SEC Lifts Ban on General Solicitation for Certain Offerings

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On July 10, 2013, the Securities and Exchange Commission lifted the ban on general solicitation relating to offers of securities exempt under Rule 144A and Rule 506 of Regulation D under the Securities Act of 1933. Lifting of the ban on general solicitation is part of a series of changes being implemented by the SEC pursuant to the JOBS Act. The rule amendments become effective 60 days after publication in the Federal Register.

Rule 506 and Rule 144A are offering and resale exemptions that have historically been used to raise substantial amounts of capital. In 2012 alone, it is estimated that $173 billion and $636 billion, respectively, were raised in Rule 506 and non-asset backed securities Rule 144A offerings by operating companies (including both equity and debt). Additionally, pooled investment funds, such as venture capital funds, private equity funds, and hedge funds, are estimated to have raised $725 billion and $4 billion, respectively, in 2012. This is compared to $1.2 trillion raised in registered public offerings in 2012.

The General Solicitation Option

Qualifying for the private offering exemption under Rule 506 has historically required an issuer to meet various criteria, including not using general solicitation or advertising in connection with the offering. However, under amended Rule 506, issuers may now conduct general solicitation efforts and advertising, so long as they comply with all terms and conditions of other applicable rules under Regulation D and take reasonable steps to verify that they sell only to accredited investors or those they reasonably believe to be accredited investors. Similarly, issuers conducting an offering using the resale exemption under Rule 144A may now make offers to non-qualified institutional buyers (QIBs), including by means of general solicitation, so long as the issuer sells only to QIBs or those they reasonably believe to be QIBs. Issuers still cannot use general solicitation in Rule 504 or Rule 505 offerings.

Issuers conducting offerings under the amended Rule 506 (codified under Rule 506(c)) may not sell to non-accredited investors and must take "reasonable steps to verify" the accredited investor status of purchasers. While the SEC has stated that this must be an objective assessment by an issuer on a case-by-case basis that considers the facts and circumstances of each purchaser and the transaction, it has also provided a non-exclusive list of methods that issuers may use. These methods include (i) reviewing copies of any IRS form that reports the income of the purchaser and obtaining a written representation that the purchaser will likely

continue to earn the necessary income in the current year or (ii) 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.

In conjunction with these amendments, the SEC also adopted a "bad actor" amendment to Rule 506, preventing issuers from using the Rule 506 exemption if the issuer or certain covered individuals (including, but not limited to, officers, directors, managing members, general partners, and ten percent beneficial holders) had a "disqualifying event."

The Existing 506 Exemption is Not Disappearing

Issuers may still avail themselves of the pre-amendment offering rules (codified under Rule 506(b)). This means no general solicitation or advertising, but it also means that purchasers may be non-accredited investors (subject to the related information requirements) and that the issuer may satisfy itself of investor status in accordance with historical practice. In addition, raising money under Rule 506(b) still allows issuers to "fall back" on a Section 4(a)(2) exemption if needed and applicable, whereas this will not be available for those offerings using general solicitation.

But there is more...

In connection with lifting the ban on general solicitation, the SEC proposed new amendments to Rule 506, including:

- A 15-day advance notice requirement on Form D in order to engage in general solicitation as part of a Rule 506 offering.
- Additional information required on Form D, such as the issuer's website address, the type of investors, the use of proceeds from the offering, the types of general solicitation used, and the methods used to verify accredited investor status.
- A one-year disqualification (measured from filing) from using Rule 506 if the issuer (or its predecessor or affiliate) did not comply with the Form D requirements in a Rule 506 offering.
- Legends or cautionary statements in any written general solicitation materials used in a Rule 506 offering.
- Confidential submission of written general solicitation materials to the SEC for a period of two years.

The SEC also proposed applying the guidance contained in 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 private funds.

These proposals are subject to a 60-day comment period.