

Corporate Alert

SEC Proposes Rule Changes to Allow General Solicitation in Rule 506 and Rule 144A Offerings

September 4, 2012

On August 29, 2012, the Securities and Exchange Commission (SEC) proposed amendments to Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 to allow general solicitation and general advertising in offers and sales of securities made pursuant to the rules. Specifically:

- *Rule 506.* The proposed amendment to Rule 506 would provide that the prohibition against general solicitation and general advertising in Rule 502(c) of Regulation D would not apply to offers and sales of securities made pursuant to Rule 506, provided that all the purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that all such purchasers are accredited investors.
- *Rule 144A.* The proposed amendment to Rule 144A would provide that securities may be offered to persons other than qualified institutional buyers (QIBs), provided that the securities are sold to only persons that the seller and any person acting on the seller's behalf reasonably believe are QIBs.

The proposed rule changes are mandated by the Jumpstart Our Business Startups (JOBS) Act, which requires the SEC to amend Rule 506 to permit general solicitation and general advertising in offerings made under the rule, provided all purchasers are accredited investors. The JOBS Act also specifies that the SEC rule changes "require the issuer to take reasonable steps to verify that purchasers are accredited investors, using such methods as determined by the Commission." Notably, the SEC has not proposed any particular methods for verifying accredited investor status and, instead, has proposed only that issuers must take "reasonable steps" to verify the status of investors. The JOBS Act also requires the SEC to permit offers of securities pursuant to Rule 144A to persons other than QIBs, including by means of general solicitation or general advertising, provided the securities are sold to only persons the seller and any person acting on the seller's behalf reasonably believe are QIBs.

The relaxation of the ban on general solicitation and general advertising in Rule 506 and Rule 144A offerings is expected to have a major impact on these types of offerings, which already play major roles in the capital markets. In 2011, issuers raised an estimated \$895 billion in Rule 506 offerings and \$168 billion in Rule 144A offerings.

The SEC is seeking comments on the proposed rules within 30 days after publication in the Federal Register.

Rule 506 Amendments

Rule 506 is a nonexclusive safe harbor under Section 4(a)(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. To qualify for the Rule 506 exemption, issuers, or any person acting on their behalf, are prohibited from offering or selling securities through any form of general solicitation or general advertising.



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Eliminating the Prohibition Against General Solicitation. The SEC has proposed new Rule 506(c), which would permit the use of general solicitation to offer and sell securities under Rule 506, provided that the following conditions are satisfied:

- The issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors.
- All purchasers of securities must be accredited investors, either because they come within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they do, at the time of the sale of the securities.
- All other terms and conditions of Rules 501, 502(a) and 502(d) must be satisfied.

Recognizing that many issuers may not wish to engage in general solicitation, the SEC did preserve an issuer's ability to conduct a Rule 506 offering without the use of general solicitation. In this regard, the proposed amendments to Rule 506 do not impose any new requirements on offers and sales of securities that do not involve general solicitation.

The SEC also stated that the lifting of the ban on general solicitation applies to only Rule 506 offerings and does not apply to Section 4(a)(2) offerings in general.

Reasonable Steps to Verify Accredited Investor Status. Proposed Rule 506(c) requires issuers using general solicitation to take reasonable steps to verify that the purchasers of the offered securities are accredited investors. Rather than proposing uniform verification methods that all issuers must follow or a nonexhaustive list of specified verification methods, the SEC is proposing a flexible approach allowing issuers to consider a number of factors when determining the reasonableness of the steps to verify that a purchaser is an accredited investor. The SEC provided the following examples of factors that issuers may want to consider:

