

**NOTICE OF REQUEST FOR PUBLIC COMMENTS REGARDING PROPOSED REVISIONS TO NASAA CORPORATION FINANCE STATEMENTS OF POLICY**

**December 18, 2017**

The Corporation Finance Section of the North American Securities Administrators Association, Inc. (“NASAA”) is seeking public comments on revisions to the following NASAA Corporation Finance Statements of Policy:

- Statement of Policy Regarding Corporate Securities Definitions
- Statement of Policy Regarding Loans and Other Material Transactions
- Statement of Policy Regarding Unsound Financial Condition
- Statement of Policy Regarding Underwriting Expenses, Underwriter’s Warrants, Selling Expenses and Selling Security Holders

Comments on the proposals are due by **January 31, 2018**. To facilitate consideration of comments, please send comments to Dennis Britson ([dennis.britson@iid.iowa.gov](mailto:dennis.britson@iid.iowa.gov)), Chair of the Corporation Finance Policy Project Group; Bill Beatty ([bill.beatty@dfi.wa.gov](mailto:bill.beatty@dfi.wa.gov)), Chair of the Corporation Finance Section Committee; and Mark Stewart ([nasaacomment@nasaa.org](mailto:nasaacomment@nasaa.org)), Counsel at the [NASAA Corporate Office](#). We encourage, but do not require, comments to be submitted by e-mail. Hard copy comments may be submitted at the address below.

NASAA Legal Department  
Mark Stewart, Counsel  
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**Note:** After the comment period has closed, NASAA will post to its website the comments it receives as submitted by the authors. Parties should therefore only submit information that they wish to make publicly available. Further, the following notice will appear on NASAA’s website where comments are posted: NASAA, its agents, and employees accept no responsibility for the content of the comments posted on this Web page. The views, expressions, and opinions expressed in the comments are solely those of the author(s).

## **Discussion & Analysis**

In an effort to keep its library of policy statements, guidelines, and other model rules current, NASAA's Corporation Finance Policy Project Group is charged with the task of reviewing NASAA's guidelines and policy statements regarding corporation finance. The proposed revisions are the result of that ongoing review.

### **Statement of Policy Regarding Corporate Securities Definitions**

The definitions have been placed in alphabetical order. A few other editorial changes have been made. The substantive changes include deleting the definition of "Insolvent," which has been replaced by the definition for "Unsound Financial Condition." A conforming amendment to the definition of "Promoter's Equity Investment" has been made to reflect prior amendments to that NASAA Statement of Policy. The definitions of "Selling Expenses" and "Underwriting Expenses" have been merged into a single definition.

### **Statement of Policy Regarding Loans and Other Material Transactions**

The revisions made to this statement of policy were primarily in response to comments received from the ABA Regulation A+ Working Group (the "ABA Working Group"). The ABA Working Group objected to including "counsel" under the required representations in the disclosure document (that the issuer's officers, directors and counsel will consider their due diligence and make other representations). Generally, under federal securities laws, counsel is not obligated to affirmatively perform due diligence concerning disclosures in the offering materials. The provision was amended to remove the need for these representations from counsel.

The independent director provision within Section VI has been revised to provide if the issuer only has two independent directors on its Board, both must be disinterested in and approve loans and other material affiliated transactions.

Finally, the policy was reorganized to improve readability.

## Statement of Policy Regarding Underwriting and Selling Expenses, Underwriter’s Warrants, and Selling Security Holders

The definitions of “Selling Expenses” and “Underwriting Expenses” were merged together and the separate limits of 1) 20% for selling expenses and 2) 17% for underwriting expenses were merged into a single overall limit of 17% to make the policy less complex and avoid potential confusion.

Revisions to the valuation formula of underwriter’s warrants were made in order to comport with FINRA’s proposed change to the valuation methodology within FINRA Rule 5110.<sup>1</sup> The proposed revision allows the issuer to choose the valuation methodology they wish to use, but the issuer must file with the Administrator a description of the methodology chosen demonstrating the method is commercially available and appropriate for the warrants under valuation. If the issuer does not choose their own valuation method, they must use the formula provided within the policy.

## Statement of Policy Regarding Unsound Financial Condition

The revisions made to this statement of policy are in response to the Project Group’s concern that the typical legal definition of the term “Insolvent” is different from the way the term is used within this statement of policy and could lead to confusion. The revision uses a definition of “Unsound Financial Condition” instead, which was the approach used prior to 2008. In addition, the suitability standards have been updated to be consistent with inflation since 2008.

## **Proposed Revisions**

The proposed revisions to these four statements of policy are set forth in Exhibit A, which contains a set of clean, un-marked drafts showing the proposed statements of policy, as revised, and Exhibit B, which contains a set of marked drafts detailing the revisions made to the statements of policy.

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<sup>1</sup> FINRA, Regulatory Notice 17-15 “Corporate Financing” (April 2017) (*See* <http://www.finra.org/industry/notices/17-15>)

# **EXHIBIT A**

**STATEMENT OF POLICY REGARDING CORPORATE SECURITIES DEFINITIONS**

*Adopted April 27, 1997; Amended September 28, 1999, & March 31, 2008 and Month XX, 2018*

**I. INTRODUCTION**

This Statement of Policy Regarding Definitions applies to definitions used in the following NASAA Statements of Policy:

- Statement of Policy Regarding the Impoundment of Proceeds
- Statement of Policy Regarding Loans and Other Material Transactions
- Statement of Policy Regarding Options and Warrants
- Statement of Policy Regarding Preferred Stock
- Statement of Policy Regarding Promoters' Equity Investment
- Statement of Policy Regarding Promotional Shares
- Statement of Policy Regarding Specificity in Use of Proceeds
- Statement of Policy Regarding Underwriting and Selling Expenses, Underwriter's Warrants, and Selling Security Holders
- Statement of Policy Regarding Unsound Financial Condition
- Statement of Policy Regarding Voting Rights

**II. The following words and terms have the meanings set forth below.**

- A. Adjusted Net Earnings means the issuer's Net Earnings after charges for interest and dividends, adjusted on a pro forma basis to reflect:
  - 1. The elimination of any required charges for debt, debt securities, or preferred stock that are to be redeemed or retired from the proceeds of the public offering of preferred stock;
  - 2. The effect of any acquisitions or capital expenditures that the issuer made after its last fiscal year, or that it proposes or is required to make during the current fiscal year, which materially affect the issuer's Net Earnings;
  - 3. The effect of any dividends or charges on debt, debt securities or preferred stock issued after the issuer's last fiscal year;
  - 4. The effect of any dividends or charges on debt, debt securities or preferred stock issued during the issuer's last fiscal year, but outstanding for only a portion of the year. Such dividends or charges must be calculated as if the debt, debt securities or preferred stock had been outstanding for the entire fiscal year; and
  - 5. The effect of any other material changes to an issuer's future Net Earnings.
- B. Administrator means the agency that regulates the securities industry in the applicable jurisdiction.

