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SEC Updates Offering Exemption Framework

In an effort to ease capital raising burdens for smaller issuers, the SEC has adopted amendments to modernize, harmonize and simplify the exempt offering framework (available here). As part of these amendments, the SEC has:

- overhauled its integration framework to provide issuers with significantly more flexibility to conduct offerings more closely in time, even concurrently, without risk of integration;
- broadened the scope of permissible communications to allow certain "test-the-waters" communications regarding exempt offerings and to exempt "demo day" and similar events from the prohibition on general solicitation or advertising;
- relaxed the 506(c) verifications to be conducted for repeat investors;
- updated the financial disclosure requirements for Rule 506(b) offerings to non-accredited investors to align them with Regulation A;
- revised certain offering limits for Regulation D, Regulation A and Regulation Crowdfunding ("CF") offerings;
- updated the bad actor disqualification provisions for greater consistency among Regulation D, Regulation A and Regulation CF; and
- amended certain eligibility restrictions under Regulation A and Regulation CF and simplified certain Regulation A compliance requirements.

Integration – Rule 152

The updated integration framework is set forth in revised Rule 152, and is centered around a statement of general principle and supplemented by specific guidance and four non-exclusive safe harbors. The introduction to Rule 152 includes a customary warning for issuers that even where there is technical compliance with Rule 152, if offerings are part of a plan or scheme to avoid registration under the Securities Act, the offerings will be subject to integration.

General Principle – Rule 152(a)

Revised Rule 152(a) sets forth a new general principle of integration: "offers and sales will not be integrated if, based on the particular facts and circumstances, the issuer can establish that each offering

either complies with the registration requirements of the [Securities Act] or that an exemption from registration is available for the particular offering."

Specific Guidance for Exempt Offerings Prohibiting General Solicitation – Rule 152(a)(1)

The SEC has codified, and expanded, its prior guidance to provide that when considering whether to integrate an exempt offering that relies on an exemption that prohibits general solicitation with other offerings, an issuer must have a reasonable belief, based on facts and circumstances, that, as to any purchaser, the issuer (or any person acting on its behalf) either did not solicit the purchaser through general solicitation, or had a substantive relationship with such purchaser established prior to the commencement of the exempt offering prohibiting general solicitation.

The SEC has clarified that a "substantive" relationship is one in which an issuer, or a person acting on its behalf (i.e., a registered broker-dealer or investment adviser), has sufficient information to evaluate, and does in fact, evaluate, whether the purchaser is an accredited investor ("AI") or a sophisticated investor. Self-certification of financial status and sophistication by a purchaser will not be sufficient to establish a substantive relationship in the SEC's view. The SEC identified examples of investors with whom an issuer will be deemed to have a prior substantive relationship: the issuer's existing or prior investors, investors in prior deals by the issuer's management, or friends and family of control persons. Similarly, such investors may also include customers of a registered broker-dealer or investment adviser with whom the registered broker-dealer or investment adviser established a substantive relationship prior to the participation in the exempt offering by the registered broker-dealer or investment adviser. The existence of a prior substantive relationship is not the exclusive means of showing the absence of general solicitation.

Specific Guidance for Exempt Offerings Permitting General Solicitation – Rule 152(a)(2)

When an issuer is conducting concurrent exempt offerings, and permitted general solicitation materials of one of those offerings include information about the terms of another concurrent exempt offering, those general solicitation materials may constitute an offer, and as a result, the general solicitation offering must comply with all of the requirements relating to the other concurrent offer (*e.g.*, applicable legend requirements and communications restrictions, including restrictions on the use of general solicitation). For example, if an issuer is conducting simultaneous offerings under Rule 506(c) and Regulation A, and the Rule 506(c) general solicitation offering materials discuss the materials terms of the Regulation A offering, then the Rule 506(c) offering must comply with all of the requirements of Regulation A as well (including any restrictions on the use of general solicitation).

Safe Harbors – Rule 152(b)

New Rule 152(b) sets forth four *non-exclusive* safe harbors from integration:

- ***30-day window***: an offering will not be integrated if more than 30 calendar days have elapsed between the termination or completion of one offering and the commencement of the other (though for exempt offerings where general solicitation is prohibited, the provisions of Rule 152(a)(1), requiring the issuer to have a reasonable belief that offerees were not solicited through general solicitation or that they had a prior substantive relationship, as discussed above, apply). This is a significant decrease from the current six-month safe harbor. To prevent issuers from conducting monthly Rule 506(b) offerings (which may each include up to 35 non-AIs), the SEC has also revised Rule 506(b) to restrict issuers from selling to more than 35 non-AIs in any 90-day calendar period.

