Small Business and the SEC

A guide for small businesses on raising capital and complying with the federal securities laws

Important Note

This guide reflects the views of the staff of the Division of Corporation Finance of the Securities and Exchange Commission (the "SEC"). It is not intended to express any statements of the SEC, and the SEC has neither approved nor disapproved its contents.

This guide is not a legal interpretation or statement of SEC policy, nor is it a comprehensive manual on the regulation of private securities offerings, registered public offerings or the laws and regulations applicable to small businesses. This guide is not intended to provide legal advice of the SEC or the SEC staff and is not a substitute for, and may not be relied on instead of, the federal securities laws themselves, the SEC's regulations and forms, and the advice of knowledgeable advisors.

This guide provides links to various statutes and rules that may lead to pages with lists of rules and regulations. Before clicking a link, please note the name or number of the rule or regulation you seek.

All the SEC laws, rules, forms and regulations associated with the Securities Act of 1933 and Exchange Act of 1934 are accessible from the SEC's home page by clicking on "Divisions—Corporation Finance" and then clicking on "Statutes, Rules and Forms."

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What are the federal securities laws?

In the 1920s, companies often sold stocks and bonds on the basis of glittering promises of fantastic profits and without disclosing any meaningful information to investors. Following the stock market crash of 1929, the U.S. Congress enacted the federal securities laws and created the SEC to administer them.

There are two primary sets of federal securities laws that come into play when a company wants to offer and sell its securities:

- Securities Act of 1933 ("Securities Act").
- Securities Exchange Act of 1934 ("Exchange Act").

Securities Act

The Securities Act regulates offers and sales of securities in the United States or that use the means of interstate commerce, such as the internet, U.S. telephone lines or the U.S mail. For offerings to the public, the Securities Act generally requires the company to file a registration statement containing information about itself, the securities it is offering and the offering. The SEC staff reviews these registration statements to see if the SEC's disclosure rules are satisfied. The SEC does not evaluate the merits of securities offerings, or determine whether the securities offered are "good" investments or appropriate for a particular type of investor. Once the review is completed, the staff declares the registration statement "effective," allowing it to be used to complete sales to investors. We describe this process in more detail below under "How does my small business register a public offering?"

In some circumstances, the Securities Act permits offers and sales of securities to occur without SEC registration. We describe these "exemptions" from the registration

requirements below under "Can my company legally offer and sell securities without registering with the SEC?"

Exchange Act

The Exchange Act requires companies that meet certain thresholds to report information regularly about their business operations, financial condition, and management. These companies must file periodic reports or other information with the SEC. In some cases, the company must deliver the information directly to investors. We discuss these obligations more fully below.

How can I get answers to my questions on the federal securities laws?

This guide provides general answers to certain questions regarding the federal securities laws, but is not comprehensive. More information is available from private securities lawyers and on the SEC website, as discussed below, and from the sources discussed under "Where can I go for more information?"

Consider consulting a securities lawyer

Companies should always consider consulting a securities lawyer before engaging in any securities offering. You may be able to find a securities lawyer at the findlegalhelp.org website sponsored by the American Bar Association, or by contacting the bar association in the state where you live.

SEC website

The SEC maintains a website at www.SEC.gov containing information on the federal securities laws. You can find information on the website tailored for small businesses at "Information for—Small Businesses." You can also find documents filed by companies, such as registration statements and periodic reports, at "Filings—Search for Company Filings."

How can my small business raise capital?

A small business can raise capital in a number of different ways, including borrowing money from banks, other financial institutions or friends/family and by selling securities. If a small business is offering and selling securities, even if to just one person, the offer and sale of the securities must either be registered with the SEC or conducted in accordance with one of the many registration exemptions under the Securities Act. Registering an offering with the SEC would make your company a public company. Going public is a very significant step for any company.

Should my company "go public"?

Potential advantages:

Companies go public for a number of reasons, and these reasons can be different for each company. Some of the reasons include:

- To raise capital and potentially broaden opportunities for future access to capital.

- To increase liquidity for a company's stock, which may allow owners and employees to more easily sell stock.
- To acquire other businesses with the public company's stock.
- To attract and compensate employees with public company stock and stock-option compensation.
- To create publicity, brand awareness, and prestige for a company.

Before deciding to become a public company, there are important factors to consider:

- Your company's public offering will take time and money to accomplish.
- Your company will take on significant new obligations, such as filing SEC reports and keeping shareholders and the market informed about the company's business operations, financial condition, and management, which will take a significant amount of time for your company's management and result in additional costs.
- Your company and you may be liable if these new legal obligations are not satisfied.
- You may lose some flexibility in managing your company's affairs, particularly when public shareholders must approve your company's actions.
- Information about your company, such as financial statements and disclosures about material contracts, customers and suppliers, will become available to the general public (including your competitors).

How does my small business register a public offering?

If you decide on a registered public offering, the Securities Act requires your company to file a registration statement with the SEC before it may offer its securities for sale. This process is often referred to as an initial public offering, or "IPO." Your company may not actually sell the securities covered by the registration statement until the SEC staff declares the registration statement "effective."