- C. Affiliate means a Person who, directly or indirectly, Controls, is Controlled by, or is under common Control with a Person as defined in this statement of policy.
- D. Aggregate Revenues means the total revenues, excluding interest and extraordinary items a Person has received during:
1. The last three consecutive fiscal years immediately before the public offering, and
  2. The period during the current fiscal year for which interim period financial information is included in the prospectus.
- E. Associate, when used to indicate a relationship with a Person, includes:
1. Corporations or legal entities, other than the issuer or majority- owned subsidiaries of the issuer, of which a Person is an officer, director, partner, or a direct or indirect, legal or beneficial owner of five percent (5%) or more of any class of Equity Securities;
  2. Trusts or other estates in which a Person has a substantial beneficial interest or for which a Person serves as a trustee or in a similar capacity; and
  3. A Person's spouse and relatives, by blood or by marriage, if that Person is a Promoter of the issuer, its subsidiaries, its Affiliates, or its parent.
- F. Average Promotional Price means the average per share price paid for Promotional Shares and other shares issued prior to the public offering that are of the same class of shares being offered in the public offering as determined by reference to the audited financial statements of the issuer included in the prospectus.
- G. Cash Analysis is the issuer's "Net Cash Provided By Operating Activities" as reflected on the Statement of Cash Flows and determined in accordance with generally accepted accounting principles. If the issuer will use the proceeds of the public offering to redeem or retire debt securities, the issuer must adjust, on a pro forma basis, for the elimination of the related interest charges, net of applicable income taxes.
- H. Control means the power to direct or influence the direction of the management or policies of a Person, directly or indirectly, through the ownership of voting securities, by contract or otherwise. A presumption of Control exists for any Person who:
1. Is a director, general partner, member, manager, or officer exercising executive responsibility (or has similar status or functions);
  2. Has the right to vote twenty percent (20%) or more of a class of voting securities;  
or

3. In the case of a partnership or limited liability company, has contributed or has the right to receive upon dissolution twenty percent (20%) or more of the capital.
- I. Disclosure Document means a prospectus, information statement, offering circular or other offering document.
- J. Equity Securities include shares of common stock or similar securities, convertible securities, and warrants, and options or rights that may be converted into or exercised to purchase shares of common stock or similar securities.
- K. Escrow Agent means:
1. A financial institution whose principal place of business and domicile is in the United States or Canada and that is not affiliated with the issuer, its Promoters, or Associates. A financial institution may act as an Escrow Agent even if the issuer, its Promoters or Associates are its customers.
  2. An attorney or certified public accountant, provided that the attorney or certified public accountant:
    - i. Is not affiliated with the issuer, its Promoters, or their Associates;
    - ii. Is licensed to do business in the state in which the attorney or certified public accountant practices; and
    - iii. Can demonstrate adequate insurance or can provide a fidelity bond.
- L. Impoundment Agent means a depository institution as defined in Section 102(5) of the Uniform Securities Act of 2002 that is domiciled and whose principal place of business is located in the United States or Canada.
- M. Independent Director means a member of an issuer's board of directors who:
1. Does not receive, other than in the director's capacity as a member of the board of directors or a board committee, any consulting, advisory or other compensatory fee from the issuer, its subsidiaries, or their Affiliates or Associates;
  2. Has not received any compensation or fees from the issuer, its subsidiaries, Affiliates, or Associates within the last two years other than in the director's capacity as a member of the board of directors or a board committee;
  3. Other than serving as a director of the issuer, is not a Promoter as defined below; and

4. Does not have a material business or professional relationship with the issuer or any of its Affiliates or Associates. For purposes of determining whether or not a business or professional relationship is material, the gross revenue that the Independent Director derives from the issuer, its Affiliates and Associates is deemed material if it exceeds 5% of the Independent Director's:
    - i. Annual gross revenue, derived from all sources, during either of the last two years; or
    - ii. Net worth, on a fair market value basis.
- N. Lock-In Agreement means an agreement entered into between an issuer and a Person as a condition of registration in which the Person agrees not to dispose of or otherwise transfer Equity Securities the Person received from the issuer or that the issuer granted to the Person.
- O. Net Earnings means the issuer's after-tax earnings, excluding extraordinary and nonrecurring items, determined in accordance with generally accepted accounting principles.
- P. Person means an individual, corporation, business trust, estate, trust, partnership, limited liability company, limited liability partnership, association, joint venture, government; governmental subdivision, agency, or instrumentality; public corporation; or any legal or commercial entity.
- Q. Promoter:
1. Includes a Person who:
    - i. Alone or in conjunction with one or more Persons, directly or indirectly, took the initiative in founding or organizing the issuer or Controls the issuer;
    - ii. Directly or indirectly, receives, as consideration for property or for services rendered, five percent (5%) or more of any class of the issuer's Equity Securities or five percent (5%) or more of the proceeds from the sale of any class of the issuer's Equity Securities;
    - iii. Is an officer or director for the issuer;
    - iv. Legally or beneficially owns, directly or indirectly, five percent (5%) or more of any class of the issuer's Equity Securities; or
    - v. Is an Affiliate or an Associate of a Person specified in paragraphs i through iv, above.



2. Does not include:
  - i. A Person who receives securities or proceeds solely as underwriting compensation unless that Person otherwise comes within the term;
  - ii. An Unaffiliated Institutional Investor, who purchased the issuer's Equity Securities more than one year prior to the filing date of the issuer's registration statement; or
  - iii. At the Administrator's discretion, an Unaffiliated Institutional investor, who purchased the issuer's Equity Securities on an arm's-length basis within one year prior to the filing date of the issuer's registration statement.
- R. Promoters' Equity Investment means the total of cash and assets Promoters contributed to the issuer, provided that the Administrator accepts the value of the tangible or intangible assets.
- S. Promotional Or Development Stage Company means an issuer:
  1. That is not listed, or authorized for listing, on the New York Stock Exchange, the American Stock Exchange, the NASDAQ Global Market, or a securities exchange that the Securities and Exchange Commission determines under Section 18(b)(1) of the Securities Act of 1933 has substantially similar listing standards;
  2. That has had annual Net Earnings for each of the last two (2) consecutive fiscal years before the public offering that have been less than five percent (5%) of the aggregate public offering; or
  3. That has had average, annual Net Earnings for the last five (5) fiscal years before the public offering that have been less than five percent (5%) of the aggregate public offering.
- T. Promotional Shares mean Equity Securities that:
  1. A Promotional Or Development Stage Company has issued within five (5) years before the filing of the registration statement or will issue to its Promoters for cash or other consideration, including services rendered, patents, copyrights, and other intangibles; or
  2. An issuer that is not a Promotional Or Development Stage Company has issued within three (3) years before the filing of the registration statement or will issue to Promoters for cash or other consideration, including services rendered, patents, copyrights and other intangibles.

- U. Public Offering Price means the per share price at which a Promotional Or Development Stage Company proposes to offer Equity Securities to the public.
- V. Unaffiliated Institutional Investor means the following investors if not Affiliated with the issuer:
1. An institutional investor as defined in Section 102(11) of the Uniform Securities Act of 2002; and
  2. A business development Company as defined in Section 2(a)(48) of the Investment Company Act of 1940.
- W. Underwriter means any Person that has agreed with the issuer or with another Person on whose behalf a distribution is to be made:
1. To purchase securities for distribution;
  2. To distribute securities on behalf of the issuer or other Person; or
  3. To manage or supervise a distribution of securities on behalf of the issuer or other Person.
- X. Underwriting and Selling Expenses means the expenses directly or indirectly incurred in the sale of registered securities, including, but not limited to the following:
1. Commissions to Underwriters or broker dealers;
  2. Non-accountable fees or expenses to be paid to Underwriters or broker-dealers;
  3. The value of Underwriter's warrants;
  4. Rights of first refusal, to be valued at 1% of the public offering or the amount payable to the underwriter if the issuer terminates the right of first refusal;
  5. Solicitation fees payable to the underwriter, to be valued at the lesser of actual cost or 1% of the public offering if the fees are payable within one year of the offering;
  6. Fees payable to an underwriter under financial consulting or financial advisory agreements, or any other similar type of agreement, however designated, which shall be valued at actual cost, excluding financial consulting or financial advisory agreements that are entered into at least twelve months before the issuer files a registration statement with the Securities and Exchange Commission;

7. Underwriter's due diligence expenses;
8. Payments made either six months prior to or required to be made six months following the public offering to investor relations firms that the Underwriter designated;
9. Other underwriting expenses incurred in connection with the public offering of securities that the Administrator determines;
10. Auditor's and accountant's fees;
11. Legal fees;
12. The cost of printing Disclosure Documents required to comply with securities laws and regulations;
13. Charges of transfer agents, registrars, indenture trustees, escrow holders, depositories, engineers, appraisers, and other experts;
14. The cost of authorizing and preparing the securities, including issue taxes and stamps;
15. Expenses incurred in connection with bridge financing in the twelve month period preceding a public offering of securities, including, but not limited to:
  - i. Direct expenses attributable to the financing, including interest charges, and underwriting expenses;
  - ii. The value of warrants and options; and
  - iii. Expenses attributable to the issuance of the securities that are not options, warrants, or convertible securities valued by the following formula:  
$$\frac{(\text{Public Offering Price per share} - \text{Cost per share}) \times \text{Number of Securities Issued} \times 100}{\text{Aggregate Public Offering Proceeds}};$$
and
16. Other cash expenses incurred in connection with the public offering of securities as determined by the Administrator.

