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Securities Law ADVISORY ■

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SEC Harmonizes and Improves "Patchwork" Exempt Offering Framework

The Securities and Exchange Commission (SEC) has finalized March's proposed amendments to simplify the exempt offering framework, which should ultimately benefit smaller-sized issuers and emerging companies. Recently the SEC held an open meeting to approve such amendments. The amendments address issuers' abilities to move from one exemption to another, increase offering and investment size limitations, standardize requirements for offering communications, and harmonize disclosure requirements and bad-actor disqualification provisions across exemptions, all of which the SEC views as being consistent with maintaining investor protections.

Amendments and Clarification of the Offering Integration Rules

The amended rules seek to eliminate regulatory uncertainty of the "integration" of multiple securities offerings, which has in the past created situations that limited the ability of some companies to raise capital. In particular, the amendments establish four new safe harbors based on the facts and circumstances to replace certain currently existing safe harbors from "integration" under the federal securities laws.

Integration framework

Generally, for any offering not covered by a safe harbor, offers and sales will not be integrated if the issuer can establish, based on the particular facts and circumstances, that each offering complies with the registration requirements under the Securities Act of 1933, as amended, or that a registration exemption is available. The new "facts and circumstances" analysis replaces the previous five-factor test the SEC established in 1962. In addition, the SEC adopted new safe harbors under the Securities Act. The SEC believes that the creation of the new safe harbors will help provide methods for smaller and emerging companies to utilize the capital markets, while at the same time protecting investors.

Safe harbors

Under amended Rule 152, the following four safe harbors are now available when a potential issuer considers raising capital under the federal securities laws, in particular when two more or offerings should be "integrated":

1. Any offering made more than 30 calendar days before the commencement of any other offering or after the termination or completion of that other offering will not be integrated, provided that for an offering for which general solicitation is not permitted, either: "(i) that the purchasers were not solicited through the use of general solicitation, or (ii) that the issuer established a substantive relationship with the purchaser prior to the commencement of the offering."

2. Offerings made under Rule 701 under the Securities Act (related to employee benefit plans) and those made in compliance with Regulation S under the Securities Act.

3. Offerings, for which a registration statement has been filed, that would not be integrated with offerings for which: (1) general solicitation is not permitted; (2) general solicitation is permitted to only qualified institutional buyers and certain accredited investors; and (3) "solicitation is permitted that terminated or completed more than 30 calendar days prior to the … registered offering."

4. "Offers and sales made in reliance on an exemption for which general solicitation is permitted … if made subsequent to any terminated or completed offering."

General solicitation and offering communications

Demo days (Rule 148)

The new Rule 148 addresses uncertainty surrounding the meaning of "general solicitation" and its application to "demo days," which banks and issuers frequently conduct during offerings. Under the new rule, demo days will not be considered general solicitation or advertising. The rule defines "demo day" as a seminar or other meeting held by higher education institutions, local governments, nonprofit organizations, angel investor groups (defined as a group of accredited investors holding regular meetings and having written processes), incubators, or accelerators ("sponsors").

The new approach limits the organizations that may sponsor events, the scope of the sponsor's activities, and the type of information that the sponsor may present, providing investor protection while still allowing issuers, particularly smaller-sized issuers and emerging companies, to expand their networks of potential investors.

A sponsor may not:

- Make investment recommendations or provide investment advice to attendees.
- Engage in investment negotiations between the issuer and event attendees.
- Charge event attendee fees (other than reasonable administrative fees).
- Receive any compensation for introducing event attendees and issuers or for investment negotiations between parties.
- Receive compensation relating to the event that would require the sponsor to register as a broker, dealer, or investment adviser.

Further, online participation under the exemption is limited to: (1) individuals who are members of, or associated with, the sponsor organization; (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."

Additionally, the rule clarifies that any advertising materials for the event may not reference any specific securities offering, and the information about the offering conveyed by or on behalf of the issuer is limited to:

- Notification that the issuer is … offering or planning to offer securities;
- The type and amount of securities being offered;
- The intended use of … proceeds; and
- The unsubscribed amount in an offering.

Solicitations of interest (Rule 241)

In light of the SEC's view that allowing issuers to gauge market interest in an exempt offering and tailor offerings to that interest serves the public interest, the SEC adopted new Rule 241, which provides a generic solicitation of interest exemption. This new exemption permits an issuer to use generic solicitation of interest materials before determining which exemption the offering will be conducted under. Any solicitations made pursuant to new Rule 241 will be deemed offers for the sale of a security.

New Rule 241 contains several conditions to ensure investors are protected. Under Rule 241, issuers or those acting on an issuer's behalf may communicate orally or in writing to determine whether there is any interest in a contemplated exempt offering. The rule provides an exemption from registration only for the generic solicitation of interest, which will be deemed an offer for purposes of antifraud provisions of federal securities laws. An issuer that tests the waters under the new exemption will not be permitted to identify the specific exemption that it plans to rely on in a subsequent offering. If an issuer has determined which exemption it will rely on, the issuer must comply with the specific terms of that exemption.

