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## INTRODUCING SILICON PRAIRIE'S MARKETBUILDER™ INVESTOR RELATIONS & REPORTING SERVICES

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### INTRODUCTION

If you intend to raise money using crowdfunding or take your company public, you will need to understand how the [securities registration requirements](#) work and how you may be able to raise money from the correct application of federal and state exemptions from registration.

Until the 1930s, the U.S. capital markets were entirely unregulated. The Wall Street crash of 1929 and the Great Depression that followed persuaded government and industry leaders that something needed to be done. The first result of their resolve was the Securities Act of 1933 (the "Securities Act"). The Securities Act set standards for the disclosure of important information in securities offerings. It specified what information needed to be disclosed and the form in which it needed to be presented. Most importantly, it established a new concept - that to be sold legally, all securities must be registered with the Securities Exchange Commission (the "SEC" or the "Commission") or must qualify for a legitimate exemption from registration.

What was needed next was a way in which the Securities Act could be administered and enforced. In response, Congress passed into law the Securities Exchange Act of 1934 (the "Exchange Act"), which created the SEC. The Securities Act and the Exchange Act are the foundation upon which the authority of the SEC rests. Both have been amended numerous times to keep them current with developments in finance. While the SEC is not perfect, it did bring order out of chaos, and a great many national securities commissions worldwide are based on the principles by which it operates.

### The Securities Act of 1933

The Securities Act became law on May 27, 1933 and was formulated by Congress under the Commerce Clause of the Constitution, which states that Congress shall have "the power to



regulate commerce with foreign nations, and among the several states, and with the Indian Tribes". Before passage of the Act, the issuance and sale of securities was regulated by a patchwork of state securities laws, called "blue sky" laws, that could sometimes be manipulated by issuers to suit their own ends.

The purpose of the new Act was to protect investors by requiring certain disclosures by issuers. Investors needed this information to decide whether an investment was worthwhile. Unlike state blue sky laws, many of which imposed "merit reviews", the provisions of the Securities Act do not address the *quality* of the securities sold in an offering; rather they enumerate the disclosures that must be made and establish a form in which they must be presented.

The central principle set forth in the Act is that all securities sold in the U.S. must be registered or qualify for a legitimate exemption from registration. Some of these exemptions are created by the Act itself, while others are offered by certain state laws. For a company to register securities for sale, it must file a registration statement with the SEC. The registration statement must include a *prospectus*, which markets the stock to the public and includes financial reports and additional information. Issuers can choose from a number of registration forms under the Securities Act, but initial offerings, used when companies first go public, are most commonly registered on Form S-1. Shorter forms used for secondary offerings are available to seasoned issuers. Registration statements must contain expansive disclosures about the issuer and its financial condition.

Securities issued in crowdfunding offerings can also be issued if they qualify for an exemption from registration. Exemptions include private offerings to individuals or institutions, offerings of limited size, and intrastate offerings. The types of crowdfunding offerings discussed below are all exemptions from the registration requirements pursuant to the Securities Act. The Securities Act also provides a common resale exemption used by investors in crowdfunding offerings known as Rule 144.

## **The Securities Exchange Act**

The Securities Act created new rules for securities offerings, but it did not create an entity to administer and enforce those rules. Initially, the Federal Trade Commission ("FTC") saw to enforcement, but on June 6, 1934, Congress passed the Securities Exchange Act, which established the SEC as the nation's federal securities regulator. Joseph P. Kennedy became its first chairman.

The Exchange Act is described in its full title as "An act to provide for the regulation of securities exchanges and of over-the-counter markets... to prevent inequitable and unfair practices on such exchanges and markets..." The Securities Act dealt with what is known as the "primary market"; that is, the market in which companies issue and sell securities directly to investors.

In contrast, the Exchange Act was designed to provide a regulatory structure for the secondary market, where investors trade already-issued securities. It gave the SEC the authority to regulate broker-dealers, self-regulatory organizations, transfer agents, and clearing agents. It also empowered the agency to enforce its own regulations and punish



violators of the securities laws. The Securities Act contained anti-fraud provisions, but the Exchange Act introduced stronger ones, and created an enforcement structure.

One of the most important innovations of the Exchange Act is contained in Sections 12, 13 and 15(d), and requires all issuers that are registrants to make periodic reports to the SEC. These filings include annual reports on Form 10-K that include audited financial statements, quarterly reports on Form 10-Q, material event reports on Form 8-K, and many more.

