SEC Approves General Solicitation for Rule 506 and Rule 144A Private Offerings

On July 10, 2013, the Securities and Exchange Commission (the "SEC") lifted the ban on general solicitation, or general advertising, contained in rules relating to certain private securities offerings made under Rule 506 of Regulation D and securities offerings made under Rule 144A.[1] The SEC action implemented Title 2 of The Jumpstart Our Business Startups Act (the "JOBS Act" or the "Act") and took the form of amendments to the relevant rules.[2] The amendments are expected to be published in the Federal Register shortly and will become effective 60 days after the date of publication.

Under the amended rules, general advertising of private offerings will be permitted provided that sales are limited to accredited investors, in the case of Rule 506 offerings, and to "qualified institutional buyers" (or "QIBs") in the case of Rule 144A offerings, and an issuer takes reasonable steps to verify that all purchasers of the securities have the required status.

In connection with the amendments to Regulation D, the SEC also proposed rules that would require issuers to provide additional information about private offerings that are made under the amended Regulation D to better enable the SEC to monitor the private offerings market once general advertising of such offerings is permissible.[3]

In a separate release, the SEC also approved amendments originally proposed in May 2011 which are intended to implement the Section 926 mandate of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") requiring rules that disqualify securities offerings involving certain "felons and other 'bad actors'" from relying on Rule 506.[4] As adopted, the "bad actor" disqualification requirements of new Rule 506(d) prohibit issuers and others from participating in Rule 506 offerings if, among other things, they have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws. These provisions do not apply to Rule 144A offerings.

I. Background

Currently, companies seeking to raise capital through the sale of securities in the United States must either register the securities offering with the SEC or rely on an exemption from registration. The exemptions from registration have generally prohibited companies relying on them from engaging in general solicitation or general advertising, which includes, among other things, advertising in newspapers or on the Internet, in connection with securities offerings. Offerings under two safe harbors from the registration requirement, Rule

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[1] *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, Release No. 33-9415 (July 10, 2013), *available at*, http://www.sec.gov/rules/final/2013/33-9415.pdf ("Adopting Release").

[2] The JOBS Act was signed into law on April 5, 2012. In addition to providing certain small-scale businesses known as "emerging growth companies" with an "on-ramp" to the initial public offering process by easing compliance with certain requirements of the Federal securities laws, the JOBS Act proposed to ease the capital formation process for private company offerings to make it easier for private companies to find investors and thereby raise capital. *Jumpstart Our Business Startups Act*, H.R. 3606, 112th Cong. (2012*), available at,* http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

[3] *Amendments to Regulation D, Form D and Rule 156 under the Securities Act,* Release No. 33-9416, *available at,* http://www.sec.gov/rules/proposed/2013/33-9416.pdf ("Proposing Release").

[4] *Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings*, Release No. 33-9414 (July 10, 2013), *available at*, http://www.sec.gov/rules/final/2013/33-9414.pdf.

506 of Regulation D and Rule 144A, each promulgated under the Securities Act, are widely used by U.S. and non-U.S. issuers to raise capital.

Rule 506 was originally adopted by the SEC as a non-exclusive safe harbor under Section 4(a)(2) (formerly Section 4(2)) of the Securities Act, which exempts transactions by an issuer "not involving any public offering" from the registration requirements of Section 5 of the Securities Act. In an offering that qualifies for exemption under Rule 506, an issuer may raise an unlimited amount of capital from an unlimited number of "accredited investors" and up to 35 non-accredited investors who meet certain "sophistication" requirements.[5] As defined under current SEC rules, accredited investors are individuals who meet certain minimum income or net worth thresholds, entities that have a specified status (*e.g.*, a registered broker-dealer) or certain institutions such as trusts, corporations, or charitable organizations that meet certain minimum asset thresholds.