- ***Offerings pursuant to Rule 701 and Regulation S***: a Rule 701 or Regulation S offering will not be integrated with other offerings, regardless of timing (and may be made concurrently with any other offerings). This codifies the SEC's long-standing position that offshore transactions complying with Regulation S will not be integrated with registered or exempt domestic offerings.

  - The SEC had proposed an amendment to the definition of "directed selling efforts" in Rule 902 and proposed Rule 906, but, in response to comments, is not adopting any amendments to Regulation S at this time.

  - As part of the conforming amendments, Rule 500(g) was amended to include a cross-reference to Rule 152(b)(2) to clarify that it is providing specific additional (not separate) guidance regarding the conduct of Regulation D offerings.

- ***Registered offerings***: a registered offering will not be integrated with another offering, if made subsequent to:

  - a terminated or completed offering for which general solicitation is not permitted;
  - a terminated or completed offering for which general solicitation is permitted that was made only to qualified institutional buyers ("QIBs") and institutional accredited investors ("IAIs"); or
  - an offering for which general solicitation is permitted that was terminated or completed 30 days prior to the commencement of the registered offering.

- ***Offers and sales where general solicitation is permitted***: an offering conducted in reliance on Regulation A, Regulation CF, Rule 147 or 147A, Rule 504(b)(1)(i), (ii) or (iii) or Rule 506(c) (none of which prohibits general solicitation) will not be integrated with another offering if made subsequent to any terminated or completed offering. For issuers that commence an offering based on an exemption that prohibits general solicitation, but then continue the offering in reliance on an exemption that does permit general solicitation, the SEC has issued guidance that these issuers may rely on this safe harbor if, once they engage in general solicitation, they rely solely on the exemption permitting general solicitation (and comply with all of its conditions and requirements).

Commencement, Termination and Completion of Offerings

In order to add further clarity to the integration analysis under Rule 152, the SEC provided definitions, including specific, non-exclusive factors applicable to different types offerings, for "commencement of an offering" (Rule 152(c)) and "termination or completion of an offering" (Rule 152(d)).

General Solicitations and Offering Communications

"Testing-the-waters" Communications – Exempt Offerings

Generic solicitations of interest exemption: New Rule 241 permits issuers to use generic solicitation of interest materials to "test-the-waters" for offerings exempt from registration under the Securities Act. Any such communications must be made prior to the issuer determining what exemption from registration it will rely upon in making the offering, and will be deemed an offer for the purposes of the antifraud provisions of the federal securities laws. Until the issuer determines which exemption it is relying on, and the offering is commenced, no money or other consideration may be solicited or accepted.

The solicitation of interest (which may be communicated orally or in writing) must state that:

- the issuer is considering an offering of securities exempt from registration, but has not yet determined which specific exemption it intends to rely upon;
- no money or other consideration is being solicited, and if sent in response, will not be accepted;
- no offer to buy the securities can be accepted and no part of the purchase price can be received until the issuer has determined which exemption it will rely upon and the requirements of such exemption are met; and
- an indication of interest involves no obligation or commitment of any kind.

Written communications may include means for persons to indicate their interest to the issuer. Any such 'response form' may ask for the name, address, telephone number and/or email address of the interested person.

The SEC did not require that the "testing-the-waters" activity be limited to QIBs or IAIs, or place any other limits on the scope of the communication. As a result, generic solicitations of interest may be conducted so broadly as to constitute a general solicitation. In that case, compliance with new Rule 241 would not foreclose the spectre of integration. If the generic solicitation of interest is conducted in a manner that would constitute a general solicitation, and the exemption then relied upon for the offering prohibits general solicitation, the issuer would need to consider whether the generic solicitation of interest and the offering would be integrated.

Regulation D offerings: The SEC has amended Rule 502(b) to require issuers, where they sell securities in an offering exempt under Rule 506(b) within 30 days of making a generic solicitation of interest under Rule 241, to provide purchasers with any written generic solicitation of interest material (written communications or broadcast scripts), regardless of whether the issuer engaged in a general solicitation in making its generic solicitation of interest and regardless of whether such general solicitation would be subject to integration with the Rule 506(b) offering.

Regulation A and Regulation CF offerings: The SEC has amended Regulation A and Regulation CF to require, if an offering is commenced within 30 days of making a generic solicitation of interest under Rule 241, that issuers publicly file any solicitation materials as an exhibit to the offering materials.

Regulation CF

Testing-the-waters: New Rule 206 permits issuers to test the waters prior to filing a Form C. Similar to Rule 255 (permitting issuers to test the waters in a Regulation A offering), issuers are required to include legends and file the solicitation materials with Form C. Unlike Regulation A, issuers can only use Rule 206 prior to the filing of Form C (thereafter, any offering communications must be made in compliance with Regulation CF).

