
Overview

The proposed rules would amend Rule 506 to provide that the prohibition against general solicitation and general advertising contained in Rule 502(c) of Regulation D would not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors and that the issuer takes reasonable steps to verify that the purchasers are accredited investors. The proposed rules also would amend Form D, which is a notice that each issuer claiming a Regulation D exemption is required to file with the SEC, to add a check box to indicate that an offering is being conducted with general solicitation. Additionally, the proposed rules would amend Rule 144A to provide that securities sold pursuant to Rule 144A may be offered to persons other than qualified institutional buyers (QIBs),

including by means of general solicitation, provided that the securities are sold only to persons whom the seller and any person acting on behalf of the seller reasonably believe are QIBs.

Eliminating the Prohibition Against General Solicitation

Rule 506 is a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act that exempts transactions by an issuer “not involving any public offering” from the registration requirements of Section 5 of the Securities Act. Rule 506 is used widely by emerging growth companies to raise capital privately from angel investors and venture capital funds. It also is used by venture capital funds, hedge funds, and private equity funds in their own capital-raising efforts. Rule 506, however, currently prohibits the issuer, or any person acting on its behalf, from offering or selling securities through any form of general solicitation or general advertisement.

As required by the JOBS Act, the SEC proposes to adopt new Rule 506(c), which would permit the use of general solicitation and general advertising 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 who qualify as accredited investors or the issuer reasonably believes that they do at the time of the sale of the securities

Offerings under proposed Rule 506(c) would not have to comply with Rule 502(b), which requires specified information to be provided to non-accredited investors, or Rule 502(c), which contains the prohibition against general solicitation and general advertising. The proposed rules would preserve, under existing Rule 506(b), the existing ability of issuers to conduct Rule 506 offerings without the use of general solicitation.

Despite calls from certain commentators, the SEC did not propose rules governing the content and manner of advertising and solicitations used in offerings conducted under the proposed Rule 506 exemption, such as a requirement that the solicitation include a balanced presentation of risks and rewards or mandatory legends.

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Defining “Reasonable Steps” to Verify Accredited Investor Status

In order to preserve sufficient flexibility to accommodate the different types of issuers that would conduct offerings under proposed Rule 506(c) and the different types of accredited investors that may purchase securities in these offerings, the SEC proposes that the determination as to whether steps taken to verify accredited investor status are “reasonable” be an objective determination based on the particular facts and circumstances of each transaction.

Under the SEC’s proposed approach, an issuer’s “reasonable steps” to verify that a purchaser is an accredited investor would depend upon a number of factors, including:

- 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 access to regarding the purchaser; and
- the nature 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.

Each of these factors is discussed in greater detail below. The proposing release indicates that the factors are interconnected, and that information obtained by examining the factors would help an issuer assess the reasonable likelihood that a potential purchaser is an accredited investor. This process would, in turn, affect the steps that would be considered reasonable in an effort to verify a purchaser’s accredited investor status. The proposing release emphasizes the importance of issuers retaining adequate records that document the steps taken to verify that a purchaser is an accredited investor.

Significance of the Nature of the Purchaser

The definition of “accredited investor” in Rule 501(a) includes natural persons and entities that come within specified categories in the rule, or that the issuer reasonably believes come within one of those categories. Some entities may be accredited investors based on their statuses and some entities may be accredited investors based on a combination of their statuses and the amounts of their total assets. Natural persons may be accredited investors based on either their net worth or their annual incomes.

The proposing release indicates that reasonable steps for an issuer to take to verify whether a purchaser is an accredited investor under proposed Rule 506(c) likely would vary depending on the type of accredited investor that the purchaser claims to be. For example, an issuer may reasonably verify that an entity is an accredited investor by virtue of being a registered broker-dealer by visiting FINRA’s BrokerCheck website, but the issuer would need to use other steps to verify whether a natural person is an accredited investor. Under the proposed approach, the particular facts and circumstances surrounding each purchaser would determine the type of information that would be sufficient to constitute reasonable steps to verify accredited investor status.