The availability of Rule 506 is subject to a number of requirements and is currently conditioned on the issuer, or any person acting on its behalf, not offering or selling securities through any form of "general solicitation or general advertising." Although the terms "general solicitation" and "general advertising" are not defined in Regulation D, Rule 502(c) does provide 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. In its interpretive releases, the SEC has confirmed that other uses of publicly available media, such as unrestricted websites, also constitute general solicitation and general advertising.[6]

Rule 144A is a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for the resale of certain "restricted securities" to QIBs.[7] Resales to QIBs in accordance with the conditions of Rule 144A are exempt from registration pursuant to Section 4(a)(1) (formerly Section 4(1)) of the Securities Act, which exempts transactions by any person "other than an issuer, underwriter, or dealer." While Rule 144A does not include an express prohibition against general solicitation or general advertising, offers of securities under Rule 144A currently must be limited to QIBs, which has the same practical effect. By its terms, Rule 144A is available solely for resale transactions; however, since its adoption by the SEC in 1990, market participants have come to use Rule 144A to facilitate capital-raising by issuers.[8]

Section 201(a)(1) of the JOBS Act directed the SEC to amend Rule 506 to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers of the securities are accredited investors. Section 201(a)(1) also stated that "[s]uch rules shall require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the [SEC]."

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[5] Under Rule 506(b)(2)(ii), each purchaser in a Rule 506 offering who is not an accredited investor must possess, or the issuer must reasonably believe immediately before the sale of securities that such purchaser possesses, either alone or with his or her purchaser representative, "such knowledge and experience in financial and business matters that he [or she] is capable of evaluating the merits and risks of the prospective investment."

[6] *See Use of Electronic Media for Delivery Purposes*, Release No. 33-7233 (Oct. 6, 1995); *Use of Electronic Media*, Release No. 33-7856 (Apr. 28, 2000).

[7] The term "qualified institutional buyer" is defined in Rule 144A(a)(1) and includes specified institutions that, in the aggregate, own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with such institutions. Banks and other specified financial institutions must also have a net worth of at least $25 million. A registered broker-dealer qualifies as a QIB if it, in the aggregate, owns and invests on a discretionary basis at least $10 million in securities of issuers that are not affiliated with the broker-dealer.

[8] Resale offerings under Rule 144A are typically made by investment banking firms that initially purchase the securities to be resold directly from the issuer in a transaction exempt from registration in reliance on Section 4(a)(2) of the Securities Act.

Section 201(a)(2) of JOBS Act also directed the SEC to amend Rule 144A to permit offers of securities pursuant to Rule 144A to persons other than QIBs, including by means of general solicitation or general advertising, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs. Under the current Rule 144A, offers of securities may only be made to QIBs.

The SEC proposed the amendments required by the JOBS Act in August 2012 and received over 225 comment letters from a wide range of commenters including issuers, investor organizations, individuals, law firms, state government officials, and professional and trade associations.

II. Final Rule – Lifting the General Solicitation Ban

A. Amended Rule 506

Accredited Investor Status

The amendments to Regulation D exclude offerings that comply with the conditions of new Rule 506(c) from the prohibition of general solicitation and general advertising contained in Rule 502(c). The conditions in Rule 506(c) permit issuers relying on that rule to use general solicitation and general advertising in the offering and selling of securities, provided that:

(i) all terms and conditions of Rule 501 and Rules 502(a) and 502(d) are satisfied,

(ii) all purchasers of the securities fall within one of the categories of persons who are accredited investors under the existing Rule 501 of Regulation D ("Rule 501"), or the issuer reasonably believes that the investors fall within one of those categories at the time of the sale of the securities, and

(iii) the issuer takes reasonable steps to verify that such investors are accredited investors.

Under existing Rule 501(a), the definition of "accredited investors" includes any person who comes within one of the definition's eight enumerated categories of persons, or whom the issuer "reasonably believes" comes within any of the enumerated categories, at the time of the sale of the securities to that person. Some purchasers may be accredited investors based on their status, such as:

- a broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934 (the "Exchange Act"); or
- an investment company registered under the Investment Company Act of 1940 (the "Investment Company Act") or a business development company as defined in Section 2(a)(48) of the Investment Company Act.

For natural persons, Rule 502(a) defines an accredited investor as a person:

- whose individual net worth or joint net worth with a spouse exceeds $1 million at the time of the purchase, excluding the value (and any related indebtedness) of a primary residence (the "net worth test"); or

- whose individual annual income exceeded $200,000 in each of the two most recent years or whose joint annual income with a spouse exceeded $300,000 for those years, and has a reasonable expectation of the same income level in the current year (the "income test").