Y. Unsound Financial Condition means:

1. The auditor's report accompanying the issuer's financial statements contains an explanatory paragraph or qualification regarding the issuer's ability to continue as a going concern; or
2. One or more of the following applies:

- i. The issuer has an accumulated deficit;
- ii. The issuer has negative shareholder equity;
- iii. The issuer is not able to satisfy current obligations as they come due; or
- iv. The issuer has negative cash flow.

Drafters' Commentary: Section II.T.1 is consistent with section 305(f) of the Uniform Securities Act of 2002 (USA), which allows a state to require as a condition of registration the escrow of shares issued within the previous five years for consideration that is substantially less than the public offering price. A state that has a statutory 'look-back' that differs from the USA should modify the look-back provision of Section II.T to comply with its statute.

# STATEMENT OF POLICY REGARDING LOANS AND OTHER MATERIAL TRANSACTIONS

*Adopted April 27, 1997; Amended March 31, 2008; and Month XX, 2018*

## I. INTRODUCTION

This statement of policy applies to all applications to register by coordination or by qualification.

## II. DEFINITIONS

This statement of policy uses the following terms defined in the *NASAA Statement of Policy Regarding Corporate Securities Definitions*.

Administrator

Affiliate

Disclosure Document

Independent Director

Promoter

## III. REGISTRATION OF OFFERINGS WITH LOANS AND LOAN GUARANTEES

The issuer or its Affiliates are allowed to have the following types of loans or loan guarantees outstanding after the offering:

- A. Advances to officers, directors, and employees for travel, business expenses, and similar ordinary operating expenditures.
- B. Loans or loan guarantees to allow the issuer's officers, directors, and employees to purchase the issuer's securities, and loans for relocation of officers, directors, and employees, if the loan is approved under Section IV.
- C. Loans the issuer or its Affiliates make to its Promoters if the issuer or its Affiliates are in the primary business of making loans provided:
  1. The loans are evidenced by promissory notes naming the lender as payee;
  2. The loans bear interest at rates comparable to those that other commercial lenders normally charge for similar loans made in the lender's locale;
  3. The loans require Promoters to repay the loans under appropriate amortization schedules;
  4. The loans are supported by credit reports and financial statements that show the issuer or its Affiliates can collect the loans and that the borrowers are satisfactory credit risks, in light of the nature and terms of the loans and other circumstances;
  5. The loans meet loan policies that other commercial lenders normally use for similar loans made in the lender's locale;
  6. The issuer will review the purposes of the loans and monitor the

disbursements of proceeds in a manner that other commercial lenders normally use for similar loans made in the lender's locale;

7. The loans will not violate the requirements of any banking or other financial institution's regulatory authority; and
8. The loans contain default provisions comparable to those other commercial lenders normally use for similar loans made in the lender's locale.

D. Loans to Promoters that exist at the time of the application for registration must be repaid by Promoters in full:

1. From the proceeds of the offering, if a portion of the offering is made on behalf of a Promoter;
2. Before the offering; or
3. After the offering using appropriate amortization schedules, if the Administrator permits.

E. The Administrator may deny the offer or sale of securities if loans or loan guarantees not allowed by this Section will be outstanding after the offering.

#### **IV INDEPENDENT DIRECTORS**

- A. A majority of the issuer's Independent Directors that do not have an interest in the transaction must approve any loan or other material affiliated transaction involving its Promoters.
- B. If the issuer has only two Independent Directors on its board of directors, both Independent Directors must be disinterested in and approve loans and other material affiliated transactions.
- C. A majority of the issuer's Independent Directors that do not have an interest in the transaction must approve any loan or other material affiliated transaction involving its Promoters.
- D. If the issuer has only two Independent Directors on its board of directors, both Independent Directors must be disinterested in and approve loans and other material affiliated transactions.

#### **V. REGISTRATION OF OFFERINGS WITH MATERIAL TRANSACTIONS WITH PROMOTERS**

The following types of affiliated transactions are allowed:

- A. A material transaction approved in accordance with Section IV, if the Disclosure Document discloses the terms of the transactions and indicates whether the terms are as favorable to the issuer or its Affiliates as those generally available from unaffiliated third parties.
- B. A transaction entered into at a time when the issuer had less than two disinterested Independent Directors, if the Disclosure Document:
  - 1. Discloses the terms of the transactions;
  - 2. Indicates whether the terms are as favorable to the issuer or its Affiliates as those generally available from unaffiliated third parties; and
  - 3. Discloses that the issuer lacked sufficient disinterested Independent Directors to approve the transaction.
- C. The Administrator may deny the offer or sale of securities if the issuer or its Affiliates have engaged in any material transactions with Promoters that are not allowed by this Section.

## **VI. DISCLOSURE DOCUMENT REQUIREMENTS**

- A. The Disclosure Document must disclose whether:
  - 1. The issuer or its Affiliates have engaged or will engage in material transactions with Promoters and the relevant terms and conditions; and
  - 2. The issuer or its Affiliates have made or will make loans to Promoters, or have made or will make loan guarantees on behalf of Promoters, and the relevant terms and conditions.
- B. If the issuer or its Affiliates have engaged in loans and other material transactions with Promoters, or if the issuer or its Affiliates are not prohibited under their organizational documents or operating agreements from entering into such transactions, the Administrator may require the Disclosure Document to contain the following:
  - 1. A statement that the issuer or its Affiliates will make all future material affiliated transactions and enter into all future loans on terms that are no less favorable to the issuer than those that can be obtained from unaffiliated third parties;
  - 2. A representation that the issuer will appoint at least two Independent Directors on its board of directors to approve any future material

transactions and loans and any forgiveness of loans in accordance with Section IV prior to engaging in such transactions;

3. A statement that the issuer's officers and directors will:
  - a. Consider their due diligence and assure that there is a reasonable basis for these representations; and
  - b. Consider whether to embody the representations in the issuer's charter or bylaws.

DRAFT



**STATEMENT OF POLICY REGARDING UNSOUND FINANCIAL CONDITION**  
*Adopted on April 27, 1997; Amended September 28, 1999, March 31, 2008; and Month XX, 2018*

I. INTRODUCTION

This statement of policy applies to all applications to register by coordination or by qualification.

II. DEFINITIONS

This statement of policy uses the following terms defined in the *NASAA Statement of Policy Regarding Corporate Securities Definitions*.

Administrator  
Disclosure Document  
Unsound Financial Condition

III. SECURITIES REGISTRATION

A. Disclosure Document Requirements. If the issuer is in Unsound Financial Condition, the Disclosure Document must:

1. State prominently that persons should not invest unless they can afford to lose their entire investment; and
2. Disclose the following risk factors, if applicable:
  - a. The auditor's report accompanying the issuer's financial statements contains an explanatory paragraph or qualification regarding the issuer's ability to continue as a going concern;
  - b. The issuer lacks revenue from operations, with an explanation of how the issuer has been financing operations;
  - c. The presence and amount of any accumulated deficit;
  - d. The presence and amount of any negative shareholder's equity; or

e. The need for future financing.

B. Suitability Standards. The Administrator may limit the sale of securities by an issuer that is in Unsound Financial Condition to accredited investors or impose specific suitability standards based on the risks of the offering. Unless otherwise required or allowed by the Administrator, public investors must have the following:

1. A minimum annual gross income of \$80,000 and a minimum net worth of \$80,000, exclusive of automobile, home and home furnishings, or
2. A minimum net worth of \$280,000, exclusive of automobile, home and home furnishings.

These suitability standards do not relieve a dealer from the responsibility to make an independent determination of suitability required under industry standards.

C. Analysis of Issuer's Financial Condition. The Administrator may permit an issuer in Unsound Financial Condition to sell securities if the issuer demonstrates, using pro forma financial statements acceptable to the Administrator, that the offering proceeds and the issuer's long-term business plan will improve the issuer's financial condition. Pro forma financial statements must include a description and documentation of any material assumptions and demonstrate when the issuer expects to be profitable.

