SULLIVAN & CROMWELL LLP

July 1, 2019

Securities Offering Registration Exemptions

The SEC Issues Comprehensive Request for Comment on the Framework for Exempt Offerings under the Securities Act

SUMMARY

The Securities Act of 1933 contains a large number of exemptions from its registration requirements and authorizes the Securities and Exchange Commission to adopt additional exemptions. The existing body of exemptions has evolved and expanded over time through SEC rulemaking and legislative changes, resulting in a framework that is complex and potentially difficult for issuers to navigate. On June 18, 2019, the SEC issued a concept release seeking public comment on possible ways to simplify, harmonize and improve the existing exempt offering framework to promote capital formation and expand investment opportunities while maintaining appropriate investor protections. Comments are due by September 24, 2019.

REQUEST FOR COMMENT

In requesting comments on the current exempt offering framework, the SEC acknowledges that, given the evolution over time, the current exemptions were not adopted as part of a cohesive regulatory scheme. The SEC also acknowledges that separate and apart from the regulatory changes, exempt markets have been significantly influenced by changes in information and communications technologies, including the rise of social media. Following on that, the SEC poses a series of broad conceptual questions, including:

- Is the existing exempt offering framework too complex? Should the SEC reduce or simplify the number of exemptions available?
- In light of the fact that some exemptions impose limited or no restrictions at the time of the offer, should the SEC revise its exemptions across the board to focus consistently on investor protections at the time of sale rather than at the time of offer? If the exemptions focused on investor protections at the time of sale rather than at the time of offer, should offers be deregulated altogether?

- Given the transformation of information dissemination that has occurred since the rules were adopted and particularly over the last two decades, should the SEC consider any rule changes to enhance an issuer's ability to communicate with investors throughout the exempt offering framework?
- In light of the increased amount of capital raised through the exempt offering framework, should the SEC consider rule changes that will help make exempt offerings more accessible to a broader group of retail investors than those who currently qualify as accredited investors?
- Should the SEC consider a more unified approach to the exempt offering framework that focuses on the types of investors permitted to invest in the offering and the size of the offering, tailoring the additional investor protections and conditions to be applied based on those characteristics?

In addition to these broad conceptual questions and requests for comment on a variety of specific exemptions, the concept release focuses on several broad aspects of the current exempt offering framework, including the definition of "accredited investor," the integration analysis applied in the context of exempt offerings, the use of pooled investment funds in exempt offerings, and the current regulatory landscape affecting the secondary trading market for securities originally sold in exempt offerings.

A. TOPICS OF GENERAL APPLICABILITY

1. Accredited Investor Definition

The definition of "accredited investor," used in Regulation D and other contexts, has long been a focus of public debate and was the subject of an SEC staff report in December 2015. Among other items, the release asks the following questions:

- Should the financial threshold requirements in the current accredited investor definition be retained in their current form or revised to increase the number of accredited investors?
- Should the definition of accredited investor be expanded to take into account considerations other than an individual's wealth, such as an investor's sophistication?
- Should an investor that is advised by a registered financial professional be considered an accredited investor? If so, should there be a limit on the type or amount of investment that such an investor can make in exempt offerings, including for example, a limit on the amount of investments made through pooled investment funds?
- Should Rule 12g-1 be revised to permit issuers to determine accredited investor status at the time of the last sale of securities to the respective purchaser, rather than at the last day of its most recent fiscal year?

The SEC also requests comment on whether it should consider steps to make a broader range of investment opportunities available to those investors who are currently considered non-accredited.