Reasonable Steps to Verify Accredited Investor Status

In order to address concerns, and reduce the risk, that the use of general solicitation or general advertising in Rule 506(c) offerings could result in sales of securities to investors who are not, in fact, accredited investors, Rule 506(c) includes, as a condition, the requirement that issuers take "reasonable steps to verify" that purchasers of the offered securities are accredited investors. This requirement is separate from and independent of the requirement that sales be limited to accredited investors, and must be satisfied even if all purchasers happen to be accredited investors.

The SEC stated that the determination of the "reasonableness" of the steps taken to verify an accredited investor "will be an objective determination by the issuer (or those acting on its behalf), in the context of the particular facts and circumstances of each purchaser and transaction." An issuer is required to consider the facts and circumstances of each purchaser and the transaction and, as noted in the Adopting Release, may, as an alternative to any of the four specific verification methods discussed below, use a principles-based facts and circumstances method of verification, in lieu of the methods listed in Rule 506(c) taking into account:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;

- the amount and type of information that the issuer has about the purchaser; and

- the nature and terms of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

Checking a Box Not Sufficient Verification

While the SEC believes that issuers will be entitled to rely on third parties that have verified a person's status as an accredited investor (provided that the issuer has a reasonable basis to rely on such third-party verification), the SEC does not believe that an issuer will have taken reasonable steps to verify accredited investor status if it, or those acting on its behalf, required only that a person check a box in a questionnaire or sign a form, absent other information about the purchaser indicating accredited investor status.[9]

Rule Provides Illustrative List of Verification Methods for Investors who are Natural Persons

The question of what type of information would be sufficient to constitute reasonable steps to verify accredited investor status under the particular facts and circumstances depends on various factors. The SEC declined to adopt a requirement that prescribes specific methods of verification that issuers must use in determining a purchaser's accredited investor status. In response to commenters' requests, however, the final rules adopted by the SEC provide a non-exclusive list of four methods that issuers may use to satisfy the

[9] Adopting Release at 33-34.

verification requirement for individual investors who are natural persons which, if used, are deemed to satisfy the verification requirement in Rule 506(c) (provided, that none of these methods will be deemed to satisfy the verification requirement if the issuer or its agent has knowledge that the purchaser is not an accredited investor).[10] The methods described include the following:

1. ***Income***: (A) Reviewing copies of any Internal Revenue Service form[11] that reports the income of the purchaser for the two most recent years, and (B) obtaining a written representation from such person attesting that the purchaser has a reasonable expectation of continuing to earn the necessary income level to qualify as an accredited investor in the current year.

2. ***Net Worth***: (A) Reviewing one or more of the below types of documentation, dated within the prior three months, and (B) obtaining a written representation from such person stating that all liabilities necessary to make a determination of net worth have been disclosed.

    - For assets, acceptable documentation includes: bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments and appraisal reports issued by independent third parties are deemed to be satisfactory.

    - For liabilities, acceptable documentation includes a consumer report (also known as a credit report) from at least one of the nationwide consumer reporting agencies.

3. ***Written Confirmation***: Receiving a written confirmation from a registered broker-dealer, SEC-registered investment adviser, licensed attorney, or certified public accountant that such entity or person has taken reasonable steps to verify the purchaser's accredited status within the prior three months and has determined that such purchaser is an accredited investor.

4. ***Pre-Rule 506(c) Accredited Investors***: With respect to any natural person who both (i) invested in an issuer's Rule 506(b) offering as an accredited investor prior to the effective date of Rule 506(c) and (ii) remains an investor of that issuer, then, for any Rule 506(c) offering conducted by that same issuer, the issuer is deemed to satisfy the verification requirement in Rule 506(c) with respect to such existing investor by obtaining a certification by such person at the time of sale that he or she qualifies as an accredited investor.