D. Denial of Registration. If the issuer cannot demonstrate to the satisfaction of the Administrator that the offering proceeds and the issuer's long-term business plan will improve the issuer's financial condition, or if other provisions of this policy are not satisfied, the Administrator may deny the application.

**STATEMENT OF POLICY REGARDING  
UNDERWRITING AND SELLING EXPENSES,  
UNDERWRITER'S WARRANTS AND SELLING SECURITY HOLDERS**  
*Adopted on April 27, 1997; Amended on September 28, 1999, March 31, 2008,  
and Month XX, 2018*

**I. INTRODUCTION**

This statement of policy applies to all applications to register by coordination and or by qualification.

**II. DEFINITIONS**

This statement of policy uses the following terms defined in the NASAA *Statement of Policy Regarding Corporate Securities Definitions*.

Administrator  
Disclosure Document  
Underwriter  
Underwriting and Selling Expenses

**III. LIMITS ON UNDERWRITING EXPENSES AND SELLING EXPENSES**

The amount of Underwriting and Selling Expenses may not exceed seventeen percent (17%) of the gross proceeds from the offering.

**IV. SELLING SECURITY HOLDERS**

Selling security holders may not offer more than ten percent (10%) of the securities for sale in the offering unless either of the following apply:

- A. The Disclosure Document discloses that selling security holders will pay the following amount of Underwriting and Selling Expenses, as applicable:
  1. Selling security holders offering at least ten percent (10%) but not more than fifty percent (50%) of the registered securities pay a pro rata share of all Underwriting and Selling Expenses of the offering, excluding the legal and accounting expenses of the offering, and
  2. Selling security holders offering more than fifty percent (50%) of the registered securities pay a pro rata share of all Underwriting and Selling Expenses of the offering.
- B. The selling security holders have a written agreement with the issuer entered into at arm's-length, under which the issuer pays all of the Underwriting and Selling Expenses of the selling security holder (excluding compensation to any Underwriter or broker-dealer).

## V. RESTRICTIONS ON WARRANTS GRANTED TO UNDERWRITERS

Warrants granted to Underwriters are subject to the following restrictions:

- A. The Underwriter must be a managing Underwriter.
- B. The offering must be either a firmly underwritten offering or a “minimum-maximum” offering. Options or warrants may be issued in a “minimum-maximum” offering only if:
  1. The options or warrants are issued on a pro rata basis, and
  2. The “minimum” amount of securities has been sold.
- C. The exercise price of the warrants must be at least equal to the offering price.
- D. The number of shares covered by the Underwriter’s options or warrants must not exceed ten percent (10%) of the shares of common stock actually sold in the offering.
- E. The options or warrants must not be exercisable more than five (5) years after the offering is completed.
- F. The options or warrants must not be exercisable during the first year after the offering is completed.
- G. The options or warrants may not be transferred, except:
  1. To partners of the Underwriter, if the Underwriter is a partnership.
  2. To officers and employees of the Underwriter, who are also shareholders of the Underwriter, if the Underwriter is a corporation, or
  3. By will, under the laws of descent and distribution, or by operation of law.
- H. The warrant agreement may not allow for a reduction in the exercise price of the options or warrants resulting from the issuer subsequently issuing shares except if the issuer issues shares under:
  1. a stock dividend or stock split, or
  2. a merger, consolidation, reclassification, reorganization,

recapitalization, or sale of assets.

## VI. VALUATION OF UNDERWRITER'S WARRANTS

The issuer must file a description of the methodology used to value any warrants received or to be received as underwriting compensation. The issuer must demonstrate to the Administrator that its valuation method is commercially available and appropriate for the warrants to be valued.

Otherwise, the value is determined by following formula.

1. Calculate 165% of the aggregate offering price;
2. Multiply the exercise price by the number of shares offered;
3. Subtract the result of step two from the result of step one;
4. Divide the result of step three by 2;
5. Divide the number of shares underlying the warrants by the number of shares offered;
6. Multiply the result from step 4 by the result from step 5. The result is the dollar value of the underwriter's warrants.

$$\frac{[1.65 \times \text{aggregate offering price}] - [\text{exercise price} \times (\# \text{ of shares offered})]}{2} \times \frac{\# \text{ shares underlying the warrants}}{\# \text{ of shares offered}}$$

(sample calculation follows on next page)

## A Sample Calculation of Warrant Value

The following information is used in the sample calculation:

- Offering of 1,000,000 shares at \$5.00 per share
- Underwriter's warrant of 100,000 shares (10%) exercisable at 120% of the \$5.00 offering price (i.e. the exercise price is \$6.00), starting one year after completion of the offering.

$$\frac{[1.65 \times (1,000,000 \text{ shares} \times \$5.00)] - (\$6.00 \times 1,000,000)}{2} \times \frac{100,000}{1,000,000}$$

$$\frac{[1.65 \times \$5,000,000] - \$6,000,000}{2} \times .10$$

$$\frac{\$8,250,000 - \$6,000,000}{2} \times .10$$

$$\frac{\$2,250,000}{2} \times .10$$

$$\$1,125,000 \times .10 = \$112,500$$

Accordingly, the resulting value of the underwriter's warrants is \$112,500. The percentage value of the underwriter's warrants is 2.25% (the \$112,500 value of the underwriter's warrants divided by the \$5,000,000 aggregate offering price).

# **EXHIBIT B**

# STATEMENT OF POLICY REGARDING CORPORATE SECURITIES DEFINITIONS

Adopted April 27, 1997; Amended September 28, 1999, & March 31, 2008 and Month XX, 20142018

## I. INTRODUCTION

This Statement of Policy Regarding Definitions applies to definitions used in the following NASAA Statements of Policy:

Statement of Policy Regarding the Impoundment of Proceeds  
Statement of Policy Regarding Loans and Other Material ~~Affiliated~~ Transactions  
Statement of Policy Regarding Options and Warrants  
Statement of Policy Regarding Preferred Stock  
Statement of Policy Regarding Promoters' Equity Investment  
Statement of Policy Regarding Promotional Shares  
Statement of Policy Regarding Specificity in Use of Proceeds  
Statement of Policy Regarding Underwriting and Selling Expenses, ~~and~~ Underwriter's Warrants, and Selling Security Holders  
Statement of Policy Regarding Unsound Financial Condition  
Statement of Policy Regarding Voting Rights

## II. The following words and terms ~~shall~~ have the following meanings, unless the context clearly indicates otherwise meanings set forth below.

- A. Adjusted Net Earnings means the issuer's Net Earnings after charges for interest and dividends, adjusted on a pro forma basis to reflect:
1. The elimination of any required charges for debt, debt securities, or preferred stock that are to be redeemed or retired from the proceeds ~~derived from~~ of the public offering of preferred stock;
  2. The effect of any acquisitions or capital expenditures that the issuer made after its last fiscal year, or that it proposes or is required to make during the current fiscal year, which materially affect the issuer's Net Earnings;
  3. The effect of any ~~charges or~~ dividends or charges on debt, debt securities or preferred stock issued after the issuer's last fiscal year;
  4. The effect of any ~~charges or~~ dividends or charges on debt, debt securities or preferred stock issued during, ~~but outstanding for only a portion of,~~ the issuer's last fiscal year, but outstanding for only a portion of the year. Such dividends or charges must be calculated as if the debt, debt securities or preferred stock had been outstanding for the entire fiscal year; and
  5. The effect of any other material changes to an issuer's future Net Earnings.