Oral communications: To more closely align Regulation A and Regulation CF, the SEC amended Rule 204 to permit oral communications after the filing of Form C so long as the communications otherwise comply with Rule 204.

Exemption for "Demo Days" and Similar Events

Under new Rule 148, "demo day" communications will not constitute general solicitation or general advertising if the following conditions are met:

- more than one issuer participates in the event;
- the event is sponsored by a college, university or other institution of higher education, state or local government or instrumentality thereof, non-profit organization or angel investor group, incubator or accelerator;
- no advertising for the seminar or meeting references a specific offering of securities by the issuer;
- the sponsor does not:
  - make investment recommendations or provide investment advice to attendees;
  - engage in any investment negotiations between the issuer and attendees;
  - charge attendees any fees (other than reasonable administrative fees);

  - receive any compensation for making introductions between attendees and issuers or for investment negotiations between them; or
  - receive any compensation with respect to the event that would require registration as a broker-dealer or investment adviser;
- the type of information regarding any offering is limited to a notice that the issuer is in the process of offering or planning to offer securities, the type and amount being offered, the intended use of proceeds and the unsubscribed amount in the offering; and
- if the event allows for virtual participation, online participation in the event is limited to:
  - individuals who are members of or associated with the sponsor;
  - individuals that the sponsor reasonably believes are AIs; and
  - individuals who have been invited by the sponsor based on their industry or investment-related experience reasonably selected by the sponsor in good faith and disclosed in public communications about the event.

Verification of Accredited Investor Status

Rule 506(c) requires issuers to take reasonable steps to verify that any purchasers of securities in a Rule 506(c) offering are AIs. In order to reduce the burden of these repeat investigations, the SEC has amended Rule 506(c) to permit issuers to rely on their previous verification of a purchaser. Issuers who have previously verified a purchaser's status may update the verification simply with a written representation from the purchaser that it qualifies as an AI at the time of sale. Issuers may only use this re-verification if they are not aware of any information to the contrary, and may only use the re-verification for five years from the initial verification (at which point, they would need to conduct a more substantive verification, anew).

The SEC reaffirmed and updated its guidance regarding the conduct of a principles-based verification inquiry and the reasonable steps issuers may take to verify AI status. The SEC declined to expand the list of verification methods for fear it would undermine the principles-based approach to verification, and emphasized that issuers apply the reasonableness standard directly to the specific facts and circumstances presented by the offering and investors. The following factors are among those to be considered when undertaking a principles-based verification inquiry:

- the nature of the purchaser and the type of AI that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

The SEC noted that, depending on the circumstances, the reasonable steps inquiry may not be substantially different from the development of "reasonable belief" for Rule 506(b) purposes. The inquiry must be fact-specific and the appropriate steps will vary with each situation (i.e., what suffices as reasonable steps in one set of circumstances may not do so in another).

Rule 502(b) Financial Disclosure Requirements

In an effort to reduce the burden on issuers to meet the 502(b) financial disclosure requirements, so that more issuers will be willing to include non-AIs in offerings under Rule 506(b), thus expanding investment opportunities for non-AIs, the SEC amended the financial disclosures requirements in Rule 502(b) to align the disclosure requirements with those in Regulation A. As a result, issuers will be required to provide the following financial information:

- For offerings of up to $20 million:
  - consolidated balance sheets of the issuer for the two previous fiscal years (or for such shorter time that the issuer has been in existence);
  - consolidated statements of comprehensive income, cash flows, and stockholders' equity of the issuer for the previous three years; and
  - financial statements of guarantors and issuers of guaranteed securities, affiliates whose securities collateralize an issuance, significant acquired or to be acquired businesses and real estate operations, and pro forma information relating to significant business combinations.

  These most recent financial statements must be not more than nine months old, with the most recent annual or interim balance sheet also not older than nine months. No audit is required unless the issuer has already obtained an audit for another purpose.

- For offerings over $20 million:
  - financial statements in compliance with Article 8 of Regulation S-X.

  These most recent financial statements must not be more than nine months old, with the most recent annual or interim balance sheet not older than nine months. An audit is required (though not for interim financials).

Offering and Investment Limits

The SEC has revised the maximum investment amounts and the maximum amount of securities that may be offered and sold under certain exemptions as follows:

- ***Regulation D*** – the maximum offering amount under Rule 504 was raised from $5 million to $10 million, with unlimited investment amounts retained.

- ***Regulation A*** – the maximum offering amount for primary offerings under Tier 2 was increased from $50 million to $75 million; and the maximum offering amount for secondary sales under Tier 2 was increased from $15 million to $22.5 million.

