

# Capital Raising in the U.S.: The Significance of Unregistered Offerings Using the Regulation D Exemption<sup>i, iv</sup>

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## ABSTRACT

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In this report we present an analysis of the information extracted from Form D filings received by the Commission since the beginning of 2009. The results are intended to inform the Commission on the amount and nature of capital raised through unregistered offerings claiming a Regulation D exemption, and to provide some preliminary perspective on the state of competition and regulatory burden in capital markets. In particular, we compare the amount of capital raised using the Regulation D exemption to capital raised from other unregistered and registered offering methods. This information may be particularly useful in assessing the merit of current or potential future rulemaking activity. This analysis is not intended to inform the Commission on compliance with or enforcement of federal securities laws.

One of the original purposes of Regulation D, first adopted in 1982 and amended on three subsequent occasions, was to collect and analyze data on issuers seeking a 1933 Act registration exemption to address the capital formation needs of smaller companies.<sup>ii</sup> However, until 2008, issuers filed Form D on paper forms, making the extraction of information for large-scale statistical analysis problematic. In February 2008, the SEC adopted amendments to Form D that require issuers to submit their Form D filings electronically and in a structured data format.<sup>iii</sup> As a result of the new requirements, which were phased in from September 2008 through March of 2009, Form D filings are now machine-readable. Using basic text parsing tools, RSFI staff was able to extract the reported elements and place them in a database enabling the large-scale statistical analysis reported here.

### Summary of main findings

- In 2010, Reg D offerings surpassed debt offerings as the dominant offering method in terms of aggregate amount of capital raised in the U.S.: \$905 billion.
- The amount of capital raised through Reg D offerings may be considerably larger than what is disclosed on Form D because there is no closing filing requirement.
- The median Reg D offering is modest in size: approximately \$1 million.
- Consistent with the original intent of Regulation D to target the capital formation needs of small business, there have been a large number of smaller offerings: 37,000 unique offerings since 2009.
- There is a strong presence of foreign issuers in the Reg D offering market. Over the period 2009 to first quarter of 2011, they account for approximately 25% of capital raised.
- Among broader trends in capital raising, there has been a shift from public to private capital raising over the past three years, due to both a decline in public issuances and an increase in private issuances: public issuances fell by 11% from 2009 to 2010 while private issuances increased by 31% over the same period.
- Although capital raised in the U.S. by domestic issuers is almost twice that raised by foreign issuers, the capital raised by foreign issuers increased by 5% from 2009 to 2010, accounting for nearly the entire increase in total capital raised in the U.S. during the period. This is evidence that the current regulatory environment is not pushing capital formation offshore; rather, this evidence is more consistent with the U.S. competing favorably with foreign markets.

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<sup>i</sup> This memorandum was prepared for Craig Lewis, Director and Chief Economist of RSFI. It was reviewed by Adam Glass, Krishna Kamath, and Jennifer Marietta, RSFI and Kevin O'Neill and Karen Wiedemann, Division of Corporation Finance. This version was updated November 10, 2011 to include additional detail on, and minor corrections to, the number and size of unregistered offerings that do not claim a Regulation D exemption.

<sup>ii</sup> Release No. 33-6389 (Mar. 8, 1982); 47 Fed. Reg. 11251 (1982). (Adopting Form D as a replacement for Forms 4(6), 146, 240 and 242).

<sup>iii</sup> Release No. 33-8891 (Feb. 27, 2008); Electronic Filing and Revision of Form D, 70 Fed. Reg. 10,592 (2008) (to be codified at 17 C.F.R. pts. 230, 232 & 239).

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**I. Regulation D offering statistics**

The market for unregistered offerings is large. Prior reports on the analysis of Reg D filings by the Office of Inspector General (OIG) support this conclusion. In 2004, the OIG reported unregistered offerings of \$1.2 trillion between January 2000 and March 2001.<sup>1</sup> More recently, the OIG in their audit of the Commission’s Regulation D Exemption Process estimated unregistered offerings of \$609 billion during 2008.<sup>2</sup>

Our analysis of information extracted from all electronic Form D filings in calendar years 2009 and 2010 reveals that unregistered offerings were \$587 and \$905 billion, respectively (Table 1). The pace of capital formation in the first quarter of 2011—already \$322 billion—corresponds to an annualized rate of \$1.3 trillion, far in excess of capital acquired through offerings reported in either of the previous two years, suggesting a significant increase in use of private market capital.