- B. Administrator means the agency that regulates the securities industry in the applicable jurisdiction.
- C. ~~An~~ Affiliate means a Person who, directly or indirectly, Controls, is Controlled by, or is under common Control with ~~the a~~ Person as defined referred to in this ~~Definitions~~ statement of Policy.
- D. Aggregate Revenues means the total revenues, excluding interest and extraordinary items a Person has received during:
1. ~~€~~The last three consecutive fiscal years immediately before the public offering, and
  2. ~~€~~The period ~~in~~ during the current fiscal year for which interim period financial information is included in the prospectus.
- E. ~~An~~ Associate, when used to indicate a relationship with a Person, includes:
1. Corporations or legal entities, other than the issuer or majority- owned subsidiaries of the issuer, of which a Person is an officer, director, partner, or a direct or indirect, legal or beneficial owner of five percent (5%) or more of any class of Equity Securities;
  2. Trusts or other estates in which a Person has a substantial beneficial interest or for which a Person serves as a trustee or in a similar capacity; and
  3. A Person's spouse and relatives, by blood or by marriage, if ~~the~~ that Person is a Promoter of the issuer, its subsidiaries, its Affiliates, or its parent.
- F. Average Promotional Price means the average per share price paid for Promotional Shares and other shares issued prior to the public offering that are of the same class of shares being offered in the public offering as determined by reference to the audited financial statements of the issuer included in the prospectus.
- G. Cash Analysis is the issuer's "Net Cash Provided By Operating Activities" as reflected on the Statement of Cash Flows and determined in accordance with generally accepted accounting principles. If the issuer will use the proceeds of the public offering to redeem or retire debt securities, the issuer must adjust, on a pro forma basis, for the elimination of the related interest charges, net of applicable income taxes.
- H. Control means the power to direct or influence the direction of the management or policies of a Person, directly or indirectly, through the ownership of voting securities, by contract or otherwise. A presumption of Control exists for any Person who:

1. Is a director, general partner, member, manager, or officer exercising executive responsibility (or has similar status or functions);
2. Has the right to vote twenty percent (20%) or more of a class of voting securities;  
or
- ~~1.3.~~ In the case of a partnership or limited liability company, has contributed or has the right to receive upon dissolution twenty percent (20%) or more of the capital.

~~H.I.~~ Disclosure Document means a prospectus, information statement, offering circular or other offering document.

~~I.J.~~ Equity Securities include shares of common stock or similar securities, convertible securities, and warrants, and options or rights that may be converted into or exercised to purchase, shares of common stock or similar securities.

~~J.K.~~ An Escrow Agent means:

1. ~~a~~A financial institution whose principal place of business and domicile is in the United States or Canada and that is not affiliated with the ~~I~~issuer, its Promoters, or Associates. A financial institution may act as an Escrow Agent even if the issuer, its Promoters or Associates are its customers.
2. ~~a~~An attorney or certified public accountant, provided that the attorney or certified public accountant:
  - i. ~~i~~Is not affiliated with the issuer, its Promoters, or their Associates;
  - ii. ~~i~~Is licensed to do business in the state in which the attorney or certified public accountant practices; and
  - iii. ~~e~~Can demonstrate adequate insurance or can provide a fidelity bond.

~~K.L.~~ An Impoundment Agent means a depository institution as defined in Section 102(5) of the Uniform Securities Act of 2002 that is domiciled and whose principal place of business is located in the United States or Canada.

~~L.M.~~ An Independent Director means a member of an issuer's board of directors who:

1. Does not receive, other than in ~~his or her~~the director's capacity as a member of the board of directors or a board committee, any consulting, advisory or other compensatory fee from the issuer, its subsidiaries, or their Affiliates or Associates;
2. Has not received, ~~other than in his or her capacity as a member of the board of directors or a board committee,~~ any consulting, advisory or other compensatory

~~fee compensation or fees~~ from the issuer, its subsidiaries, ~~or their~~ Affiliates, or Associates within the last two years other than in the director's capacity as a member of the board of directors or a board committee;

3. Other than serving as a director of the issuer, is not a Promoter as defined below; and
4. Does not have a material business or professional relationship with the issuer or any of its Affiliates or Associates. For purposes of determining whether or not a business or professional relationship is material, the gross revenue that the Independent Director derives from the issuer, its Affiliates and Associates is deemed material if it exceeds 5% of the Independent Director's:
  - i. ~~a~~Annual gross revenue, derived from all sources, during either of the last two years; or
  - ii. ~~n~~Net worth, on a fair market value basis.

~~M. — A Person is Insolvent if it:~~

- ~~1. — Has an accumulated deficit;~~
- ~~2. — Has negative shareholder equity;~~
- ~~3. — Is unable to satisfy current obligations as they come due;~~
- ~~4. — Has negative cash flow; or~~
- ~~5. — Has financial statements that include a footnote or explanatory paragraph in the auditor's report regarding the issuer's ability to continue as a going concern.~~

- N. Lock-In Agreement means an agreement entered into between an issuer and a Person as a condition of registration in which the Person agrees not to dispose of or otherwise transfer Equity Securities the Person received from the issuer or that the issuer granted to the Person.
- O. Net Earnings means the issuer's after-tax earnings, excluding extraordinary and nonrecurring items, determined in accordance with generally accepted accounting principles.
- P. Person ~~has the same meaning as set forth in Section 102(20) of the Uniform Securities Act of 2002~~ means an individual, corporation, business trust, estate, trust, partnership, limited liability company, limited liability partnership, association, joint venture, government; governmental subdivision, agency, or instrumentality; public corporation; or any legal or commercial entity.

Q. Promoter:

1. Includes a Person who:

- i. Alone or in conjunction with one or more Persons, directly or indirectly, took the initiative in founding or organizing the issuer or Controls the issuer;
- ii. Directly or indirectly, receives, as consideration for property or for services rendered, five percent (5%) or more of any class of the issuer's Equity Securities or five percent (5%) or more of the proceeds from the sale of any class of the issuer's Equity Securities;
- iii. Is an officer or director for the issuer;
- iv. Legally or beneficially owns, directly or indirectly, five percent (5%) or more of any class of the issuer's Equity Securities; or
- v. Is an Affiliate or an Associate of a Person specified in paragraphs i through iv, above.

2. Does not include:

- i. A Person who receives securities or proceeds solely as underwriting compensation unless that Person otherwise comes within the term;
- ii. An Unaffiliated Institutional Investor, who purchased the issuer's Equity Securities more than one year prior to the filing date of the issuer's registration statement; ~~or~~
- iii. At the Administrator's discretion, an Unaffiliated Institutional investor, who purchased the issuer's Equity Securities on an arm's-length basis within one year prior to the filing date of the issuer's registration statement.

R. Promoters' Equity Investment means the total of cash and assets Promoters contributed to the issuer, provided that the Administrator accepts the value of the tangible or intangible assets. ~~The Administrator may require the issuer to adjust Promoters' Equity Investment by the issuer's earned surplus immediately prior to the public offering.~~

S. Promotional Or Development Stage Company means an issuer:

1. That is not listed, or authorized for listing, on the New York Stock Exchange, the American Stock Exchange, the NASDAQ Global Market, or a securities

exchange that the Securities and Exchange Commission determines under Section 18(b)(1) of the Securities Act of 1933 has substantially similar listing standards;

2. That has had annual Net Earnings for each of the last two (2) consecutive fiscal years before the public offering that have been less than five percent (5%) of the aggregate public offering; or
3. That has had average, annual Net Earnings for the last five (5) fiscal years before the public offering that have been less than five percent (5%) of the aggregate public offering.

T. Promotional Shares mean Equity Securities that:

1. A Promotional Or Development Stage Company has issued within five (5) years before the filing of the registration statement or will issue to its Promoters for cash or other consideration, including services rendered, patents, copyrights, and other intangibles; or
2. An issuer that is not a Promotional Or Development Stage Company has issued within three (3) years before the filing of the registration statement or will issue to Promoters for cash or other consideration, including services rendered, patents, copyrights and other intangibles.

U. Public Offering Price means the per share price at which a Promotional Or Development Stage Company proposes to offer Equity Securities to the public.

