MAJOR CAPITAL RAISING LIBERALIZATION: SEC PROPOSES NEW RULES TO FACILITATE REGULATION D, REGULATION A, AND CROWDFUNDING EXEMPT SECURITIES OFFERINGS

March 6, 2020

I. Executive Summary

On March 4, 2020, the U.S. Securities and Exchange Commission ("SEC") proposed several important new amendments to liberalize, harmonize and simplify its exempt securities offering rules and regulations, notably Regulation D (Rules 506(b), (c) and 504), Regulation A and the "Crowdfunding" Regulation. Other rules and regulations, including the inconsistent and disparate "safe harbors," are also affected. These amendments are likely to have major impact in facilitating the process of raising capital in the capital markets. The proposals are part of the SEC's ongoing initiative to harmonize and simplify the patchwork securities disclosure regime, and in particular the regime for offers and sales of securities exempt from the general public registration requirement of section 5 of the U.S. Securities Act of 1933, as amended (the "Securities Act"), which governs the initial issuance of securities. Exemptions from the registration requirement are valuable because the registration process, especially for an initial public offering, is costly, rigorous, and leads to extensive ongoing compliance obligations under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which regulates both offers and sales of securities after their initial issuance and the reporting obligations of public companies. For a review of the exempt offering process, see our *Raising Capital through Private Placements: Deal Points* Whitepaper, available on our website at https://kurtinlaw.com/articles-whitepapers or on request to info@kurtinlaw.com). *Raising Capital* compares in detail Regulations D, A, and S and other principal Securities Act sections, rules, and regulations that may be used for registration-exempt offers and sales of securities for the purpose of raising capital and discusses their respective uses, requirements, advantages, and disadvantages.

II. Background

We have reported over the last year on a number of linked SEC rulemakings as part of its exempt offering regime and disclosure liberalization, harmonization and simplification efforts. Most recently, on January 30, 2020, the SEC proposed amendments to the Management Discussion & Analysis ("MD&A") disclosure requirements under Regulation S-K, its integrated disclosure regime for Exchange Act reporting companies (*see, SEC Proposes Simplified MD&A Disclosure Requirements,*

February 14, 2020) (prior advisories cited here are also available on our website at https://kurtinlaw.com/articles-whitepapers or on request to info@kurtinlaw.com).

On December 18, 2019, the SEC moved to expand the definitions of "Accredited Investors," critical to Regulation D (Rules 501-508), the most popular method of raising capital through private placements exempt from public offering registration under the Securities Act and "Qualified Institutional Buyers," critical to resales pursuant to Securities Act Rule 144A of restricted securities issued in private placements (*see, SEC Proposes Accredited Investor and Qualified Institutional Buyer Amendments Critical to Exempt Private Placements and Resales,* December 26, 2019, *id.*).

In June 2019, the SEC issued a request for public comments on how to harmonize and streamline the exempt-from-registration framework to allow startups, early stage companies and investors readier access to capital and investment opportunities, with special focus on whether the existing limitations on who can invest in certain offerings exempt for registration are too restrictive notwithstanding the SEC's mission of protecting the investing public and unduly choke off access to available capital (*see, SEC Seeks Public Comment on Revising and Harmonizing Securities Exempt Offering Regime,* July 8, 2019, *Id.*).

On March 20, 2019, the SEC adopted amendments to modify and simplify other portions of Regulation S-K to facilitate investor access to material information and ability to analyze it (*see, SEC Adopts Simplified Disclosure Requirements,* April 30, 2019, *Id.*).

III. The Proposed Amendments

The SEC's proposed amendments, which will be open for public comment for 60 days following publication in the Federal Register, are in short form as follows:

a. Regulation D

- Increase the aggregate offering limit of Regulation D, Rule 504 from $5 million to $10 million.

- Allow "Test-the-Waters" and "Demo Day" communications with a new rule allowing an issuer to use a generic solicitation of interest materials to "test-the-waters" and use

"Demo Day" materials for a prospective exempt sale of securities prior to determining which exemption it will use, without violating "no general solicitation" rules.

