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March 15, 2018

Capital Access: SEC Regulation A+ ("Mini-IPO")

Companies turn to a variety of sources to access the funding they need to grow and make new investments. Among them are capital markets, segments of the financial system in which capital is raised through equity (representing ownership of a firm) or debt (representing creditorship of a firm) securities. As the principal regulator of U.S. capital markets, the Securities and Exchange Commission (SEC) requires that offers and sales of securities either be registered with the SEC (referred to as *public offerings*), or be undertaken with an exemption from registration (referred to as *private offerings*). Regulation A+ (15 U.S.C. §77a et seq.), or "Mini-IPO," is a regime to facilitate private offerings for small- to medium-sized companies. A mini-IPO is like a regular initial public offering (IPO) in the sense that the securities for the most part can be sold to all investors and not just sophisticated investors, and could potentially be listed on public stock exchanges. But unlike an IPO, it is subject to reduced disclosure requirements and certain offering size and investor limits, among other differences.

Congress has a long-standing concern about helping smaller companies access capital. Despite Regulation A+'s perceived potential as a means of aiding smaller companies, the total offering volume and breadth of participation at the early stage were considered relatively low. In an effort to spur greater use, there are legislative proposals in the 115th Congress to further expand Regulation A+'s upper limit, broaden its eligible issuer base, and to create new venues for its use in resale and trading.

Background

Regulation A was initially adopted under Section 3(b) of the Securities Act in 1936 as a private securities offering that exempts small issuers from certain registration requirements. It was a seldom-used program prior to the Jumpstart Our Business Startups Act (JOBS Act; P.L. 112-106), which was signed into law in 2012. Title IV of the JOBS Act revamped Regulation A (thus the name Regulation A+). The program's annual offering upper limit was increased from $5 million set in 1992 to $50 million through the JOBS Act. Regulation A+ became effective on June 19, 2015. It provides two tiers of offerings.

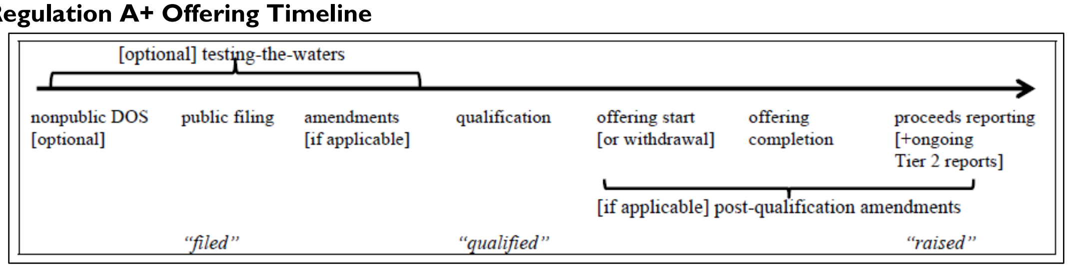
- **Tier 1**. Under the Tier 1 regime, an issuer can conduct securities offerings of up to $20 million in a 12-month period. Tier 1 offerings are subject to both state and federal registration, but have fewer federal-level requirements relative to Tier 2.

- **Tier 2**. Under the Tier 2 regime, an issuer can conduct securities offerings of up to $50 million in a 12-month period. Unlike Tier 1 offerings, Tier 2 offerings are generally not subject to state registration requirements.

As **Figure 1** illustrates, to raise capital through Regulation A+, an issuer first files an offering statement with the SEC. During the filing period, the issuer has the option to file a draft offering statement (DOS), a draft disclosure document that receives confidential review from SEC staff before being formally publicly released. Issuers also have a "testing-the-waters" option that allows for communication with potential investors to gauge their buying interests. The actual sale of Regulation A+ securities takes place after the SEC declares through a "notice of qualification" that the securities are ready for sale. No Regulation A+ securities transactions, payments, or even commitment of future payments are allowed prior to the notice of qualification.

As discussed earlier, Tier 2 offerings are subject only to federal regulation, while Tier 1 offerings are subject to both SEC and state regulation. Each state has its own securities regulators who enforce state laws. These laws cover many of the same areas the SEC regulates, such as the sale of securities and those who sell them, but are confined to securities offerings and sales within each state. Registration requirements can vary from state to state.

Figure 1. Regulation A+ Offering Timeline



Source: Anzhela Knyazeva, *Regulation A+: What Do We Know So Far?,* November 2016.

Market Trends

Private offerings have outpaced public offerings in recent years to become the preferred option for raising capital (much of the growth was driven by other private offering types, instead of Regulation A+), as measured by aggregate capital raised. According to an SEC staff white paper, private debt and equity offerings for 2012 through 2016 combined exceeded public offerings by about 26%. Going public is arguably no longer a necessity for certain private companies to raise capital, at least up to a certain size.