- ***Regulation CF*** – the maximum offering amount was raised from $1.07 million to $5 million.

  The maximum investment limits under Regulation CF were also amended so that no investment limits apply to AIs and the calculation method for investment limits for non-AIs permits investors to rely on the greater of their annual income or net worth.

  New temporary Rule 201(bb) extends for an additional 18 months (until August 28, 2022) the existing temporary relief that provides an exemption from certain Regulation CF financial statement review requirements for issuers offering, in the preceding 12-month period, securities in the amount of more than $107,000 but less than $250,000.[1]

Bad Actor Disqualification

The SEC harmonized the bad actor disqualification provisions in Regulation D, Regulation A and Regulation CF so that the disqualification lookback period includes "the time of sale" in addition to "the time of filing" with the exception of the lookback period applicable to covered beneficial owners in Regulation A and Regulation CF, which remains unchanged (*i.e.*, through the time of filing, rather than through the time of sale). Additionally, the definition of promoter in Rule 503(a) was expanded to cover not only promoters connected with the issuer in any capacity "at the time of such sale" but also at the time "of filing" and "any offer after filing."

Regulation A and Regulation CF

The SEC has amended certain eligibility restrictions existing under Regulation A and Regulation CF, and has simplified certain Regulation A compliance requirements.

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[1] Under new temporary Rule 201(bb), an eligible issuer may provide financial statements of the issuer and certain information from the issuer's federal income tax returns, both certified by the principal executive officer, instead of the financial statements reviewed by a public accountant that is independent of the issuer that would otherwise be required. This temporary relief is available only if reviewed or audited financial statements of the issuer are not otherwise available. Additionally, an issuer relying on the temporary relief is required to provide prominent disclosure that financial information certified by the principal executive officer of the issuer has been provided instead of financial statements reviewed by a public accountant that is independent of the issuer.

- ***Eligibility restrictions:*** Regulation A and Regulation CF are subject to specific eligibility restrictions that exclude certain types of investment vehicles and issuers. To harmonize and streamline the eligibility requirements, the following amendments were adopted:

  - The use of certain special purpose vehicles is now permitted to facilitate investing in Regulation CF issuers through a new exclusion from the definition of "investment company" under the Investment Company Act of 1940 for a limited-purpose crowdfunding vehicle (a "crowdfunding vehicle"). The vehicle should not have a separate business purpose and should be designed to serve solely as a conduit for investors to invest in a single crowdfunding issuer. There are several conditions that these vehicles must meet to qualify for the exemption.[2]

    The crowdfunding issuer will act as a co-issuer with the crowdfunding vehicle and the combined offering of the crowdfunding issuer's securities and the crowdfunding vehicle's securities must comply with Section 4(a)(6) of the Securities Act and Regulation CF. The SEC clarified that the crowdfunding vehicle is not considered an investor for the purposes of Regulation CF. A crowdfunding vehicle will constitute a single record holder in the crowdfunding issuer as long as all investors in the vehicle are natural persons. When determining whether its equity securities should be registered pursuant to Section 12(g)(1) of the Exchange Act, a crowdfunding issuer may exclude securities issued by a crowdfunding vehicle that are held by natural persons, but must include securities that are held by investors that are not natural persons.

  - The scope of the issuers excluded from being able to offer and sell securities in reliance on Regulation A was expanded to include Exchange Act reporting companies that are delinquent, for the two prior years, in their reporting obligations under Section 13 or 15(d) of the Exchange Act.

- ***Compliance requirements under Regulation A:*** The SEC has simplified certain compliance requirements applicable to Regulation A offerings in order to establish greater consistency between Regulation A and registered offerings. The changes include:

  - amendments to Form 1-A that provide issuers with an option to file redacted material contracts and plans of acquisition, reorganization, arrangement, liquidation and succession without the need to submit a confidential treatment request; issuers will have the option to redact from these exhibits any information the disclosure of which would constitute a clearly unwarranted invasion of personal privacy, as well as information that is not material and that the issuer customarily and actually treats as private or confidential;

  - simplification of the procedures for the public filing of previously non-public draft Regulation A offering statements so that they can be made available on EDGAR;

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2 *See* Rule 3a-9(a), Adopting Release, pp. 274–275.

- permitting issuers to incorporate previously filed financial statements by reference into a Regulation A offering circular, provided that the issuers satisfy certain specified criteria; and
- amendments to the abandonment provisions in Regulation A that allow the SEC to declare a specific post-qualification amendment to an offering statement abandoned, instead of declaring the entire offering statement abandoned.

Effectiveness

The amendments take effect 60 days after publication in the *Federal Register*.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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