SEC ADOPTS MAJOR EXEMPT SECURITIES OFFERING RULE AMENDMENTS TO FACILITATE CAPITAL RAISING UNDER REGULATION D, REGULATION A, AND CROWDFUNDING

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I. Executive Summary

On November 2, 2020, the U.S. Securities and Exchange Commission ("SEC") adopted several important new rule amendments to liberalize, harmonize and simplify exempt securities offerings, notably Regulation D, Regulation A and Crowdfunding. The rule amendments:

- Increase the aggregate offering limits under Rule 504 of Regulation D, Regulation A, Regulation Crowdfunding, and liberalize certain individual investment limits;
- Establish in one clear and broadly applicable Rule 152 on "integration," the ability of issuers of exempt securities to use different exemptions in series or in tandem;
- Harmonize and clarify rules concerning communications with prospective investors in private placements, including "Test-the-Waters" and "Demo Day" activities in a new Rule 148; and
- Harmonize disclosure and eligibility requirements and bad actor disqualification provisions.

The new rules are part of the SEC's ongoing initiative to harmonize, liberalize 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). The next edition of "*Raising Capital,*" in January, will discuss these amendments in the full context of the exemptions' different features, advantages and disadvantages.

II. Background

We reported on these proposed rule amendments in March, and have reported since 2019 on a number of linked SEC rulemakings as part of its exempt offering regime and disclosure liberalization, harmonization and simplification efforts. On August 26, 2020, the SEC expanded the definitions 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. The new rule amendments liberalize and expand the Accredited Investor definition in Rule 501 by:

- Qualifying natural persons as Accredited Investors by reason of professional certifications such as a Series 7, 65 or 82 broker-dealer license or other educational credentials (in other words, even if the other net worth or net income or insider status qualifications are not met).

- Including investments in private funds, including "knowledgeable employees" of the fund (again, irrespective of meeting the other qualifying thresholds).

- Including in the list of qualified business entities limited liability companies ("LLCs") with $5 million in assets, SEC and state-registered investment advisers, exempt reporting advisers and rural business investment companies ("RBICs").

- Including any entity, including Native American tribes, governmental bodies, funds and entities existing under the laws of foreign countries, owning "investments," as defined in the Investment Company Act, in excess of $5 million and that is not a "blank check" company (one formed for the specific purpose of investing in the offered securities).

- Including "family offices" with at least $5 million in assets under management and their "family clients" as those terms are defined in the Investment Advisers Act.

- Adding the term "Spousal Equivalent" to the Accredited Investor definition to allow spousal equivalents to pool their finances for the purposes of Accredited Investor qualification (for example, the net worth or net income qualifications) (as noted above, the proposed amendments do not affect those monetary thresholds themselves).

III. The Rule Amendments

The SEC's rule amendments, which will be effective 60 days following publication in the Federal Register (with the exception of immediately effective temporary Crowdfunding rules), are in short form as follows:

a. Regulation D (Rules 501 - 508)

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

- Allow Issuers to engage in "Test-the-Waters" and "Demo Day" (organized pitch presentations *by at least two issuers* under the auspices or sponsorship of a university, not-for-profit entity, investment bank or fund, organized angel investors, accelerators, incubators, state and local governments and their agencies, and other parties) communications with generic solicitation-of-interest materials for a prospective exempt sale of securities prior to determining which exemption it will use pursuant to a new Rule 148, without violating the no "general solicitation"/"general advertising" requirements of Rule 506(b) if that exemption (by far the most popular) is eventually chosen, provided, among other things, that the "Demo Day" sponsor made no investment recommendations at the event, received no payments in the nature of a brokerage commission, nor charged a fee to attend it; and that the event advertising made no reference to any specific offering of securities.

- Change the tiered levels (depending on size of offering) of financial information that must be provided to non-accredited investors under Regulation D, Rule 506(b) private placements, widely considered too burdensome, to align with the information that investors must provide to investors in Regulation A offerings pursuant to Form 1-A.

- Add a new item to Accredited Investor verification to permit issuers to confirm that a previously verified Accredited Investor remains one 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 and which permits actual sales *only* to Accredited Investors; the general solicitation permission explains the heightened Accredited Investor verification requirements compared to Rule 506(b)).

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, compared to those of Regulation D securities, which are restricted securities for resale purposes).

- 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.

- 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 individual investment limits for 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 certain types 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.*).

- Extend, effective immediately upon publication in the Federal Register, for 18 months the Covid-19 pandemic-related liberalization inaugurated by the May 4 temporary, conditional crowdfunding amendments to:

  - 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. Integration and "Safe Harbor" Harmonization

- The amendments harmonize and simplify the SEC's "integration" rules under Rules 152 - 155. Securities offerings pursuant to these rules either 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, and therefore determine when, and in what combination, different exemptions can be used by an issuer. For example, under the new Rule, an issuer may conduct simultaneous Rule 506(b), without general solicitation, and 506(c), with general solicitation, offerings, if it had a reason to do so. Amended Rule 152(a) establishes 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 Rule 152(b) amendments eliminate a prior, difficult-to-apply-and-rely-upon "five-factor" test and establish four non-exclusive safe harbors from integration, meaning that if they are complied with, the prior offering will *not* count against the aggregate offering limit, if any, of the current offering:

  - 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. This safe harbor replaces a previous

generally, but not universally, applicable six-month safe harbor. Former Rule 155 is eliminated, superseded by new Rule 152(b)(1).

- Rule 701 (employee benefit/stock option and other equity compensation) or Regulation S (offshore) offerings will not be integrated with other offerings per Rule 152(b)(2) (*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" ("IAI's"); or (iii) an offering that was terminated or completed more than 30 calendar days prior to the commencement of the registered offering, per Rule 152(b)(3).

- 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, per Rule 152(b)(4). The safe harbor includes offers made under Regulation A, Regulation Crowdfunding, Rules 147 and 147A (governing intrastate offerings), Rule 504 and Rule 506(c).

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