Registration statements have two principal parts

- Part I is the prospectus, the legal offering or "selling" document. Your company—the "issuer" of the securities—must describe in the prospectus important facts about its business operations, financial condition, results of operations, risk factors, and management. It must also include audited financial statements. The prospectus must be delivered to everyone who buys the securities, as well as anyone who is made an offer to purchase the securities.
- Part II contains additional information that the company does not have to deliver to investors but must file with the SEC, such as copies of material contracts.

The basic form for registration statements—Form S-1

All companies may use SEC Form S-1 to prepare a registration statement for a securities offering. The prospectus you include in the registration statement should provide clear, readable information written in plain English.

If your company decides to prepare and file a registration statement using Form S-1, it must include specified disclosures about the company in the prospectus, including:

- a description of your company's business, properties, and competition;
- a description of the risks of investing in your company;
- a discussion and analysis of the company's financial results and financial condition as seen through the eyes of management;
- the identity of the company's officers and directors and their compensation;
- a description of material transactions between the company and its officers, directors, and significant shareholders;
- a description of material legal proceedings involving the company and its officers and directors; and
- a description of the company's material contracts.

The company must also provide information about the offering, including:

- a description of the securities being offered;
- the plan for distributing the securities; and
- the intended use of the proceeds of the offering.

Information about how to prepare these and other non-financial disclosures in the registration statement is set out in Regulation S-K, which contains form and content rules for non-financial portions of registration statements. In addition, the SEC staff has issued guidance to aid small businesses in preparing these disclosures for initial public offerings of securities.

Registration statements also must include financial statements that comply with the form and content requirements of Regulation S-X. For most companies, financial statements must be prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). Companies that are organized outside of the United States and that meet the requirements to be a "foreign private issuer" under Rule 3b-4(c) may prepare their financial statements under U.S. GAAP or under international financial reporting standards or generally accepted accounting principles in their home jurisdiction, with reconciliation to U.S. GAAP on certain key line items if required.

Annual financial statements must be audited by an independent certified public accountant registered with the Public Company Accounting Oversight Board or "PCAOB." The PCAOB

registers and regulates public accounting firms that audit financial statements filed with the SEC.

In addition to the information expressly required by Form S-1, your company also must provide any other information that is necessary to make your disclosures not misleading.

Alternative disclosure requirements for small businesses and newly public companies

Securities laws and SEC rules allow certain smaller companies and newly public companies to prepare their disclosures using rules designed to make compliance easier.

Smaller Reporting Company. If your company qualifies as a "smaller reporting company," as defined in Item 10(f)(1) of Regulation S-K, it may choose to prepare the disclosure in the prospectus relying on disclosure requirements that are scaled for smaller companies. These requirements are found primarily in paragraphs labeled "smaller reporting companies" within Regulation S-K and in Article 8 of Regulation S-X.

A company qualifies as a "smaller reporting company" if its public equity float is less than $75 million or, if it cannot calculate its public equity float, it has less than $50 million in annual revenue. Public equity float is calculated by multiplying the number of the company's common shares held by the public by the market price and, in the case of an IPO, adding to that number the product obtained by multiplying the common shares covered by the registration statement by their estimated public offering price.

The disclosure requirements scaled for smaller reporting companies permit your company, among other things to:

- include less extensive narrative disclosure than required of other reporting companies, particularly in the description of executive compensation;
- provide audited financial statements for two fiscal years, in contrast to other reporting companies, which must provide audited financial statements for three fiscal years; and
- not have to provide an auditor attestation of internal control over financial reporting, which is generally required for SEC reporting companies under Sarbanes-Oxley Act Section 404(b).

Emerging Growth Company. If your company qualifies as an "emerging growth company," as defined in Section 2(a)(19) of the Securities Act, it may choose to follow disclosure requirements that are scaled for newly public companies.

A company qualifies as an emerging growth company if it has total annual gross revenues of less than $1 billion during its most recently completed fiscal year and, as of December 8, 2011, had not sold common equity securities under a registration statement. A company continues to be an emerging growth company for the first five fiscal years after it completes an IPO, unless one of the following occurs:

- its total annual gross revenues are $1 billion or more;

- it has issued more than $1 billion in non-convertible debt in the past three years; or
- it becomes a "large accelerated filer," as defined in Exchange Act Rule 12b-2.

Emerging growth companies, among other things, are permitted to:

- follow the smaller reporting company requirements for disclosure and audited financial statements;
- not have to provide an auditor attestation of internal control over financial reporting under Sarbanes-Oxley Act Section 404(b); and
- choose not to become subject to certain changes in accounting standards.

The filing process; confidential filing for some issuers

Registration statements must be filed with the SEC using the SEC's Electronic Data Gathering, Analysis and Retrieval (EDGAR) system. In general, anyone can see the information and documents your company files as part of Part I and Part II of the registration statement, by looking it up on the SEC website.

If your company is an "emerging growth company," however, its initial filings can be made on a confidential basis. If your company is a "foreign private issuer" under Rule 3b-4, it may also submit its initial filings on a non-public basis.