If you conduct a Regulation A offering, you will be required to provide periodic reports to the SEC. These include one annual report on Form 1-K with audited financial statements, one six-month report on Form 1-SA, and current information reports on Form 1-U.

Originally, all of these reports were prepared on paper and mailed to the SEC, but today investors can file and access them electronically using the EDGAR system. "EDGAR" is an acronym that stands for *Electronic Data Gathering and Retrieval*.

## Crowdfunding Exemptions

Crowdfunding is a great way to raise money to establish and grow your business. In April 2012, Congress passed the *Jumpstart Our Business Startups Act* (the "JOBS Act") which instructed the Securities Exchange Commission (the "SEC") to adopt or amend rules under the Securities Act of 1933, as amended (the "Securities Act") to facilitate capital raising for small companies.

See Table 1 for more detailed information about offerings exempt from SEC registration. In summary, the "crowdfunding" rules include:

- Regulation A ("Reg A+") for securities offerings up to \$75 million per year;
- Regulation Crowdfunding ("Reg CF") for offerings of up to \$5 million per year through registered portals;
- Rule 504 under Regulation D ("Reg D") for limited offerings of up to \$10 million;
- Rule 506(b) under Reg D for limited offerings to *accredited investors*<sup>1</sup>; and
- Rule 506(c) under Reg D for unlimited offerings to accredited investors, provided reasonable verification procedures are followed.

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<sup>1</sup> In general, an *accredited investor* is defined as:

- a. Any natural person:
  - i. Whose individual net worth, or joint net worth with their spouse, exceeds \$1 million, excluding the value of their primary residence;
  - ii. Who had an individual income over \$200,000 in each of the two most recent years and a reasonable expectation of reaching the same income level in the current year;
  - iii. Who had a joint income with their spouse over \$300,000 in each of the two most recent years and a reasonable expectation of reaching the same income level in the current year;
  - iv. Holding a General Securities Representative license (Series 7), a Private Securities Offerings Representative license (Series 82), or an Investment Adviser Representative license (Series 65) in good standing; or
  - v. That is a director or executive officer of the issuer;
- b. Any trust, institution, endowment plan or business with total assets of more than \$5 million and where all of the equity owners are accredited investors.



## State Blue Sky Laws

In addition to federal securities laws, crowdfunding offerings must comply with state laws that regulate the offer and sale of securities. These regulations are often referred to as state “blue sky” laws. Sometimes state blue sky laws are preempted by federal laws. This means that states cannot impose more regulations than those imposed under federal law.

The crowdfunding exemptions listed above are treated differently under state blue sky laws, which can lead to some confusion. For example, offerings under Tier 2 of Reg A+, Reg CF, and Rule 506(c) of Reg D are exempt from compliance with state securities laws while offerings pursuant to Reg A, Tier 1 and Rule 504 are not.

There is some confusion as to whether all state laws related to the offer and sale of securities, such as the requirement that an issuer register as a broker-dealer if there is no FINRA broker-dealer involved, are preempted, so check with counsel as to the status of this issue in the affected states before you start selling securities in each state.

Regardless of which crowdfunding exemption used, state securities regulators retain their authority to:

- Require the filing of any document already filed with the SEC and the payment of filing fees;
- Investigate and bring enforcement actions against the perpetrators of fraudulent securities transactions and unlawful conduct by broker-dealers in such offerings; and
- Enforce the filing and fee requirements by suspending the offer or sale of securities within a given state for the failure to file or pay the appropriate fee.

## Anti-Fraud Provisions

Even though crowdfunding offerings are exempt under most circumstances, the anti-fraud provisions the securities laws mandate disclosure of certain information to investors. Section 10(b) of the Exchange Act prohibits the use of any manipulative or deceptive device in contravention of the SEC’s rules and regulations. For example, Rule 10b-5 was adopted pursuant to Section 10(b) and prohibits fraudulent devices and schemes, material misstatements and omissions of any material facts, and acts and practices that operate as a fraud or deceit on any person in connection with the purchase or sale of a security.

This means that each participant in a company’s offering, including the company itself and its officers, directors, consultants, advisors, underwriters, accountants, and others are potentially liable under this provision. Section 20(a) of the Exchange Act imposes liability on any person who directly or indirectly controls any person liable under Section 10(b) or Rule 10b-5 to the same extent as the controlled person.

