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CLIENT ALERT

SEC Improves Registration Exemptions for Private Company Issuers and Investors

November 9, 2020

On November 2, 2020, the U.S. Securities and Exchange Commission (**SEC**) voted to approve significant amendments to the exemptions from SEC registration requirements for private companies. The amendments, approved with all three Republican commissioners voting in favor and the two Democrat commissioners voting against, were described in the SEC's press release as the "next step in the Commission's efforts to improve the exempt offering framework for the benefit of investors, emerging companies, and more seasoned issuers."

Under the SEC regulatory regime, all securities offerings must be registered with the SEC unless they qualify for an exemption from registration. Private companies, entrepreneurs and investors routinely take advantage of one or more exemptions from registration requirements to raise capital. In his statements supporting the amendments, SEC Chair Clayton described the existing regulatory framework of exemptions as "patchwork." The amendments to the SEC rules are thus intended to harmonize certain disclosures and eligibility requirements and to set clear and consistent rules governing certain offering communications. While the changes are fairly sweeping and detailed, this alert focuses on areas of most interest to our private company clients and their investors.

In particular, and of most interest to small and medium-sized private companies, the SEC increased the offering limits for Regulation A, Regulation Crowdfunding (**Regulation CF**), and Rule 504 offerings, and revised certain individual investment limits. Regulation A offering limits were raised from $50 million to $75 million and the maximum offering amount for secondary sales was raised from $15 million to $22.5 million. Regulation CF was amended to raise total offering limits from $1.07 million to $5 million and to amend investment limits for individual investors to (i) remove the investment limits completely for *accredited investors* and (ii) use the greater of their annual income or net worth when calculating their investment limits for *non-accredited investors*. Rule 504 of Regulation D was amended to raise the maximum offering amount from $5 million to $10 million.

The increase to the cap on offerings under Regulation CF is a particularly welcome change by the SEC. Too often we have seen companies consider utilizing Regulation CF to raise capital, only to abandon such plans upon weighing the costs of closing a Regulation CF financing transaction with the benefit of raising only $1.07 million. The increase in the cap to $5 million will allow companies that would not have previously considered Regulation CF to now utilize this exemption from registration. The net effect should be more opportunities for participation in private company investments for non-institutional investors and access to alternative streams of financing for companies.

The SEC changes also established a broad "integration framework" for when private offering exemptions are used by issuers in parallel or in close time proximity, which can lead to questions as to the need to view the offerings as "integrated" for purposes of analyzing compliance. Four additional non-exclusive safe harbors from integration were announced such that companies will be able to make exempt offerings within 30 days of each other instead of the current six-month waiting period and offerings made pursuant to an employee benefit plan under Rule 701 will not be integrated with other offerings, amongst others. This provides additional benefits to private companies to enable them to plan more effectively for each fundraising round.

Additionally, the SEC amended offering communications rules to allow for “test-the-waters” and “demo day” communications. The amendments permit an issuer to use generic solicitation of interest materials to “test-the-waters” for an exempt offer of securities prior to determining which exemption to use for the sale of securities. The amendments also permit Regulation CF issuers to “test-the-waters” prior to filing offering documents with the SEC in a manner similar to current Regulation A. Additionally, certain “demo day” communications will not be deemed general solicitation or general advertising, specifically, if the communications are made in connection with a seminar or meeting sponsored by a college, university, or other institute of higher education, a state or local government, a non-profit organization, or an angel investor group, incubator, or accelerator sponsoring the “demo day.”

Lastly, we would call special attention to the SEC’s new rules that permit the use of certain special purpose vehicles (**SPVs**) that invest in a single company under Regulation CF. Previously investors purchasing securities in an offering under Regulation CF had to hold securities in their own name, leading to unwieldy cap tables containing, in some cases, thousands of investors and administrative complexities. The new amendments allow for limited-purposes crowdfunding SPV’s that meet certain conditions, namely that they are specifically designed to function as a conduit for investors to invest in a business that seeks to raise capital through a crowdfunding vehicle, enabling companies to streamline and manage their cap tables more effectively.

The amendments will become effective on the sixtieth day following their publication in the Federal Register, except for the extension of the temporary Regulation Crowdfunding provisions, which will be effective upon publication in the Federal Register.

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For more information on these recent changes to the exempt offering framework, see the summary from the SEC here.

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