~~V. The term Selling Expenses means the expenses directly or indirectly incurred in the sale of the registered securities, including, but not limited to, the following:~~

- ~~1. Commissions to Underwriters or broker-dealers,~~
- ~~2. Non-accountable fees or expenses to be paid to the Underwriters or broker-dealers,~~
- ~~3. Auditor's and accountant's fees,~~
- ~~4. Legal fees,~~
- ~~5. The cost of printing Disclosure Documents required to comply with securities laws and regulations,~~
- ~~6. Charges of transfer agents, registrars, indenture trustees, escrow holders, depositories, engineers, appraisers, and other experts,~~
- ~~7. The cost of authorizing and preparing the securities, including issue taxes and stamps,~~

- ~~8. Financial consulting and financial advisory agreements with an Underwriter or any similar type agreement or fees, however designated, which shall be valued at actual cost, excluding financial and consulting agreements that are entered into at least twelve months before the issuer files a registration statement with the Securities and Exchange Commission;~~
- ~~9. Payments made either six months prior to or required to be made six months following the public offering to investor relations firms that the Underwriter designated;~~
- ~~10. Other cash expenses incurred in connection with the public offering of securities that the Administrator determines; and~~
- ~~11. Expenses incurred in connection with bridge financing in the twelve month period preceding a public offering of securities, including, but not limited to:
 
  - ~~i. Direct expenses attributable to the financing, including interest charges, underwriting and selling expenses.~~
  - ~~ii. The value of warrants and options.~~
  - ~~iii. Expenses attributable to the issuance of the securities that are not options, warrants, or convertible securities valued by the following formula:~~~~

$$\frac{(\text{Public Offering Price per share} - \text{Cost per share}) \times \text{Number of Securities Issued} \times 100}{\text{Aggregate Public Offering Proceeds}}$$

~~W.V.~~ Unaffiliated Institutional Investor means the following investors if not Affiliated with the issuer:

- ~~1. An institutional investor as defined in Section 102(11) of the Uniform Securities Act of 2002; and~~
- ~~2. A business development Company as defined in Section 2(a)(48) of the Investment Company Act of 1940.~~

~~X.W.~~ Underwriter means any Person that has agreed with the ~~I~~ issuer or with another Person on whose behalf a distribution is to be made:

- ~~1. To purchase securities for distribution;~~
- ~~2. To distribute securities on behalf of the issuer or other Person; or~~

3. To manage or supervise a distribution of securities on behalf of the issuer or other Person.

Y.X. ~~The term~~ Underwriting and Selling Expenses means the expenses directly or indirectly incurred in the sale of registered securities, including~~includes~~, but ~~are~~ not limited to the following;

1. Commissions to Underwriters or broker dealers;
2. Non-accountable fees or expenses to be paid to Underwriters or broker~~—~~dealers;
3. The value of Underwriter's warrants;
4. Rights of first refusal, to be valued at 1% of the public offering or the amount payable to the underwriter if the issuer terminates the right of first refusal;
5. Solicitation fees payable to the underwriter, to be valued at the lesser of actual cost or 1% of the public offering if the fees are payable within one year of the offering;
6. Fees payable to an underwriter under Ffinancial consulting or financial advisory agreements, ~~with an underwriter~~ or any other similar type of agreement ~~or fees~~, however designated, which shall ~~to~~ be valued at actual cost, excluding financial consulting or financial advisory agreements that are entered into at least twelve months before the issuer files a registration statement with the Securities and Exchange Commission;
7. Underwriter's due diligence expenses;
8. Payments made either six months prior to or required to be made six months following the public offering to investor relations firms that the Underwriter designated; ~~and~~
9. Other underwriting expenses incurred in connection with the public offering of securities that the Administrator determines;
10. Auditor's and accountant's fees;
11. Legal fees;
12. The cost of printing Disclosure Documents required to comply with securities laws and regulations;
13. Charges of transfer agents, registrars, indenture trustees, escrow holders, depositories, engineers, appraisers, and other experts;

14. The cost of authorizing and preparing the securities, including issue taxes and stamps;

15. Expenses incurred in connection with bridge financing in the twelve month period preceding a public offering of securities, including, but not limited to:

i. Direct expenses attributable to the financing, including interest charges, and underwriting expenses;

ii. The value of warrants and options; and

iii. Expenses attributable to the issuance of the securities that are not options, warrants, or convertible securities valued by the following formula:

$$\frac{(\text{Public Offering Price per share} - \text{Cost per share}) \times \text{Number of Securities Issued} \times 100}{\text{Aggregate Public Offering Proceeds}};$$
 and

16. Other cash expenses incurred in connection with the public offering of securities as determined by the Administrator.

Y. Unsound Financial Condition means:

1. The auditor's report accompanying the issuer's financial statements contains an explanatory paragraph or qualification regarding the issuer's ability to continue as a going concern; or

2. One or more of the following applies:

i. The issuer has an accumulated deficit;

ii. The issuer has negative shareholder equity;

iii. The issuer is not able to satisfy current obligations as they come due; or

iv. The issuer has negative cash flow.

Drafters' Commentary: Section II.~~R-T~~.1 ~~has been revised to be is~~ consistent with section 305(f) of the Uniform Securities Act of 2002 (USA), which allows a state to require as a condition of registration the escrow of shares issued within the previous five years for consideration that is substantially less than the public offering price. A state that has a statutory 'look-back' that differs from the USA should modify the look-back provision of Section II.~~R-T~~ to comply with ~~that-its~~ statute.



# STATEMENT OF POLICY REGARDING LOANS AND OTHER MATERIAL TRANSACTIONS

Adopted April 27, 1997; Amended March 31, 2008 and Month XX, 2018

## **I. INTRODUCTION**

This statement of policy applies to all applications to register by coordination or by qualification.

## **II. DEFINITIONS**

This statement of policy uses the following ~~terms defined~~ definitions adopted by the North American Securities Administrators Association, Inc. (“NASAA”) in the *NASAA Statement of Policy Regarding Corporate Securities Definitions*.

Administrator

Affiliate

Disclosure Document

Independent Director

Promoter

## **III. REGISTRATION OF OFFERINGS WITH LOANS AND LOAN GUARANTEES**

~~The Administrator may deny the offer or sale of securities if:~~

- ~~A. The issuer or its Affiliates have loans outstanding after the offering that are not permitted by this Statement of Policy;~~
- ~~B. The issuer or its Affiliates have engaged in material transactions with Promoters that are not permitted by this Statement of Policy; or~~
- ~~C. Required representations and statements are not included in the Disclosure Document.~~

## **IV. LOANS AND LOAN GUARANTEES**

The issuer or its ~~a~~Affiliates are ~~permitted~~ allowed to have the following types of loans or loan guarantees outstanding after the offering:

- A. Advances to officers, directors, and employees for travel, business expenses, and similar ordinary operating expenditures.
- B. Loans or loan guarantees to allow the issuer’s officers, directors, and employees to purchase the issuer’s securities, and loans for relocation of officers, directors, and employees, if the loan is approved under Section ~~VI~~ IV.

C. Loans the issuer or its Affiliates make to its Promoters if ~~an~~ the issuer or its Affiliates are in the primary business of making loans, provided and if:

1. The loans are evidenced by promissory notes naming the lender as payee;
2. The loans bear interest at rates comparable to those that other commercial lenders normally charge for similar loans made in the lender's locale;
3. The loans require Promoters to repay the loans under appropriate amortization schedules;
4. The loans are supported by credit reports and financial statements that show the issuer or its Affiliates can collect the loans and that the borrowers are satisfactory credit risks, in light of the nature and terms of the loans and other circumstances;
5. The loans meet loan policies that other commercial lenders normally use for similar loans made in the lender's locale;
6. The issuer will review the purposes of the loans and monitor the disbursements of proceeds in a manner that other commercial lenders normally use for similar loans made in the lender's locale;
7. The loans will not violate the requirements of any banking or other financial institution's regulatory authority; and
8. The loans contain default provisions comparable to those other commercial lenders normally use for similar loans made in the lender's locale.

#### **~~V. REPAYMENT OF LOANS~~**

D. Loans to Promoters that exist at the time of the application for registration must be repaid by Promoters in full:

1. From the proceeds of the offering, if a portion of the offering is made on behalf of a Promoter;
2. Before the offering; or
3. After the offering using appropriate amortization schedules, if the Administrator permits.

E. The Administrator may deny the offer or sale of securities if loans or loan guarantees not allowed by this Section will be outstanding after the offering.