The estimates in Table 1 include the “total amount sold” at the time of the filing as well as any additional capital raised in an amended filing corresponding to a previous issue.<sup>3</sup> However, these estimates likely underestimate that actual amount sold. This is because Reg D filings can be made prior to the completion of the offer. In such cases, amendments to reflect additional capital are not required if the offer is completed within a year and the amount sold does not exceed the original offering size by more than 10%.<sup>4</sup>

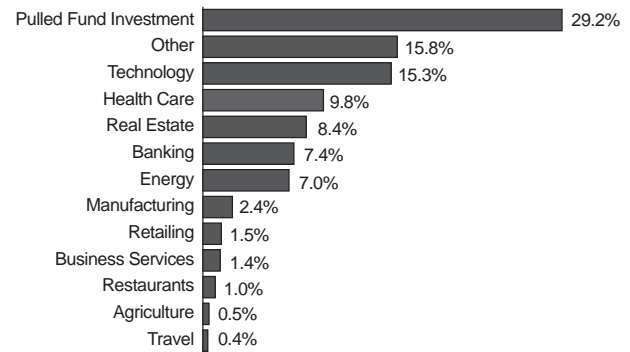
When estimates are based on “total offering amount,” which is the statistic used in the OIG reports, the amounts in 2009 and 2010 are substantially larger, \$1.5 trillion and \$1.2

trillion respectively. Adjusted for inflation, the 2009 estimate is similar to the 2000 Commission estimate. However, because offers may not be fully subscribed, this is best viewed as an upper bound of total capital raised.

Although the aggregate amount of capital raised through Reg D offerings is large, the average offering is modest: around \$30 million in all years. Moreover, the distribution is skewed; the median offering size is around \$1 million in all years. This suggests that, despite a relatively small number of relatively large offerings, the original regulatory objective to target the capital formation needs of small business have been satisfied.

The summary statistics in Table 1 indicate that a large fraction of offerings are amendments to previously filed offerings, suggesting that capital acquisition is an ongoing effort at many filers. This stands in sharp contrast to

**FIGURE 1a.** Top issuers—percent of all offerings by number of offerings



**TABLE 1.** Summary statistics for capital raised through Reg D and Reg D/A (amended) offerings

Year	Reg D filings (number)	Reg D/A filings (number)	Total capital raised (\$ millions)	Mean offer size (\$ millions)	Median offer size (\$ millions)
2009	14070	6560	586644	28.4	1.2
2010	18264	11005	905554	30.9	1.0
2011Q1	5048	5421	321696	30.7	1.2

<sup>1</sup> Cited in *Small Business Regulation D Exemption Process*, Report No. 371, issued on March 29, 2004 and based on Commission analysis.

<sup>2</sup> *Regulation D Exemption Process*, Report No. 459, issued on March 31, 2009; see footnote 18 on page 2. The estimate is a projection based on a sample of 323 electronic form D filings made between September 15, 2008 and December 31, 2008.

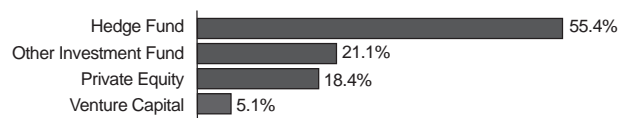
<sup>3</sup> See the Appendix for details of the methodology used to collect the Reg D sample.

<sup>4</sup> Further underestimation may occur to the extent that issuer do not report at all. Rule 503 requires the filing of a notice on Form D for all offerings under Regulation D. However, filing Form D is not a condition to claiming a Regulation D safe harbor or exemption. We understand that some issuers do not file Form Ds for offerings intended to be eligible for relief under Regulation D.

