

U. S. Securities and Exchange Commission

Briefing Paper: Proposed Regulation D governing the
exempt offers and sales of securities.

[This summary of proposed Regulation D has been prepared to assist persons attending the open Commission meeting scheduled for August 5, 1981, at which time the draft release will be considered. Users of the summary should be aware that it is neither exhaustive nor definitive and that the Commission may determine to make changes in the rulemaking recommendations described herein.]

The Commission today is considering an important proposed new series of rules, designated Regulation D, governing the offers and sales of securities without registration under the Securities Act of 1933. Securities which are sold in limited offering transactions can play an important role in the capital formation process. However the current exemptive regulations have been criticized as unnecessarily complex, burdensome, and limited particularly as applied to small business. The proposed regulation to be considered today is an effort to alleviate some of the compliance burdens by coordinating the various limited offering exemptions, streamlining the existing requirements applicable to private offers and sales of securities, and expanding the amounts which can be so raised. In addition, the exemptive scheme provided by proposed Regulation D is intended to be the basis for a uniform federal-state exemption, in an effort to achieve increased uniformity of regulation at both the federal and state levels. Consequently simultaneous with the consideration by the Commission, the Board of Directors of the North American Securities Administrator's Association

("NASAA") will be soliciting comments on the proposed exemptions from its membership.

The proposed regulation was developed, in part, in response to comments received by the Commission to an advanced notice of proposed rule-making, Securities Act Release No. 6274 (December 23, 1980). At that time, the Commission solicited comments on the interrelationship between certain exemptions from the Securities Act, particularly as they relate to the capital formation needs of small business, as well as whether those exemptions, considered together, provide a coherent scheme for relieving companies of the burdens of the registration provisions consistent with adequate investor protection.

In addition, new Section 19(c) of the Securities Act which was added by the recently enacted Small Business Investment Incentive Act of 1980, authorized the Commission to work closely with state securities associations in encouraging greater uniformity in federal-state securities matters. Section 19(c) is designed to encourage collaborative work on such projects as standardization of forms, the elimination of forms, the elimination of duplication in clearance procedures and the development of a uniform small business exemption. Pursuant to that authority, the Commission's Office of Small Business Policy in the Division of Corporation Finance began developing the proposed regulation as a basis for a uniform federal-state exemption with the cooperative efforts of NASAA's Subcommittee on Small Business Financing.

As a result of the comments received from the Commission's advanced notice of proposed rulemaking and discussions with NASAA's Subcommittee on Small Business Financing, the Commission will today consider the proposed regulation, which would significantly revise current Rules 146, 240 and 242 and consolidate them onto one regulation that would govern transactions involving limited offers and sales of securities. This approach will enable the Commission to define certain common terms, concepts, and requirements uniformly as they are used throughout the proposed regulation. Concurrently, the commission will also consider adopting amendments to the disclosure provisions of Regulation A. All of these initiatives to be considered by the Commission are intended to provide a basic component to other rulemaking initiatives that are part of the Commission's ongoing small business program.

Overview of Proposed Regulation D

Proposed Regulation D is a series of six rules, designated Rules 501-506. Proposed Rule 501 would contain common definitions and terms as they are used throughout the Regulation. Proposed Rule 502 sets forth general conditions to be met which apply to the exemptions contained in the Regulation. Proposed Rule 503 would provide for a uniform notice of sales form, designated Form D, to be used for all exempt offerings pursuant to Regulation D and Section 4(6) of the Securities Act. Finally, proposed Rules 504-506 would contain the specific exemptions from the registration provisions of the Securities Act and would replace current Rules 240, 242, and 146.

Proposed Rule 504 is an expansion of the Commission's current Rule 240. The principal differences between proposed Rule 504 and Rule 240 are: (1) an increase in the limitation on the amount that can be sold in any 12 month period under the Rule from \$100,000 to \$500,000; (2) removal of the prohibition in Rule 240 against the payment of brokerage commissions, provided such commissions are paid to broker-dealers registered both under the Exchange Act and pursuant to applicable regulations in those states in which the securities are to be offered or to any bank as defined in Section 3(a)(2) of the Securities Act; (3) elimination of the requirement that there be no more than 100 shareholders at the time the offer is completed and, in lieu thereof, a restriction on the availability of the rule to issuers not subject to the reporting requirements of the Exchange Act; and (4) elimination of restrictions concerning manner of offering and restrictions on resale where the offering is limited to states in which the offering is registered and a disclosure document is delivered pursuant to applicable state law. As in current Rule 240, no specific disclosure requirements would be prescribed.