2. Secondary Trading Market for Securities Sold in Exempt Offerings

The release notes that secondary market liquidity for investors acquiring securities through an exempt offering is an integral component of capital formation in the primary offering market. The SEC requests comment on whether it should revise the existing rules governing exemptions for resales of securities, such as Rule 144 and Rule 144A, to facilitate capital formation by improving secondary market liquidity. The release asks a number of specific questions in this area, including:

- Do concerns about secondary market liquidity have a significant effect on issuers' decision-making with respect to primary capital-raising options? In considering which exemption may be best suited for a particular offering, do issuers take into account whether the securities issued in the transaction will be restricted securities and/or subject to other resale restrictions?
- Should the Rule 144 safe harbor be revised, for example, by reducing the holding period for securities from six months to three months and from 12 months to six months for securities of issuers not meeting the public information requirement? If the SEC expands the population of investors who may qualify as accredited investors, should it impose any issuer disclosure requirements in connection with resales?
- Do issuers that are not currently subject to registration under the Securities Exchange Act of 1934 prefer that their securities have restrictions on resale, due to concerns that trading in the securities could lead to more record holders, thereby potentially triggering the requirement to register under Section 12(g)?

3. Integration Doctrine

The integration doctrine provides an analytical framework for determining whether multiple securities transactions should be considered part of the same offering in order to prevent an issuer from improperly avoiding Securities Act registration requirements by artificially dividing a single offering into several offerings. The traditional test for whether two or more offerings should be integrated (also reflected in Regulation D) is a facts and circumstances test and is evaluated under five factors that consider whether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of considerations are to be received in the offerings and (5) the offerings are made for the same general purposes. The five-factor test has been widely criticized as arbitrary and inflexible. In addition to this five-factor test, the SEC rules provide a number of safe harbors for different types of exempt offerings with objective standards that issuers may rely on to prevent two or more offerings from being integrated into one combined offering. The SEC requests comment on various integration matters, including:

- Should the SEC articulate one integration doctrine that would apply to all types of exempt offerings?
- Should the five-factor test that is utilized when a safe harbor does not apply be replaced with a test that assesses whether each offering complies with the requirements of the exemption that is being relied on for the particular offering or are there other integration analyses the SEC should consider? Should the SEC consider whether other categories of transactions do not need to be integrated into other offerings, similar to the treatment of offerings conducted in accordance with Regulation S, Rule 144A and Rule 701?
- Should the SEC shorten the six-month integration safe harbor in Rule 502(a) of Regulation D, and if so, what time period is appropriate?
- Should Rule 152 be revised to provide an integration safe harbor for an issuer that conducts a Rule 506(c) offering and then subsequently engages in a registered public offering?

- Should the SEC revise Rule 155, for example, to define a private offering as an exempt offering that does not involve any form of general solicitation or advertising, or to expand Rule 155(c) to include an abandoned offering that involved general solicitation followed by a private offering?

4. Pooled Investment Funds

Pooled investment funds can serve as an important source of funding for growth-stage issuers, and retail investors who invest through such funds are potentially able to reduce risk by holding a diversified portfolio. The release discusses different types of pooled investment vehicles that may afford retail investors access to exempt offerings, including, among others, mutual funds, interval funds, closed-end funds, business development companies or “BDCs,” tender offer funds, and target date retirement funds. The SEC asks whether issuers view pooled investment funds as an important source of capital for exempt offerings, and requests specific comment on certain aspects of the current pooled investment fund framework, including, among other items:

- Are there regulatory provisions or practices that effectively discourage participation by registered investment companies and BDCs in exempt offerings? For closed-end funds and BDCs, are there regulatory provisions or practices that discourage the introduction of investment products that focus on issuers seeking capital at key stages of their growth cycle and if so, how do these regulatory provisions or practices create barriers?
- Should there be any restrictions on the ability of closed-end funds, including BDCs, to invest in private funds or to offer their shares to retail investors? For example, should there be a maximum percentage of assets that closed-end funds and BDCs can invest in private funds, or diversification requirements, in cases where their offerings are not restricted to accredited investors?
- Should the SEC add more flexibility to the repurchase offer rules applicable to interval and other eligible funds? Should the SEC shorten the two-year minimum time period between an interval fund’s last discretionary repurchase offer and another discretionary repurchase offer, or amend the conditions under which a majority of an interval fund’s directors can suspend or postpone a repurchase offer?
- Should the SEC broaden the scope of pooled investment funds that qualify as accredited investors without satisfying any quantitative criteria, such as certain registered investment companies, BDCs and SBICs?
- Should “qualified purchasers” be considered “accredited investors” by definition under Regulation D, similar to their inclusion as “qualified clients” under the Investment Advisers Act of 1940?
- Should the SEC consider making any rule changes that would enable target date retirement funds or advisory services (including robo-advisers) focused on retirement savings to seek exposure to exempt offerings in their portfolios?
- Does the issue of secondary market liquidity have a significant effect on investors’ decision-making with respect to whether to invest in pooled investment vehicles, particularly closed-end funds and BDCs, and, with respect to closed-end funds and BDCs, should the SEC consider rule changes to encourage the establishment or improvement of secondary market trading and, if so, what changes should it consider?

