NORTON ROSE FULBRIGHT

US SEC amends rules to simplify and expand the exempt offering framework

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On November 2, 2020, in an effort to harmonize and modernize the exempt offering framework under the Securities Act of 1933 (the Securities Act), the Securities and Exchange Commission (SEC) adopted, by a vote of 3 to 2, a final rule entitled "Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets."

These new amendments, along with the recently expanded definition of "accredited investor" (see our legal update, *US SEC adopts amendments to expand scope of accredited investor definition*), are intended to greatly increase access to both capital raising for issuers and capital investment for investors through private and other offerings that are exempt from registration under the Securities Act

Background

Offerings of securities in the US must either be registered with the SEC or qualify for an exemption from the registration requirements of the Securities Act. Emerging companies, entrepreneurs and small businesses typically take advantage of the exempt offering framework to raise capital without having to navigate the complex, time consuming and often expensive registration process. At the same time, as SEC Chairman Jay Clayton points out, under the current framework, "prospective investors must navigate a system of multiple exemptions and safe harbors, each with different requirements". The amendments seek to address the gaps and complexities, while continuing to enhance established investor protections.

The amendments generally:

- Increase the offering limits for Regulation A, Regulation Crowdfunding and Rule 504 offerings, and revise certain individual investment limits;
- Set clear and consistent rules governing certain offering communications, including permitting certain "test-the-waters" and "demo day" activities;
- Clarify the integration framework and make it easier for issuers to move from one exemption to another; and
- Harmonize certain disclosure and eligibility requirements and bad actor disqualification provisions.

The amendments will be effective 60 days after publication in the Federal Registration, except for the temporary Regulation Crowdfunding provisions, which will be effective immediately upon publication in the Federal Register.

Offering and investment limits

The amendments increase certain offering amount thresholds and revise eligibility criteria for Regulation A, Regulation Crowdfunding and Rule 504 of Regulation D.

Regulation A:

- Raises the maximum offering amount for primary offerings under Tier 2 from US$50 million to US$75 million; and
- Raises the maximum offering amount for secondary sales under Tier 2 from US$15 million to US$22.5 million.

Regulation Crowdfunding:

- Raises the offering limit from US$1.07 million to US$5 million;
- Amends investor limits by:
  - Removing investment limits for accredited investors; and
  - When calculating investment limits for non-accredited investors, allowing investors to use the greater of annual income or net worth; and
- Extends for an additional 18 months the existing temporary relief that provides an exemption from certain financial statement review requirements for issuers offering between US$250,000 or less of securities in reliance on the exemption within a 12-month period. The relief will apply to all offerings initiated under Regulation Crowdfunding between May 4, 2020 and August 28, 2022.

Rule 504:

- Raises the maximum offering amount from US$5 million to US$10 million.

Offering communications

"Test-the-waters" communications:
The amendments relax the offering communication rules to:

- Permit issuers to use generic solicitation of interest materials to "test-the-waters" for an exempt offering of securities before determining which exemption it will use for the sale of the securities; and
- Permit issuers under Regulation Crowdfunding to "test-the-waters" prior to filing an offering document with the SEC in a manner similar to the current process under Regulation A.

"Demo day" communications:
The amendments create a new offering communication rule to provide that certain "demo day" communications will not be deemed general solicitation or general advertising provided certain conditions are met. 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, a nonprofit organization, or an angel investor group, incubator or accelerator. Under the new rule, "angel investor group" means a group: (A) of accredited investors; (B) that holds regular meetings and has written processes and procedures for making investment decisions, either individually or among the membership of the group as a whole; and (C) is neither associated nor affiliated with brokers, dealers or investment advisers.

The sponsor of the "demo day" event may not:

- Make investment recommendations or provide investment advice to attendees of the event;
- Engage in any investment negotiations between the issuer and investors attending the event;
- Charge attendees any fees, other than reasonable administrative fees;
- Receive any compensation for making introductions between event attendees and issuers, or for investment negotiations between the parties; or
- Receive any compensation with respect to the event that would require it to register as a broker or dealer or an investment adviser.