#### **~~VI. IV. INDEPENDENT DIRECTORS~~**

A. A majority of the issuer's Independent Directors that do not have an interest in the transaction must approve any loan or other material affiliated transaction involving its Promoters. If there have been or will be loans and other material affiliated transactions, the Disclosure Document must represent that the issuer

*STATEMENT OF POLICY REGARDING LOANS AND OTHER MATERIAL TRANSACTIONS*

~~will maintain at least two Independent Directors on its board of directors.~~

- ~~B. If the issuer has only two Independent Directors on its board of directors, both Independent Directors must be disinterested in and approve loans and other material affiliated transactions. The issuer must provide Independent Directors with access, at the issuer's expense, to legal counsel for the issuer or independent legal counsel.~~
- C. A majority of the issuer's Independent Directors that do not have an interest in the transaction must approve any loan or other material affiliated transaction involving its Promoters.
- D. If the issuer has only two Independent Directors on its board of directors, both Independent Directors must be disinterested in and approve loans and other material affiliated transactions.

## **VII. DISCLOSURE REQUIREMENTS**

- ~~A. Loans. The issuer must disclose in the Disclosure Document whether or not it or its Affiliates have made or will make loans to or have made or will make loan-guarantees on behalf of Promoters and the relevant terms and conditions.~~
- ~~B. Affiliated Transactions. The issuer shall disclose in the Disclosure Document whether or not it or its Affiliates have engaged or will engage in material transactions with Promoters and the relevant terms and conditions.~~
- ~~C. Representations. The Administrator may require the following statements and representations to appear in the Disclosure Document.
  - ~~1. A statement that the issuer or its Affiliates will make all future material-affiliated transactions and enter into all future loans on terms that are no less favorable to the issuer than those that can be obtained from unaffiliated third parties.~~
  - ~~2. A statement that a majority of the issuer's Independent Directors will approve all future material transactions and loans, and any forgiveness of loans, in accordance with Section VI.~~
  - ~~3. A statement that the issuer's officers, directors, and counsel will:
    - ~~a. Consider their due diligence and assure that there is a reasonable basis for these representations, and~~
    - ~~b. Consider whether to embody the representations in the issuer's charter or bylaws.~~~~~~

## **VIII. V. REGISTRATION OF OFFERINGS WITH MATERIAL TRANSACTIONS WITH PROMOTERS**

The following types of affiliated transactions are allowed:

- A. A material transaction approved in accordance with Section IV ~~VI~~, if the Disclosure Document discloses the terms of the transactions and indicates whether the terms are as favorable to the issuer or its Affiliates as those generally available from unaffiliated third parties.
- B. A transaction entered into at a time when the issuer had less than two disinterested Independent Directors, if the Disclosure Document:
  - 1. Discloses the terms of the transactions;
  - 2. Indicates whether the terms are as favorable to the issuer or its Affiliates as those generally available from unaffiliated third parties; and
  - 3. Discloses that the issuer lacked sufficient disinterested Independent Directors to approve the transaction ~~at the time of the transactions were initiated.~~
- C. The Administrator may deny the offer or sale of securities if the issuer or its Affiliates have engaged in any material transactions with Promoters that are not allowed by this Section.

~~The Administrator expects the issuer and its officers and directors to consider their due diligence and other obligations to demonstrate a reasonable basis for these representations.~~

## VI. DISCLOSURE DOCUMENT REQUIREMENTS

- A. The Disclosure Document must disclose whether:
  - a. The issuer or its Affiliates have engaged or will engage in material transactions with Promoters and the relevant terms and conditions; and
  - b. The issuer or its Affiliates have made or will make loans to Promoters, or have made or will make loan guarantees on behalf of Promoters, and the relevant terms and conditions.
- B. If the issuer or its Affiliates have engaged in loans and other material transactions with Promoters, or if the issuer or its Affiliates are not prohibited under their organizational documents or operating agreements from entering into such transactions, the Administrator may require the Disclosure Document to contain the following:
  - a. A statement that the issuer or its Affiliates will make all future material affiliated transactions and enter into all future loans on terms that are no less favorable to the issuer than those that can be obtained from unaffiliated third parties;
  - b. A representation that the issuer will appoint at least two Independent Directors on its board of directors to approve any future material transactions and loans and any forgiveness of loans in accordance with

Section IV prior to engaging in such transactions:

- c. A statement that the issuer's officers and directors will:
  - i. Consider their due diligence and assure that there is a reasonable basis for these representations; and
  - ii. Consider whether to embody the representations in the issuer's charter or bylaws.

DRAFT

# STATEMENT OF POLICY REGARDING UNSOUND FINANCIAL CONDITION

*Adopted on April 27, 1997; Amended September 28, 1999; ~~and~~ March 31, 2008 and Month XX, 2018*

## I. INTRODUCTION

This statement of policy applies to all applications to register by coordination or by qualification.

## II. DEFINITIONS

This statement of policy uses the following terms defined in the NASAA *Statement of Policy Regarding Corporate Securities Definitions*.

Administrator

Disclosure Document

~~Insolvent~~

Unsound Financial Condition

## III. ~~DENIAL OF~~ SECURITIES REGISTRATION

A. Disclosure Document Requirements. If the issuer is in Unsound Financial Condition, the Disclosure Document must: ~~The Administrator may deny the registration if the issuer is Insolvent.~~

1. State prominently that persons should not invest unless they can afford to lose their entire investment; and
2. Disclose the following risk factors, if applicable:
  - a. The auditor's report accompanying the issuer's financial statements contains an explanatory paragraph or qualification regarding the issuer's ability to continue as a going concern.
  - b. The issuer lacks revenue from operations, with an explanation of how the issuer has been financing operations;
  - c. The presence and amount of any accumulated deficit;
  - d. The presence and amount of any negative shareholders equity; or
  - e. The need for future financing.

B. ~~The Administrator may permit an Insolvent issuer to sell securities if the issuer demonstrates that the offering proceeds and the issuer's long term business plan will improve the issuer's financial condition. The~~

~~Administrator may require pro forma financial statements acceptable to the Administrator. The pro forma financial statements must include a description and documentation of any material assumptions and demonstrate when the issuer expects to be profitable. Suitability Standards. The Administrator may limit the sale of securities by an issuer that is in Unsound Financial Condition to accredited investors or impose specific suitability standards based on the risks of the offering. Unless otherwise required or allowed by the Administrator, public investors must have the following:~~

- ~~1. A minimum annual gross income of \$80,000 and a minimum net worth of \$80,000, exclusive of automobile, home and home furnishings, or~~
- ~~2. A minimum net worth of \$280,000, exclusive of automobile, home and home furnishings.~~

~~These suitability standards do not relieve a dealer from responsibility to make an independent determination of suitability required under industry standards.~~

- ~~C. Analysis of Issuer's Financial Condition. The Administrator may permit an issuer in Unsound Financial Condition to sell securities if the issuer demonstrates, using pro forma financial statements acceptable to the Administrator, that the offering proceeds and the issuer's long-term business plan will improve the issuer's financial condition. Pro forma financial statements must include a description and documentation of any material assumptions and demonstrate when the issuer expects to be profitable.~~
- ~~D. Denial of Registration. If the issuer cannot demonstrate to the satisfaction of the Administrator that the offering proceeds and the issuer's long-term business plan will improve the issuer's financial condition, or if other provisions of this policy are not satisfied, the Administrator may deny the application.~~

#### ~~IV. DISCLOSURE REQUIREMENTS~~

~~If the issuer is insolvent, the Disclosure Document must disclose the following prominently:~~

~~A. Persons should not invest unless they can afford to lose their entire investment; and~~

~~B. The following risk factors, if applicable:~~

- ~~1. The presence of an explanatory paragraph in the independent~~  
*STATEMENT OF POLICY REGARDING UNSOUND FINANCIAL CONDITION*

auditor's report;

- ~~2. The issuer's lack of revenue from operations and an indication of how the issuer has been financing operations;~~
- ~~3. The presence and amount of any accumulated deficit;~~
- ~~4. The presence and amount of any negative shareholder's equity; or~~
- ~~5. The need for future financing.~~

#### ~~V. SUITABILITY STANDARDS~~

- ~~A. If the issuer is Insolvent, the Administrator may impose net worth standards or limit the sale of securities to accredited investors instead of, or in addition to, the requirements in Sections IV and V. The imposition of these minimal net worth standards does not relieve a dealer from the responsibility to make an independent determination of suitability required under industry standards.~~
- ~~B. Unless the Administrator determines that the risk associated with the offering would require lower standards, public investors must have the following:
  - ~~1. A minimum annual gross income of \$70,000 and a minimum net worth of \$70,000, exclusive of automobile, home and home furnishings, or~~
  - ~~2. A minimum net worth of \$250,000, exclusive of automobile, home and home furnishings.~~~~



**STATEMENT OF POLICY REGARDING  
UNDERWRITING AND SELLING EXPENSES,  
UNDERWRITER'S WARRANTS, ~~SELLING EXPENSES~~ AND SELLING  
SECURITY HOLDERS**

*Adopted on April 27, 1997; Amended on September 28, 1999 ~~and~~, March  
31, 2008, and Month XX, 2018*

**I. INTRODUCTION**

This statement of policy applies to all applications to register by coordination and or by qualification.