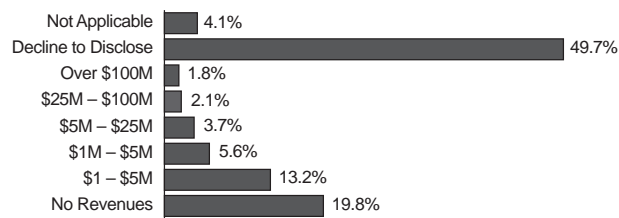
classically underwritten offerings that are well-defined single events.

The information contained in Figures 1a through 1c describes issuer characteristics. Less than one-third (29%) of issuers are pooled investment funds, of which a little more than half (55%) are hedge funds (i.e., 16% of all Reg D offerings are by self-reported hedge funds). Excluding hedge funds and other investment funds, the issuer revenue ranges reported in Figure 1c show that issuers of private offerings tend to be small. Although a significant number of issuers decline to disclose their sizes (50%), for those that do, most have revenue less than \$1 million. Only 1.8% of all new offerings are by issuers that report more than \$100 million in revenues.<sup>5</sup> By way of comparison, 48% of SEC registrants with publicly traded equity report revenues of greater than \$100 million.<sup>6</sup> This further supports our prior assertion that Regulation D facilitates capital formation among smaller entities.

**FIGURE 1b.** Distribution of “Pooled investment funds” by number of offerings



**FIGURE 1c.** Distribution of issuers by reported revenue—excluding “Hedge” and “Other investment” funds



**FIGURE 2.** Reg D exemption claimed by number of offerings



Figure 2 shows that most issuers are issuing under Rule 506, which provides for a safe harbor for the private offering exemption under Section 4(2) of the Securities Act without any limit on the offering amount. This evidence is consistent with recent Commission estimates on the use of 506, which is one of three exemptive rules for limited and private offerings under Regulation D. Rule 506 permits sales of an unlimited dollar amount of securities to be made, without registration, to an unlimited number of accredited investors and up to 35 non-accredited investors, so long as there is no general solicitation, appropriate resale limitations are imposed, any applicable information requirements are satisfied and the other conditions of the rule are met.<sup>7</sup> In contrast, Rule 504 and 505 offerings are limited to \$1 million and \$5 million respectively, and with substantially similar requirements as 506 offerings.<sup>8</sup>

## II. Regulation D offerings compared to other methods of raising capital

In this section, we compare the total capital raised annually through Reg D offerings to other common sources of capital:<sup>9</sup>

- Public debt offerings (registered)
- Public equity (initial public offerings and public offerings by seasoned companies)
- Rule 144A (resale of unregistered company securities)<sup>10</sup>
- Regulation S (offshore component of 144A offering)<sup>11</sup>
- Other Section 4(2) private offerings

<sup>5</sup> Form D also contains information on net asset value (NAV) of hedge funds and other investment funds. Since 2009, more than three-quarters of issuers have declined to disclose NAV, but of those that do, a trend similar to revenue is reported – the largest set of issuers is in the smallest NAV categories

<sup>6</sup> Calculated based on an RSFI analysis of 8,224 SEC registrants in 2008 who had a class of equity security with a reported market price reported by Thomson Financial Datastream at calendar year-end.

<sup>7</sup> See SEC Release No. 33-9211, page 4 and footnote 8.

<sup>8</sup> See discussion of rules 504, 505, and 506 or Regulation D at <http://www.sec.gov/answers/regd.htm>.

<sup>9</sup> Information on all non Reg D offering methods was extracted from Thomson Financial’s SDC Platinum service on June 15, 2011.

<sup>10</sup> A Rule 144A offering is often the second leg of a private offering using the Section 4(2) registration exemption in the 1933 Securities Act, including where the initial purchaser of the securities intends to immediately re-sell them to QIBs. Rule 144A offerings are distinct from those seeking safe harbor through rule 506 of Regulation D and may only be purchased by qualified institutional buyers (QIBs) and not by individuals – regardless of how wealthy or sophisticated they may be.

<sup>11</sup> SDC Platinum uses information from underwriters, issuer websites, and issuer SEC filings to compile its Private Issues database. These include offerings under Section 4(2) of the Securities Act that do not claim a Reg D or Reg S exemption and that are without a follow-on Rule 144A sale. These numbers are accurate only to the extent that SDC is able to collect such information, and may understate actual the amount of capital raised under Section 4(2) if issuers and underwriters do not make this data available.