Rule 241 further requires that generic gauging-the-market materials must provide specified legends notifying potential investors that:

- The issuer is considering a registration-exempt offering but has not determined which specific exemption it will rely on.
- No money or other consideration is being solicited or accepted.
- No sales will be made or commitments to purchase accepted until the issuer identifies a specific exemption and complies with any required filings, disclosure, or qualification requirements of that exemption.
- Any indication of interest in the offering is nonbinding.

The SEC also adopted an amendment to the information requirement of Rule 502(b), which requires an issuer to provide purchasers with any written generic solicitation-of-interest materials used under new Rule 241 within 30 days of a generic solicitation of interest to non-accredited investor purchasers. A similar amendment to Regulation A and Regulation Crowdfunding requires Rule 241 solicitation materials be added as an exhibit to offering materials filed with the SEC if the offering is commenced within 30 days of the generic solicitation.

New Rule 241 does not preempt state securities law registration and qualification requirements.

Regulation Crowdfunding

New Rule 206

New Rule 206 is adopted as proposed. Currently, an issuer may not make offers or sales under Regulation Crowdfunding without first filing a Form C with the SEC. New Rule 206 permits Regulation Crowdfunding issuers to test the waters with all potential investors before filing a Form C, permitting potential investors to communicate the types of information they are interested in and contribute to an offering's structure, ultimately lowering the issuer's capital expense.

Specifically, Rule 206 requires issuers to state that:

- "No money or other consideration is being solicited" or 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."
- "A prospective purchaser's indication of interest is non-binding."

Rule 204

The SEC also amended Rule 204 to align the Regulation Crowdfunding communication rules more closely with Rule 255 of Regulation A. The amendments permit oral communications with prospective investors once the Form C is filed so long as it complies with Rule 204. The communications may also include a brief description of the planned use of proceeds and information on the issuer's progress toward meeting its funding goals.

Verification Requirements (Rule 506(c))

The SEC amended Rule 506(c) substantially as proposed to add a new item to the nonexclusive list of verification methods in the rule. Under the rule, an issuer that previously verified that an investor is an accredited investor may establish that the investor remains an accredited investor at the time of a subsequent sale if the investor provides a written representation that it continues to qualify as an accredited investor and the issuer is not aware of information to the contrary. The reliance will be subject to a five-year limitation period.

Harmonization of Disclosure Requirements

The SEC adopted amendments to the financial statement information requirements of Regulation D to realign with Regulation A's less burdensome requirements.

Rule 502(b) of Regulation D

For Regulation D offerings up to $20 million, Rule 502(b)(2)(i)(B)(1) refers issuers to comply with paragraph (b) of part F/S of Form 1-A. For offerings greater than $20 million, Rule 502(b)(2)(i)(B)(2) refers issuers to paragraph (c) of part F/S of Form 1-A.

Regulation A offerings

The SEC also amended Regulation A requirements and registered offerings by allowing Regulation A issuers to:

- Redact, from certain exhibits, information that "would constitute a clearly unwarranted invasion of personal privacy," similar to the process in Items 601(b)(2) and (b)(10) of Regulation S-K.
- Make draft offering statements and related correspondence available via EDGAR to comply with Rule 252(d), and issuers will no longer be required to file non-public offering statements and correspondence as exhibits.
- Incorporate previously filed financial statements by reference.

The last amendment permits the SEC to declare a post-qualification amendment to an offering statement abandoned.

Confidential information redaction standard

The SEC's previous definition of "confidential" was patterned after a definition used by the U.S. Court of Appeals for the District of Columbia Circuit. Recently, the U.S. Supreme Court used a new definition of "confidential." The SEC has adopted a new definition that is closely aligned to the Court's recent definition. Under the amendment, information may 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 that is also not material.

Offering and Investment Limits

The SEC also adopted amendments to raise the limit on capital that can be raised under Regulation A, Regulation 504, and Regulation Crowdfunding:

- The maximum offering amount under Tier 2 of Regulation A is increased from $50 million to $75 million, and the secondary sale maximum offering offer is increased from $15 million to $22.5 million.
- The Rule 504 offering limit is raised from $5 million to $10 million in a 12-month period.
- The Regulation Crowdfunding offering limit is raised from $1.07 million to $5 million in a 12-month period. Further, there will no longer be an investment limit for accredited investors, and limits for non-accredited investors will be based on the greater of the investor's annual income or net worth.

Regulation A Eligibility Restrictions and Delinquent Exchange Act Filers

The new rules amend Regulation A to include an eligibility requirement like that covering Exchange Act reports. Companies that do not file all reports required by Section 13 or 15(d) of the Exchange Act in the two-year period preceding the filing will be ineligible to conduct a Regulation A offering.

Bad-Actor Disqualification Provisions

The SEC amended the bad-actor disqualification provisions in Rule 506(d) of Regulation D, Rule 262(a) of Regulation A, and Rule 503(a) of Regulation Crowdfunding to address inconsistencies in their lookback periods. The rules have been amended to use the same lookback period by adding "or such sale" to any lookback references that refer to the time of filing. The SEC did not adopt proposed amendments to adjust the lookback periods in Regulation A and Regulation Crowdfunding to require issuers to undertake an analysis of the disqualification of bad actors both at the time of filing and the time of sale.

Going Forward

The new rules will become effective 60 days after publication in the *Federal Register*.

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