

## SUMMARY OF NEW REGISTRATION EXEMPTIONS

	Dollar Limit	Type of Offering	Issuer Requirements	Investor Requirements
<b>Rule 506(b)</b>	Unlimited	Private placement	U.S. or foreign company SEC registered or private companies No bad actors involved	Each non-accredited investor must be sophisticated  No more than 35 non-accredited investors  Number of accredited investors is unlimited
<b>Rule 506(c)</b>	Unlimited	Private placement  U.S. or foreign company	U.S. or foreign company SEC registered or private companies No bad actors involved	All accredited investors are eligible
<b>Crowdfunding</b>	\$1 million + inflation	Public offering	U.S. or Canadian companies that are not registered with the SEC (non-reporting companies)  No bad actors involved	Aggregate amount sold cannot exceed a given percentage of investor's annual income or net worth (greater of 2% or \$5,000 for investors with annual income or net worth less than \$100,000, and 10% but not exceed \$100,000 for all other investors)
<b>Rule 147</b>	Does not apply	Public offering to in-state residents	Principal place of doing business must be in the state  Must meet at least one: <ul style="list-style-type: none"> <li>• 80% of revenues must come from within the state</li> <li>• 80% of business assets must come from within the state</li> <li>• 80% of proceeds must be used in-state</li> </ul>	Must be in-state residents to purchase security

## 1.2. CONDUCT RULES

### 1.2.1. COMMUNICATIONS RULES FOR A PUBLIC UNDERWRITING

Before an issuer can begin selling its securities, the issuer must register the new securities with the SEC. Before the stock market crash of 1929, many people invested in securities without having much information about securities they were buying.

The Securities Act of 1933 was enacted to make sure investors have enough information about a security to make an informed decision. The Securities Act requires a registration process (described below) that culminates in a comprehensive document called a **prospectus**. An acceptable prospectus provides investors with enough detailed information about the issuer of the security to make an informed investment decision about the investment. When judging whether a prospectus is acceptable, the SEC assesses whether all the relevant information is contained in the prospectus and that there are no material omissions.

The SEC does not judge the merits of the securities themselves. In other words, the SEC transfers the burden of good financial decision-making from the government to the investor. For this reason, a broker, underwriter, or issuer of a security cannot say that the SEC “approved” of the security, even if the security is registered with the SEC. This is a basic and critical point that may come up in some form on the exam.

The registration process can be divided into three periods: the pre-filing period, the cooling-off period, and the post-effective period. The **pre-filing period** is the period before the issuer files the registration statement with the SEC. The **cooling-off period** is the time period after the registration statement has been filed until the registration statement become effective. This period must be at least 20 days long. During this time, the SEC will evaluate the registration statement. During the cooling-off period, the company will not be able to sell shares to the public, and only certain kinds of limited offers will be allowed.

During this time, the SEC will not try to determine whether the security is a good investment. Rather, it will make sure everything that is supposed to be in the registration statement is actually in it. If the SEC finds no material omissions or misleading statements, the registration statement will become effective after 20 calendar days.

If the SEC does find issues with the prospectus, it will return a **qualified decision**, and the issuer will have to file an amendment to the registration statement. Once an amendment has been filed, the company must wait an additional 20 days for SEC review.

During the cooling-off period, both the issuer and the lead underwriter will try to solicit investor interest in the new issue. This often involves a **road show**, where the lead underwriter and the issuer’s management will meet with institutional investors. The issuer’s management will give a presentation informing the investors about the company and the securities it will be selling. The lead underwriter will collect **indications of interest** from the investors, which are simply indications of an interest in buying, but not promises to buy. In return, the underwriters will not promise to sell to these potential buyers, but they will get priority when the shares are sold.

The **post-effective period** is the period after the registration statement has become effective. At this point, the company is allowed to sell its securities to the public.