SEC staff review of registration statements

The SEC staff examines registration statements for compliance with disclosure requirements, but does not evaluate the merits of the securities offering or determine whether the securities offered are "good" investments or appropriate for a particular type of investor.

If a filing or confidential submission appears incomplete or if the staff has questions regarding the registration statement or the offering, they usually inform the company with an initial "comment letter," typically within 30 days after filing or confidential submission. The company may file correcting or clarifying amendments to respond to the comments. The initial comment letter may be followed by additional comment letters. The review process is not subject to time limits.

Once the company has satisfied the disclosure requirements, the staff declares the registration statement "effective." The company may then complete sales of its securities.

More information on the process for SEC review of registration statements is available on the SEC website at http://www.sec.gov/divisions/corpfin/cffilingreview.htm.

If my company goes public, what disclosures must it regularly make and what other rules apply?

Reporting obligations because of Securities Act registration

Once the SEC staff declares your company's Securities Act registration statement effective, the company becomes subject to Exchange Act reporting requirements. These rules require your company to file annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K with the SEC on an ongoing basis. If your company qualifies as a "smaller reporting company" or an "emerging growth company," it will be eligible to follow scaled disclosure requirements for these reports.

Once your company begins reporting, it will be required to continue reporting unless it satisfies one of the following "thresholds," in which case its filing obligations are suspended:

- your company has fewer than 300 shareholders of record of the class of securities offered (1,200 shareholders of record if your company is a bank or bank holding company); or
- your company has fewer than 500 shareholders of record of the class of securities offered and less than $10 million in total assets for each of its last three fiscal years.

If your company is subject to Exchange Act reporting requirements, it must file with the SEC much of the same information about the company as is required in the registration statement for a public offering, described above.

All of this information must be filed electronically with the SEC through its EDGAR system, and will immediately become publicly available upon filing. Your company's CEO and CFO must certify the financial and certain other information contained in annual reports on Form 10-K and quarterly reports on Form 10-Q.

Your company must file current reports on Form 8-K to report a wide range of specified events, some within four business days after occurrence of the event. Examples of the events that trigger this requirement are:

- entry into and termination of a material definitive agreement (a copy of the agreement must also be publicly filed);
- completion of an acquisition or disposition of assets;
- notice of a delisting or failure to satisfy a continued listing rule or standard or transfer of listing;
- unregistered sales of equity securities;
- material modifications to rights of security holders;
- changes in your company's certifying accountant;
- changes in control of the company;
- election of directors, appointment of principal officers, and departure of directors and principal officers; and
- amendments to charter and bylaws.

Exchange Act registration requirements

Even if your company has not issued securities under a registration statement declared effective by the SEC staff, it could still become an SEC reporting company. In general, your company will be required to file a registration statement under Section 12 of the Exchange Act registering the pertinent class of securities if:

- it has more than $10 million in total assets and a class of equity securities, like common stock, that is held of record by either (1) 2,000 or more persons or (2) 500 or more persons who are not accredited investors; or

- it lists the securities on a U.S. exchange.

For banks and bank holding companies, the threshold is 2,000 or more holders of record; the separate registration trigger for 500 or more non-accredited holders of record does not apply.

In calculating the number of holders of record for purposes of determining whether Exchange Act registration is required, your company may exclude persons who acquired their securities under an employee compensation plan in a transaction that was exempt from Securities Act registration. Once the SEC adopts rules to permit crowdfunding as contemplated by the JOBS Act, which we describe in more detail below, your company will also be able to exclude holders of securities issued under the JOBS Act crowdfunding exemption.

The information about the company required for an Exchange Act registration statement is similar to what is required for a registration statement under the Securities Act.

Exchange Act reporting and other requirements

If your company files a registration statement under Section 12 of the Exchange Act, it becomes an SEC reporting company and subject to the same annual, quarterly, and current reporting obligations that result from Securities Act registration described above. In addition, the company's shareholders and management become subject to various requirements discussed below.

Proxy rules

A company with Exchange Act-registered securities must comply with the SEC's proxy rules whenever its management submits proposals to shareholders that will be subject to a shareholder vote, usually at a shareholders' meeting. These rules get their name from the common practice of management asking shareholders to provide them with a document called a "proxy card" granting authority to vote the shareholders' shares at the meeting. The proxy rules require the company to provide certain disclosures in a proxy statement to its shareholders, together with a proxy card in a specified format, when soliciting authority to vote the shareholders' shares. Proxy statements describe matters up for shareholder vote, and include management and executive compensation information if the shareholders are voting for the election of directors.

If shareholders will take action on a matter but management is not soliciting proxies, the company must provide shareholders with an information statement that is similar to a proxy statement. The proxy rules also require the company to send an annual report to shareholders if the shareholders are voting for directors. The proxy rules also govern when

your company must provide shareholder lists to investors and when it must include a proposal from a shareholder in its proxy statement or information statement.

Beneficial ownership reports

If your company has registered a class of its equity securities under the Exchange Act, shareholders who acquire more than 5% of the outstanding shares of that class must file beneficial owner reports on Schedule 13D or 13G until their holdings drop below 5%. These filings contain background information about the shareholders who file them as well as their investment intentions, providing investors and the company with information about accumulations of securities that may potentially change or influence company management and policies.

