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Insights

SEC MODERNIZES FRAMEWORK FOR EXEMPT OFFERINGS

Nov 04, 2020

In another 3-2 vote, on November 2, 2020 the SEC approved significant amendments to the framework for exempt offerings intended to harmonize and simplify the framework for exempt offerings under the Securities Act of 1933. The amendments:

- Simplified the "integration doctrine" that restricts the ability of issuers to move or switch from one exemption to another
- Permit certain "demo day" and "test-the-waters" communications, and clarify other rules on communications
- Increase the offering limits for certain offerings and individual investment
- Harmonize certain disclosure and eligibility requirements and bad actor disqualifications

In statements at the November 2 open meeting and in the press release announcement, the SEC majority noted that it believes the amendments reduce complexity and costs, and therefore facilitate capital raising for smaller and medium-sized businesses, as well expand investment opportunities, all while preserving or improving investor protections and market integrity. By contrast, the dissenting Commissioners expressed concern that the amendments will increase risk for investors and that, because private markets are opaque, the SEC lacked solid data to support the changes.

The amendments will be effective on the 60th day after publication in the Federal Register, except for certain temporary rules relating to Regulation Crowdfunding which have specified periods of effectiveness.

Integration Doctrine

The integration doctrine seeks to prevent an issuer from avoiding registration by artificially dividing a single offering into multiple offerings so that Securities Act exemptions would apply to the multiple offerings that would not be available for the combined offering. Over time, the doctrine evolved through a mix of rules and interpretative guidance to become increasingly complex.

New Framework

The amendments establish a new integration framework for registered and exempt offerings that set forth a general principle of integration in new Rule 152(a) and four safe harbors applicable to all securities offerings – including registered and exempt offerings – in new Rule 152(b).

The general principle in Rule 152(a) provides that if the safe harbors are not available, two or more offerings will not be integrated if, based on the particular facts and circumstances, the issuer can establish that each offering either (1) complies with the registration requirements of the Securities Act, or (2) that an exemption from registration is available for the particular offering. Additionally, the rule distinguishes between offerings that either prohibit or permit general solicitation:

Exempt Offering that Prohibits General Solicitation. For an exempt offering that prohibits general solicitation, the issuer must have a reasonable belief, based on the facts and circumstances, with respect to each purchaser that the issuer (or any person acting on the issuer's behalf) either:

- Did not solicit such purchaser through the use of general solicitation

  For example, the SEC noted that an issuer could not engage in general solicitation in a 506(c) offering and then sell to investors in a Rule 506(b) offering, unless either the issuer did not solicit the purchaser in the Rule 506(b) offering through the use of the general solicitation used in the Rule 506(c) offering, or the issuer established a substantive relationship with such purchaser before the Rule 506(b) offering.

OR

- Established a substantive relationship with such purchaser prior to the commencement of the exempt offering prohibiting general solicitation

  The SEC explained that it generally views a "pre-existing" relationship as one that the issuer established with an offeree before commencement of the offering or, alternatively, that was established through another person (for example, a registered broker-dealer or investment adviser) before that person's participation in the offering. A "substantive" relationship is one in which the issuer (or a person acting on its behalf, such as a registered broker-dealer or investment adviser) has sufficient information to evaluate, and does, in fact, evaluate, an offeree's financial circumstances and sophistication, in determining his or her status as an accredited or sophisticated investor.

  The SEC stated that it does not believe that self-certification alone (by checking a box) without any other knowledge of a person's financial circumstances or sophistication would be sufficient to form a "substantive" relationship for these purposes.

Examples of investors cited by the SEC that may have a pre-existing substantive relationship include the issuer's existing or prior investors, investors in prior deals of the issuer's management, or friends or family of the issuer's control persons. Similarly, such investors may also include customers of a registered broker-dealer or investment adviser with whom the broker-dealer or investment adviser established a substantive relationship before the offering began.

Concurrent Exempt Offerings that Allow General Solicitation. For concurrent exempt offerings that both allow general solicitation (such as Rule 506(c), Regulation A and Regulation Crowdfunding), each offering must comply with all the requirements for offers under the exemption being relied on for the other offering, including any legend requirements and communications restrictions – to the extent the material terms of the other offering are discussed. This is because general solicitation offering materials for one offering that include information about the concurrent offering under another exemption may constitute an offer of the securities in that other offering. In addition, each offering must satisfy the requirements of the particular exemption relied on.