Persons participating in crowdfunding offerings can mitigate their exposure by conducting a thorough due diligence review and making appropriate disclosures to their investors.

## Primary Markets

The crowdfunding rules have been successful in generating activity and funding for smaller businesses. According to the SEC, in the five years beginning May 15, 2018 and ending May,



15, 2023, there have been nearly 13,000 Reg CF and over 4,000 Reg A filings. For additional information about recent activity, see the [Fiscal 2022 Annual Report](#) of the SEC's [Office of the Advocate for Small Business Capital Formation](#), specifically the section entitled State of Small Business Capital Formation.

According to a May 4, 2023 article in [The Wall Street Journal](#), [How Investors Can Evaluate Reg A+ and Reg CF Private Offerings](#):

"Securities and Exchange Commission data show offerings using Reg A+ growing to more than \$1 billion in 2019 from roughly \$200 million in 2016. Manhattan Street Capital, an online fundraising platform, estimates that \$1.8 billion was raised through Reg A+ in 2022, and it projects that the 2023 total will be about \$1.6 billion, a slight drop due in part to high market volatility."

According to a February 3, 2023 [article](#) published on [crowdfundinsider.com](#), [Crowdfund Capital Advisors \("CCA"\)](#), a leading authority on the market said:

"In brief, for 2022, Reg CF issuers ... increased slightly to 1,584 in 2022 in comparison to 1,563 in 2021. Looking back, ... in ... 2016, just 188 firms raised capital under the exemption. At the same time, in 2022, 1,132 offerings were funded (452 were not), a slight decline from 2021 as the success rate dipped to 71.5%, from 74.8% in 2021. Total funded capital ... declined to \$506.7 million in 2022 from \$564.5 million in 2021 – about a 10% drop. The average raise declined from \$455,000 in 2021 to \$428,000 in 2022. It is important to remember that the funding cap was raised to \$5 million in 2021 from the prior \$1.07 million. Investment volume since 2016 now stands at around \$1.63 billion ... CCA predicts that the number of issuers will hit a record in 2023, adding that by 2030, Reg CF will be responsible for over \$200 billion being contributed to the economy while creating 2.4 million jobs. In total, there have been 5,588 firms that have raised money using the exemption since 2016.

## **Compliance, Ongoing Reporting & Secondary Markets**

In addition to detailing disclosure rules pursuant to which an issuer may offer and sell securities, the crowdfunding regulations also specify after-market reporting requirements. As shown by Table 1 below, the on-going reporting requirements for a Reg A+ Tier 2 issuer are the most extensive while those under Reg D are non-existent – one must just file a Form D - Notice of Exempt Offering of Securities 15 days after a sale.

In addition to maintaining compliance with the SEC's rules and regulations, on-going reporting after the close has the benefit of providing an information base from which a secondary market in an issuer's securities may be built.

This reporting is expensive. For example, according to SEC data and our calculations, an annual report on Form 1-K under Reg A typically costs about \$100,000 while a Reg CF Form C-AR annual report might run \$8,400. However, this is a far cry from the costs incurred by companies subject to the reporting requirements under Sections 13 or 15(d) of the Securities Exchange Act of 1934. At minimum and excluding any current reports on Form 8-K, each year, these publicly-reporting companies file three quarterly reports on Form 10-Q that cost about \$30,000 each and an annual report on Form 10-K that might run more than \$375,000 for reporting costs of \$465,000 per year! See Table 2 for more information.



Part of the reason that these costs are as high as they are is that each report is normally prepared on a custom basis with minimal automation. We are aiming to reduce these costs, yet still provide a high-quality, easy to read and understand report.

## OVERVIEW OF CAPITAL-RAISING EXEMPTIONS

The chart below provides a summary of the SEC’s current exemptions from securities registration requirements under the Securities Act that went into effect on March 15, 2021<sup>2</sup>.