**FIGURE 3.** Aggregate capital raised in 2009, 2010, and Q1 2011 by offering method (\$billions)

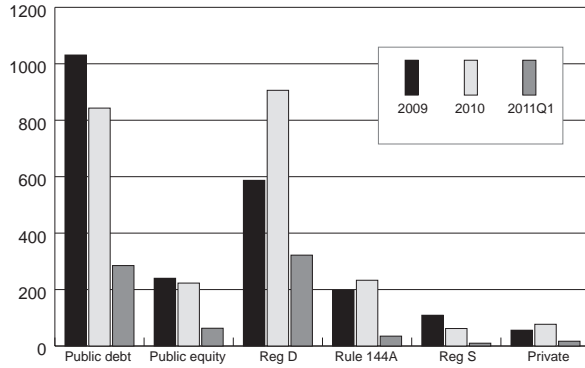


Figure 3 illustrates that capital raised through Reg D offerings is more than twice as large as public equity offerings as well as each other category of unregistered offerings. Capital acquired through Reg D offerings is second only to public debt offerings in 2009, and is the largest source of capital in 2010 and through the first quarter of 2011.

These results indicate that Reg D offerings have been an important if not dominant method of capital acquisition since the beginning of 2009. Their importance is magnified when considering that approximately two-thirds of Reg D offerings represent new equity capital (Figure 4), which is a more permanent source of capital than debt, and thus more likely to reflect new investment as opposed to the refinancing of existing investment.<sup>12</sup> Put differently, to the extent that debt offerings are attributed to the “rolling over” of existing debt due to an expiring term or refinancing due to a change in interest rate environment, such transactions do not reflect the financing of new investment.

**FIGURE 4.** Number and percent of Reg D offerings by type of security issued

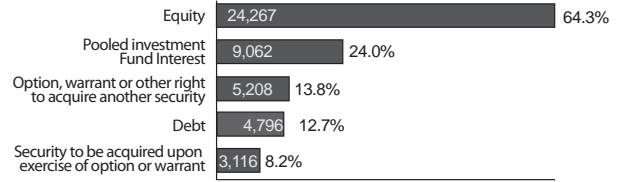


Table 2 shows that Reg D offerings occur with far greater frequency than any other offering method surveyed. There were 29,269 new and amended Reg D filings in 2010, and there have already been more than 10,000 in the first quarter of 2011. No other offering method was used even a tenth as much during the same period. This evidence shows that the accumulation of capital raised through Reg D is occurring by way of much smaller offering denominations than other methods, and is consistent with it being a primary tool for smaller entities.

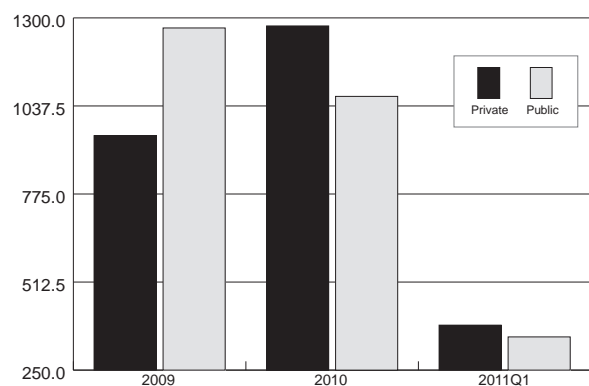
These results provide an empirical perspective for the current policy debate on whether the burdens of public reporting requirements encourage issuers to seek capital from private sources or from investors in foreign markets.<sup>13</sup> Although no causal inference can be made as to why, Figure 3 reveals a substantial shift in capital raised from public to private methods. This result is made clear in Figure 5 where all public capital sources (registered debt and equity) are compared to all private capital sources (Reg D, Rule 144A, Reg S, and all other Section 4(2) private offerings). In 2009, public offerings raised 44% more capital than private offerings. This reversed in 2010 when private offerings produced 8% more capital than public offerings (\$1.16 trillion versus \$1.07 trillion). This trend has continued into 2011 with private offerings eclipsing public ones by 3%.

