

U. S. Securities and Exchange Commission

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

[This summary of Regulation D has been prepared to assist persons attending the open Commission meeting scheduled for March 3, 1982, 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.]

Background

The Commission today is considering the publication of a release announcing the adoption of an important 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 regulation to be considered today is a product of the Commission's ongoing small business program designed to evaluate the impact its rules and regulations have on the ability of small businesses to raise capital. Specifically,

through public hearings, and the solicitation of public comments the Commission endeavored to ascertain the extent to which the existing exemptive rules should be modified to provide a more coherent scheme for relieving issuers, particularly smaller companies, of the burdens associated with the raising of capital. Regulation D represents a significant initiative designed 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, Section 19(c) of the Securities Act, which was added by the 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 Regulation D as a basis for a uniform federal-state exemption with the cooperative efforts of the Subcommittee of Small

Business Financing of the North American Securities Administrator's Association. To that end, the exemptive scheme provided by the final regulation is intended to be the basis for a uniform federal-state exemption. Accordingly, it is anticipated that NASAA's Subcommittee on Small Business Financing will be recommending adoption of Regulation D, with modifications, as the basis for its official policy guideline establishing a uniform limited offering exemption.

Overview of Regulation D

Regulation D is a series of six rules, designated Rules 501-506. Rule 501 would contain common definitions and terms as they are used throughout the regulation. Rule 502 sets forth general conditions to be met which apply to the exemptions contained in the regulation. 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, 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.

Rule 504 is an expansion of the Commission's current Rule 240. The principal differences between Rule 504 and Rule 240 are: (1) an increase in the limitation on the amount that can be sold in any 12 month period from \$100,000 to \$500,000; (2) 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 Securities Exchange Act of 1934; (3) removal of the prohibition in Rule 240 against the payment of brokerage commissions; and (4) elimination of restrictions concerning manner of offering and restrictions on resale where the offering is limited to states in which it 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.

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 Rule 505 include: (1) the expansion of the availability of the rule to all issuers regardless of legal structure or line of business; and (2) 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.

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. Rule 506 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, 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. Rule 506:

- (1) would not mandate the delivery of a disclosure document if only accredited investors participate in the transaction;
- (2) would 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) would 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.

Rule 215

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