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Memorandum

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SEC Seeks Comments on Harmonization of Rules Governing Exempt Offerings

On June 18, 2019, the Securities and Exchange Commission (the “SEC”) published a Concept Release on Harmonization of Securities Offering Exemptions (the “Release”), seeking comments on simplifying the existing regulatory regime for exempt offerings¹. The SEC generally issues concept releases when it is seeking input on broad reforms to its rules. In this case, the Release contains 138 questions on which the SEC is seeking comments. Specifically, the SEC is seeking input on whether, in light of increased activity in exempt markets, the current exemptions to the registration requirements effectively provide issuers access to capital and investment opportunities while maintaining appropriate investor protections. The deadline for comments is September 24, 2019.

Exempt Offerings

Exempt offerings now represent a significant majority of capital-raising transactions in the United States. In the Release, the SEC notes that in 2018 registered offerings accounted for \$1.4 trillion of new capital while exempt offerings are estimated to have raised approximately \$2.9 trillion.

The SEC is undertaking a comprehensive review of available registration exemptions to assess whether the current regulatory approach to unregistered offerings is consistent, accessible and effective for both issuers and investors. In particular, the SEC is seeking comments relating to proposed changes that would simplify, improve or harmonize the rules governing exempt offerings, and to evaluate whether the current limitations on investor participation provide an appropriate level of protection when balanced against potential obstacles to capital formation or investor access to investment opportunities.

The Release seeks input and comments on several broad topics fundamental to the regulation of exempt offerings, including:

- whether information requirements should be focused exclusively on investor protection at the time of sale, rather than during the course of an offering and/or at the time of offer – and whether disclosure should be required following the completion of an offering;
- whether efforts to harmonize and simplify the available exempt offering provisions would result in issuers remaining private longer or forgoing registered offerings altogether;
- which conditions or requirements are most or least effective at protecting investors in exempt offerings in light of the increased use of exempt offerings in raising capital;

¹ The Release is available at <https://www.sec.gov/rules/concept/2019/33-10649.pdf>.

- whether a more uniform set of disclosure requirements and investor suitability standards or definitions across exemptions would provide greater access, both for issuers and investors, while adequately protecting investors; and
- whether the definition of “accredited investor” requires revisiting or expanding.

Integration

In addition to addressing the requirements for exempt offerings, the Release seeks comment on whether the SEC should take action to clarify previous guidance on the integration of exempt offerings in which general solicitations are not permitted, as well as those (such as offerings conducted under Rule 506(c) of Regulation D) in which general solicitation is permitted.

The SEC is seeking comments on its approach to the integration doctrine, including such matters as:

- whether a single, consistent integration doctrine would make it easier for issuers to transition between exempt offerings and registered offerings, and to what extent such a doctrine would raise investor protection concerns; and
- whether the time period set forth in existing integration safe harbors should be shortened, or new safe harbor periods permitting general solicitation should be added.

Pooled Investment Funds

The Release raises detailed questions about the potentially expanding investment opportunities for non-accredited retail investors to participate in exempt offerings through pooled investment funds. Currently, non-accredited investors seeking to invest in a pooled investment fund are generally limited to investments in registered investment companies and business development companies, or BDCs, because private equity funds, venture capital funds and hedge funds must limit their investor pools to comply with exemptions from registration under the Securities Act, as well as exemptions or exclusions from registration under the Investment Company Act. In particular, the SEC is seeking comments relating to how to expand investment opportunities for non-accredited investors in pooled investment funds.

Secondary Trading

The implementation of the JOBS Act and related initiatives by the SEC have sought to provide additional avenues for small- and medium-sized issuers to raise capital. However, limited secondary market liquidity may limit the willingness of investors to invest in an illiquid exempt offering, due to the lack of a clear exit opportunity. The SEC is soliciting comments on potential revisions to improve secondary market liquidity.

Specifically, the Release asks for comment on whether concerns about secondary market liquidity have a significant effect on issuers’ decision-making with respect to primary capital-raising options, and whether the availability of liquidity in the secondary markets affects the decision-making of individual investors.

The Release also seeks comments on related technical considerations, such as whether concerns about becoming subject to Exchange Act registration as a result of having a large number of record holders affects whether private issuers have a preference for conducting an exempt offering, and whether an exemption from the Exchange Act registration requirements based on the number of record holders could impact issuers’ access to capital or investors’ access to secondary market liquidity. In addition, the Release seeks comments on the nature and extent of issuer disclosure requirements that may be necessary or desirable to facilitate resales of unregistered securities, and whether Rule 144 holding periods should be shortened.

Conclusion

In response to the market trend toward exempt offerings, the SEC is undertaking a comprehensive review of currently available offering exemptions, with the goal of creating a more cohesive and efficient set of rules for regulating the exempt offering market. While it is unlikely that changes will be implemented right away (if at all), to the extent that proposed changes (or other changes suggested by market participants who comment on the topics raised in the Release) are implemented, private companies may be afforded easier access to the exempt offering market, while increasing opportunities for retail investors to participate in exempt offerings.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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