SEC Declined to Provided Illustrative List for Entities

The SEC declined to provide a similar non-exclusive list for verifying the accredited investor status of entities. In the Adopting Release, the SEC states that the reasonable steps to verify the accredited status of entities will necessarily differ from the non-exclusive list provided for natural persons, and might include:

[10] The SEC was of the view that adopting a " principles-based framework" in lieu of specific verification methods would give issuers and market participants the flexibility "to adopt different approaches to verification depending on the circumstances, to adapt to changing market practices, and to implement innovative approaches to meeting the verification requirement, such as the development of reliable third-party databases of accredited investors and verification services." Adopting Release at 98-99.

[11] Relevant forms include, but are not limited to, a Form W-2, Form 1099 (report of various types of income), Schedule K-1 of Form 1065 ("Partner's Share of Income, Deductions, Credits, etc."), and a copy of a filed Form 1040. Rule 506(c)(2)(ii), Adopting Release at 112-113.

- Reviewing on FINRA's BrokerCheck website the membership status of an investor that claims to be accredited because it is a broker-dealer.

- Reviewing publicly available information about a company in filings with Federal, state, or local regulatory authorities.

- Reviewing a 501(c)(3) organization's Form 990 series return filed with the IRS, which discloses the organization's total assets.

Verification Record Retention

As each issuer bears the burden of demonstrating that its offering is entitled to an exemption from the registration requirements of Section 5 of the Securities Act, it is important for issuers (and their verification service providers) to retain adequate records regarding the steps taken to verify that a purchaser was an accredited investor.

Existing Provisions of Rule 506 Unaffected

The existing provisions of Rule 506 as a separate exemption are not affected by the amendments. Issuers conducting Rule 506 offerings without the use of general solicitation or general advertising may continue to conduct private securities offerings in a manner consistent with prior practice under Regulation D and will not be subject to the new verification rule.

The SEC noted that the amendment to Rule 506 does not amend or modify the requirements relating to existing Rule 506(b) and issuers will continue to have the ability to conduct Rule 506(b) offerings subject to the prohibition against general solicitation and general advertising. The SEC viewed retaining the safe harbor under existing Rule 506(b) as having possible benefits for issuers that do not wish to generally solicit in their private offerings to avoid the added expense of complying with the rules applicable to Rule 506(c) offerings. It would also allow an issuer to continue selling privately to up to 35 non-accredited investors who meet existing Rule 506's sophistication requirements and to investors with whom an issuer has a pre-existing substantive relationship.[12] However, once a general solicitation has been made in a Rule 506(c) offering, an issuer would be precluded from making a claim of reliance on Rule 506(b), which remains subject to the prohibition against general solicitation and advertising.[13]

Form D and Other Amendments

The SEC also revised Form D to add a separate field or check box in Item 6 of Form D which issuers conducting Rule 506(c) offerings must check to indicate that they are relying on the Rule 506(c) exemption.[14] In addition, the current check box for "Rule 506" will be renamed "Rule 506(b)," and the current check box for "Section 4(5)" will be renamed "Section 4(a)(5)" to update the reference to former Section 4(5) of the Securities Act. As noted above, the SEC is of the view that an issuer may not check both boxes at the same time for the same offering.

[12] Adopting Release at 95.

[13] Adopting Release at 46.

[14] Item 6 of Form D currently requires the issuer to identify the claimed exemption or exemptions for the offering from among Rule 504's paragraphs and subparagraphs, Rule 505, Rule 506 and former Section 4(5), as applicable.

The SEC believed the revision to Form D will permit it to obtain additional information to assist its efforts in analyzing the use of general solicitation and general advertising in Rule 506(c) offerings and the size of the private offering market. The information should also allow the SEC to analyze practices that may develop to satisfy the verification requirement to assist in assessing the effectiveness of various verification practices for identifying and excluding non-accredited investors from participation in Rule 506(c) offerings.

The SEC also approved a number of technical and conforming amendments to Rules 502 and 506 of Regulation D, in order to amend various provisions in Rule 502(b) to clarify that the references to sales to non-accredited investors under Rule 506, and the corresponding informational requirements, would be applicable to offerings under Rule 506(b) and not to offerings under Rule 506(c).