Further, advertising for the event cannot reference any specific offering of securities by the issuer, and there are also certain limitations on the information that may be conveyed at such an event and on virtual "demo day" events. If the "demo day" is virtual, participation must be limited to:

- Individuals who are members of, or otherwise associated with the sponsor organization;
- Individuals the sponsor reasonably believes are accredited investors; and
- Individuals invited by the sponsor based on industry or investment-related experience reasonably selected by the sponsor in good faith and disclosed in public communications about the event.

Regulation Crowdfunding and Regulation A eligibility

The amendments create new rules that permit investors to aggregate their investments with the use of certain special purpose crowdfunding vehicles (crowdfunding vehicles) to make investments in an issuer raising capital under Regulation Crowdfunding. The new rules exclude such crowdfunding vehicles from the definition of "investment company" under the Investment Company Act of 1940.

The amendments also impose certain eligibility restrictions on the ability to use Regulation A for issuers that are delinquent in their reporting obligations under the Securities and Exchange Act of 1934 (Exchange Act). For example, an issuer would not be permitted to conduct a Regulation A offering if the issuer failed to file the reports required by Section 13 or 15(d) of the Exchange Act in the two years preceding the filing of an offering statement.

Integration framework

Historically, the determination of whether two securities offerings in close proximity to one another should be "integrated" as really one integrated offering has been a convoluted process highly dependent on a set of "five factors" without much clarity which of those factors carried the greatest, if any, weight. The amendments establish a new integration framework with a general principle that looks to the facts and circumstances surrounding two or more offerings and focuses the analysis on whether each particular offering either complies with the registration requirements of the Securities Act or an exemption for registration.

Additionally, the amendments provide four non-exclusive safe harbors from integration as follows:

- **Safe Harbor 1:** An offering made more than 30 calendar days before the commencement of any other offering, or more than 30 calendar days after the termination or completion of any other offering, will not be integrated with another offering; except:
  - if the earlier offering allows general solicitation, but the later offering does not, then the purchasers in the later offering either were not solicited through the use of general solicitation or established a substantive relationship with the issuer prior to the commencement of such offering.
- **Safe Harbor 2:** Offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan, or in compliance with Regulation S, will not be integrated with other offerings.
- **Safe Harbor 3:** An offering pursuant to a filed Securities Act registration statement will not be integrated if made after:
  - a terminated or completed offering for which general solicitation is not permitted;
  - a terminated or completed offering for which general solicitation is permitted and was made only to qualified institutional buyers and institutional accredited investors; or
  - an offering for which general solicitation is permitted that terminated or was completed more than 30 calendar days prior to the commencement of the registered offering.
- **Safe Harbor 4:** Offers and sales made in reliance on an exemption for which general solicitation is permitted will not be integrated if made after any terminated or completed offering.

Other amendments

Among other things, the amendments provide greater clarity to certain requirements for Regulation A offerings, particularly with respect to required disclosures. For example, required disclosures to non-accredited investors would be "scaled".

Also, the amendments harmonize the bad actor disqualification provisions in Regulation D, Regulation A and Regulation Crowdfunding by adopting the same look-back period for disqualifying events. For example, a disqualifying event that occurs during an offering, not just prior to filing, would disqualify the "bad actor" from participating in the offering.

The amendments also add a new item to the non-exclusive list of verification methods in Rule 506(c). An investor for which the issuer previously took reasonable steps to verify accredited investor status remains an accredited investor as of the time of a subsequent sale if the investor provides a written representation to that effect and the issue is not aware of contrary information. This method is subject to a five-year time limit.

Further, the amendments change the financial information that must be provided to non-accredited investors in a Rule 506(b) private offering to align with the less burdensome financial information that issuers must provide to investors in Regulation A offerings. For example, an issuer would no longer have to provide audited financial statements in a Regulation D offering of less than US$20 million.

