BRYAN CAVE LEIGHTON PAISNER BCLP

FINANCIAL REGULATION: EMERGING THEMES IN 2021

US FOCUS

SEC UPDATES:

Private Capital Transactions

Building RESILIENCE

Today's speakers

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Issuers and Finders: An Overview

- Issuers’ Needs
- Finders’ Goals
- Exempt Offerings

Issuers and Finders: The Current Federal and State Regulatory Landscape

- Exchange Act Registration Requirements for Brokers
- Patchwork of No-Action Letters
- Common Law and SEC Decisions
- State Regulations
- Regulatory Enforcement

The Proposed Finders Exemption

- Natural persons acting as finders will have a limited, conditional exemption from registration as a broker
- Must meet seven threshold requirements
  1. The issuer is not required to file reports under Section 13 or Section 15(d) of the Exchange Act;
  2. The issuer is seeking to conduct the securities offering in reliance on an applicable exemption from registration under the Securities Act of 1933;
  3. The Finder does not engage in general solicitations;
  4. The potential investor is an "accredited investor" as defined in Rule 501 of Regulation D or the Finder has a reasonable belief that the potential investor is an "accredited investor";
  5. The Finder provides services pursuant to a written agreement with the issuer that includes a description of the services provided and associated compensation;
  6. The Finder is not an associated person of a broker-dealer; and
  7. The Finder is not subject to statutory disqualification, as that term is defined in Section 3(a)(39) of the Exchange Act, at the time of his or her participation.

The Proposed Finders Exemption (con't)

- Finder's activity must fall into one of the following tiers:
- **Tier I** finders are limited to providing contact information of potential investors in connection with only one capital raising transaction by a single issuer within a 12-month period. No contact with the potential investors about the issuer
- **Tier II** finders may engage in wider range of solicitation-related activities on behalf of an issuer but these are limited to:
  - Identifying, screening, and contacting potential investors;
  - Distributing issuer offering materials to investors;
  - Discussing issuer information included in any offering materials; provided that the finder does not provide advice as to the valuation or advisability of the investment; and
  - Arranging or participating in meetings with the issuer and investor. Tier II Finders would also be required to make certain disclosures in writing and to obtain a signed investor acknowledgement.
- Under either Tier, finders will still be subject to other applicable laws such as the antifraud provisions of the Securities Act of 1933 and the Exchange Act and state law

Challenges with the Proposed Finders Exemption

The Proposed Exemption does not:

- Require finders to file any notice with the SEC of reliance on the exemption from broker registration;
- Preclude finders from being subject to registration requirements for other regulated entities, i.e., investment advisers or municipal advisors;
- Provide any relief for preemption of state securities statutes and regulations;
- Create any formal recordkeeping requirements;
- Clarify which "bad actor" disqualification lists finders are subject to;
- Have the full support of the SEC Commissioners.
- Have support of NASAA.

HYPOTHETICAL #1

- A limited partnership is seeking to raise $100mm to acquire commercial real estate assets in Texas and the southeast.
- The LP is led by a three-member team (the "GP") having expertise in the field of commercial real estate.
- The GP has some substantial pre-existing relationships that would likely have and interest in investing in the LP—to the tune of $25mm (we call this a "soft circle").
- The GP, on behalf of the LP, is exploring the possibility of hiring a finder to facilitate the raising of the additional $75mm+ under the offering.
- Let's discuss the LP's options under the current rule.
- Internal sales OR External Finder (i.e., broker-dealer)

HYPOTHETICAL #2

- Same scenario, but let’s assume the capital raise will start in Q2 of 2020 and the proposed Finder’s Exemption has passed as has become effective

- Now, let’s discuss the LP’s options under the new rule effective under our hypothetical:
  - Internal Sales
  - External Sales through a broker-dealer
  - External Sales through an Exempt Finder
  - External Sales through an Exempt Finder contracted by the broker-dealer

Rule 501(a)

Accredited Investor Definition

An accredited investor is any person that:

- Individual income of $200,000
- Joint income with spouse **or spousal equivalent** of $300,000
- Individual or joint net worth with spouse or **spousal equivalent** in excess of $1.0MM
- Director or executive officer of the issuer
- **Hold a (i) General Securities Representative license (Series 7), (ii) Private Securities Offering Representative license (Series 82), or (iii) an Investment Adviser Representative license (Series 65)**
- **A knowledgeable employee of an investment company where the investment company is the issuer**

Rule 501(a)

Accredited Investor Definition

Or any entity that:

- All beneficial owners are accredited investors
- Banks and savings and loan associations; Registered B/Ds; ***RIAs and IAs exempt from registration***; Insurance companies; Registered Investment Companies; Small Business and ***Rural Business Investment Companies***; "Private Business Development Company" under the 40 Act
- A plan established by a state or its political subdivisions if it has total assets in excess of $5.0 MM
- ERISA plans if the investment decision is made by a plan fiduciary, the plan has in excess of $5.0 MM in assets or the plan is self-directed by an accredited investor

Rule 501(a)

Accredited Investor Definition Continued

Or any entity that:

- Assets in excess of $5 MM not formed for the specific purpose of acquiring the offered securities and is: a 501(c)(3), a corporation, a business trust, a partnership and a ***limited liability company***
- ***Entity not formed for the purpose of making the investment with assets in excess of $5.0 MM***
- ***"Family Office" as defined under the 40 Act (i) with assets in excess of $5.0 MM, (ii) not formed for the purpose of making the investment, and (iii) directed by a person with knowledge and experience to evaluate the investment***
- ***"Family Client" as defined under the 40 Act***

Rule 506(c)

Accredited Investor Verification

- Rule 506(c) requires the issuer to take reasonable steps to confirm that each investor is an accredited investor.
- In addition to the verification methods expressly approved by the rule, an issuer's "reasonable steps" can be based on:
  - The nature of the purchaser and the type of accredited investor 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.