Transition Matters

For an ongoing offering under Rule 506 that commenced before the effective date of Rule 506(c), an issuer may choose to continue the offering after the effective date in accordance with the requirements of either Rule 506(b) or Rule 506(c). If an issuer chooses to continue the offering in accordance with the requirements of Rule 506(c), any general solicitation or general advertising that occurs after the effective date will not affect the exempt status of offers and sales of securities that occurred prior to the effective date in reliance on Rule 506(b).[15]

B. Amended Rule 144A

Section 201(a)(2) of the JOBS Act also directed the SEC to revise Rule 144A(d)(1) under the Securities Act to provide that securities sold pursuant to Rule 144A may be *offered* to persons other than QIBs, including by means of general solicitation or general advertising, provided that securities are *sold* only to persons that the seller and any person acting on behalf of the seller reasonably believe is a QIB. To implement the mandated rule change, the SEC amended Rule 144A(d)(1) to eliminate the references in Rule 144A to "offer" and "offeree." Under the amended rule, securities may be offered to investors who are not QIBs as long as the securities are sold only to persons whom the seller reasonably believes are QIBs.

The SEC stated that the general solicitation and general advertising that is permitted in connection with Rule 144A resales by initial purchasers to QIBs will not affect the availability of the Section 4(a)(2) exemption for the initial sale of securities by issuers to initial purchasers.[16]

For an ongoing Rule 144A offering that commenced before the effective date of the amendment to Rule 144A(d)(1), offering participants will be entitled to conduct the portion of the offering following the effective date of the amendment to Rule 144A(d)(1) using general solicitation and general advertising, without affecting the availability of Rule 144A for the portion of the offering that occurred prior to the effective date of the amended rule.[17]

The SEC also made technical and conforming revisions to the exceptions in Regulation M to Rule 144A, as amended, by similarly eliminating the references to "offered" and "offerees."

[15] Adopting Release at 19.

[16] Adopting Release at 55, Note 172.

[17] Adopting Release at 56.

C. SEC Guidance for Private Funds and for Regulation S Offerings

Private Funds May Continue to Rely on Investment Company Act Exemptions

Private funds, such as hedge funds, venture capital funds and private equity funds, typically rely on Securities Act Section 4(a)(2) and Rule 506 to offer and sell their securities without registration under the Securities Act. In addition, private funds generally rely on one of two exclusions from the definition of "investment company" under the Investment Company Act -- Section 3(c)(1) or Section 3(c)(7) -- which enables them to be excluded from substantially all of the regulatory provisions of that Act. Private funds are precluded from relying on either of these two exclusions if they make, or propose to make, a public offering of their securities.

The SEC has historically regarded Rule 506 transactions as non-public offerings for purposes of Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. In the Adopting Release, the SEC stated its view that private funds could engage in general solicitation or general advertising in compliance with new Rule 506(c) without losing either of these exclusions under the Investment Company Act."[18]

No Integration with Offshore Offerings under Regulation S

In response to questions received by the SEC, the SEC affirmed that concurrent offshore offerings that are conducted in compliance with Regulation S under the Securities Act will not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A, as amended.[19]

III. Proposed Rules

In addition to adopting the new rules described above in Section II, the SEC also issued a proposal intended to amend Regulation D and Form D to enhance the SEC's ability to analyze the Rule 506 market and assess the development of market practices in Rule 506(c) private placement offerings once the ban on general solicitation and general advertising becomes effective. In addition, the proposal is intended to address certain concerns that may arise in connection with permitting issuers to engage in general solicitation and general advertising under Rule 506(c). Concerns of some commenters have been focused on the possibility that permitting general solicitation and general advertising for Rule 506(c) offerings may attract both accredited and non-accredited investors and could result in an increase in fraudulent activity in the Rule 506 market and an increase in unlawful sales of securities to non-accredited investors.

Regulation D and Related Proposed Amendments

Under Rule 503 of Regulation D, an issuer offering or selling securities in reliance on Rule 504, 505 or 506 of Regulation D must file a notice of sales on Form D with the SEC for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering. The information required to be provided in a Form D filing includes basic identifying information, such as the name of the issuer of the securities

[18] The SEC noted that Section 201(a)(1) of the JOBS Act directed it to eliminate the prohibition against general solicitation and general advertising for a new category of Rule 506 offerings, and made no specific reference to private funds. However, Section 201(b) of the JOBS Act also provides that "[o]ffers and sales exempt under [Rule 506, as revised pursuant to Section 201(a)] shall not be deemed public offerings under the Federal securities laws as a result of general advertising or general solicitation." The SEC noted that the Investment Company Act is one of the Federal securities laws. Adopting Release at 48-49.