Non-Exclusive Safe Harbors

The new rules establish four safe harbors, two of which involve a 30-day cooling off period. Although some commentators proposed a 90-day period, the SEC believes 30 days is sufficient in light of the changes in technology, the markets and the securities laws since the adoption of Regulation D in 1982, as well as the goal of expanding capital-raising options available to issuers.

First, offerings more than 30 days before or after commencement or termination of another offering will not be integrated, except that – in the case of an exempt offering for which general solicitation offering is not permitted that follows an offering that allows general solicitation – the requirements described above must be satisfied. The SEC noted that if the safe harbor is unavailable because the cooling-off period is less than 30 days, an issuer may still avoid integration if it meets the terms and conditions of the general principle of integration in Rule 152(a).

Second, offerings for which a Securities Act registration statement has been filed will not be integrated if made after:

- A terminated or completed offering where general solicitation is not permitted
  - This is generally consistent with existing Rule 152, and reflects the view that such prior offers and sales are not the type that are likely to condition the market for the registered offering.

- A terminated or completed offering where general solicitation is permitted that was made only to "qualified institutional buyers" (QIBs) or "institutional accredited investors" (IAIs)
  - The SEC considered but rejected a proposal to expand the safe harbor to refer only to offerings in which sales were made to QIBs and IAIs, out of concern the broader solicitation

could adversely condition the market for the registered offering.

- An offering for which general solicitation is permitted that terminated or completed more than 30 days before commencement of the registered offering
  - If an issuer files a registration statement within the 30-day period, the determination of whether to integrate the offerings would depend on the application of the general principle of integration discussed above to the particular facts and circumstances.

Third, offerings that comply with the Rule 701 exemption for employee benefit plans or the Regulation S exemption for offshore offerings will not be integrated with other offerings.

- This safe harbor applies regardless of when the offerings occur, including offers and sales made concurrently with other offerings.
- The SEC considered but did not adopt certain proposals to amend the definition of "directed selling efforts" under Regulation S, to avoid disrupting existing market practices. Further, the SEC clarified that it does not believe that general solicitation activity for exempt domestic offerings would preclude reliance on Regulation S for concurrent offshore offerings, and reaffirmed its existing guidance with respect to concurrent Regulation S and domestic offerings, including its 1998 release regarding use of offshore websites.

Fourth, an exempt offering where general solicitation is permitted will not be integrated if made after any terminated or completed offering.

- This reflects the view that such exempt offerings that permit general solicitation are not susceptible to concerns about the prior offering conditioning the market for the subsequent exempt offering. Examples of such exempt offerings include Regulation A, Regulation Crowdfunding, Rule 147 or 147A, Rules 504(b)(1)(i), (ii), or (iii) and Rule 506(c).
- In these cases, where the issuer engages in general solicitation, it must rely on the new exemption for all subsequent sales, thereby terminating any prior offering that did not permit general solicitation -- for example, by selling exclusively to accredited investors and properly verifying their status, in the case of a Rule 506(c) offering.

Commencement or Termination of an Offering

Commencement of an Offering. New Rule 152(c) provides a non-exclusive list of factors to consider in determining when an offering will be deemed to have commenced for purposes of both the general principle of integration in Rule 152(a) and the safe harbors in Rule 152(b). The listed factors address the types of actions taken under various exempt and registered offering scenarios.

The SEC notes that, due to their non-public nature, communications between an issuer, its agents or underwriters and QIBs and IAIs will not be considered as the commencement of a registered public offering for purposes of new Rule 152. By contrast, the commencement of private communications between an issuer or its agents (including private placement agents) and prospective investors in an exempt offering in which general solicitation is prohibited, may be considered as the commencement of the non-public exempt offering, if such private communication involves an offer of securities.

The SEC believes the initial public filing of a shelf registration statement will not necessarily be viewed as commencement, since the mere filing or existence of a shelf registration statement – without any actual selling effort or description of the securities to be offered and sold – is unlikely to meaningfully condition the market for a subsequent exempt offering. However, commencement of such an offering is likely to occur when the issuer, its agents and underwriters begin public efforts to offer and sell the securities, for example, through a widely disseminated public disclosure, such as a press release, or the public filing of a prospectus supplement.

Termination or Completion of an Offering. New Rule 152(d) provides a non-exclusive list of factors to consider in determining when an offering will be deemed to be "terminated or completed," i.e., when the issuer and its agents cease efforts to make further offers to sell the securities in the particular offering. The rule as drafted accommodates an issuer that wishes to terminate an offering in reliance on one exemption and simultaneously commence an offering on another. The listed factors address the types of actions taken under various exempt and registered offering scenarios.