TABLE 1 - OVERVIEW OF CAPITAL RAISING EXEMPTIONS							
Type of Offering	Offering Limit (Within a 12-month period)	Marketing	Issuer Requirements	Investor Requirements	SEC Filing Requirements	Restrictions on Resale	Preemption of State Registration & Qualification
Reg A: Tier 1	\$20 million	<ul style="list-style-type: none"> <li>Testing the waters permitted before and after the Offering Statement is filed</li> <li>General solicitation permitted before qualification</li> </ul>	<ul style="list-style-type: none"> <li>U.S. or Canadian issuers</li> <li>Excludes:               <ul style="list-style-type: none"> <li>Blank check companies</li> <li>Registered investment companies</li> <li>Business development companies</li> </ul> </li> <li>Issuers of certain securities</li> <li>Certain issuers subject to a §12(j) order</li> <li>Reg A and Exchange Act reporting companies that have not filed certain required reports.</li> <li>“Bad actor” disqualifications apply*</li> <li>No asset-backed securities</li> </ul>	None	<ul style="list-style-type: none"> <li>Form 1-A Offering Statement (including 2 yrs of financials)</li> <li>Form 1-Z Exit Report</li> </ul>	No	No
Reg A: Tier 2	\$75 million	<ul style="list-style-type: none"> <li>General solicitation permitted before qualification</li> </ul>	<ul style="list-style-type: none"> <li>Business development companies</li> <li>Issuers of certain securities</li> <li>Certain issuers subject to a §12(j) order</li> <li>Reg A and Exchange Act reporting companies that have not filed certain required reports.</li> <li>“Bad actor” disqualifications apply*</li> <li>No asset-backed securities</li> </ul>	Non-accredited investors are subject to investment limits based on the greater of annual income and net worth unless securities will be listed on a national securities exchange, e.g., NYSE, Nasdaq, OTC Market	<ul style="list-style-type: none"> <li>Form 1-A Offering Statement (including 2 yrs of audited financial statements)</li> <li>Form 1-K Annual Report</li> <li>Form 1-SA Semi-Annual Report</li> <li>Form 1-U Current Report, and</li> <li>Form 1-Z Exit Report</li> </ul>	No	Yes

<sup>2</sup> See [Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets](#), Rel. No. 33-10884 for further information.



**TABLE 1 - OVERVIEW OF CAPITAL RAISING EXEMPTIONS**

<b>Type of Offering</b>	<b>Offering Limit</b> (Within a 12-month period)	<b>Marketing</b>	<b>Issuer Requirements</b>	<b>Investor Requirements</b>	<b>SEC Filing Requirements</b>	<b>Restrictions on Resale</b>	<b>Preemption of State Registration &amp; Qualification</b>
Reg CF (Regulation Crowdfunding, §4(a)(6))	\$5 million	<ul style="list-style-type: none"> <li>• Testing the waters permitted before Form C is filed</li> <li>• General solicitation permitted with limits on advertising after Form C is filed</li> <li>• Offering must be conducted on an internet platform through a registered intermediary</li> </ul>	<ul style="list-style-type: none"> <li>• Excludes:               <ul style="list-style-type: none"> <li>• Non-U.S. issuers</li> <li>• Blank check companies</li> <li>• Exchange Act reporting companies</li> <li>• Investment companies</li> </ul> </li> <li>• "Bad actor" disqualifications apply</li> </ul>	<ul style="list-style-type: none"> <li>• No investment limits for accredited investors (1)</li> <li>• Non-accredited investors are subject to investment limits based on the greater of annual income and net worth</li> </ul>	<ul style="list-style-type: none"> <li>• Form C Offering Statement (including 2 yrs of certified, reviewed, or audited financial statements, as required)</li> <li>• Form C-U Progress Update</li> <li>• Form C-AR Annual Report</li> <li>• Form C-TR Termination of Reporting</li> </ul>	12-month resale limitations	Yes
Reg D - Rule 504	\$10 million	Permitted in limited circumstances	<ul style="list-style-type: none"> <li>• Excludes:               <ul style="list-style-type: none"> <li>• "Blank check" companies,</li> <li>• Exchange Act reporting companies</li> <li>• Investment companies</li> </ul> </li> <li>• "Bad actor" disqualifications apply</li> </ul>	None	<ul style="list-style-type: none"> <li>• Form D – Notice of Exempt Offering of Securities</li> </ul>	Yes. Restricted securities except in limited circumstances	No
Reg D - Rule 506(b)	None	No general solicitation	"Bad actor" disqualifications apply	<ul style="list-style-type: none"> <li>• Unlimited accredited investors (1)</li> <li>• Up to 35 sophisticated but non-accredited investors in a 90-day period</li> </ul>	<ul style="list-style-type: none"> <li>• Form D – Notice of Exempt Offering of Securities</li> </ul>	Yes. Restricted securities	Yes