[19] Adopting Release at 57.

and the issuer's year and place of incorporation or organization; information about related persons (executive officers, directors and promoters); the exemption or exemptions being claimed for the offering; and factual information about the offering, such as the duration of the offering, the type of securities offered and the total offering amount. The Form D filing requirements in Rule 503 were, historically, intended to serve a data collection functions, including, among other things, for the SEC's rulemaking efforts. Although the requirement to file a Form D pursuant to Rule 503 was a condition of Rules 504, 505 and 506 when all of these rules were originally adopted, it is currently not a condition of those rules.[20]

The proposed amendments to Regulation D would require

- the filing of a Form D no later than 15 calendar days **in advance** of the first use of general solicitation in a Rule 506(c) offering, before the issuer engages in general solicitation, and
- the filing of a closing amendment to Form D within 30 calendar days after the termination of a Rule 506(b) or Rule 506(c) offering.

Until the closing amendment is filed, the offering would be deemed to be ongoing and the issuer would be subject to the current Rule 503 requirements to file amendments to Form D at least annually and otherwise as needed to reflect changes in previously filed information and to correct material mistakes and errors. The SEC believes these filings will provide it with information about the Regulation D market without imposing additional compliance burdens on smaller offerings conducted in reliance on Rule 504 or Rule 505.

The proposed amendments would also require additional content be provided on Form D, including, among others: (i) the identification of the issuer's publicly accessible (Internet) website address, if any; (ii) the name and address of any person who directly or indirectly controls the issuer in addition to the information currently required for "related persons"; (iii) details to populate a "clarification" field if the issuer checks the "Other" box in Item 4, which requires the issuer to identify its industry group from a specified list; (iv) information, to the extent applicable, on the trading symbol and a generally available security identifier ("security identifier") for the offered securities; (v) a table requiring, with respect to Rule 506 offerings, information on the number and type of accredited investors and non-accredited investors (*e.g.*, natural persons who qualified as accredited investors on the basis of the income test or net worth test that have purchased in the offering, whether they are natural persons or legal entities and the amount raised from each category of investors); (vi) if a class of the issuer's securities is traded on a national securities exchange, alternative trading system ("ATS") or any other organized trading venue, and/or is registered under the Exchange Act, the name of the exchange, ATS or trading venue and/or the Exchange Act file number and whether the securities being offered under Rule 506 are of the same class or are convertible into or exercisable or exchangeable for such class; (vii) if the issuer used a registered broker-dealer in connection with the offering, whether any general solicitation materials were filed with FINRA; (viii) in the case of a pooled investment fund advised by investment advisers registered with, or reporting as exempt reporting advisers to, the SEC, the name and SEC file number for each investment adviser who functions directly or indirectly as a promoter of the issuer; (ix) for Rule 506(c) offerings, the types of general solicitation used or to be used (*e.g.*, mass mailings, emails, public websites, social media, print media and broadcast media); and (x) for Rule 506(c) offerings, the methods used or to be used to verify accredited investor status (*e.g.*, principles-based method using publicly available information, documentation provided by the purchaser or a third party).

[20] In 1988, the SEC proposed to eliminate the requirement to file a Form D as a condition to the availability of the Regulation D exemptions, noting that "[c]ommenters have frequently criticized" this condition. Regulation D, Release No. 33-6759 (Mar. 3, 1988). Proposing Release at 16, Note 34.