Transaction reporting by officers, directors and 10% shareholders

Section 16 of the Exchange Act applies to an SEC reporting company's directors and officers, as well as shareholders who own more than 10% of a class of the company's equity securities registered under the Exchange Act. The rules under Section 16 require these "insiders" to report most of their transactions involving the company's equity securities to the SEC within two business days.

Section 16 also establishes mechanisms for a company to recover "short swing" profits, or profits an insider realizes from a purchase and sale of the company's security that occur within a six-month period. In addition, Section 16 prohibits short selling by insiders of any class of the company's securities, whether or not that class is registered under the Exchange Act.

Loans to directors and officers

Section 13(k) of the Exchange Act prohibits SEC reporting companies from making personal loans to their directors and officers. Loans made in the ordinary course of business at market rates by issuers that are financial institutions or in the business of consumer lending are excepted from the prohibition.

Tender offers

The SEC's tender offer rules apply to transactions in which a public company faces a third-party tender offer or "takeover." The rules also apply if a public company makes a tender offer for its own securities. The filings required by these rules provide information to the holders of the securities about the person making the tender offer and the terms of the offer. The company that is the subject of a takeover must file its responses to the tender offer with the SEC. The rules also set minimum time periods for the tender offer and provide other protections to shareholders.

Listing standards

If your company lists its securities on a securities exchange such as the Nasdaq or New York Stock Exchange, it will be subject to the rules or "listing standards" governing all companies listed on that exchange, including rules on corporate governance and audit committees. Companies whose securities are not listed on an exchange but are traded only through the

facilities of the OTC Bulletin Board or OTC Markets Group's OTC Link typically are not subject to additional standards on corporate governance and audit committees.

Whistleblower protection

Employees of SEC reporting companies may not be discharged or disciplined for providing information to authorities on possible fraud against the company's shareholders. In 2011, the SEC established the Office of the Whistleblower as required under Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Dodd-Frank Act directs the SEC in certain circumstances to make monetary awards to eligible individuals who voluntarily provide information that leads to successful SEC enforcement actions.

Can my company legally offer and sell securities without registering with the SEC?

Your company's securities offering may qualify for one of several exemptions from the registration requirements of the Securities Act. We explain the most common ones below. You must remember, however, that all securities transactions, even exempt transactions, are subject to the antifraud provisions of the federal securities laws. This means that you and your company will be responsible for false or misleading statements that you or others on your behalf make regarding your company, the securities offered, or the offering. You and your company are responsible for any such statements, whether made by your company or on behalf of the company, and regardless of whether they are made orally or in writing.

The government enforces the federal securities laws through criminal, civil and administrative proceedings. Private parties also can bring actions under certain securities laws. Also, if all conditions of the exemptions are not met, purchasers may be able to return their securities and obtain a refund of their purchase price.

In addition, offerings that are exempt from provisions of the federal securities laws may still be subject to the notice and registration requirements of various state laws. You should make sure to check with the appropriate state securities regulators before proceeding with your company's offering. For more information on these requirements, see "Do state law requirements apply in addition to federal requirements?" You can find contact information for state securities regulators on the website of the North American Securities Administrators Association.

Non-public offering (private placement) exemption

Section 4(a)(2) of the Securities Act exempts from registration "transactions by an issuer not involving any public offering." To qualify for this exemption, which is sometimes referred to as the "private placement" exemption, the purchasers of the securities must:

- either have enough knowledge and experience in finance and business matters to be "sophisticated investors" (able to evaluate the risks and merits of the investment), or be able to bear the investment's economic risk;
- have access to the type of information normally provided in a prospectus for a registered securities offering; and

- agree not to resell or distribute the securities to the public.

In general, public advertising of the offering, and general solicitation of investors, is incompatible with the non-public offering exemption.

The precise limits of the non-public offering exemption are not defined by rule. As the number of purchasers increases and their relationship to the company and its management becomes more remote, it is more difficult to show that the offering qualifies for this exemption. If your company offers securities to even one person who does not meet the necessary conditions, the entire offering may be in violation of the Securities Act.

Rule 506(b) provides objective standards that your company can rely on to meet the requirements of the Section 4(a)(2) non-public offering exemption. Rule 506(b) is part of Regulation D, which is described more fully below.

Regulation D — Rules 504, 505 and 506

Regulation D contains Rules 504, 505 and 506, which establish exemptions from Securities Act registration. The only filing requirement under each of these exemptions is the requirement to file a notice on Form D with the SEC. The notice must be filed within 15 days after the first sale of securities in the offering. Many states also require the filing of a Form D notice in a Regulation D offering. The main purpose of the Form D filing is to notify federal (and state) authorities of the amount and nature of the offering being undertaken in reliance upon Regulation D.

Some rules under Regulation D specify particular disclosures that must be made to investors, while others do not. Even if your company sells securities in a manner that is not subject to specific disclosure requirements, you should take care that sufficient information is available to investors. All sales of securities are subject to the antifraud provisions of the securities laws. This means that you should consider whether the necessary information was available to investors, and that any information provided to investors must be free from false or misleading statements. Similarly, information should not be omitted if, as a result of the omission, the information that is provided to investors is false or misleading.

