UPDATE TO SEC PROPOSED NEW REGULATION D, REGULATION A, AND REGULATION CROWDFUNDING EXEMPT SECURITIES OFFERINGS RULES

July 6, 2020

I. Executive Summary

On March 4, 2020, the U.S. Securities and Exchange Commission ("SEC") proposed major new amendments to its exempt securities offering rules and regulations, notably Regulation D (Rules 506(b), (c) and 504), Regulation A and Regulation Crowdfunding. On May 4, the SEC implemented additional temporary rules to liberalize Crowdfunding requirements to facilitate capital raising during the Covid-19 crisis. The March proposed rules, which have now passed their comment period deadline, 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 costly and onerous general public registration requirement of section 5 of the U.S. Securities Act of 1933, as amended (the "Securities Act"). 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

The current series of rulemakings started in June 2019, when 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, also available on our website or on request.).

On December 18, 2019, the SEC moved to expand the definition of "Accredited Investors," critical to Regulation D, 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.*).

III. The Proposed Amendments

The SEC's proposed exempt offering regime amendments 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 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 the "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, although 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, thereby theoretically allowing one or a small number of Accredited Investors to subscribe for up to the full aggregate offering, including the new $5 million aggregate offering limit.

- 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.*).

In addition to the proposed permanent rules, the SEC on May 4 also implemented temporary, final rules to relax the Regulation Crowdfunding requirements to facilitate capital raising during

the Covid-19 Pandemic. The temporary rules are currently scheduled to sunset on August 31, but on June 26, the SEC released a public statement to the effect that it was reviewing the state of the crisis to determine whether the temporary rules should be extended. The temporary Regulation Crowdfunding rules:

- Amend eligibility by providing that in addition to existing eligibility criteria (the Crowdfunding exemption is not available to non-U.S. issuers, reporting companies under Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, investment companies, "blank check" companies, companies disqualified under Regulation Crowdfunding rules or which have failed to file prior Regulation Crowdfunding annual reports), to use the temporary rules, the issuer cannot have been organized and operating less than six months prior to the offering. Also, if the issuer has previously sold securities in a Regulation Crowdfunding offering, it must have complied with Securities Act section 4A(b) and related rules.

- Allow acceptance of investment commitments after filing an offering statement that includes financial statements or an amended offering statement including financial statements in lieu of existing requirement of financial statements included in initial offering statement.

- Relax financial statement requirements when the issuer is offering more than $107,000 and not more than $250,000 in a 12-month period by allowing CEO certification in lieu of independent public accountant review.

- Allow sales as soon as issuer has received binding investment commitments covering the target offering amount (after 48 hour waiting period for "binding" commitments to vest), in lieu of 21-day waiting period after public filing of offering statement.

- Allow early closing as soon as binding commitments reaching target amount are reached if issuer has complied with temporary Rule 201(z) disclosure requirements, intermediary gives notice that target offering amount has been reached, and the target offering amount has still been reached or exceeded at the time of closing, again in lieu of 21-day waiting period and five-day intermediary notice period.

- Allow cancellation of investment commitments for any reason for 48 hours after investor's commitment (or greater period specified by issuer), after which investment commitment becomes binding in the absence of material change to the offering, in lieu existing rules' 48 hours prior to deadline identified in issuer's offering materials.

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 would 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.

Owen D. Kurtin