Form D, Item 16 would also be amended to require information on the percentage of the offering proceeds from a Rule 506 offering that was or will be used: (1) to repurchase or retire the issuer's existing securities; (2) to pay offering expenses; (3) to acquire assets, otherwise than in the ordinary course of business; (4) to finance acquisitions of other businesses; (5) for working capital; and (6) to discharge indebtedness. This additional information requirement would apply only to Rule 506 offerings by issuers that are not pooled investment funds.[21]

Furthermore, the SEC proposed new Rule 509 which would require additional written information be incorporated in general solicitation materials used in Rule 506(c) offerings, including prescribed legends in any written communication that constitutes a general solicitation in any offering conducted in reliance on Rule 506(c) ("written general solicitation materials").[22] Private funds would also be required to include a legend disclosing that the securities being offered are not subject to the protections of the Investment Company Act and additional disclosures in written general solicitation materials that include performance data so that potential investors are aware that there are limitations on the usefulness of such data and provide context to understand the data presented. Performance data included in general solicitation materials would be required to be as of the most recent practicable date considering the type of private fund and the media through which the data will be conveyed, and the private fund would be required to disclose the period for which performance is presented.[23]

Although the SEC is requesting comments on whether content restrictions should apply to private fund general solicitation materials, it is not proposing to prohibit private funds from including performance information in general solicitation materials at this time.[24]

Rules 506 and Rule 507 Proposed Amendments

To assist the SEC in monitoring developments in the Rule 506 market after the effectiveness of Rule 506(c), the SEC is proposing Rule 510T to require issuers, on a temporary basis, to submit any written general solicitation materials used in their Rule 506(c) offerings to the SEC no later than the date of the first use of these materials. Such materials would be required to be submitted through an intake page on the SEC's website. The SEC is not proposing, at this time, that such materials be made available to the public; therefore, issuers would not file their written general solicitation materials through the SEC's EDGAR system. The proposed rule would disqualify an issuer from relying on Rule 506 for future offerings if such issuer, or any predecessor or affiliate of the issuer, has been subject to any order, judgment or court decree enjoining such person for failure to comply with proposed Rule 510T.

Additionally, the rule proposal would also disqualify an issuer from relying on Rule 506 for future offerings if such issuer, or any predecessor or affiliate of the issuer, has been subject to any order, judgment or court decree enjoining such person for failure to comply with proposed Rule 509. Moreover, the proposed rules would amend Rule 507 of Regulation D to disqualify an issuer from relying on Rule 506 for one year for future offerings if the issuer, or any predecessor or affiliate of the issuer, did not comply, within the last five years, with

[21] Proposing Release at 34-44; and proposed Rule 509, Proposing Release at 170.

[22] The requirement to include these legends and other disclosures, as applicable, would not be a condition of the Rule 506(c) exemption, so that the failure to include legends or other disclosures in any written general solicitation materials would not render Rule 506(c) unavailable for the offering. Proposing Release at 69.

[23] Acknowledging that the investment strategies employed by private funds vary, the SEC is not proposing that private funds provide performance data for a specific period (*e.g.*, as of the most recently completed month).

[24] Proposing Release at 71.

all of the Form D filing requirements in a Rule 506 offering.[25] Under proposed Rule 507(b), disqualification would end one year after the required Form D filings are made or, if the offering has been terminated, one year after a closing amendment is made. Because this approach creates potentially significant consequences for an issuer's future capital-raising activities based on its failure to file or amend the form for a current or prior offering, the SEC anticipates that proposed Rule 507(b), if adopted, could significantly reduce non-compliance with Form D filing requirements for Rule 506 offerings.

Relatedly, the SEC is also proposing to amend Rule 156 under the Securities Act, which interprets the antifraud provisions of the Federal securities laws in connection with sales literature used by investment companies, to extend the antifraud guidance contained in the rule to the sales literature of private funds. The SEC stated that it believes it is important for private funds to consider the SEC's views on the applicability of the antifraud provisions to their sales literature.

Finally, the SEC has directed its staff to execute a comprehensive work plan upon the effectiveness of Rule 506(c) to review and analyze the use of Rule 506(c) (the "Rule 506(c) Work Plan"), which will involve a coordinated effort of staff from the Division of Corporation Finance, the Division of Economic and Risk Analysis, the Division of Investment Management, the Division of Trading and Markets, the Office of Compliance Inspections and Examinations and the Division of Enforcement. The SEC expects that the implementation of the Rule 506(c) Work Plan will assist the SEC in evaluating the development of market practices in Rule 506(c) offerings.

