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SEC “Harmonizes” Exempt Offering Framework

On November 2, 2020, the Securities and Exchange Commission voted to harmonize, simplify, and improve the current tangled framework for exempt securities offerings, a move intended to promote capital formation and expand investment opportunities while preserving or improving important investor protections.

Under SEC requirements, all securities offerings must be either registered with the SEC or qualify for an exemption from registration. The registration process generally is designed for larger companies with substantial resources. As a result, most entrepreneurs and emerging businesses raise capital by selling securities in reliance on an offering exemption, such as Regulation D, Regulation A, or Regulation CF (Crowdfunding). This important capital formation activity ranges from raising seed capital for new businesses to growth capital for companies of all sizes. The SEC has estimated that approximately \$2.7 trillion of new capital was raised through exempt offering channels in 2019, of which approximately \$1.3 billion (0.05 percent) was raised under Regulation A, Regulation Crowdfunding, and Rule 504 combined.

In many cases, businesses, particularly smaller businesses, have found the framework for exempt offerings confusing and difficult to navigate. Each exemption has its own specific requirements to be met, which can be inconsistent among offering exemptions available. In some cases, choosing to pursue one exemption path makes it more difficult to switch to other options.

Integration

When issuers use various private offering exemptions in parallel or in close time proximity, questions can arise as to the need to view the offerings as “integrated” for purposes of analyzing compliance. Integration means multiple offerings will be treated together as one offering for purposes of securities regulation. The integration doctrine seeks to prevent an issuer from improperly avoiding registration by artificially dividing a single offering into multiple offerings such that Securities Act exemptions would apply to the multiple offerings that would not be available for the combined offering. Issues can arise from the fact that many exemptions have differing limitations and conditions on their use, including whether the general solicitation (public advertising) for investors is permitted. For example, if an issuer starts by conducting an offering that is designed to meet the requirements for a specific exemption, but shortly after decides to change the

offering to meet the requirements for a different specific exemption, and the requirements for the two exemptions are incompatible (for example, allowing for public advertising or not), the offerings when considered on a combined basis may be in violation of securities law.

The amendments provide four non-exclusive safe harbors from integration providing that:

- any 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 such other offering(s); provided that where an exempt offering that doesn't allow for general solicitation follows an offering that does allow for general solicitation, certain conditions are met so that each purchaser in the offering that doesn't allow for general solicitation, is not purchasing the securities in the offering as a result of the previous general solicitation;
- offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan, or in compliance with Regulation S, offerings made outside the U.S., will not be integrated with other offerings;
- an offering for which a Securities Act registration statement has been filed will not be integrated if it is made subsequent to a terminated or completed private placement without general solicitation, or a private placement with general solicitation, so long as the private placement offering was only made to certain types of qualified investor or was terminated or completed more than 30 days before the commencement of the registered offering; and
- offers and sales made in reliance on an exemption for which general solicitation is permitted will not be integrated if made subsequent to any terminated or completed offering.

Increased Maximum Offering Amounts

Many offering exemptions are characterized by a maximum offering limit. The new amendments increase many of these limits:

Regulation A:

- raise the maximum offering amount under Tier 2 of Regulation A from \$50 million to \$75 million; and
- raise the maximum offering amount for secondary sales (sales by existing shareholders) under Tier 2 of Regulation A from \$15 million to \$22.5 million.

Crowdfunding:

- raise the offering limit in Regulation Crowdfunding from \$1.07 million to \$5 million;
- amend the investment limits for investors in Regulation Crowdfunding offerings by:
 - removing investment limits for accredited investors; and
 - using the greater of their annual income or net worth when calculating the investment limits for non-accredited investors.

Rule 504 of Regulation D:

- raise the maximum offering amount from \$5 million to \$10 million

Investor Communications

The SEC is amending offering communications rules, by:

- permitting an issuer to use generic solicitation of interest materials to “test-the-waters” for an exempt offer of securities prior to determining which exemption it will use for the sale of the securities;
- permitting Regulation Crowdfunding issuers to “test-the-waters” prior to filing an offering document with the Commission in a manner similar to current Regulation A; and
- providing that certain “demo day” communications will not be deemed general solicitation or general advertising, so long as certain conditions and qualifications are met.

Other Changes

The amendments also:

- change the financial information that must be provided to non-accredited investors in Rule 506(b) private placements (placements without general solicitations) to align with the financial information that issuers must provide to investors in Regulation A offerings;
- add a new item to the non-exclusive list of verification methods in Rule 506(c) (private placements with general solicitations) to allow an issuer to rely on steps previously taken to verify an investor’s accredited status to certify continuing accredited investors status;

- simplify certain requirements for Regulation A offerings and establish greater consistency between Regulation A and registered offerings, including permitting incorporation by reference of certain previously filed financial information; and
- harmonize the bad actor disqualification provisions in Regulation D, Regulation A, and Regulation Crowdfunding.

The Amendments will be effective 60 days after publication in the Federal Register.

Overview of Amended Capital-Raising Exemptions

Type of Offering	Offering Limit within 12-month Period	General Solicitation	Issuer Requirements	Investor Requirements	SEC Filing or Disclosure Requirements
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
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

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 1-A, including two years of financial statements Exit report
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 1-A, including two years of audited financial statements Annual, semi-annual, current, and exit reports

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
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



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