Rule 506(c)

Accredited Investor Verification

- The SEC notes that “reasonable steps”:
- “may not be substantially different from an issuer’s development of a ‘reasonable belief’ for Rule 506(b) purposes.”
- an issuer’s receipt of a representation from an investor as to his or her accredited status could meet the “reasonable steps” requirement if the issuer “reasonably takes into consideration a prior substantive relationship with the investor or other facts that make apparent the accredited status.”

Rule 506(c)

Accredited Investor Verification

Subsequent offerings:

- If an issuer previously took "reasonable steps" to verify an investor as an accredited investor per 506(c)(2)(ii),
- at the time of a subsequent offering, the issuer can establish that the investor remains an accredited investor if the investor provides a written representation that the investor continues to qualify as an accredited investor and the issuer is not aware of information to the contrary,
- the original verification cannot be more than five years prior to the confirming representation

Regulation CF – Crowd Funding

Reg CF creates a path for non-reporting companies to raise small amounts of capital from accredited investors and non-accredited investors.

In the interest of investor protection, Reg CF includes numerous procedures and limits placed on:

- the issuer,
- the offering,
- the intermediary, and
- the investor

Regulation CF – Crowd Funding

Issuer requirements

Issuer must file a Form C in connection with a crowd funding offering, which includes a significant amount of disclosure, including:

- **Use of proceeds**
- **Targeted offering size**
- **Offering price**
- **Business**
- ***Directors and officers***
- ***Beneficial ownership and capital structure***
- **Indebtedness**
- **Related party transaction**
- **Prior exempt offerings**

- **Risk factors**
- **Transfer restrictions**
- ***Management discussion and analysis***
- ***Financial statements***
  - **If offering is $100,000 or less, federal tax filing information unless review or audited financial statements are available.**
  - ***If offering is more than $100,000 and less than $500,000, reviewed by an accountant.***
  - ***If offering is $500,000 or more, audited financial statements***

Regulation CF – Crowd Funding

By a 3-2 vote, the SEC approved changes to Regulation CF:

- Raises the offering limit from $1 million to $5 million;
- Raises the investment limits for investors in Regulation Crowdfunding offerings by: (i) removing investment limits for accredited investors; and (ii) using the greater of their annual income or net worth when calculating the investment limits for non-accredited investors;
- Extends for 18 months an exemption from certain Regulation CF financial statement review requirements for issuers offering $250,000 or less of securities in reliance on the exemption within a 12-month period; and
- Permitting crowdfunding vehicles as a method of aggregating investors.

Testing the Waters

New Rules 206 and 241 permits issuers to "test the waters" with potential investors.

Issuers must include the following legends in the testing-the-waters materials:

- No money or other consideration is being solicited, and if sent, 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 offering statement is filed and only through an intermediary's platform; and
- A prospective purchaser's indication of interest is non-binding.

Demo Day Communications

This new exemption is available if the sponsor does not:

- Make investment recommendations or provide investment advice to attendees of the event
- Engage in any investment negotiations between the company and investors attending the event
- **Charge attendees of the event any fees, other than reasonable administrative fees**
- Receive any compensation for making introductions between event attendees and companies, or for investment negotiations between the parties
- Receive any compensation with respect to the event that would require it to register as a broker or dealer under the Securities Exchange Act of 1934, or as an investment adviser under the Investment Advisers Act of 1940

Demo Day Communications

Information conveyed at the event regarding the offering must be limited to:

- Notice of the offering
- The type and amount of securities being offered
- The intended use of offering proceeds
- The unsubscribed amount in the offering

Demo Day Communications

Under new Rule 148, certain communications to attendees at demo days and angel networks are now expressly permitted and not deemed general solicitations

The communications are made in connection with a seminar or meeting sponsored by:

- a college, university, or other institution of higher education;
- a state or local government or an instrumentality of a state or local government;
- a nonprofit organization; or
- an angel investor group, incubator, or accelerator.

Integration

The revised rule provides four non-exclusive safe harbors:

1) Offerings separated by more than 30 days

2) Rule 701 and Regulation S offerings will be "walled off" so that neither will be integrated with other offerings.

3) Offerings for which a registration statement has been filed will not be integrated if made after (a) a terminated or completed offering for which general solicitation is not permitted, (b) a terminated or completed offering for which general solicitation is permitted, if such solicitation was made only to qualified institutional buyers or institutional accredited investors, or (c) more than 30 days from the termination or completion of an offering for which general solicitation is permitted.

Integration continued

1) Offerings made in reliance on an exemption for which general solicitation is permitted will not be integrated if made subsequent to any terminated or completed offering.

Establishes principle that no integration is required if each offering, based on its particular facts and circumstances, meets the requirements for an exemption or complies with the registration requirements of the Securities Act.

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