**TABLE 1 - OVERVIEW OF CAPITAL RAISING EXEMPTIONS**

Type of Offering	Offering Limit (Within a 12-month period)	Marketing	Issuer Requirements	Investor Requirements	SEC Filing Requirements	Restrictions on Resale	Preemption of State Registration & Qualification		
Reg D - Rule 506(c)	None	General solicitation permitted	"Bad actor" disqualifications apply	<ul style="list-style-type: none"> <li>Unlimited accredited investors (1)</li> <li>Issuer must take reasonable steps to verify that all purchasers are accredited*</li> </ul>	<ul style="list-style-type: none"> <li>Form D – Notice of Exempt Offering of Securities</li> </ul>	Yes. Restricted securities	Yes		
§4(a)(2)	None	No general solicitation	None	Transactions by an issuer not involving any public offering. See <i>SEC v. Ralston Purina Co.</i>	None	Yes. Restricted securities	No		
Intrastate - §3(a)(11)	<ul style="list-style-type: none"> <li>No Federal limit</li> <li>Generally individual State limits between \$1 and \$5 million</li> </ul>	Offerees must be in-state residents	<ul style="list-style-type: none"> <li>In-state residents "doing business" and incorporated in-state</li> <li>Excludes registered investment companies</li> </ul>	Offerees and purchasers must be in-state residents	None	Securities must come to rest with in-state residents	No		
Intrastate - Rule 147								Yes. Resales must be within state for six months	No
Intrastate - Rule 147A								General solicitation permitted	Purchasers must be in-state residents





## REPRESENTATIVE DISCLOSURE COSTS

The following table summarizes the SEC’s estimates of the time and cost of preparing and filing certain required forms in accordance with the Paperwork Reduction Act of 1986 (the “PRA”) as submitted to the Office of Management and Budget (“OMB”).

**TABLE 2 - REPRESENTATIVE DISCLOSURE COSTS**

Form	~Average Hours per Response			~Cost per Response (2)
	Total (1)	Internal (1)	External (1)	
<b>Exempt Filings</b>				
Form 1-A – Offering Statement.....	728.0	546.0	182.0	\$ 121,700
Form 1-K – Annual Report.....	600.0	450.0	150.0	100,300
Form 1-SA – Semi-Annual Report.....	188.0	141.0	47.0	31,400
Form 1-U – Current Report.....	5.0	3.8	1.3	800
Reg CF (3).....	50.0	37.5	12.5	8,400
Form D – Notice of Exempt Offering of Securities.....	5.0	12.5	37.5	16,100
Private Placement Memorandum (4).....	700.0	525.0	175.0	117,000
<b>Selected Non-Exempt Filings</b>				
Form S-1 – Offering Statement.....	641.0	480.8	160.3	107,100
Form S-11 – Offering Statement.....	722.0	541.5	180.5	120,700
Form 8-K – Current Report.....	9.0	6.8	2.3	1,500
Form 10-K – Annual Report.....	2,255.0	1,691.3	563.8	376,900
Form 10-Q – Quarterly Report.....	182.0	136.5	45.5	30,400

### Sources

Individual [SEC forms](#), [Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets](#), SPCP estimates and calculations.

### Notes

- For purposes of the PRA, the SEC allocated the total hourly paperwork burden between internal persons and outside professionals, principally lawyers and accountants. For Reg A and CF filings, the internal/external allocation was 75%/25% while for Reg D it was 25%/75%.
- The formula for estimating costs = internal hours x \$89.49/hr + external hours x \$400/hr (the SEC’s estimated average cost of retaining outside professionals). For the cost of internal hours, SPCP used 75% financial manager time at \$79.83/hour and 25% chief executive time at \$118.48/hour, resulting in an average hourly rate of \$89.49. See the [May 2022 National Occupational Employment and Wage Estimates](#), released Apr 25, 2023, by the [U.S. Bureau of Labor Statistics](#) for additional information.
- Reg CF requires the following filings: Form C – Offering Statement, Form C-U – Progress Update, Form C/A – Amendment to Offering Statement (including material changes), Form C-AR – Annual Report, Form C-AR/A – Amendment to Annual Report, and Form C-TR – Termination of Reporting.
- The SEC does not mandate a form for Private Placement Memorandums, however, in practice, most well-prepared PPMs follow a very similar disclosure outline as a Reg 1-A Offering Circular or an S-1 Prospectus and take about as much effort, say about 700 hours.