- *Nature of the purchaser/type of accredited investor.* For example, the SEC acknowledges that the steps reasonable to verify that a registered broker-dealer is an accredited investor would differ from the steps reasonable to verify whether a natural person is an accredited investor.
- *Amount and type of information about the purchaser.* The more information an issuer has indicating that a purchaser is an accredited investor, the fewer steps it would have to take to verify such status. Examples of information that issuers could review or rely upon include:
 - publicly available information in federal, state or local filings, such as compensation disclosed in a proxy statement or tax forms for 501(c)(3) organizations
 - third-party information that provides reasonably reliable evidence of accredited investor status, such as a natural person's W-2 forms
 - verification of accredited investor status by a third party, such as a broker-dealer, attorney, accountant or other third-party service provider.
- *Nature and terms of the offering.* How the issuer publicly solicits purchasers, e.g., through a website accessible to the general public or from a reliable database of prescreened accredited investors, may be relevant in determining the reasonableness of the steps taken to verify accredited investor status. The terms of the offering are also factors to consider. For example, a purchaser's ability to meet a high minimum investment amount, without third-party financing, could be taken into consideration in verifying accredited investor status.

Form D. The SEC also proposed amending Form D to include a separate check box for issuers to indicate whether they are claiming an exemption under Rule 506(c). During the SEC's open meeting to discuss the proposed rules,

Commissioner Walter suggested that filing the Form D should be a condition to reliance on proposed Rule 506(c), but no such condition was included in the proposed rules.

Rule 144A Amendments

The SEC's proposed rules also amend Rule 144A, which exempts an offer or sale of securities from the registration requirements of the Securities Act so long as, along with the satisfaction of other conditions, all persons who are offered securities are QIBs. The current requirement that all offerees be QIBs effectively prohibits the use of general solicitation or general advertising in such offerings. Under the proposed amendment, resales of securities pursuant to Rule 144A could be conducted using general solicitation so long as the securities are ultimately sold to only QIBs or purchasers that the seller and any person acting on the seller's behalf reasonably believe are QIBs.

Important Clarifications

In the proposing release, the SEC also provided clarification and confirmation regarding the following:

- *Reasonable Belief that Purchasers Are Accredited Investors.* Many commentators raised concerns that Section 201(a) of the JOBS Act could be interpreted to subject an issuer's determination under Rule 506 as to whether a purchaser is an accredited investor to an "absolute" standard, rather than the current "reasonable belief" standard. This concern stems from references in Section 201(a) to a reasonable belief standard when discussing amendments to Rule 144A, but not when discussing amendments to Rule 506. The SEC explained that both Rule 506 and Rule 144A currently provide for a reasonable belief standard regarding the eligibility of purchasers under the respective rules, but, because the rules include the standard in different ways, the language in the JOBS Act simply reflects this difference. As such, the SEC confirmed that the definition of accredited investor in Rule 501(a) remains unchanged and continues to include persons that are within any of the listed categories of accredited investors, as well as persons that the issuer reasonably believes fall within any such categories.
- *Availability of Investment Fund Exemptions.* Privately offered funds, including hedge funds, venture capital funds and private equity funds, typically rely on exclusions set forth in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act to avoid registration under that act. These exclusions are not available if the fund makes a "public offering" of its securities. The SEC confirmed that privately offered funds may make a general solicitation under proposed Rule 506(c) without losing either of the exclusions from registration under the Investment Company Act.
- *Integration with Offshore Offerings.* In response to concerns on how the proposed rules may affect Regulation S offerings, the SEC confirmed that concurrent offshore offerings that are conducted in compliance with Regulation S would not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A, as proposed to be amended.

Conclusion

The SEC's proposed rule changes would give issuers wide latitude in tailoring investor verification procedures for offerings. While this flexibility reflects the realities of the marketplace and the variety of issuers and types of offerings conducted under Rule 506, the SEC's proposed approach that issuers take "reasonable steps" to verify accredited investor status introduces an element of uncertainty in a rule that is intended to serve as a safe harbor. This may lead some issuers to forego the use of proposed Rule 506(c), at least until industry practices become more fully developed. Until final rules are adopted, the current ban on general solicitation and general advertising in Rule 506 and Rule 144A offerings remains in effect.

For more detail on the impact of the proposed rule to private funds, please click [here](#).

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