The SEC's below chart provides an overview of the new exempt offering framework:

Type of Offering	Offering Limit within 12-month Period	General Solicitation	Issuer Requirements	Investor Requirements	SEC Filing or Disclosure Requirements	Restrictions on Resale	Preemption of State Registration and Qualification
Section 4(a)(2)	None	No	None	Transactions by an issuer not involving any public offering. See SEC v. Ralston Purina Co.	None	Yes. Restricted securities	No
Rule 506(b) of Regulation D	None	No	"Bad actor" disqualifications apply	Unlimited accredited investors Up to 35 sophisticated but non-accredited investors in a 90-day period	Form D Aligned disclosure requirements for non-accredited investors with Regulation A offerings	Yes. Restricted securities	Yes
Rule 506(c) of Regulation D	None	Yes	"Bad actor" disqualifications apply	Unlimited accredited investors Issuer must take reasonable steps to verify that all purchasers are accredited investors	Form D	Yes. Restricted securities	Yes

Type of Offering	Offering Limit within 12-month Period	General Solicitation	Issuer Requirements	Investor Requirements	SEC Filing or Disclosure Requirements	Restrictions on Resale	Preemption of State Registration and Qualification
Regulation A: Tier 1	$20 million	Permitted; before qualification, testing-the-waters permitted before and after the offering statement is filed	U.S. or Canadian issuers Excludes blank check companies,* registered investment companies, business development companies, issuers of certain securities, certain issuers subject to a Section 12(j) order, and Regulation A and reporting issuers that have not filed certain required reports "Bad actor" disqualifications apply No asset-backed securities	None	Form 1A, including two years of financial statements Exit report	No	No

Type of Offering	Offering Limit within 12-month Period	General Solicitation	Issuer Requirements	Investor Requirements	SEC Filing or Disclosure Requirements	Restrictions on Resale	Preemption of State Registration and Qualification
Regulation A: Tier 2	$75 million			Non-accredited investors are subject to investment limits based on the greater of annual income and net worth, unless securities will be listed on a national securities exchange	Form 1A, including two years of audited financial statements Annual, semi-annual, current, and exit reports	No	Yes
Rule 504 of Regulation D	$10 million	Permitted in limited circumstances	Excludes blank check companies, Exchange Act reporting companies, and investment companies "Bad actor" disqualifications apply	None	Form D	Yes. Restricted securities except in limited circumstances	No

Type of Offering	Offering Limit within 12-month Period	General Solicitation	Issuer Requirements	Investor Requirements	SEC Filing or Disclosure Requirements	Restrictions on Resale	Preemption of State Registration and Qualification
Regulation Crowdfunding; Section 4(a)(6)	$5 million	Testing the waters permitted before Form C is filed Permitted with limits on advertising after Form C is filed Offering must be conducted on an internet platform through a registered intermediary	Excludes non-U.S. issuers, blank check companies, Exchange Act reporting companies, and investment companies "Bad actor" disqualifications apply	No investment limits for accredited investors Non-accredited investors are subject to investment limits based on the greater of annual income and net worth	Form C, including two years of financial statements that are certified, reviewed or audited, as required Progress and annual reports	12-month resale limitations	Yes
Intrastate: Section 3(a)(11)	No federal limit (generally, individual state limits between $1 and $5 million)	Offerees must be in-state residents.	In-state residents "doing business" and incorporated in-state; excludes registered investment companies	Offerees and purchasers must be in-state residents	None	Securities must come to rest with in-state residents	No

Type of Offering	Offering Limit within 12-month Period	General Solicitation	Issuer Requirements	Investor Requirements	SEC Filing or Disclosure Requirements	Restrictions on Resale	Preemption of State Registration and Qualification
Intrastate: Rule 147	No federal limit (generally, individual state limits between $1 and $5 million)	Offerees must be in-state residents.	In-state residents "doing business" and incorporated in-state; excludes registered investment companies	Offerees and purchasers must be in-state residents	None	Yes. Resales must be within state for six months	No
Intrastate: Rule 147A	No federal limit (generally, individual state limits between $1 and $5 million)	Yes	In-state residents and "doing business" in-state; excludes registered investment companies	Purchasers must be in-state residents	None	Yes. Resales must be within state for six months	No