Because the price is typically set right before the offering, this is when the underwriting agreement is signed and the securities are delivered from the issuer to the underwriter. The underwriter then sells the securities to the public at the **public offering price (POP)**.

Once the price has been determined, the price is inserted into the preliminary prospectus, and the resulting **final prospectus** is filed with the SEC.

### 1.2.1.1. Prospectus

When most of us think of a prospectus, we think of a long, detailed document. In fact, a prospectus is any written or broadcast offer to sell securities. It can be as short or as long as you like. What defines a prospectus is its contents. Section 2 of the Securities Act gives the following broad definition of prospectus:

Any notice, circular, advertisement, letter, or communication, written or broadcast, which offers a security for sale or confirms the sale of any security.

Thus, any written or broadcast communication that contains an offer to sell securities, explicitly or implicitly, is a prospectus.

Two kinds of prospectuses (offers to sell securities) are critical to a public offering. A **preliminary prospectus** is filed with the SEC at the time of registration and may be distributed to potential investors during the cooling-off period as both a marketing and disclosure document. The SEC will have 20 calendar days to determine whether the document has the necessary and proper disclosure. If the SEC finds that the preliminary prospectus contains material omissions or misleading information, the SEC will issue a stop order and suspend the process to wait for a rewrite. The issuer will then file an amendment, and the 20-day waiting period will begin again. If the SEC requests no changes, registration will become effective after 20 days. The preliminary prospectus is often called the “red herring” because there has traditionally been a legend on the front cover in red stating that the document is not the final prospectus. This red ink is no longer required by the SEC, but the phrase red herring is often still used.

The **final prospectus** is the document that accompanies the public offering after the registration statement has become effective. This document is provided to investors to inform them about the offering. It will contain all the critical information that the investor needs to make an informed decision about whether to invest in the security or not.

### 1.2.1.2. Specific Communications Rules

The **Securities Act of 1933** prohibits anyone engaged in an underwriting from selling securities in an issue before the filing of a registration statement. Section 5(b) of the Act permits offers to sell during the cooling-off period if they are made by means of a valid prospectus.

Making an offer during the pre-filing period or during the cooling-off period without a prospectus is often referred to as “**gun-jumping**” because the person who is making the offer is jumping the gun. Over the years, the SEC has issued many interpretive rulings to clarify and modify these gun-jumping provisions of the Securities Act. These rules further define what constitutes a prospectus and what types of communications are permissible under the Act. You will need to know some of the rules, and they are summarized below.

#### 1.2.1.2.1. Tombstone Ads

The SEC does allow communications/advertisements about the new offering that include

only general information about the offering. Often this information is presented in what is called a **tombstone ad**. This kind of ad is placed in a newspaper or financial magazine and contains a black border that resembles a tombstone. A tombstone ad tells the public general information about the offering.

To ensure that they will not be construed as an offer, tombstone ads and other general advertisements must contain a statement similar to the following:

*This announcement is under no circumstances to be construed as an offer to sell or as a solicitation of an offer to buy any of these securities. The offering is only made by prospectus.*

Information that is allowed in a general information advertisement includes:

- Price of security (if known) or price range, amount, and type of securities
- Final maturity, interest rate, and yield (for fixed-income securities)
- Name of underwriters
- Name of issuer and brief description of business
- Description of marketing events
- Expected ticker symbol and exchange where listed
- Contact info of the organization sending the advertisement

All tombstone ads must state where the preliminary prospectus can be found, that the securities cannot yet be sold, and that offers to buy cannot be accepted until the registration date.

SEC Rule 134

*This announcement is not an offer of securities for sale or a solicitation of an offer to buy securities*

150,000 shares

**MEGAHUGE CORPORATION**

Common Stock

*Copies of the Prospectus may be obtained from such of the undersigned (who are among the underwriters named in the prospectus) as may legally offer these securities under applicable securities laws.*

*Selle & Proffitt Co.*

*Wheeler & Dealer Co.*

*F.R. Palomino & Co.*