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SEC Proposes Rules to Allow General Solicitation and Advertising in Rule 506 and Rule 144A Securities Offerings

When the Jumpstart Our Business Startups Act (JOBS Act) became law in April of this year, one of its promised jump-start mechanisms was the elimination of the ban on using general solicitations and advertising in private offerings exempt from securities registration, subject to further Securities and Exchange Commission (SEC) rulemaking. On August 29, the SEC proposed its rules to implement the creation of these "public" private offerings. The proposed rules affect the existing Rule 506 and Rule 144A. Rule 506 presently allows an issuer to sell an unlimited number of securities to "accredited investors" (and a small number of nonaccredited investors if additional disclosures are made) but specifically prohibits offerings using "general solicitation or general advertising." Similarly, Rule 144A presently allows resales of restricted securities to "qualified institutional buyers" (QIBs) but without means of a general solicitation. (A QIB is defined as an institution managing at least \$100 million in securities or a registered broker-dealer investing more than \$10 million in certain securities.) Examples of general solicitations or advertising include print ads, radio and television commercials, seminars and presentations where the attendees were invited by general solicitation or advertising, and even unrestricted websites. **RULE 506 PROPOSALS** The SEC is proposing a new Rule 506(c) that would essentially disable Rule 502(c), which contains the prohibition on general advertising, and would allow issuers to use general solicitation and advertising to sell securities to accredited investors only. However, the SEC would require under new Rule 506(c) that issuers take "reasonable steps" to verify that the ultimate purchasers of those securities are actually accredited investors. Currently, under Rule 501(a), issuers are merely required to have a "reasonable belief" that an investor is accredited. Because "reasonable steps" is not defined in the new Rule 506(c), determining precisely what it means will likely require a great deal of time and effort by regulators, commentators and practitioners over the next few years. The SEC release states that what is "reasonable" would be an objective determination based on the facts and circumstances of a given situation. The release also offers a suggested framework of factors for issuers to consider in making this determination, including the following:

- Consideration of the nature of the purchaser and the type of accredited investor it claims to be
- The amount and type of information the issuer has regarding the purchaser
- The nature and manner of the offering

For example, because a registered broker or dealer is considered an accredited investor, an issuer could verify the accreditation on FINRA's website, and presumably it would not be necessary for an issuer to take any additional steps. The SEC also indicated that the more information the issuer has indicating that the prospective purchaser is an accredited investor, the fewer steps it would have to take, and vice versa. Accordingly, issuers may not have to conduct meaningful steps with regard to accredited investors with whom the issuer is well-acquainted through a preexisting relationship. The release acknowledges that verifying the status of natural persons based on their net worth or income poses greater practical difficulties. Interestingly, the release posits the notion that a third party such as a broker-dealer, attorney or accountant might be a reasonable source for verification of a person's status. This one aspect of the new rules by itself could well give rise to a new cottage industry based on

accredited investor verification, such as websites or other social media accessible to potential issuers. The SEC considered comments sent to them previously but specifically rejected recommendations that would have required them to regulate the content and manner of general solicitations and advertising. Importantly, the SEC maintained the current Rule 506 exemption for offerings that do not involve a public offering. Accordingly, an issuer may conduct a "non-public" Rule 506 offering without the need to take "reasonable steps" to verify that purchasers are accredited investors. However, if an industry emerges dedicated to prescreening accredited investors as a result of these rule changes, it is conceivable that industry practice could change to require such verification. The new rules would also modify Form D, which is filed in connection with Rule 506 offerings, to include a separate check box for issuers to indicate whether they are using general solicitation or advertising in their offering. **RULE 144A PROPOSALS** The JOBS Act directs the SEC to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs. Offerings under the proposed new Rule 144A may be made through general solicitation. However, the securities can be sold only to persons that the seller, or anyone acting on behalf of the seller, reasonably believes are QIBs. In the amendment proposed by the SEC, references to "offer" and "offeree" in Rule 144(d)(1) would be removed. With this amendment, the SEC would require under Rule 144A only that the seller or its agent sell to a QIB or to a purchaser whom the seller or its agent reasonably believes to be a QIB. Further, sales of securities that are resold under Rule 144A could be conducted through general solicitation, as long as the purchasers are indeed QIBs. **NEXT STEPS** The SEC has requested comments to the proposed new rules. Comments must be submitted within the 30-day period after publication of the proposed rules. Following the SEC's subsequent consideration of comments submitted, the SEC will promulgate the final rules regarding the allowable uses of general solicitations and advertising in Rule 506 and Rule 144A offerings. Consequently, no issuer or person should sell or resell securities by use of a general solicitation or advertising under those offering exemptions until the final rules have been adopted.