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SEC Opens the Door to General Solicitation and Advertising in Private Placements

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On July 10, 2013, the Securities and Exchange Commission (SEC) adopted long-awaited amendments to Rules 506 and 144A promulgated under the Securities Act of 1933 as required by Section 201(a) of the Jumpstart Our Business Startups Act (the "JOBS Act"). [1] The amendments implement key provisions of the JOBS Act that are expected to have a substantial impact on how businesses and private funds raise capital by permitting, for the first time, general solicitation and advertising in private, unregistered offerings. As a result of the new rules, issuers will be able to use unrestricted internet sites, print, broadcast or social media, and public invitation presentations or seminars in conducting their Rule 506 offerings, provided that they limit sales to "accredited investors."[2]

Set forth below is a summary of the amendments and certain additional proposed rule changes that the SEC made in the Adopting Release.

Rule 506 Private Placements and "Reasonable Steps" to Verify Accredited Investor Status

The SEC's final rules remove the long-standing prohibition on general solicitation and advertising for Rule 506 private securities offerings,[3] provided that the issuer takes reasonable steps to verify that all ultimate purchasers are accredited investors.

Although the SEC did not dictate specific requirements for verifying accredited investor status, the SEC indicated that taking "reasonable steps" requires an objective assessment of investors' financial circumstances. In addition, the SEC provided the following non-exclusive list of four ways that an issuer could satisfy the "reasonable steps" requirement with respect to investors who are natural persons:

1. Review statements regarding the investor's net worth dated within the prior three months:

   · *Assets* : bank statements, brokerage statements, tax assessments and appraisal reports; and

   · *Liabilities* : a consumer credit report from a nationwide consumer reporting agency;

2. Review the investor's income tax filings (e.g., Form W-2, Form 1099, Schedule K-1, Form 1040, etc.) for the two most recent years, and obtain a written representation from the investor that s/he reasonably expects to reach the necessary income level during the current year;

3. Obtain a written confirmation from a registered broker-dealer, an SEC-registered investment adviser, a licensed attorney or a certified public accountant that, within the last three months, such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor; or

4. If the investor already owns securities of the issuer purchased as an accredited investor in a Rule 506(b) offering before amended Rule 506(c) was effective, obtain a certification from the investor that, at the time of purchase, s/he is an accredited investor.

The SEC also opined that an issuer is *not* taking reasonable steps for purposes of "new" Rule 506 if a potential investor is "required only [to] check a box in a questionnaire or sign a form"—which, in our experience, was the most common method of establishing accredited investor status under "old" Rule 506.

Option to Rely on "Old" Rule 506 and Forego General Solicitation and Advertising

While the amendments open the door to general solicitation and advertising for Rule 506 private offerings, not all issuers will be interested in this option. For example, issuers that wish to accept non-accredited investors and issuers who do not want to meet the burdens of complying with the new requirements (including taking "reasonable steps" to verify accredited investor status) may still conduct a private offering under the "old" Rule 506 requirements. Form D has been amended to include a check box to indicate whether the offering is being conducted under the new rule (permitting general solicitation and advertising) or not (complying with historic Rule 506 requirements). Issuers should consult with counsel about the best approach for their Rule 506 offerings based on their needs and circumstances.

General Solicitation and Advertising in Rule 144A Offerings

The SEC also adopted amendments permitting general solicitation and advertising in Rule 144A offerings. Rule 144A is technically an exemption from SEC registration for privately offered resales of securities (as opposed to initial issuances) to qualified institutional buyers (QIBs), which are generally institutional investors with at least $100 million under management. Many established businesses have traditionally raised private capital by placing securities to investment banks (referred to as "initial purchasers" in such transactions) who then immediately resell the securities to QIBs under Rule 144A. These Rule 144A offerings resemble traditional underwritten SEC-registered public offerings.

Under the amendments, securities may be offered in a Rule 144A offering to persons other than QIBs, provided that sales are only made to buyers that the seller reasonably believes are QIBs. As a result, Rule 144A offerings may be made using general solicitation and advertising.

Disqualification of Bad Actors

The SEC has also adopted a rule that disqualifies issuers from a Rule 506 offering if the issuer or its directors, executive and certain other officers, underwriter(s), placement agent(s) or, for investment funds, investment manager(s) has a "disqualifying event," such as securities fraud or certain other criminal convictions and regulatory sanctions. The prohibition applies for disqualifying events occurring after the new rules become effective. Events that would constitute disqualifying events but for the fact they occurred before the new rules became effective will not prohibit reliance on Rule 506, but these events must be disclosed to investors.

Proposed Amendments to Rule 506 Private Offering Rules

Separately, the SEC proposed further amendments to Regulation D, Form D and Rule 156 (governing investment company sales literature) under the Securities Act of 1933 that, if adopted, will also affect Rule 506 offerings. The following amendments are proposed:

- Requirement to file Form D at least 15 days before engaging in general solicitation or advertising for the offering;
- Requirement to update Form D within 30 days of completing an offering;
- Temporary two-year requirement for issuers to submit general solicitation and advertising materials to the SEC; and
- Certain additional disclosure and legending requirements.

Regarding the temporary requirement to submit general solicitation materials (including, presumably, soliciting website content), while the materials would not be available to the public, the SEC did indicate they would be available to "other securities regulators" in addition to the SEC itself.

These proposed amendments are open for comment until September 8, 2013.

Conclusion

The SEC's Rule 506 and Rule 144A amendments are historic because they will permit private offerings to use public media (e.g., internet, newspapers, magazines, radio, TV, etc.) for the first time. Many have suggested that the changes will revolutionize the private offering marketplace and expand capital access as Congress intended in adopting the JOBS Act, but others worry that the changes will unintentionally increase fraud and investor abuse. We hope that issuers take advantage of the new opportunities presented by the amendments without abusing the privileges they afford.

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[1] Release No. 33-9415; No. 34-69959; No. IA-3624; File No. S7-07-12 (the "Adopting Release").

[2] The "accredited investor" definition includes, among other categories of investors, individuals with income in excess of $200,000 in each of the last two years, or $300,000 jointly with the individual's spouse (with a reasonable expectation of the same in the current year); individuals with $1 million of net worth, individually or jointly with the individual's spouse; corporations and other entities with assets in excess of $5 million; and any entity in which all the equity owners are themselves accredited investors.

[3] Prior to the amendments, issuers could only offer securities in a Rule 506 offering to potential investors with whom the issuer or its agents had a substantial, pre-existing relationship.

For more information about these issues, please contact the author(s) of this Legal Alert or your existing firm contact.

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