**TABLE 2.** Number of offerings by type of offering and year

Year	Reg D	Public Equity	Public Debt	Rule 144A	Reg S	Other 4(2)
2009	20630	942	1445	388	294	648
2010	29269	1072	1930	473	262	668
2011Q1	10469	290	568	113	97	240

<sup>12</sup> There are 46,449 issues referenced, which is greater than the total 37,382 new issues in Table 1. This is due to multiple securities listed in the same filing.

<sup>13</sup> See, for example, the letter from Rep. Darrell E. Issa, Chairman of the Committee on Oversight and Government Reform, to the Chairman of the SEC, March 22, 2011.

**FIGURE 5.** Aggregate capital raised in the U.S. by public and private offerings (\$billions)

The shift from public to private capital over the past three years can be attributed not only to the recession and weak public issue markets, but also an increase in the frequency of private offerings. Public offerings fell by 17% from 2009 to 2010 while private issuances increased by 31% over the same period. This shift is consistent with anecdotal evidence that some firms are putting off the “going public” decision during “cold issue” markets. For instance, Facebook recently conducted a private offering outside the U.S. for \$1.5 billion, an amount of capital commensurate to what some might consider a large or at least medium size initial public offering (IPO).

It is interesting to note that the total amount of capital raised in 2010 (\$2.2 trillion) is 3% greater than what was raised in 2009 (\$2.1 trillion). This finding does not support the notion, at least in the broader sense, that impediments to capital formation in the current regulatory environment lead to capital raising moving offshore.<sup>14</sup>

If there were a built-in bias against private offerings as suggested in a recent *Wall Street Journal* article<sup>15</sup>, it is not manifested through dominance in capital raised through public offerings or supported by current capital raising trends. Moreover, the estimated amount of capital raised through Reg D offerings in 2010 (\$878 billion) is similar in magnitude to the estimated amount of capital raised in 2000 prior to start of the Sarbanes-Oxley regulatory environment (\$960 billion<sup>16</sup>). In this respect, and given the pace of 2011

Reg D offerings, there is no evidence that the Reg D offering market has shrunk over this period.

### III. Statistics on capital raised by foreign and domestic issuers

Over the period 2009 to first quarter of 2011, foreign issuers account for approximately 25% of all capital raised by Reg D offerings. As Figure 6 shows, this fraction appears to be relatively stable over time. By comparison, foreign issuers account for 50% of capital acquired by all other unregistered offerings (Rule 144A combined with Reg S), or 20% of capital when considering Rule 144A offerings alone. In an analogous manner, foreign issuers account for 35% of capital raised through public debt offerings but only 16% through public equity offerings.

When aggregated across type of offerings, U.S. issuers acquire more than twice as much capital as foreign issuers (Figure 7). The capital raised by foreign issuers increased by 5% from 2009 to 2010. In the first quarter of 2011 alone,<sup>17</sup> foreign issuers raised almost \$222 billion (\$888 billion annualized). This finding—that foreign capital raising increased at a rate commensurate of the increase in all capital raised—is evidence that the current regulatory environment is not pushing capital formation offshore; rather, this evidence is more consistent with the U.S. competing favorably with foreign markets.

### IV. Regulation D amended offering statistics

A significant portion (41%) of Reg D filings by number of offerings are amendments to earlier filings. Following the method outlined in the appendix, Figure 8 depicts quarterly capital formation through unregistered Reg D offerings. The bars separately denote whether the amount raised is disclosed in an original or amended filing.

Two patterns emerge. First, the amount of new capital raised and reported through amended Form D filings increases over time. Second, there is a spike in new capital reported in amended offerings in the first quarter of 2009, 2010, and 2011. This may be an artifact of filer behavior sur-