- Change the financial information that must be provided to non-accredited investors under Regulation D, Rule 506(b) private placements to align with the information that investors must provide to investors in Regulation A offerings pursuant to Regulation D, Rule 502 and Regulation A Form 1-A.

- Add a new item to Accredited Investor verification under Regulation D, Rule 506(c) (which, unlike Rule 506(b), permits general solicitation, but which requires greater Accredited Investor due diligence by the issuer company and which permits actual sales only to Accredited Investors (Rule 506(b) permits sales to an unlimited number of Accredited Investors and up to 35 non-accredited investors, although we do not recommend selling to non-accredited investors (*see, Raising Capital, Id.*)).

b. Regulation A

- Increase the aggregate offering limit of Regulation A, Tier 2 (often called "Reg. A+") from $50 million to $75 million.

- Increase the aggregate offering limit for secondary sales under Tier 2 from $15 million to $22.5 million.

- Simplify some of the Regulation A offering requirements and establish greater consistency between registered offerings and Regulation A offerings (Regulation A is actually a type of public offering, though a less expensive and complicated one than Securities Act section 5 registered offerings; Regulation A securities are consequently freely resalable).

- Harmonize the "bad actor" disqualification provisions from Regulation D.

c. Regulation Crowdfunding

- Increase the aggregate offering limit in Regulation Crowdfunding from $1.07 million to $5 million.

- Amend a proposed rule to allow Test-the-Waters activity in crowdfunding prior to filing an offering document with the SEC similar to the method used for Regulation A.

- Remove investment limits for Accredited Investors (this would effectively make Crowdfunding an unlimited aggregate offering exemption, like Regulation D, Rule 506, when selling to Accredited Investors).

- Amend the calculation method for non-accredited investors to permit them to rely on the greater of their annual income or net worth when calculating how much they can invest.

- Harmonize the “bad actor” disqualification provisions from Regulation D.

- Permit the use of Special Purpose Vehicles (“SPVs”) to facilitate Regulation Crowdfunding investment, and limit the type of securities that may be offered and sold in reliance on the Regulation Crowdfunding exemption (*see, Special Purpose Vehicles: Uses and Abuses,* January 2020, *Id.*).

d. “Safe Harbor” and Integration Harmonization

- The amendments propose to harmonize and simplify the SEC’s “integration” rules. Securities offerings pursuant to these rules are or are not “integrated” with prior offerings, meaning the prior offerings do or do not count against the aggregate offering price limitation for the current offering. One proposed rule is for a unified, facts-and-circumstances based analysis to determine whether an issuer can establish that an offering and the prior offerings fit into an exemption or require Securities Act registration.

- The SEC is also proposing four non-exclusive safe harbors from integration:

    - That any offering made more than 30 calendar days before the commencement of another offering, or more than 30 calendar days after completion or termination of any other offering would not be integrated with the other, provided that for an exempt offering for which general solicitation is not permitted the purchasers were not solicited though general solicitation or established a substantive

relationship with the issuer prior to the commencement of the offering for which general solicitation is not permitted.

- Rule 701 (employee benefit/stock option and other equity compensation) or Regulation S offerings will not be integrated with other offerings (*see, Raising Capital; see Rule 701 Amendment Encourages Stock Option and other Equity-based Compensation Plans*, *Id.*).

- A Securities Act registered offering would not be integrated with another offering if made subsequent to (i) a terminated or completed offering for which general solicitation was not permitted; or (ii) one for which general solicitation was permitted but which was made only to Qualified Institutional Buyers or institutional Accredited Investors; or (iii) an offering that was terminated or completed more than 30 calendar days prior to the commencement of the registered offering.

- Offers and sales made in reliance on an exemption for which general solicitation is permitted would not be integrated with another offering if made subsequent to any prior terminated offering.

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