Proposed Rule 505 would replace current Rule 242 and continue to permit sales to an unlimited number of accredited investors and to 35 non-accredited investors. The principal features of proposed Rule 505 include: (1) the expansion of the availability of the rule to all issuers regardless of legal structure or line of business; (2) a revision of the informational requirements to provide for information similar

to that provided by Regulation A for offerings in amounts not exceeding \$1,500,000 and Form S-18 type disclosure for offerings in amounts between \$1,500,001 and \$5,000,000; (3) an increase in the aggregate offering limitation from \$2,000,000 in a six month period to \$5,000,000 in a 12 month period; (4) a provision identical to that contained in proposed Rule 504 permitting the payment of brokerage commissions if such commissions are paid to broker-dealers registered both under the Exchange Act and pursuant to applicable regulations in those states in which the securities are to be offered or to any bank as defined in Section 3(a)(2) of the Securities Act; and (5) elimination of the availability of this rule for those issuers who have been subject to the reporting requirements under the Exchange Act for 36 calendar months preceding the offering.

Proposed Rule 506 would modify existing Rule 146 in several respects. Currently, Rule 146 requires the issuer to make a subjective determination prior to making any offers of securities that each offeree has such knowledge and experience in financial matters that he is capable of evaluating the merits and risk of the prospective investment or that such offeree is able to bear the economic risk of the investment. The proposed Rule would eliminate the requirement to determine the qualifications with respect to each offeree whether or not he purchases. The requirement that the issuer make a determination as to the qualifications of the purchaser will be retained in modified form. In addition, proposed Rule 506 would incorporate the accredited investor concept into the rule.

Thus, certain purchasers would be presumed to meet the purchase qualifications, thereby eliminating the need for subjective judgments by the issuer about the suitability of such investors. Proposed Rule 506 would also: (1) eliminate the need to deliver disclosure documents if only accredited investors participate in the transactions; (2) permit sales to a unlimited number of accredited investors and to 35 non-accredited investors provided such non-accredited investors meet certain qualifications; and (3) retain the "purchaser representative" concept to permit the continued participation by persons who, acting alone, may lack the requisite knowledge and experience to independently evaluate the merits and risk of the investment.

Proposed Rule 215

Simultaneous with the consideration of proposed Regulation D, the Commission will also consider proposed Rule 215 which would define "accredited investor" for purposes of Section 4(6) under the Securities Act. This definition would be incorporated into proposed Regulation D in response to commentators who unanimously favored the adoption of a uniform definition of accredited investor. Proposed Rule 215 would expand upon the definition of accredited investor contained in Section 2(15) of the Securities Act and include the following new classes of accredited investor:

- 1) certain private venture capital entities; 2) certain college or university endowment funds; 3) persons who purchase \$100,000 or more of

securities of the issuer with an unconditional obligation to pay to be discharged within 2 years of the first issuance of securities and which is secured by an unconditional letter of credit issued by a bank as defined in Section 3(a)(2) of the Securities Act; 4) any natural person who, at the time of the offering, has a net worth in excess of \$750,000; and 5) any natural person who had an adjusted gross income in excess of \$100,000 as reported for Federal income tax purposes in his most recent tax return.

Amendments to Regulation A

The amendments to Regulation A, which were published for comment in December of 1980 (Securities Act Release No. 6275) involve a comprehensive revision and updating of the disclosure requirements applicable to the offer and sale of securities under Regulation A. The amendments are designed to reduce the time spent in processing and thereby reduce costs by codifying the disclosure policies and practices currently followed on an administrative basis.

FOR FURTHER INFORMATION CONTACT: Paula L. Chester at (202)/272-2644) with respect to Regulation D and Rule 215; Daniel J. Abdun-Nabi at (202)/272-2644 with respect to Regulation A.