IV. Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings

In a separate release, the SEC also amended Rule 506 by adding a paragraph (d) that prohibits issuers and others from participating in Rule 506 offerings if, among other things, they have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws. The new provisions, which do not apply to Rule 144A offerings, apply to the bad acts of the issuer and any of its predecessors and affiliated issuers, the issuer's participating directors and officers, beneficial owners of at least 20% of the issuer's outstanding voting equity, significant shareholders, promoters, investment managers, and compensated solicitors involved in the offering (each a "covered person"). Prior to the amendment, Rule 506 did not impose any bad actor disqualification requirements.

If a covered person engages in an event that triggers disqualification under the new Rule 506, the relevant securities offering will no longer have available Rule 506's protection. Rule 506 disqualifying events under the new rule include, among others, felony and misdemeanor criminal convictions in connection with the purchase or sale of securities or false SEC filings, court injunctions and restraining orders within the last five years related to the purchase or sale of securities or false SEC filings; final orders issued by state banking, credit union, and insurance regulators, Federal banking regulators and the National Credit Union Administration barring association with regulated entities of the type those regulators oversee and dealing with fraudulent, manipulative, or deceptive conduct; disciplinary or stop orders issued by the SEC; suspension or expulsion from membership in a Self-Regulatory Organization (such as FINRA or a stock exchange); stop orders applicable to a registration statement; and false representation orders by the U.S. Postal Service within the last five years.

[25] The SEC proposal includes a cure period as a mitigation provision for late filings under which issuers would generally be regarded as having complied with the Rule 503 filing deadlines for a Form D or Form D amendment if they filed the relevant filing within a cure period after the filing is due under Rule 503. Under current Rule 507, disqualification under the rule may also be waived by the SEC if the SEC determines "upon a showing of good cause, that it is not necessary under the circumstances that exemption be denied." Proposed Rule 507(b), Proposing Release at 169.

The new disqualifications apply only to triggering events occurring after effectiveness of the new rules. For triggering events occurring prior to the effectiveness of the new rules, in lieu of disqualification, the issuer must provide written disclosure to each purchaser of its securities, at a reasonable time prior to sale, disclosing matters that would have triggered disqualification had they occurred before the effective date of the new disqualification provisions. The final rule includes a reasonable care exception from disqualification that will apply if an issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of a covered person. Issuers must also exercise reasonable care in determining whether a disqualification exists, however, the SEC did not specify what constitutes reasonable care, stating instead that the determination is a fact specific inquiry, dependent upon a number of circumstances, and requiring a factual inquiry into whether any disqualification exists. The nature and scope of the factual inquiry will depend on the facts and circumstances concerning the issuer and the participants involved. Issuers may also request waivers for disqualification, which may be granted by the SEC when good cause is shown.[26] In addition, disqualification will not apply if an authority issuing the relevant judgment or order determines and advises the SEC that disqualification should not arise.

V. Conclusion

It is anticipated that issuers using Rule 506(c) will be able to reach a greater number of potential investors than is currently the case in Rule 506 offerings, thereby increasing their access to sources of capital. As a result, accredited investors may be able to find and potentially invest in a larger and more diverse pool of investment opportunities, which could result in a more efficient allocation of capital by accredited investors. Commenters have raised concerns, however, that a general solicitation for a Rule 506(c) offering would attract both accredited and non-accredited investors and could result in an increase in fraudulent activity in the Rule 506 market, as well as an increase in unlawful sales of securities to non-accredited investors.

The amendments to Rule 144A might not have as significant an impact as might occur under amended Regulation D. QIBs, to which Rule 144A offerings are made, are for the most part, identifiable on publicly accessible databases. Therefore, a significant expansion of the target Rule 144A investor group by virtue of a general solicitation would seem less likely than in the case of a Rule 506(c) private placement. In addition, given the transaction practices for confirming QIB status that have been developed since the promulgation of Rule 144A, the likelihood of securities offered in a Rule 144A transaction being purchased by an ineligible investor would not seem to be greatly increased by virtue of the amended rule.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Margaux Knee at 212.701.3130 or mknee@cahil.com.

[26] The SEC declined to specify what would potentially constitute good cause.