



## Securities Offering Reform

New SEC rules will facilitate securities offerings by permitting more communications during the registration process, clarifying liability, and further integrating the procedures and disclosures for periodic reporting with those for Securities Act registration statements.<sup>1</sup> The complex reform package applies to foreign as well as to domestic registrants, is effective December 1, 2005, and requires large registrants to disclose in annual reports material comments from the SEC staff unresolved for more than 180 days.

This edition of *Defining Issues* presents summarized highlights from the SEC release. Issuers who apply the new rules should consult with their securities counsel.

### Four Categories of Issuers

The securities-offering-reform rules are designed to apply differently to issuers depending on their reporting history under the Exchange Act and their following in the market place. Requirements are relaxed more for issuers with greater reporting history and presumed following by investors, analysts, and the financial press. For this purpose, all issuers are now divided into four categories. The categories are described below, sequenced from lesser to greater reporting history and presumed following.

- A “non-reporting issuer” is not required to file reports under the Exchange Act. The category includes those who file reports voluntarily even though not required to do so.
- An “unseasoned issuer” is required to file reports under the Exchange Act but does not satisfy the requirements of Form S-3 or Form F-3 for a primary offering of its securities.
- A “seasoned issuer” is required to file reports under the Exchange Act and is eligible to use Form S-3 or Form F-3 to register primary offerings of securities.
- A “well-known seasoned issuer” is eligible to use Form S-3 or Form F-3 and has either \$700 million or more of common equity market capitalization held by non-affiliates or has issued \$1 billion or more aggregate amount of fixed-income securities in primary regis-

Four Categories of Issuers	1
“Ineligible Issuer”	2
Communications	2
The Registration Process	2
Section 11 Liability	3
New Disclosures	4

©2001-2005 KPMG LLP, the U.S. member firm of KPMG International, a Swiss cooperative. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative. All rights reserved. A16911NYGR

Photo: GettyImages/Duncan Smith/Photodisc AA000685

<sup>1</sup> SEC Release No. 33-8591, Securities Offering Reform, July 19, 2005, available at <http://www.sec.gov/rules/final/33-8591.pdf>

tered offerings for cash (not exchange) during the past three years. A majority-owned subsidiary of a well-known seasoned issuer is also generally considered a well-known seasoned issuer in connection with certain offerings involving guarantees and non-convertible debt and sale of its own securities. The rules do not prohibit issuers who report material weaknesses in internal control over financial reporting or whose financial statements include an independent auditors' "going concern" opinion from qualifying as well-known seasoned issuers.

An issuer who meets any of the criteria that identify an "ineligible issuer" does not qualify as a well-known seasoned issuer.

### **"Ineligible Issuer"**

Being an ineligible issuer disqualifies an entity from being a well-known seasoned issuer and significantly affects the extent to which an entity may use a "free writing prospectus." An issuer is ineligible if it:

- Is not current in its Exchange Act reports and other materials required to be filed in the prior 12 months,
- Is, or it or any of its predecessors was during the prior three years, a blank check or shell company or an issuer for an offering of penny stock,
- Was a limited partnership offering and sold its securities other than through a firm-commitment underwriting,
- Filed for bankruptcy or insolvency during the past three years,
- Has been or is the subject of refusal or stop orders under the Securities Act during the past three years or is the subject of a pending proceeding under Securities Act Sections 8 or 8A, or

- Has been, or whose subsidiaries have been, convicted of any felony or misdemeanor described in specified provisions of the Exchange Act, found to have violated the anti-fraud provisions of the federal securities laws, or the subject of a judicial or administrative decree or order prohibiting conduct or activities regarding the anti-fraud provisions of the federal securities laws during the past three years.

### **Communications**

The new rules substantially relax limitations on communication by issuers, other offering participants, and research analysts before, during, and after a registered securities offering. Among the most significant of the new permissions is the so-called "free writing prospectus."

**The "Free Writing Prospectus."** This new term refers to any written communication other than a statutory prospectus that satisfies the regulatory requirements for prospectuses. A free writing prospectus may include written communications that constitute offers to sell securities in the form of e-mails, faxes, term sheets, recorded electronic road shows, and other written communications that are or will be the subject of a registration statement, if specified conditions are met.

A free writing prospectus that satisfies the specified conditions can be used by a well-known seasoned issuer at any time and by any other issuer that is not ineligible or offering participant after a registration statement has been filed. Free writing prospectuses generally must be filed on or before the date of first use. The documents are not considered part of a registration statement subject to liability under Section 11 of the

Securities Act unless the issuers elect to file them as part of the registration statement. Whether or not it is filed, any seller offering or selling securities by means of a free writing prospectus is subject to disclosure liability under Section 12 of the Securities Act.

**Other Communications Provisions.** These provisions of the new rules will increase the information flows among the participants in offerings.