Felons and other "bad actors" are disqualified from involvement in Rule 505 and 506 offerings. An issuer seeking reliance on either of these rules is required to determine whether the issuer or any of its covered persons has had a disqualifying event. The list of covered persons and disqualifying events differs for Rules 505 and 506. Issuers relying on Rule 505 must refer to the disqualification provisions of Rule 262 of Regulation A. Issuers relying on Rule 506 will find the applicable disqualification provisions in Rule 506(d). An issuer that is disqualified from these rules may still qualify to apply for a waiver of disqualification. See "Process for Requesting Waivers of 'Bad Actor' Disqualification Under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D" for a description of the waiver process. We address each of the Regulation D exemptions separately below.

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Rule 504. Rule 504, sometimes referred to as the "seed capital" exemption, provides an exemption for the offer and sale of up to $1,000,000 of securities in a 12-month period. Your company may use this exemption so long as it is not a blank check company and is not subject to Exchange Act reporting requirements. In general, you may not use general

solicitation or advertising to market the securities, and purchasers generally receive "restricted securities." Purchasers of restricted securities may not sell them without SEC registration or using another exemption, which is further explained below under the heading "Resales of restricted securities." Investors should be informed that they may not be able to sell securities of a non-reporting company for at least a year without the issuer registering the transaction with the SEC.

Your company may, however, use the Rule 504 exemption for a public offering of its securities with general solicitation and advertising, and investors will receive non-restricted securities, under one of the following circumstances:

- It sells in accordance with a state law that requires the public filing and delivery to investors of a substantive disclosure document; or
- It sells in accordance with a state law that requires registration and disclosure document delivery and also sells in a state without those requirements, so long as your company delivers to all purchasers the disclosure documents mandated by a state in which it registered; or
- It sells exclusively according to state law exemptions that permit general solicitation and advertising, so long as sales are made only to "accredited investors" (we describe the term "accredited investor" in more detail below in connection with our description of Rule 506 offerings).

Rule 505. Rule 505 provides an exemption for offers and sales of securities totaling up to $5 million in any 12-month period. Under this exemption, your company may sell to an unlimited number of "accredited investors" and up to 35 persons that are not accredited investors. Purchasers must buy for investment purposes only, and not for the purpose of reselling the securities. The issued securities are "restricted securities," meaning purchasers may not resell them without registration or an applicable exemption, as explained below under the heading "Resales of restricted securities." If your company is not an SEC reporting company, investors should be informed that they may not be able to sell securities for at least a year without the company registering the transaction with the SEC. Your company may not use general solicitation or advertising to sell the securities.

Under Rule 505, if your offering involves any purchasers that are not accredited investors, you must give these purchasers disclosure documents that generally contain the same information as those included in a registration statement for a registered offering. There are also financial statement requirements that apply to Rule 505 offerings involving purchasers that are not accredited investors. For instance, if financial statements are required, they must be audited by a certified public accountant. You must also be available to answer questions from prospective purchasers who are not accredited investors.

You may decide what information to give to accredited investors, so long as it does not violate the antifraud prohibitions of the federal securities laws. If your company provides information to accredited investors, it must make this information available to the non-accredited investors as well.

Rule 506. Rule 506 provides two different ways of conducting a securities offering that is exempt from registration: Rule 506(b) and Rule 506(c). Rule 506(b) is a long-standing rule. Rule 506(c) was added in 2013 to implement a statutory mandate under the JOBS Act.

Rule 506(b). As discussed earlier, Rule 506(b) is a "safe harbor" for the non-public offering exemption in Section 4(a)(2) of the Securities Act, which means it provides specific requirements that, if followed, establish that your transaction falls within the Section 4(a)(2) exemption. Rule 506 does not limit the amount of money your company can raise or the number of accredited investors it can sell securities to, but to qualify for the safe harbor, your company must:

- not use general solicitation or advertising to market the securities;
- not sell securities to more than 35 non-accredited investors (unlike Rule 505, all non-accredited investors, either alone or with a purchaser representative, must meet the legal standard of having sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment);
- give non-accredited investors specified disclosure documents that generally contain the same information as provided in registered offerings (the company is not required to provide specified disclosure documents to accredited investors, but, if it does provide information to accredited investors, it must also make this information available to the non-accredited investors as well);
- be available to answer questions from prospective purchasers who are non-accredited investors; and
- provide the same financial statement information as required under Rule 505.

Rule 506(c). To implement Section 201(a) of the JOBS Act, the SEC promulgated Rule 506(c) to eliminate the prohibition on using general solicitation under Rule 506 where all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors.

Under Rule 506(c), issuers may offer securities through means of general solicitation, provided that:

- all purchasers in the offering are accredited investors,
- the issuer takes reasonable steps to verify their accredited investor status, and
- certain other conditions in Regulation D are satisfied.