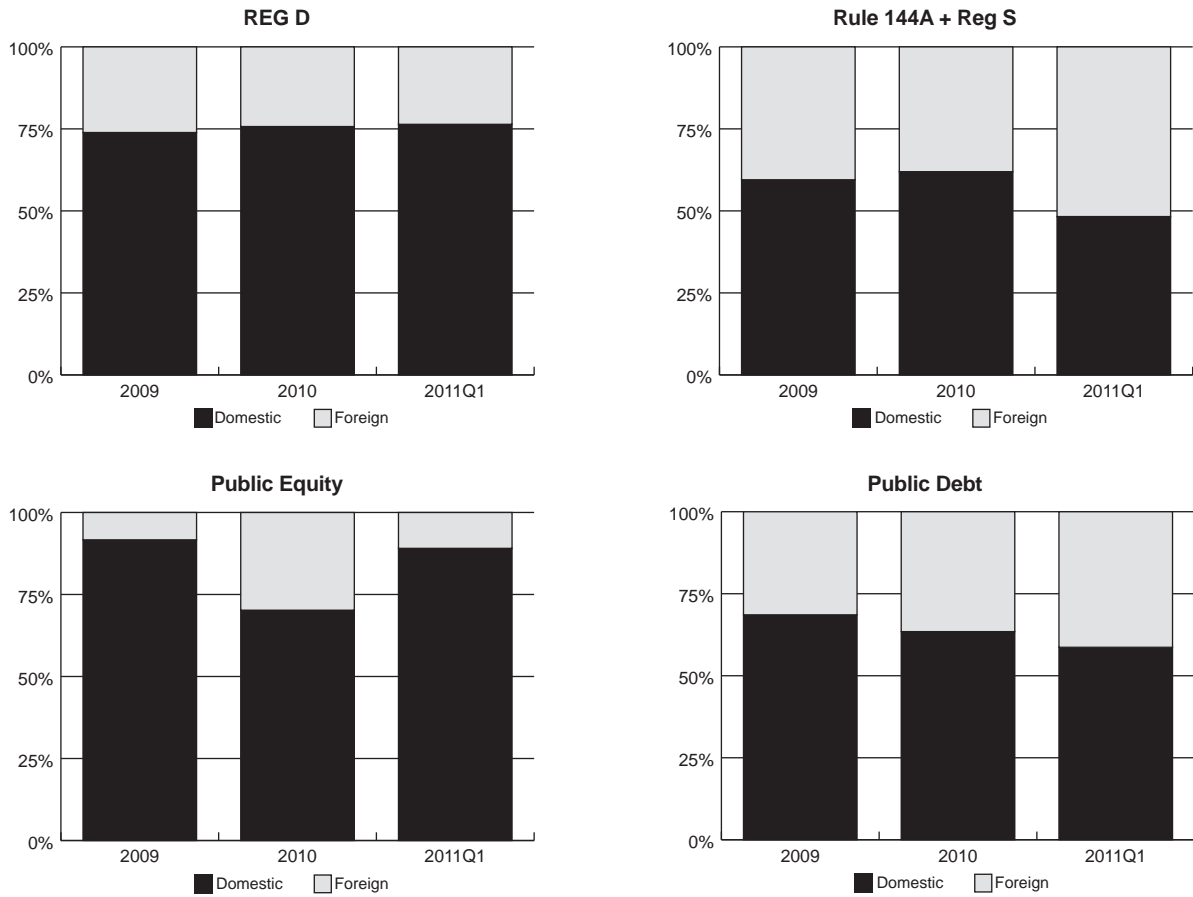
<sup>14</sup> Because this analysis does not consider capital formation in foreign markets, it remains possible that regulatory burden did push capital formation offshore, and that absent this loss, total capital raised would have been greater than the 10% increase documented.

<sup>15</sup> Joseph McLaughlin, *How the SEC Stifles Investment—and Speech*.

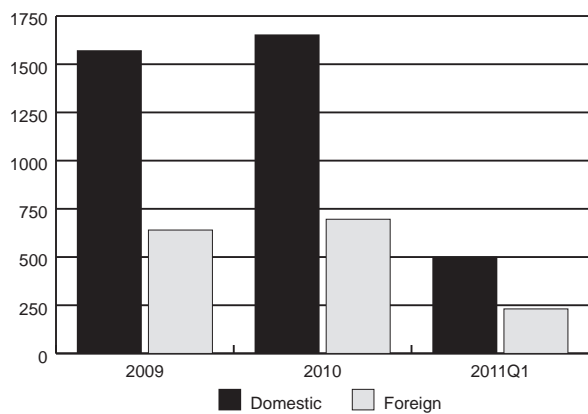
<sup>16</sup> See footnote 3 and discussion in Section I.