Other Changes to Integration Rules

The introductory language to new Rule 152 provides that the rule will not have the effect of avoiding integration for any transaction or series of transactions that, although in technical compliance with the rule, is part of a plan or scheme to evade the registration requirements of the Securities Act. Further, the SEC noted that none of the provisions of new Rule 152 may be used as a means to circumvent the communication restrictions before a registered offering, for example, for communications occurring within 30 days of a registered offering.

Existing Rule 155, which relates to integration of abandoned offerings, was removed.

Rule 506(b) will now limit the number of non-accredited investors purchasing in Rule 506(b) private placements to no more than 35 within a 90-day period.

The integration provisions of several Securities Act exemptions will be replaced with references to new Rule 152.

Scope of Integration Rules

Although its focus is on capital-raising, the SEC noted that the new rules apply to business-combination offerings as well that occur concurrently or close in time. Further, the new rules do not change the Regulation M-A business combination rules.

Permitted Communications -- "Demo Days"

The amendments add new Rule 148 to facilitate "demo days", where issuers discuss their business plans with potential investors. The new rule is intended to provide flexibility for issuers to disclose that they are seeking capital without uncertainty as to whether they have jeopardized their ability to rely on a certain exemption from registration.

Under the rule, an issuer will not be deemed to have engaged in general solicitation if 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 instrumentality), a nonprofit organization or an "angel investor group," incubator or accelerator, subject to the following requirements:

- More than one issuer must participate in the seminar or meeting. This is intended to prevent an organization from attempting to hold an event that is, in essence, a sales pitch for the securities of one issuer, while characterizing the event as a "demo day."
- No advertising for the seminar or meeting may reference a specific offering of securities by the issuer.
- The sponsor is not permitted to (1) make investment recommendations or provide investment advice to attendees, (2) engage in any investment negotiations between an issuer and attendees, (3) charge attendees any fees, other than reasonable administrative fees, (4) receive any compensation for making introductions or for investment negotiations, or (5) receive any compensation with respect to the event that would require it to register as a broker or dealer, or an investment adviser.
- The rule limits the information conveyed at the event by an issuer about an offering of securities to (1) notification that the issuer is in the process of offering or planning to offer securities, (2) the type and amount of securities being offered, (3) the intended use of the proceeds of the offering, and (4) the unsubscribed amount in an offering.
- To reduce potential solicitation of non-accredited investors, online participation in events must be limited to (1) individuals who are members of, or otherwise associated with the sponsor organization (such as members of an angel investor group or students, faculty, or alumni of a college or university), (2) individuals that the sponsor reasonably believes are accredited investors, or (3) individuals who have been invited to the event by the sponsor based on industry or investment-related experience reasonably selected by the sponsor in good faith and disclosed in the public communications about the event.

As defined, an “angel investor group” means a group of accredited investors that holds regular meetings and has defined processes and procedures for making investment decisions, either individually or among the group as a whole, and is neither associated nor affiliated with brokers, dealers or investment advisers. The “defined processes and procedures” do not necessarily need to be written.

The SEC notes that issuers may continue to rely on previously issued guidance (in which case they would not be subject to the conditions of Rule 148, including the limit on communications) if the organizer of the event has limited participation in the event to individuals or groups of individuals with whom the issuer or the organizer has a pre-existing substantive relationship or that have been contacted through an informal, personal network of experienced, financially sophisticated individuals.

Permitted Communications – Testing the Waters

Exempt Offerings

Under new Rule 241, an issuer (or any person authorized by the issuer) may communicate orally or in writing to determine whether there is any interest in a contemplated offering of securities exempt from registration under the Securities Act – before determining which exemption would be utilized.

The rule provides an exemption from registration only with respect to a “generic” solicitation of interest, and that solicitation will still be subject to the antifraud provisions of the Federal securities laws. In addition, an issuer determine which exemption it will rely on and commence the offering in compliance with that exemption before it may solicit or accept money or other consideration, or any commitment, binding or otherwise, from any person .

If the issuer moves forward with an exempt offering following the generic solicitation of interest, it must comply with an applicable exemption for the subsequent offering, and investors will have the benefit of the investor protections applicable to that exemption. The rule does not address integration with a subsequent private placement, as the SEC believes an issuer may reasonably conclude on its own that testing-the-waters activity so limited would not constitute general solicitation, depending on the facts and circumstances.