An "accredited investor" is:

- a bank, insurance company, registered investment company, business development company, or small business investment company;
- an employee benefit plan (within the meaning of the Employee Retirement Income Security Act) if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;
- a tax exempt charitable organization, corporation or partnership with assets in excess of $5 million;

- a director, executive officer, or general partner of the company selling the securities;
- an enterprise in which all the equity owners are accredited investors;
- an individual with a net worth of at least $1 million, not including the value of his or her primary residence;
- an individual with income exceeding $200,000 in each of the two most recent calendar years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; or
- a trust with assets of at least $5 million, not formed only to acquire the securities offered, and whose purchases are directed by a person who meets the legal standard of having sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment.

Purchasers receive "restricted securities" in a Rule 506 offering. Therefore, they may not freely trade the securities after the offering, as explained below under the heading "Resales of restricted securities."

Section 18 of the Securities Act provides a federal preemption or exemption from state registration and review of private offerings that are exempt under Rule 506. The states still have authority, however, to investigate and bring enforcement actions for fraud, impose state notice filing requirements and collect state fees.

Regulation A

Regulation A is an exemption for public offerings not exceeding $5 million in any 12-month period. If you choose to rely on this exemption, your company must file an offering statement with the SEC on Form 1-A, consisting of a notification, offering circular, and exhibits. The SEC staff will review this offering statement.

Felons and other "bad actors" are disqualified from Regulation A. An issuer seeking reliance on Regulation A is required to determine whether the issuer or any of its covered persons has had a disqualifying event. The list of covered persons and disqualifying events appear in Rule 262 of Regulation A. An issuer that is disqualified from these rules may still qualify to apply for a waiver of disqualification. See "Process for Requesting Waivers of 'Bad Actor' Disqualification Under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D" for a description of the waiver process.

Regulation A offerings share many characteristics with registered offerings. For example, purchasers must be provided with an offering circular similar to a prospectus. Just as in registered offerings, the securities can be offered publicly, using general solicitation and advertising, and purchasers do not receive "restricted securities," as explained below under the heading "Resales of restricted securities." The principal differences between Regulation A offerings and registered public offerings are:

- financial statements for a Regulation A offering are simpler and do not need to be audited unless audited financial statements are otherwise available;
- Regulation A issuers do not incur either Exchange Act reporting obligations after the offering or Sarbanes-Oxley Act obligations applicable only to SEC reporting

companies, unless the company meets the thresholds that trigger Exchange Act registration;

- companies may choose among three formats to prepare the Regulation A offering circular, one of which is a simplified question-and-answer document; and
- companies may "test the waters" to determine market interest in their securities before going through the expense of filing with the SEC.

SEC reporting companies are not eligible to use Regulation A. All other types of companies may use Regulation A, except development stage companies without a specified business (for example, "blank check companies") and investment companies registered or required to be registered under the Investment Company Act of 1940. In most cases, shareholders may use Regulation A to resell up to $1.5 million of securities.

The "test the waters" provisions of Regulation A allow companies to publish or deliver a written document to prospective purchasers or make scripted radio or television broadcasts to determine whether there is an interest in their contemplated securities offering before filing an offering statement with the SEC. This gives companies the opportunity of being able to determine whether enough market interest in their securities exists before they incur the full range of legal, accounting, and other costs associated with filing an offering statement with the SEC. Companies may not, however, solicit or accept money for securities offered under Regulation A until the SEC staff completes its review of the filed offering statement and the company delivers offering materials to investors.

Accredited investor exemption—Section 4(a)(5)

Section 4(a)(5) of the Securities Act exempts from registration offers and sales of securities to accredited investors when the total offering price is less than $5 million.

The definition of accredited investor is the same as that used in Regulation D, which is summarized above. Like the exemptions in Rule 505 and 506, this exemption does not permit any form of general solicitation or advertising. There are no document delivery requirements, but all transactions are subject to the antifraud provisions of the securities laws.

Intrastate offering exemption

Section 3(a)(11) of the Securities Act is generally known as the "intrastate offering exemption." This exemption facilitates the financing of local business operations. To qualify for the intrastate offering exemption, your company must:

- be organized in the state where it is offering the securities;
- carry out a significant amount of its business in that state; and
- make offers and sales only to residents of that state.

The intrastate offering exemption does not limit the size of the offering or the number of purchasers. Your company must determine the residence of each offeree and purchaser. If any of the securities are offered or sold to even one out-of-state person, the exemption may be lost. Without the exemption, the company could be in violation of the Securities Act.

If a purchaser resells any of the securities to a person who resides outside the state within a short period of time after the company's offering is complete (the usual test is nine months), the entire transaction, including the original sales made within the required state, might violate the Securities Act.

Your company may have difficulty relying on the intrastate exemption unless you know the persons to whom the securities are offered and the actual purchasers, and the sale is directly negotiated with them. If your company holds some of its assets outside the state, or derives a substantial portion of its revenues outside the state where it proposes to offer its securities, it may also have difficulty qualifying for the exemption.

You may follow Rule 147, a "safe harbor" rule, to ensure that you meet the requirements for the intrastate offering exemption. It is possible, however, that transactions not meeting all the requirements of Rule 147 may still qualify for the exemption.

