



## SEC REPEALS THE BAN ON GENERAL SOLICITATION AND ADVERTISING

**July 11, 2013**

Yesterday, the Securities and Exchange Commission (the “Commission”) adopted amendments to Rule 506 of Regulation D (“Rule 506(c)”) implementing changes mandating by the Jumpstart Our Business Startups Act (“JOBS Act”). Rule 506(c) permits an issuer to engage in general solicitation or general advertising<sup>1</sup> in offering and selling of securities under Rule 506 provided such issuer reasonably believes and takes “reasonable steps” to verify that all investors in such offering are “accredited.”<sup>2</sup> The amendments also include a non-exclusive list of methods issuers may use to satisfy the verification requirements of 506(c). In separate releases the Commission also adopted rules disqualifying “felons and other ‘bad actors’ from participating in Rule 506 offerings and proposed rule changes to Regulation D, Form D and Rule 156 of the Securities Act, including a requiring additional information on Form D, the filing of Form D 15 prior to engaging in general solicitation and submission of written solicitation materials to the Commission on a confidential basis, among other changes.

*Rule 506(c) becomes effective 60 days after its publication in the Federal Register (mid to late September 2013).*

### **A. “Principles-Based Approach” to Determining Whether Reasonable Steps to Verify Accredited Investors Status**

In keeping with its proposed rules, the Commission adopted a “principles-based approach” to determining whether reasonable steps were taken to verify the accreditation of an investor. This approach relies on an objective determination by the issuer in the context of the particular facts and circumstances of each transaction and purchaser involved. An issuer should consider a number of factors when determining the reasonableness of steps taken to verify including:

- The nature of the purchaser and the type of accredited investor they claim to be;
- The amount and type of information that the issuer has about the purchaser;
- The nature of the offering, such as the manner in which the purchaser was solicited to participate and the terms of the offering, such as the minimum investment amount.

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<sup>1</sup> Although the terms “general solicitation” and “general advertising” are not defined in Regulation D, Rule 502(c) provides examples of general solicitation and general advertising, including advertisements published in newspapers and magazines, communications broadcast over television and radio, and seminars where attendees have been invited by general solicitation or general advertising. By interpretation, the Commission has confirmed that other uses of publicly available media, such as unrestricted websites, also constitute general solicitation and general advertising.

<sup>2</sup> Rule 501(a) of the ‘33 Act sets forth various classes of accredited investors including natural persons with over \$1 million in net worth (excluding the value of their primary residence), individuals with more than \$200,000 in income over the previous two year, registered investment companies and 501(c)(3) organizations with \$5 million in total assets, among others.

When considered together these factors will enable an issuer to assess the reasonable likelihood that an investor is accredited. By way of example, the reasonable steps needed to verify the status of a registered broker dealer (which can be done readily with an internet search on Edgar) will not be the same as those needed to verify the qualification of a natural person. When ready verification is more difficult, such as in the case of a natural person, the more information an issuer has indicating a prospective purchaser is accredited the fewer steps are needed to verify, and vice versa. Publically available information, in federal or state securities filings, disclosing a prospective purchaser's qualification, copies or information regarding where a prospective purchaser works (such as an industry publication indicating that average annual salary for an employee of the purchaser's type) is information an issuer may reasonable rely on to determination accreditation. In regard to the manner and terms of an offering, if solicitation was conducted on a website accessible to the general public or through a widely disseminated email, an issuer is likely to be required to take greater measures than if investors were culled from a pre-screened database of accredited investors compiled by a registered broker dealer, for instance. If the terms of the offering require a high minimum investment amount and a purchaser is able to meet those terms, then the likelihood of that purchaser satisfying the definition of accredited investor may be sufficiently high such that, absent any facts that indicate that the purchaser is not an accredited investor, it may be reasonable for the issuer to take fewer steps to verify or, in certain cases, no additional steps to verify accredited investor status other than to confirm that the purchaser's cash investment is not being financed by a third party. The Commission noted however that regardless of the factors involved in each individual determination, it is important that issuers retain adequate records that document the steps taken to verify.

#### Non-Exclusive List of Methods to Verify Accredited Investor Status

In addition to the principles based approach to verification, the Commission specified four non-exclusive methods of verifying accredited investor status for natural persons that if used are deemed *to satisfy* the verification requirement:

- *Income Test.* Copies of any IRS income report such as a W-2, Form 1099, Schedule K-1 and copy of the filed 1040 for the most recent two years along with a written representation from such individual that they have a reasonable expectation of reaching the required income level in the current year satisfies the verification requirement;
- *Net Worth Standard.* Bank or brokerage statements, certificates of deposit and appraisal reports by independent third parties dated within the prior three months would be deemed satisfactory along with a credit report from a national consumer credit reporting agency to indicate liabilities;
- *Third Party Attestation.* A written confirmation from a registered broker dealer, an SEC registered investment adviser, a licensed attorney, or certified public accountant that such person or entity has taken reasonable steps to verify that the investor is accredited within the prior three months is sufficient;

- *Existing Accredited Investors.* An issuer may rely on a certification of accreditation by any individual who participated in such issuer's 506(b) offering.

### Form D Amendment

The Commission adopted a revision to Form D3 to provide for a new check box where an issuer must indicate whether they intend to rely on Rule 506(c) exemption or the existing 506(b).

### **B. Bad Boy Disqualifications:**

The Commission also adopted amendments, to be codified as Rule 506(d), providing for the disqualification of felons and other 'bad actors' from Rule 506 Regulation D offerings, as mandated by the JOBS Act. Disqualifying events include:

- Felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission within the last five years.
- Injunction and court orders within the last five years engaging in or continuing conduct in connection with the purchase or sale of securities
- U.S. Postal Service false representation orders with the last five years

### **C. Proposed Rule Changes**

Additionally, the Commission proposed rule changes that would significantly increase the compliance requirements applicable to Rule 506(c) offerings. As proposed, the rule changes would:

- Require additional information on Form D;
- Restrict an issuer's ability to use Rule 506 if it failed to file a required Form D during the prior five-year period (with certain cure provisions);
- Require issuers using Rule 506(c) to file a Form D at least 15 days prior to engaging in any general solicitation and to file a final amendment to that Form D not later than 30 days after completing the offering;
- For a two-year period, require issuers engaging in general solicitations to submit their written solicitation materials to the SEC on a confidential basis;
- Require issuers to incorporate legends in general solicitation materials regarding accreditation and performance reports; and
- Extend the advertising guidance in Rule 156 to private funds.

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<sup>3</sup> Form D is the notice of an offering of securities conducted without registration in reliance on Regulation D. Pursuant to Rule 503, Form D must be filed with the Commission no later than 15 calendar days after the first sale of securities.

The proposed rules will be subject to public comment for 60 days after publication. Importantly, the proposed rule changes will not be effective before Rule 506(c) becomes effective. Neither the Staff nor the Commission discussed any potential transitional provisions that would impose these requirements on issuers conducting offerings under Rule 506 prior to their effectiveness, although that issue may be addressed in the proposing release when it becomes available.