**II. DEFINITIONS**

This statement of policy uses the following terms defined in the NASAA Statement of Policy Regarding Corporate Securities Definitions.  
~~Statement of Policy Regarding Corporate Securities Definitions.~~

Administrator

Disclosure Document

Underwriter

Underwriting and Selling Expenses ~~Underwriter~~

**III. LIMITS ON UNDERWRITING EXPENSES AND SELLING EXPENSES**

The amount of  
Underwriting and  
Selling Expenses

**I. GROUND~~S~~ FOR DENIAL OF SECURITIES REGISTRATIONS**

~~The Administrator may deny the registration of securities if:~~

~~The underwriting expenses not exceed seventeen percent (17%) of the gross proceeds from the public offering.~~

~~A. The selling expenses of the offering exceed twenty percent (20%) of the gross proceeds from the public offering, or~~

**IV. SELLING SECURITY HOLDERS**

~~B. Selling security holders are offering may not offer more than ten percent (10%) of the securities for sale in the public offering.~~

**H. SELLING SECURITY HOLDERS.**

~~The Administrator may permit a public offering or sale of securities that includes selling security holders offering more than ten percent (10%) of the~~

~~securities for sale in the public offering if unless~~ either of the following apply:

- A. The Disclosure Document discloses ~~the amount of selling expenses that the~~ that selling security holders will pay ~~the following amount of Underwriting and Selling Expenses, as applicable:~~
1. Selling security holders offering at least ten percent (10%) but not more than fifty percent (50%) of the registered securities pay a pro rata share of all Underwriting and Selling Expenses of the public offering, excluding the legal and accounting expenses of the offering, and expenses of the public offering, and
  2. Selling security holders offering more than fifty percent (50%) of the registered securities pay a pro rata share of all Underwriting and Selling Expenses of the public offering.
- B. ~~With the exception of Underwriter's or broker-dealer's compensation,~~ The selling security holders have a written agreement with the issuer ~~that was~~ entered into in an arm's-length transaction, under which the issuer ~~agreed to pay~~ pays all of the Underwriting and Selling Expenses of the selling security holders' selling expenses, holder (excluding compensation to any Underwriter or broker-dealer).

### III.V. RESTRICTIONS ON WARRANTS GRANTED TO UNDERWRITERS

Warrants granted to Underwriters are subject to the following restrictions:

- A. The Underwriter must be a managing Underwriter.
- B. The ~~public~~ offering must be either a firmly underwritten offering or a "minimum-maximum" offering. Options or warrants may be issued in a "minimum-maximum" ~~public~~ offering only if:
  1. The options or warrants are issued on a pro rata basis, and
  2. The "minimum" amount of securities has been sold.
- C. The exercise price of the warrants must be at least equal to the ~~public~~ offering price.
- D. The number of shares covered by the Underwriter's options or warrants must not exceed ten percent (10%) of the shares of common stock actually sold in the ~~public~~ offering.
- E. The options or warrants must not be exercisable more than five (5)

years after the ~~public~~ offering is completed.

- F. The options or warrants must not be exercisable during the first year after the ~~public~~ offering is completed.
- G. ~~Option~~ The options or warrants may not be transferred, except:
1. To partners of the Underwriter, if the Underwriter is a partnership.
  2. To officers and employees of the Underwriter, who are also shareholders of the Underwriter, if the Underwriter is a corporation, or
  3. By will, under the laws of descent and distribution, or by operation of law.
- H. The warrant agreement may not allow for a reduction in the exercise price of the options or warrants resulting from the issuer subsequently issuing shares except if the issuer issues shares under:
1. a stock dividend or stock split, or
  2. a merger, consolidation, reclassification, reorganization, recapitalization, or sale of assets.

### ~~III. PROHIBITED UNDERWRITING EXPENSES~~

~~Underwriting expenses must not include financial consulting or financial advisory agreements with the underwriter payable at the time the services are rendered, provided that the issuer entered into the agreement at least twelve months before the issuer filed the registration statement with the Securities and Exchange Commission.~~

### ~~IV. VI. VALUATION OF UNDERWRITER'S WARRANTS~~

~~Formula. The following formula must be used to value Underwriter's warrants:~~

~~$$\frac{[165\% \times \text{Aggregate Offering Price}] - (\text{Exercise Price} \times \# \text{ of shares offered to public}) \times \# \text{ shares underlying warrants}}{\text{the public}}$$~~

~~the public~~

~~where~~

$\frac{2}{\text{\# shares offered to public}}$

$\frac{A - B \times C}{2 - D}$

A equals The issuer must file a description of the methodology used to value any warrants received or to be received as underwriting compensation. The issuer must demonstrate to the Administrator that its valuation method is commercially available and appropriate for the warrants to be valued.

Otherwise, the value is determined by the following formula.

1. Calculate 165% of the aggregate offering price;
2. ~~B equals~~ Multiply the exercise price ~~multiplied~~ by the number of shares offered to the public;
3. C equals Subtract the result of step two from the result of step one;
4. Divide the result of step three by 2;

Divide the number of shares underlying the warrants, ~~and~~

5. D equals by the number of shares offered to;
6. Multiply the result from step 4 by the result from step 5. The result is the dollar value of the underwriter's warrants.

$\frac{[1.65 \times \text{aggregate offering price}] - [\text{exercise price} \times (\text{\# of shares offered}) \times \text{\# shares underlying the warrants}]}{2 - \text{\# of shares offered}}$

public

(sample calculation follows on next page)

## A Sample Calculation of Warrant Value

Assumptions: Public

The following information is used in the sample calculation:

- Offering of 1,000,000 shares at \$5.00 per share
- ~~and an~~ Underwriter's warrant of 100,000 shares (10%) ~~at 120% of a \$6.00 public offering price,~~ exercisable at 120% of the \$5.00 offering price (i.e. the exercise price is \$6.00), starting one year after completion of the ~~public~~ offering.

1. ~~Dollar value of Underwriter's warrant is \$112,500~~  
~~(\$1,125,000 x .10) = \$112,500 (See below).~~

2. ~~Percentage value is 2.25% (\$112,500 divided by~~  
~~\$5,000,000).~~

### Calculation of warrant value:

$$\frac{[165\% \times \text{Aggregate Offering Price}] - (\text{Exercise Price} \times \# \text{ of shares offered to public}) \times \# \text{ shares underlying warrants}}{2} \div \# \text{ shares offered to public}$$

~~165% x (~~

$$\frac{[1,000,000 \text{ shares} \times \$5.00] - .65 \times (1,000,000 \text{ shares} \times \$5.00) - (\$6.00) \times 1,000,000}{2} \times \frac{100,000}{1,000,000}$$

$$\frac{[165\% \times 1.65 \times \$5,000,000] - \$6,000,000}{2} \times .10$$

~~\_\_\_\_\_~~

$$\frac{\$8,250,000 - \$6,000,000}{2} \times .10$$

$$\frac{\$2,250,000}{2} \times .10$$

$$\underline{\$1,125,000 \times .10 = \$112,500}$$

Accordingly, the resulting value of the underwriter's warrants is \$112,500. The percentage value of the underwriter's warrants is 2.25% (the \$112,500 value of the underwriter's warrants divided by the \$5,000,000 aggregate offering price).