Coordinated limited offering exemption under California law — Rule 1001

SEC Rule 1001 provides an exemption from the registration requirements of the Securities Act for offers and sales of securities in amounts of up to $5 million that satisfy the conditions of Section 25102(n) of the California Corporations Code. This California law exempts offerings made by California companies to "qualified purchasers" whose characteristics are similar to, but not the same as, accredited investors under Regulation D. The California provisions allow limited general solicitation before sales. Securities issued under this exemption are "restricted securities," meaning they can only be resold by registration or an applicable exemption from SEC registration, as explained below under the heading "Resales of restricted securities."

Exemption for sales of securities through employee benefit plans — Rule 701

SEC Rule 701 exempts certain sales of securities made to compensate employees. This exemption is available only to companies that are not subject to Exchange Act reporting requirements. You can sell at least $1,000,000 of securities under this exemption, regardless of your company's size. You can sell even more if you satisfy certain formulas based on your company's assets or on the number of its outstanding securities. If you sell more than $5 million in securities in a 12-month period, you are required to provide disclosure to your employees that includes certain financial and other information. Employees receive "restricted securities" in these transactions, and may not freely offer or sell them to the public, unless the securities are registered or the holders can rely on an exemption.

Resales of restricted securities

"Restricted securities" are previously-issued securities held by security holders that are not freely tradable because the sale transaction from the issuer to the security holders was a private transaction. After such a private transaction, the security holders can only resell the securities into the market by using an "effective" registration statement under the Securities Act or a valid exemption from the registration requirements of the Securities Act for the resale, such as Rule 144 under the Securities Act.

If holders of restricted securities want to resell using an effective registration statement, the issuing company can provide a registration statement for them to make sales in a public

offering by following the process discussed above for registering a public offering of securities.

Alternatively, a holder of restricted securities can resell using an exemption. For example, Securities Act Rule 144 provides an exemption that permits the resale of restricted securities if a number of conditions are met, including holding the securities for six months or one year, depending on whether the issuer has been filing reports under the Exchange Act. Rule 144 may limit the amount of securities that can be sold at one time and may restrict the manner of sale, depending on whether the security holder is an affiliate. An affiliate of a company is a person that, directly, or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, the company.

What are the new exemptions mandated by the JOBS Act?

The Jumpstart Our Business Startups Act (or JOBS Act), enacted in 2012, is intended, among other things, to reduce barriers to capital formation, particularly for smaller companies. Among other things, the JOBS Act requires the SEC to adopt rules amending existing exemptions and creating new exemptions that permit companies to raise capital without SEC registration. Additional information about the JOBS Act is available here.

Eliminating the ban on general solicitation under Rule 506

The JOBS Act requires the SEC to eliminate the prohibition on the use of general solicitation and general advertising in Rule 506 of Regulation D, so long as all purchasers in the offering are accredited investors and the issuer takes reasonable steps to verify their accredited investor status. Rule 506(c) implements this statutory mandate.

Crowdfunding

The JOBS Act requires the SEC to develop new rules permitting capital raising by "crowdfunding." Crowdfunding is a means to raise money by attracting relatively small individual contributions from a large number of people. In recent years, crowdfunding websites have proliferated to raise funds for charities, artistic endeavors and businesses. These sites did not offer securities, such as an ownership interest or share of profits in a business; rather, money was contributed in the form of donations, or in return for the product being made. The JOBS Act creates an exemption from the registration requirements of the Securities Act that provides for a form of securities crowdfunding.

Under JOBS Act crowdfunding, companies will be limited to raising $1 million in any 12-month period. Companies cannot crowdfund on their own, but will have to engage an intermediary that is registered with the SEC. These intermediaries will be subject to a number of requirements.

Individual investors will be limited in the amount they can invest by way of crowdfunding in any 12-month period to:

> if your annual income or net worth is less than $100,000—the greater of $2,000 or 5 percent of annual income or net worth, or
>
> if your annual income or net worth is more than $100,000—10 percent of annual income or net worth up to a maximum of $100,000.

(When calculating your net worth, you should not count the value of your primary residence.)

The SEC must first write rules that govern how companies can use JOBS Act crowdfunding to raise money from investors and set out the responsibilities of intermediaries. These rules will include what must be disclosed to prospective investors before they decide to participate, as well as requirements for how intermediaries will operate. Initial guidance on crowdfunding intermediaries is available here.

Companies cannot use JOBS Act crowdfunding to raise funds from investors until the SEC adopts these rules.

Expansion of Regulation A

The JOBS Act requires the SEC to develop rules for a new exemption similar to existing Regulation A, which will permit offerings of up to $50 million a year without SEC registration (Regulation A currently has a limit of $5 million).

Like current Regulation A, the new exemption will require the filing of an offering statement that will be subject to review by SEC staff. The new exemption will also permit "testing the waters" in connection with the offering. In a change from current Regulation A, issuers will be required to file audited financial statements annually with the SEC, and may be subject to additional reporting requirements, depending on the terms and conditions the SEC ultimately imposes on the exemption.

Companies cannot use this new exemption until the SEC adopts final rules.

Do state law requirements apply in addition to federal requirements?