<sup>17</sup> Reg S offerings involve exclusively offers and sales made outside the United States.

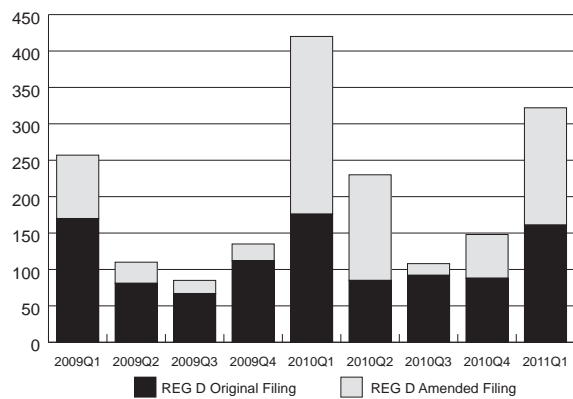
**FIGURE 6.** Percent of capital raised in U.S. by domestic and foreign issuers by offering method

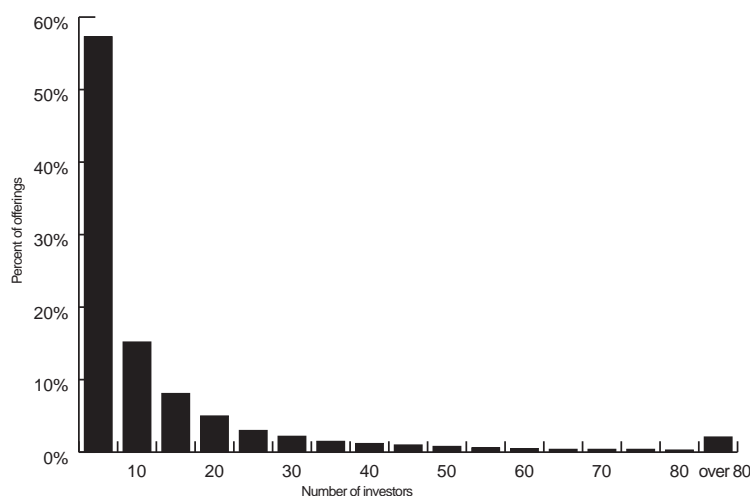


**FIGURE 7.** Aggregate capital raised in the U.S. by domestic and foreign issuers (\$billions)



**FIGURE 8.** Aggregate capital raised through unregistered Reg D offerings separated by whether the offering is reported in the original Reg D filing or an amended filing (\$billions)



**FIGURE 9.** Histogram of total number of investors per Reg D offering)

rounding the move to electronic filing, which was mandated until March 2009. It is possible that issuers, in an effort to delay their first electronic filing, made their initial electronic filing at the last possible moment: right before the expiration of the deadline. Thus, the annual amendments for ongoing offerings (those with duration longer than a year) would be due before the end of the first quarter in each subsequent year. Consistent with this hypothesis, our examination of the filing pattern of Reg D offerings during the period March 2000–March 2001 revealed no significant clustering in the first quarter of the year.

#### V. Total number of investors per Reg D offering

Both Rule 505 and Rule 506 (the most frequently used exemption in the Reg D filings) allow an issuer to sell securities to an unlimited number of accredited investors and up to 35 non-accredited investors.<sup>18</sup> The average amount of non-accredited investors in the Reg D offerings over the entire period is 0.1, while the median is 0. In fact, in approximately 90% of the offerings there are no non-accredited investors.<sup>19</sup>

Figure 9 presents the distribution of total number of investors in Reg D offerings. As can be seen, the distribution is highly skewed—the median number of investors is 4, while

almost 90% of the offerings involve approximately 30 investors. In 99% of the offerings the number of investors is fewer than 155.

