as “Regulation A+”, it can be an attractive approach for companies that are not ready to do an IPO and do not want to limit themselves to accredited investors. If your company is eligible and follows the A+ procedures, then you can offer and sell securities (typically common stock) to individual investors.

The revamped Reg A includes many detailed requirements. Here are a few highlights:

- Each company chooses “Tier 1” or “Tier 2”.
- Tier 1 is for offerings up to $20 million. Audited financial statements are not required, but companies must comply with state securities laws (blue sky laws) in each state where they offer securities.
- Tier 2 allows offerings up to $50 million. Audited financial statements are required. But Tier 2 offerings are not reviewed and registered at the state level.
- Reg A companies must file detailed offering documents with the SEC.

- Tier 2 companies must file ongoing disclosure documents with the SEC. Tier 1 companies do not have ongoing reporting requirements.

Here are some practical tips for companies pursuing a Reg A offering:

- Use Tier 2 if possible. Tier 2 “pre-empts” review by state securities regulators, which can be a major expense and potential roadblock for Tier 1 companies.
- Companies with products and businesses that can be easily understood by individuals make the best candidates.
- Selling stock is hard work. Raising $3 million at $10,000 per investor requires 300 investors. Consider hiring a broker-dealer or crowdfunding firm to help you with the many aspects of identifying and getting commitments from investors.
- Coordinate with your broker/marketing firm, your lawyer and your accountant to make sure everyone is on the same page about how the offering will work.

In the first 16 months after the SEC revamped Regulation A, 147 companies filed with the SEC to do a Regulation A+ offering (compared to only 11 filings in all of 2011). The median time is 78 days from the initial filing with the SEC until they declare the offering “qualified” so that sales may be made.

It will be interesting to see if Regulation A+ takes off and becomes a useful tool to companies in the years to come.

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