Yes. State governments have their own securities laws and regulations. If your company is selling securities, it must comply with both federal regulations and state securities laws and regulations in the states where securities are offered and sold (typically, the states where offerees and investors are based). A particular offering exempt under the federal securities laws is not necessarily exempt from any state laws. Each state's securities laws have their own separate registration requirements and exemptions to registration requirements. To locate a state securities regulator and learn more about a particular state's securities laws, you may visit the website of the North American Securities Administrators Association (NASAA).

Historically, most state legislatures have followed one of two approaches in regulating public offerings of securities, or a combination of the two approaches. Some states review the securities offerings of small businesses to determine whether companies disclose to investors all information needed to make an informed investment decision. Other states also analyze the terms of public offerings using substantive standards to determine whether the structure of the offerings are fair to investors.

To facilitate small business capital formation, NASAA, in conjunction with the American Bar Association, developed the Small Company Offering Registration or "SCOR" program. The program includes a simplified "question and answer" registration form that companies can use as the disclosure document for investors in connection with a Rule 504 offering. The SCOR program was primarily designed for state registration of small business securities

offerings of up to $1 million annually conducted under the SEC's Rule 504 of Regulation D. To assist small business securities issuers in the SCOR program, NASAA maintains a web page providing information on the program.

To assist small businesses seeking to undertake registration of a securities offering in several states, some states coordinate their reviews through a NASAA program called "coordinated review." NASAA maintains a web page that provides information for companies seeking additional information on its coordinated review program.

What resources and opportunities are available through the U.S. Small Business Administration?

When assessing your capital needs, you may want to consider the programs and services offered by the U.S. Small Business Administration (SBA). Congress established the SBA in 1953 to aid, counsel, and protect the interests of the nation's small business community. The SBA accomplishes this in part by working with intermediaries, banks, and other lending institutions to provide loans and surety bonds. Though the SBA does not provide grants to help you start a business, it does provide information on organizations and sites that can assist you in locating special purpose grants. Visit the SBA's website and learn about financing, contracting, disaster assistance, and training opportunities to help your business succeed.

The SBA Answer Desk is a national toll-free telephone service providing information to the public on small business problems and concerns; moreover, this service provides general information about SBA programs and other programs available to assist the small business community. You can contact the SBA Answer Desk by dialing 1-800-U-ASK-SBA (1-800-827-5722) or TTY at (1-800-704) 344-6640, or by e-mailing them at answerdesk@sba.gov.

Where can I go for more information?

Help from the SEC

The SEC maintains a website with features addressing the needs of small businesses. The SEC also provides informal guidance to small businesses by answering telephone and e-mail questions.

SEC website. You can access information addressed specifically to small businesses by visiting the SEC website at www.sec.gov and clicking on "Information for—Small Businesses." The SEC forms and regulations used most frequently by small businesses are available from this location by clicking on "Forms and Regulations." Other SEC forms are available through the online SEC forms list.

The SEC's Division of Corporation Finance maintains a web page that provides tools and resources for obtaining more information on SEC rules affecting smaller companies, including staff interpretations of SEC rules and regulations.

The SEC makes available on its website a number of online publications for investors that are often useful for small businesses.

You can also submit complaints or tips about possible securities laws violations on the SEC's questions and complaints page at http://www.sec.gov/complaint.shtml.

Office of Small Business Policy. The Office of Small Business Policy in the SEC's Division of Corporation Finance acts as an office of advocacy within the SEC to serve small businesses and represent their concerns within the SEC. The staff of the Office of Small Business Policy acts as the SEC's ombudsman for small business.

The Office of Small Business Policy will be glad to assist you with any questions you may have regarding the federal securities laws. You may send them an e-mail message at SmallBusiness@SEC.gov or submit a request for interpretive advice using their online form. You also may reach the office staff at:

Office of Small Business Policy
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-3628
Telephone: (202) 551-3460

SEC Government-Business Forum on Small Business Capital Formation. The SEC sponsors the Government-Business Forum on Small Business Capital Formation. This annual gathering provides the only national forum for small businesses to let officials from the SEC and other parts of the federal government know how laws, rules and regulations impact the ability of small companies to raise capital. The SEC publishes a report on each year's Forum.

SEC small business compliance guides. The SEC publishes small business compliance guides on new rules that may affect small businesses. You can find these guides on the small business compliance guides page of the SEC's website.

Other useful web links, addresses, and contact information

U.S. Small Business Administration: Headquarters Office
409 Third Street, SW
Washington, DC 20416
Telephone: 1-800-U-ASK-SBA
Website: http://www.sba.gov

State securities regulators:

North American Securities Administrators Association, Inc.
750 First Street, N.E., Suite 1140
Washington, DC 20002
Telephone: (202) 737-0900
Website: http://www.nasaa.org

American Bar Association:

You can find legal help with the tools provided by the American Bar Association at

http://apps.americanbar.org/legalservices/findlegalhelp/home.cfm.

How can we improve this guide?

If you have any suggestions about how we can make this guide more useful, please contact the SEC Office of Small Business Policy at the e-mail or postal address or phone number noted above.

http://www.sec.gov/info/smallbus/qasbsec.htm