APPENDIX A: COMPARATIVE CHART OF SECURITIES ACT LIMITED OFFERING EXEMPTIONS

OPERATION OF EXISTING RULES

OPERATION OF PROPOSED RULES

Comparison Item	Current Rule 240 Proposed Rule 504	Current Rule 242 Proposed Rule 505	Current Rule 146 Proposed Rule 506	Section 4(6) (No change)
Aggregate price Limitation	\$100,000 \$500,000	\$2,000,000 (6 Mos.) \$5,000,000 (12 Mos.)	unlimited No change	\$5,000,000
Number of Inves- tors	100 (total share- holders) Unlimited	35 plus unlimited accredited 35 plus unlimited accredited	35 plus those purchas- ing in excess of \$150,000 offeree and pur- chaser must be sophisticated or wealthy (with representative)	Unlimited accredited only
Investor qualifi- cations	None required None required	Accredited or none required Accredited or none required	Sophisticated (alone or with representative) accredited presumed to be qualified	Accredited
Commissions	prohibited	permitted	permitted	permitted
	permitted provided that such commission or similar re- muneration is paid to a broker-dealer registered both under the Exchange Act and each state or jurisdiction in which the securities are to be sold or a bank			
limitations on Resale	restricted restricted, unless registered in states that require the de- livery of a disclosure document.	restricted	restricted	restricted
		No change		

OPERATION OF EXISTING RULES

OPERATION OF PROPOSED RULES

Comparison Item	<u>Current Rule 240</u> Proposed Rule 504	<u>Current Rule 242</u> Proposed Rule 505	<u>Current Rule 146</u> Proposed Rule 506	<u>Section 4(6)</u> (No change)
Information Requirements	No information specified	(1) Accredited: No specific requirements if purchased solely to accredited. If both accredited and non-accredited involved, all purchasers to be furnished information required if only non-accredited involved. (2) Non-accredited purchasers: (a) Reporting companies - most recent annual report, definitive proxy statements and recent periodic reports. (b) Non-Reporting Companies - info required by Part I of Form S-18 to the extent material with 1 year audited financials	Must furnish (unless offeree has access via economic bargaining power): (1) Below \$1,500,000 info may be limited to Schedule I Reg. A info. (2) other offerings - (a) reporting companies-recent Form S-1 or Form 10, definitive proxy statement and recent periodic reports. (b) Non-reporting companies - info that be required to be included in registration statement on form which issuer would be entitled to use.	No information specified
	no change	(1) Accredited: Same as current Rule 242 (2) Non-accredited (a) Reporting Companies: Most recent annual report to shareholders which meets requirements of Rule 14a-3, all subsequent reports and proxies, and undertaking to furnish Form 10-K; if annual report to shareholders not available, substitute most recent of Form S-1, Form 10-K, and Form 10.		

Comparison Item	Current Rule 240 Proposed Rule 504	Current Rule 242 Proposed Rule 505	Current Rule 146 Proposed Rule 506	Section 4(6) (No change)
Information Requirements (cont'd)	(cont'd)			
	(b) Non-reporting companies \$500,001 - \$1,500,000 - information required by Part II of Form 1-A under Regulation A except 1 year audited financials if obtainable without undue burden or expense; if not balance sheet only must be audited. \$1,500,001 - \$5,000,000 - information required by Part 1 of Form S-18 to extent material.			
	Over \$5,000,000 - info that would be required to be included in registration statement on form which issuer would be entitled to use.			
	If 60% or more of offering is purchased by accredited institutional investors and all others purchase on same or better terms, all other purchasers may receive info received by institutions if requested in writing, as well as info they would be entitled if only non-accredited involved.			
Report of Sales	required as condition of rule, except for first offerings under rule. Form 240	required as a condition of Rule. Form 242	required as a condition of Rule. Form 146	required as condition of exemption Form 4(6)

Required as condition of Rules
Form D

OPERATION OF EXISTING RULES
OPERATION OF PROPOSED RULES

Comparison Item	<u>Current Rule 240</u> Proposed Rule 504	<u>Current Rule 242</u> Proposed Rule 505	<u>Current Rule 146</u> Proposed Rule 506	<u>Section 4(6)</u> (No change)
Issuer qualifications	Any company having more than 100 shareholders at completion of offering is prohibited. No reporting companies.	Limited to domestic or Canadian corporate issuers; limited partnerships, investment companies and oil and gas companies prohibited. investment companies and issuers subject to Exchange Act for 36 consecutive months prohibited.	<u>None</u> no change	None
Manner of offering	no general solicitation permitted no general solicitation unless registered in state that requires the delivery of a disclosure document	<u>No general solicitation permitted</u> no change	no general solicitation permitted	