If the generic solicitation is done in a manner that would constitute general solicitation, and the issuer ultimately decides to conduct an unregistered offering under an exemption that does not permit general solicitation, the issuer will need to conduct an integration analysis, as discussed above, which could as a result make an exemption that does not permit general solicitation unavailable.

The generic testing-the-waters materials must provide specified disclosures notifying potential investors about the limitations of the generic solicitation:

- The issuer is considering an offering of securities exempt from registration under the Securities Act, but has not determined a specific exemption from registration the issuer intends to rely on for the subsequent offer and sale of the securities;
- 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 determines the exemption under which the offering is intended to be conducted and, where applicable, the filing, disclosure, or qualification requirements of such exemption are met; and
- A person's indication of interest involves no obligation or commitment of any kind.

The communication may include a means to indicate interest in a potential offering along with the person's name and contact information.

An issuer must provide purchasers – a reasonable time before sale – with any written generic solicitation of interest materials used under new Rule 241 if the issuer sells securities under Rule 506(b) within 30 days of the generic solicitation of interest to any purchaser that is not an accredited investor. Corresponding amendments to Regulation A and Regulation Crowdfunding will require that the Rule 241 generic solicitation materials be made publicly available as exhibits to the offering materials filed if the Regulation A or Regulation Crowdfunding offering is commenced within 30 days of the generic solicitation.

The SEC declined to preempt state blue sky laws for these communications. Although acknowledging that could affect the utility of the rule and potentially expose issuers to civil and criminal liabilities, the SEC believes issuers should be able to navigate such requirements as with other exemptions that do not provide for preemption.

Crowdfunding

New Rule 206 will permit Regulation Crowdfunding issuers to test the waters orally or in writing prior to filing a Form C with the SEC. Similar to existing Rule 255 of Regulation A, the rule will require issuers to state that: (1) no money or other consideration is being solicited, and if sent, will not be accepted; (2) 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 (3) a prospective purchaser's indication of interest is non-binding.

These testing-the-waters materials would be subject to antifraud rules and required to be included with the Form C filed with the SEC. Once the Form C is filed, any offering communications will be required to comply with the terms of Regulation Crowdfunding, including the Rule 204 advertising restrictions.

Amended Rule 204 will permit oral communications with prospective investors once the Form C is filed, so long as the communications comply with the requirements of the rule. The SEC also expanded the information permitted under Rule 204 to include: (1) a brief description of the planned use of proceeds of the offering; and (2) information on the issuer's progress toward meeting its funding goals. The SEC noted that investors receiving the information will continue to be directed to the intermediary's platform where they can access more information.

Further, new Rule 204(d) will allow an issuer to provide information about the terms of a Crowdfunding offering in the materials for a concurrent offering, such as a concurrent Regulation A offering or a Securities Act registration statement, without violating Rule 204. To do so, the information provided about the Crowdfunding offering must comply with Rule 204, including the requirement to include an inactive link directing the potential investor to the intermediary's platform.

Offering and Investment Limits

For Regulation A, the amendments:

- raise the maximum offering amount under Tier 2 of Regulation A from $50 million to $75 million; and
- raise the maximum offering amount for secondary sales under Tier 2 of Regulation A from $15 million to $22.5 million.

The SEC noted that Tier 2 offerings will continue to be preempted from State law registration and qualification requirements pursuant to the exemption for "covered securities".

For Regulation Crowdfunding, the amendments:

- raise the offering limit from $1.07 million to $5 million;
- amend the investment limits for investors by:
  - removing investment limits for accredited investors; and
  - using the greater of their annual income or net worth when calculating the investment limits for non-accredited investors; and
- extend for 18 months the existing temporary relief providing an exemption from certain Regulation Crowdfunding financial statement review requirements for issuers offering $250,000 or less of securities in reliance on the exemption within a 12-month period.

For Rule 504 of Regulation D, the amendments:

- raise the maximum offering amount in a 12-month period from $5 million to $10 million.

Rule 506(c) Verification Requirements

Rule 506(c) allows an issuer to generally solicit and advertise an offering, provided the issuer takes reasonable steps to verify all purchasers are accredited, among other requirements. The SEC amended the rule to add a new item to the non-exclusive list that would allow an issuer to treat an investor as accredited if: (1) the issuer previously verified the investor within the last five years, (2) the investor provides a written representation that the investor continues to qualify as an accredited investor and (3) the issuer is not aware of information to the contrary.