#### VI. Reg D offerings by public companies

Reg D offerings are available to any potential issuer without regard to its public status. In the universe of Reg D issuers, public firms are unique because they are usually able to access both public and private capital markets. While there could be many reasons why a public firm would do a Reg D offering (e.g., lower all-in cost compared with issuing registered securities, confidentiality issues, temporary lack of access to public capital markets, etc.), it is interesting to know what fraction of public companies raise capital via this market, how much they raise, and how large the capital raised through Reg D offerings is compared to their public offerings.<sup>20</sup>

Table 3 shows that roughly 10% of all public firms raised capital through Reg D offerings over the period 2009 to first quarter of 2011. The annual amount raised is on average 2% of the total amount raised through Reg D offerings, but varies significantly by year. For example, the amount raised in 2009 is much larger than that raised in subsequent years. Public firms that issue Reg D offerings also tend to raise on

<sup>18</sup> The federal securities laws define the term “accredited investor” in Rule 501 of Regulation D.

<sup>19</sup> In cases where a new Reg D filing is followed by amendments, we use only the last amendment in the analysis, assuming that it would have the most recent information on total investors and non-accredited investors.

<sup>20</sup> We used listings in the Standard and Poor’s Compustat and the University of Chicago’s Center for Research in Securities Prices (CRSP) databases to determine public companies, although it is possible that smaller public companies are not reported by these data aggregation service providers.



**TABLE 3.** Capital raised by public companies that issue Reg D offerings (\$billions)

Year	Number of firms (% of total public firms)	Size of Reg D issues (% of total)	Size of public issues (% of total)	Size of 144A issues (% of total)
2009	533 (9.3%)	\$26.8 (4.6%)	\$28.2 (2.2%)	\$19.0 (6.5%)
2010	542 (9.7%)	\$6.6 (0.7%)	\$24.2 (2.1%)	\$23.3 (5.4%)
2011Q1	542 (9.7%)	\$4.9 (1.5%)	\$13.5 (3.8%)	\$6.0 (7.8%)

average \$26 billion annually via public offerings and \$21 billion via Rule 144A offerings. The size of the private offerings (Reg D and Rule 144A) by these firms in 2009 and 2010 is larger than that of their public offerings, suggesting, at least in the time period under consideration, a preference for private capital markets. Consistent with such a preference, we also find that public firms relying on Reg D tend to be smaller and less profitable than their industry peers. This evidence is consistent with the notion that for various reasons these firms find it costly, particularly during economic downturns, to access public markets. Thus, private markets represent an important venue for them to raise the capital they need.

## APPENDIX

This appendix describes the procedures used to collect the Reg D sample and the data on the other offerings.

### Reg D sample

We collected information from all Form D filings (new filings and amendments) in EDGAR over the period January 2009–March 2011.

- We deleted all amendments that were filed on the same date as the new offers and had the same characteristics (offer size, offer date, amount sold, securities types, etc.)
- Subsequent amendments to a new filing are treated as incremental fundraising and recorded in the quarter in which the amendment is filed. If an issuer has filed only amended filings, and those reference a post-2008 sale date, the first filed amended filing is treated as an original Reg D filing.

- For post-2008 original filing/ latest amended filing data pairs, the incremental amount sold between the original filing and the latest amended filing of the same issue is determined by taking the difference between the “total amount sold” reported in each such filing. Amendments of pre-2008 Reg D original filings are also treated as incremental fundraising. The amount raised in each pre-2008 Reg D original filing is estimated by multiplying the cumulative sold amount reported in the latest filed amendment by a haircut percentage. This percentage is the average of the fraction (incremental amount sold in all amendments, as shown in the latest filed amendment / the amount sold in the related original Reg D offering) for the sub-sample of post-2008 original filing/latest amended filing data pairs, divided into the categories “indefinite size offer” and “specific offer size”). Different haircut percentages (11% and 27%, respectively) are used for indefinite size offers and offers with specific offer size, since the two categories differ markedly in terms of the amounts by which the initial offering size is increased by amendments, as shown the latest filed amendment.
- Foreign issuers are determined based on the information on Issuer State that they provide.

### Other offerings

- Data on IPOs, equity offerings by seasoned issuers (EOSIs), convertible debt offerings, public debt offerings, private offerings, and Rule 144A offerings are taken from Securities Data Corporation’s New Issues database (Thomson Financial).
- Public debt offerings by government, state, municipal, and quasi-governmental issuers (e.g., Fannie Mae, Freddie Mac) are excluded from the public debt sample.