This last question might be particularly relevant for BDCs that have sought exemptive relief from, or elimination of, the requirement to include “Acquired Fund Fees and Expenses” (AFFE) as a line item in the "Fees and Expenses" table of their SEC filings. BDCs have sought relief from this requirement because certain key index providers have excluded BDCs from indexes, citing concerns over the AFFE requirement's impact on overall expense ratios, resulting in, among other things, less institutional ownership of BDCs.

B. SPECIFIC SECURITIES ACT REGISTRATION EXEMPTIONS

The release also requests comment on a number of specific exemptions available under the Securities Act and various rules. Specifically, the release requests comment on private placements made under Section 4(a)(2) of the Securities Act (including offerings made pursuant to the safe harbors provided in Rule 506 of Regulation D), Regulation A offerings, limited offerings under Rule 504 of Regulation D, intrastate offerings under Section 3(a)(11) of the Securities Act and crowdfunding transactions pursuant to Regulation Crowdfunding. With respect to each of these different exemptions, the release includes a number of specific questions that address whether the exemption (and the requirements for an issuer to rely on the exemption) may be improved, simplified or harmonized with other components of the exempt offering framework.

*   *   *

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York

Ari B. Blaut	+1-212-558-1656	blauta@sullcrom.com
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert G. DeLaMater	+1-212-558-4788	delamaterr@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
John E. Estes	+1-212-558-4349	estesj@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Jared M. Fishman	+1-212-558-1689	fishmanj@sullcrom.com
Sergio J. Galvis	+1-212-558-4740	galviss@sullcrom.com
Marion Leydier	+1-212-558-7925	leydierm@sullcrom.com
Christopher L. Mann	+1-212-558-4625	mannc@sullcrom.com
S. Neal McKnight	+1-212-558-3316	mcknightn@sullcrom.com
John P. Mead	+1-212-558-3764	meadj@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Inosi M. Nyatta	+1-212-558-7822	nyattai@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
Benjamin H. Weiner	+1-212-558-7861	weinerb@sullcrom.com

Washington, D.C.		
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Los Angeles		
Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Rita-Anne O'Neill	+1-310-712-6698	oneillr@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com
Palo Alto		
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com
London		
Chris Beatty	+44-20-7959-8505	beattyc@sullcrom.com
Vanessa K. Blackmore	+44-20-7959-8480	blackmorev@sullcrom.com
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
John Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
Oderisio de Vito Piscicelli	+44-20-7959-8589	devitopiscicellio@sullcrom.com
Evan S. Simpson	+44-20-7959-8426	simpsone@sullcrom.com
Paris		
William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Olivier de Vilmorin	+33-1-7304-5895	devilmorino@sullcrom.com
Frankfurt		
Carsten Berrar	+49-69-4272-5506	berrarc@sullcrom.com
Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Wolfgang Feuring	+49-69-4272-5511	feuringw@sullcrom.com
Sydney		
Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
Tokyo		
Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong		
Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Ching-Yang Lin	+852-2826-8606	linc@sullcrom.com
Kay Ian Ng	+852-2826-8601	ngki@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com
Beijing		
Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com