Significance of the Amount and Type of Information the Issuer Has Regarding the Purchaser

The proposing release indicates that the amount and type of information that an issuer has regarding a purchaser would be a significant factor in determining any additional steps that an issuer could reasonably take to verify the purchaser’s accredited investor status. The more information an issuer has indicating that a prospective purchaser is an accredited investor, the proposing release states, the fewer steps an issuer would have to take to verify that status, and vice versa. The proposing release provides examples of the types of information that issuers could review or rely upon—any of which might in and of themselves constitute reasonable steps to verify a purchaser’s accredited investor status, depending on the circumstances—including:

- publicly available information in filings with a federal, state, or local regulatory body;
- third-party information that provides reasonably reliable evidence that a person falls within one of the enumerated categories in the accredited investor definition; and
- verification of a person’s status as an accredited investor by a third party, such as a broker-dealer, attorney, or accountant, provided that the issuer has a reasonable basis to rely on such third-party verification.

Significance of the Nature and Terms of the Offering

The proposing release indicates that the nature of the offering, such as the means through which the issuer publicly solicits purchasers, may be relevant in determining the reasonableness of the steps taken to verify accredited investor status. For example, solicitation through a website accessible to the general public or through a widely disseminated email or social media post may require an issuer to take greater measures to verify accredited investor status than solicitation from a database of pre-screened accredited investors created and maintained by a reasonably reliable third party, such as a registered broker-dealer.

The proposing release also indicates that the terms of the offering would affect whether the verification methods used by the issuer are reasonable. For example, the ability of a purchaser to satisfy a minimum investment amount requirement that is high enough that only accredited investors could reasonably be expected to meet it could be relevant to the issuer’s evaluation of the types of steps that would be reasonable to take in order to verify that purchaser’s status as an accredited investor.

Form D Check Box for Rule 506(c) Offerings

Rule 503 of Regulation D requires an issuer offering or selling securities in reliance upon Rules 504, 505, or 506 to file a notice of sales

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on Form D with the SEC no later than 15 calendar days after the first sale of securities in the offering. The SEC is proposing a revision to Form D to add a separate check box that issuers can use to indicate whether or not they are claiming an exemption under Rule 506(c).

Specific Issues for Privately Offered Funds

Hedge funds, venture capital funds, and private equity funds rely on the Rule 506 safe harbor to offer and sell their interests without registration under the Securities Act. Such funds also generally rely on one of two exclusions from the Investment Company Act’s definition of “investment company” in their fund-raising activities, which enables them to be excluded from the regulatory provisions of that act. Privately offered funds are precluded from relying on either of the two exclusions set forth in Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act if they make a public offering of their securities. The proposing release indicates that the effect of Section 201(b) of the JOBS Act is to permit privately offered funds to make a general solicitation under amended Rule 506 without losing either of the exclusions under the Investment Company Act.

Proposed Amendment to Rule 144A

The proposed rules would amend Rule 144A to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, provided that securities are sold only to persons whom the seller and any person acting on behalf of the seller reasonably believe is a QIB. Rule 144A(d)(1) would be amended to eliminate the references to “offer” and “offeree.” As amended, the rule would require only that the securities are sold to a QIB or to a purchaser that the seller and any person acting on behalf of the seller reasonably believe is a QIB. Under this proposed amendment, resales of securities pursuant to Rule 144A could be conducted using general solicitation, so long as the purchasers are limited in this manner.

Integration with Offshore Offerings

Regulation S under the Securities Act provides a safe harbor for offers and sales of securities outside the United States and includes an issuer safe harbor and a resale safe harbor. Two general conditions apply to both safe harbors: (1) the securities must be sold in an offshore transaction and (2) there can be no directed selling efforts in the United States. The proposing release indicates that, consistent with the historical treatment of concurrent Regulation S and Rule 144A/Rule 506 offerings, 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 in their amended state as proposed.

Proposed Effective Date

The SEC will seek public comment on the proposed rules for 30 days. Shortly thereafter, the SEC will review the comments and determine whether to adopt the proposed rules.

As we indicated in a previous WSGR Alert, which is available at http://www.wsgr.com/publications/PDFSearch/wsgralert-JOBS-Act-Signed.pdf, Wilson Sonsini Goodrich & Rosati, along with a number of other law firms, issued guidance reflecting our collective understanding of the impact of the JOBS Act on transactions taking place during the period prior to the effective date of the amendments to Rule 506 and Rule 144A. A copy of that guidance is available at http://www.wsgr.com/PDFs/general-solicitation.pdf. We believe that the guidance still applies until the SEC adopts the proposed amendments to Rule 506 and Rule 144A, as required by the JOBS Act.

For any questions or for more information on these or any related matters, please contact your regular Wilson Sonsini Goodrich & Rosati attorney or any member of the firm’s corporate and securities practice.