However, concerns persist that smaller companies face difficulties accessing capital. Private offerings are especially important for smaller companies, since they are traditionally viewed as the funding tool for smaller, pre-IPO firms. Though one of the goals of the JOBS Act was to facilitate public offerings for smaller companies, some argue that the JOBS Act has not revived public capital access for smaller companies with market capitalization of less than $75 million. The SEC's Advisory Committee on Small and Emerging Companies stated in May 2017 that "identifying potential investors is one of the most difficult challenges for small businesses trying to raise capital." Smaller companies' relative difficulty accessing capital through public offerings has encouraged the use of private offerings as an alternative funding source. If funding needs remain constant, the increased use of private offerings would reduce the need to go public. It is within this context that Congress has initiated a number of policy changes and legislative proposals focusing on a scaled regulatory approach that would ease smaller firms' access to private offerings, including Regulation A+.

Regulation A experienced a ramp up starting June 19, 2015, when Regulation A+ went into effect. It had 97 qualified offerings seeking $1.8 billion over the initial 18 months after going into effect, a significant increase over the pre-JOBS Act long-term average. Though it increased significantly, its annual volume is relatively low compared to the total private offering issuance of $1.68 trillion in 2016. In addition, instead of being broadly adopted across various sectors, the program so far has mainly been utilized by the financial services industry, with around 37% of the Regulation A+ filings and half of the proceeds going to that sector, according to an SEC staff report.

Furthermore, although securities issued under Regulation A+ have the option to trade on public exchanges, the listing of Regulation A+ securities on public trading platforms is still uncommon. There were reportedly a total of eight listed Regulation A+ offerings in 2017. Seven of the eight listed offerings were trading at an average of 42% below their offer prices (relative to an average price rise of 22% for a traditional IPO in 2017), meaning the listing is rare and they generally underperform traditional IPOs.

Policy Issues

The JOBS Act initiated a number of policy changes to facilitate both public and private offerings for smaller companies. The act has helped focus attention on a scaled regulatory approach that would ease access to private offerings for smaller firms, including through its establishment of Regulation A+. But some argue that because of the relatively low adoption of the regime, more regulatory relief is warranted to further expand Regulation A+. There are legislative proposals in the 115th Congress to expand the amount that can be raised under Regulation A+ (§498 of H.R. 10, which has passed the House, and H.R. 4263, which has been marked up by the Financial Services Committee) and to broaden the eligible issuers for participation (H.R. 2864, which has passed the House, and §508 of S. 2155, which has passed the Senate).

Proponents argue that in its current form, Regulation A+ still faces hurdles in gaining market acceptance because such offerings are said to cost more than traditional private offerings, but tend not to attract major underwriters, broker-dealers, and research coverage, because the deal sizes are small relative to traditional IPOs. By further lifting the upper limit, proponents believe it would potentially alleviate the size-related concerns for market intermediaries. Proponents of a proposal to broaden the eligible issuer base also argue that thousands of SEC reporting companies, which include public companies and voluntary disclosure companies, are not currently able to access Regulation A+. By allowing more companies to participate, the regime would enhance capital formation.

Others consider the expansion of Regulation A+ to potentially reduce incentives for companies to go public, thus undermining public securities markets. This may be considered "harmful" to both investors and markets because public offerings provide greater investor protections and liquidity for trading. Some argue against an immediate expansion, raising concerns that the program is still in its early stage. After all, the upper limit was increased by 10 times to $50 million from $5 million in 2015. The regime's long-term effects have not been observed in full, leading some to question whether now is the optimal time to extend the program, especially given that the SEC already has the discretion to change the size limit.

As mentioned earlier, Regulation A+ securities have no resale restrictions and could potentially trade on public exchanges, but the incidences of exchange-listed trading have been rare. One policy proposal would be to permit the private sector's establishment of a "venture exchange" (§456 of H.R. 10) that would serve as a new market specifically for Regulation A+ and other eligible securities. This new trading platform is believed to be of value to smaller companies seeking capital and liquidity because it creates more exit opportunities for investors by exchanging securities ownership for cash, among other benefits. Opponents of the proposal raise concerns over the viability of a new venture exchange. They cite the failed attempts in the past and the availability of existing infrastructure that could be altered to serve the same needs, which are believed by some to be less opaque and more efficient than establishing a whole new platform. Experts generally believe that, among other things, appropriate regulatory oversight and securities disclosure are the necessary prerequisites for a proposed venture exchange to succeed, which would depend on SEC rulemaking.

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