- Well-known seasoned issuers may communicate at any time orally and in writing, subject to conditions that include filing the communication with the SEC in specified circumstances.
- All reporting issuers may publish regularly released factual business information and forward-looking information.
- Non-reporting issuers may publish at any time regularly released factual business information that is intended for use by persons other than in their roles as investors or potential investors.
- Communications more than 30 days before filing a registration statement are not prohibited offers if they do not reference a securities offering that is or will be the subject of a registration statement.
- The exemptions for research reports are expanded.

### **The Registration Process**

The new rules streamline shelf registration, removing some restrictions and adding efficiencies. Well-known seasoned issuers benefit more from these changes than other categories of issuers, but seasoned issuers will find it easier to use the revised shelf-registration system.

Well-known seasoned issuers no longer must specify the amount of securities to be offered. However, the duration of the shelf registration statement is limited to three years after its initial date. Primary offerings on Forms S-3 and F-3 can now occur immediately after the effectiveness of the shelf registration statement.

***Updating and Incorporating by Reference.***

The new rules provide primary shelf-eligible issuers and well-known seasoned issuers with guidance on updating a base prospectus used in a shelf registration and allow them to add additional or omitted information to a prospectus by means other than a post-effective amendment.

Forms S-3 and F-3 are amended to allow all information required in a prospectus about the issuer and its securities to be incorporated by reference from Exchange Act reports. Such information can also be presented in the prospectus or prospectus supplement. The changes to Forms S-3 and F-3 are intended to allow disclosure requirements to be satisfied through incorporation by reference or through a filed prospectus or prospectus supplement, not to change the deadlines for filing information.

The principal exceptions to this approach are that an issuer must use a post-effective amendment to add to a registration statement new types of securities or new eligible issuers, including guarantors, and the securities they may issue. New issuers and their officers and directors must be signatories to the post-effective amendment.

A reporting issuer that has filed at least one annual report and is current on its reporting obligations under the Exchange Act may

incorporate by reference into Forms S-1 and F-1 information from its previously filed Exchange Act reports and documents. The permission is available only if the issuer makes its incorporated Exchange Act reports and other materials readily accessible on its Web site or a dedicated site maintained for it.

These changes make Forms S-2 and F-2 superfluous, so they have been rescinded.

***Prospectus Delivery.*** The new rules eliminate the requirement to deliver a hard copy of the final prospectus to each investor prior to delivering confirmation of the transaction or at the same time. The rules presume that investors have access to the Internet and that making information readily available is sufficient. Issuers and intermediaries can therefore satisfy their delivery requirements by filing the final prospectus with the SEC as part of the registration statement and notifying investors that they have purchased securities in a registered offering and have the right to request physical delivery of a final prospectus. Registered investment and business development companies, which are subject to a separate framework governing communications with investors, will not benefit from this new rule. The rules identify other transactions, such as offerings made on Form S-8 and business combinations, that are excluded from the access-equals-delivery model.

***Automatic Shelf Registration.*** Well-known seasoned issuers will be able to take advantage of a new procedure whereby a shelf registration statement becomes effective immediately upon filing without SEC staff review. This type of shelf registration can be used by well-known seasoned issuers for all primary and secondary offerings, to register unspeci-

fied amounts of different types of securities, to add additional classes of securities, and to add eligible majority-owned subsidiaries as additional registrants.

Issuers determine whether they are well-known seasoned issuers, and therefore eligible for this procedure, at the time of the first filing of the registration statement, and their status as well-known seasoned issuers is reassessed annually.

The new rules will allow a well-known seasoned issuer to omit information from the base prospectus that was historically required in a shelf registration statement. Omitted information can be added to the base prospectus by a post-effective amendment to the registration statement, incorporation by reference from an Exchange Act report, or a prospectus or prospectus supplement. The approach used to make additions depends on the type of information omitted and being added.

Effectiveness-without-review registration will speed the process by which the largest public companies raise capital in the U.S. public market and will require accelerated coordination among all offering participants.

**Section 11 Liability**

The new rules' provisions affect the definition of the shelf registration statement and its effective date for purposes of Section 11 liability.

Information in a prospectus supplement will be considered part of the registration statement. If the prospectus supplement is not required to be filed in connection with a takedown of securities, all of the supplement's information will be considered included in the registration statement as of the date the

supplement is first used. If the prospectus supplement is required to be filed in connection with a shelf takedown, all of the supplement's information will be considered part of the registration statement as of the earlier of the date it is first used or the date and time of the first contract for sale of securities in the offering to which the supplement relates.

The rules establish a new effective date for a shelf registration statement for purposes of issuers' and underwriters' liability under Section 11 in connection with a takedown.

The new effective date is the date a prospectus supplement filed in connection with the takedown or takedowns is considered part of the shelf registration statement. The new effective date will apply only to the part of the registration statement relating to the securities to which the prospectus relates.