In addition, the SEC reaffirmed and updated its prior guidance that the following factors are among those an issuer should consider when using this principles-based method of verification:

- 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.

The SEC believes that, in some circumstances, the reasonable steps determination may not be substantially different from an issuer's development of a "reasonable belief" for Rule 506(b) purposes. For example, 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 of the investor. That same representation from an investor may not meet the "reasonable steps" requirement if the issuer has no other information about the investor or has information that does not support the view that the investor was an accredited investor.

The SEC reminded issuers that they are not required to use any of the methods set forth in the non-exclusive list and can apply the reasonableness standard directly to the specific facts and circumstances.

Harmonization of Disclosure Requirements

The SEC amended Rule 502(b)'s requirements for financial information that non-reporting companies must provide to non-accredited investors in Regulation D offerings. The changes are intended to align with the financial information required under Regulation A as follows:

- For Regulation D offerings of $20 million or less – paragraph (b) of part F/S of Form 1-A, which applies to Tier 1 Regulation A offerings

- For offerings of greater than $20 million, paragraph (c) of part F/S of Form 1-A, which applies to Tier 2 Regulation A offerings
- Foreign private issuers that are not Exchange Act reporting companies – financial statement disclosure consistent with the Regulation A requirements, in accordance with either U.S. GAAP or International Financial Reporting Standards
- For business combinations and exchange offers, non-Exchange Act reporting companies – financial statements consistent with the Regulation A requirements.

The current Rule 502(b) provisions that permit an issuer, other than a limited partnership, that cannot obtain audited financial statements without unreasonable effort or expense, to provide only the issuer's audited balance sheet, are removed.

The SEC believes that by relaxing the disclosure requirements, additional issuers may be willing to include non-accredited investors in their offerings and thereby expand investment opportunities for them.

Other Changes

Simplification of Regulation A

Item 17 of Form 1-A is amended to allow issuers the option to file redacted material contracts and plans of acquisition, reorganization, arrangement, liquidation or succession, consistent with recent amendments to Regulation S-K. Issuers still have the option to request confidential treatment under existing rules.

Form 1-A is amended to harmonize the procedures for publicly filing Regulation A offering statements with those for draft Securities Act registration statements.

Issuers will be allowed to incorporate previously filed financial statements by reference into a Regulation A offering circular, subject to criteria similar to the requirement for Form S-1.

Rule 259(b) is amended to permit the SEC to declare a post-qualification amendment to an offering statement abandoned, consistent with Rule 479 for registered offerings.

Confidential Information Standard

In a June 2019 decision, the U.S. Supreme Court adopted a new definition of "confidential" under FOIA that does not include a competitive harm requirement. In response, the SEC adopted amendments to adjust the exhibit filing requirements by removing the competitive harm requirement and replacing it with a standard that permits information to be redacted from material contracts if it is the type of information that the issuer both customarily and actually treats as private and confidential, and which is also not material.

Regulation Crowdfunding and Regulation A Eligibility

The amendments establish rules that permit the use of certain special purpose vehicles that function as a conduit for investors to facilitate investing in Regulation Crowdfunding issuers, including new Rule 3a-9 under the Investment Company Act that will exempt a crowdfunding vehicle that meets certain conditions.

The amendments additionally impose eligibility restrictions on the use of Regulation A by issuers that are delinquent in their Exchange Act reporting obligations.

Other Changes to Specific Exemptions

The amendments also:

- clarify that securities offered and sold under Regulation Crowdfunding will constitute "covered securities" so that state securities law registration and qualification requirements will not apply
- harmonize the bad actor disqualification provisions in Regulation D, Regulation A, and Regulation Crowdfunding by adjusting the lookback requirements in Regulation A and Regulation Crowdfunding to include the time of sale in addition to the time of filing.

For further information on this topic, please contact Randy Wang, Rob Endicott or any other BCLP Securities and Corporate Governance lawyer. Additional resources are available on our website for the BCLP Securities and Corporate Governance Practice. Bryan Cave Leighton Paisner LLP makes available the information and materials in its website for informational purposes only. The information is general in nature and does not constitute legal advice. Further, the use of this site, and the sending or receipt of any information, does not create any attorney-client relationship between us. Therefore, your communication with us through this website will not be considered as privileged or confidential.

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