With limited exceptions, the new provisions will not create a later Section 11 liability date than the date now applicable to other participants in the offering, including directors, signing officers, and experts.

The effective date of the shelf registration statement for auditors who previously provided a consent would not change unless a new consent is needed. The date would not change merely because the registration statement that contains their report on previously issued financial statements or previous reports on management's assessment of internal control is used for an offering. A consent would be needed if a prospectus supplement (and any Exchange Act report incorporated by reference into the prospectus and registration statement) or a post-effective amendment contains new audited financial information or other information as to which the auditor is an expert and for which a new consent is needed.

## Shell Companies

The SEC adopted new rules on shell companies that address the practice of using Form S-8 to register offerings of securities when a reporting "shell company" is combined with a formerly private business in order to make the private operating company a reporting company.\* With limited exceptions, shell companies are no longer permitted to use Form S-8 to report events that cause it to cease being a shell company. Instead they must report on Form 8-K under new Item 5.06 (Form 20-F for foreign private issuers). The Form 8-K filed with the SEC must contain the same information that would be required to register a class of securities under the Exchange Act, and it must be filed within four business days after the transaction is completed. The surviving entity may not use Form S-8 to register offerings of securities for 60 days following its filing of Form 8-K.

**Definition.** The rules define a shell company as a company that (1) is not an asset-backed issuer, (2) has no or nominal operations, and (3) has no or nominal assets, assets consisting solely of cash and cash equivalents, or some mix of cash and cash equivalents and nominal other assets. The SEC release provides no quantitative threshold to be used in assessing "nominal" in order to identify a shell company.

The release excludes from the definition a "business combination related shell company," which is defined as a shell company formed by an entity that is not a shell company solely to change that entity's domicile within the United States or to complete a business combination transaction among one or more entities other than the shell company.

Registrants that are shell companies must check a box on the cover pages of Forms 10-Q, 10-QSB, 10-K, 10-KSB, and 20 to indicate whether or not they are shell companies.

The rules on shell companies are effective August 22, 2005, except for Item 5.06 of Form 8-K, which is effective November 7, 2005.

\* SEC Release No. 33-8587, Use of Form S-8, Form 8-K, and Form F-20 by Shell Companies, July 15, 2005, available at <http://www.sec.gov/rules/final/33-8587.pdf>.

## New Disclosures

The new rules require three additional disclosures: unresolved comments from the SEC staff, risk factors, and status as a voluntary filer.

Large registrants will have to disclose unresolved material comments from the SEC

staff on their periodic reports. More specifically, accelerated filers and well-known seasoned issuers will have to disclose in their annual reports on Form 10-K or Form 20-F written comments unresolved at the time of filing made by the SEC staff on Exchange Act reports that the issuer believes are material and were issued more than 180 days



before the end of the fiscal year covered by the annual report.<sup>2</sup> The disclosure must address the substance of the staff comments and may present the issuer's position on the unresolved matter.

Under the new rules, SEC reporting companies will have to disclose risk factors in annual reports on Form 10-K and in Exchange Act registration statements on Form 10.<sup>3</sup> The disclosures would present the most significant factors that may adversely affect the issuer's business, operations, industry, financial position, or future financial performance. Previously disclosed risk factors would be updated quarterly for material changes and reported on Form 10-Q.

The SEC permits issuers that are not required to file Exchange Act reports to file voluntarily. In most cases, voluntary filers have completed a registered offering under the Securities Act and continue to file reports after their reporting obligations have been suspended. Because voluntary filers are free to stop filing their Exchange Act reports, a cover-page box, when checked, will inform readers that the filer is acting voluntarily. The box will be on the cover pages of Forms 10-K, 10-KSB, and 20-F.

The descriptive and summary statements above are not intended to substitute for the text of SEC releases No. 33-8591 and No. 33-8587 or the text of any of the other documents and requirements cited and are not necessarily applicable to any entity's specific circumstances. Entities that file with the SEC should rely on the text of the applicable documents that set out requirements and consult their legal and accounting advisors.

This is a publication of KPMG's  
Department of Professional  
Practice—Audit and Risk Advisory  
212-909-5600

**Contributing authors:**

Melanie F. Dolan  
Michael Dimitriou  
Blaine Versaw

Earlier editions are available at:  
[www.aro.kpmg.com](http://www.aro.kpmg.com)

Defining Issues® is a registered trademark of KPMG LLP © 2001-2005 KPMG LLP, the U.S. member firm of KPMG International, a Swiss cooperative. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative. All rights reserved. A16911NYGR

<sup>2</sup> The disclosures are required under new Items 1B or 4A in annual reports on Form 10-K or Form 20-F.

<sup>3</sup> New Item 1A in both Form 10-K and Form 10. The requirement refers to the same type of risk factors disclosed in a Securities Act registration statement under Item 503 of Regulation S-K.