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A Legal Update from Dechert's Financial Services Group

SEC Proposes Additional Requirements to Regulation D, Form D and Rule 156

The Securities and Exchange Commission (SEC) has proposed a suite of amendments¹ to Regulation D, Form D and Rule 156 under the Securities Act of 1933 (Securities Act) (Proposed Rules). According to the SEC, the Proposing Release comes in connection with the adoption of amendments to permit general solicitation and general advertising in certain circumstances, as discussed in a recent OnPoint.² A majority of the SEC Commissioners state that the Proposed Rules are intended to (i) enhance the SEC's ability to monitor how the market will implement the new private offering regime and (ii) provide additional investor safeguards to combat concerns in connection with permitting issuers to engage in general solicitation and general advertising under the newly created paragraph (c) of Rule 506.

If adopted, the Proposed Rules would:

- Amend Rule 503 of Regulation D to require an issuer to: (i) file Form D no later than 15 calendar days in advance of the first use of general solicitation in a Rule 506(c) offering; and (ii) file a closing Form D amendment within 30 calendar days after the termination of a Rule 506 offering;
- Amend Form D to require additional information, primarily with respect to Rule 506 offerings;
- Amend Rule 507 of Regulation D to disqualify an issuer from relying on Rule 506 for one year in connection with future offerings if the issuer, or any predecessor or affiliate,³ did not comply within the last five years with Form D filing requirements as part of a Rule 506 offering;
- Adopt Rule 509 of Regulation D to mandate certain legends and other disclosures on written general solicitation materials used in Rule 506(c) offerings;
- Adopt Rule 510T of Regulation D to require that written general solicitation materials used in Rule 506(c) offerings be submitted to the SEC on a temporary basis; and
- Amend Rule 156 under the Securities Act (currently applicable to registered funds, including mutual funds) to apply to sales literature of private funds.

According to the Proposing Release, the SEC anticipates that the elimination of the ban against general solicitation vastly impacts the private issuer market and will potentially increase the types of issuers that raise capital using Rule 506, the types of investors who are solicited and the amount of capital that will be

¹ [Release No. 33-9416, Amendments to Regulation D, Form D and Rule 156 under the Securities Act, July 10, 2013 \(Proposing Release\)](#) (PDF).

² See *DechertOnPoint*, [SEC Approves Final Rules that \(1\) Permit General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings and \(2\) Disqualify "Bad Actors" from Using Rule 506 to Offer Securities](#) (PDF).

³ Rule 501(b) of Regulation D defines an "affiliate" as a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified.

raised in reliance on Regulation D. The stated purpose of the Proposed Rules is to enhance the SEC's ability to evaluate market practices in Rule 506 offerings and to address issues that are expected to arise in connection with general solicitations and general advertising.

Proposed Form D Amendments

Background: Current Form D Requirements

Rules 504, 505 and 506 of Regulation D⁴ provide safe harbors for issuers to offer securities without registration under the Securities Act (Safe Harbor Rules). Under Rule 503 of Regulation D, an issuer offering securities in reliance on the Safe Harbor Rules must file a notice of sales on Form D with the SEC for each new offering of securities within 15 calendar days after the first sale of securities in the offering. However, filing a Form D notice is not currently a condition precedent for an issuer to offer securities under any of the Safe Harbor Rules. Therefore, failure to timely file a Form D does not affect the validity of an offering under the Safe Harbor Rules or restrict an issuer's ability to rely on the Safe Harbor Rules in any future offerings.⁵

The Proposed Rules, if adopted, would amend Regulation D and Form D to require: (i) advanced filing of Form D for Rule 506(c) offerings; (ii) the filing of an amendment to Form D after the termination of a Form D offering; (iii) additional information in Form D for Rule 506 offerings; and (iv) disqualification of an issuer from using Rule 506 for future offerings until one year has elapsed after the required Form D filings are made if the issuer, or any predecessor or affiliates, failed to comply within the past five years with the Form D filing requirement for a Rule 506 offering. Should an issuer or affiliate fail to comply with a required Form D filing under the Proposed Rules, any current offerings – including the offering for which the issuer failed to make a required Form D filing – would be unaffected, and only future offerings would be disqualified from using Rule 506.

Timing of Filing Form D

Under the Proposed Rules, Rule 503 would be amended to require issuers who intend to engage in general solicitation in reliance on Rule 506(c) to file a shortened version of Form D no later than 15 calendar days *in advance* of the first use of general solicitation (Advance Form D). No Advance Form D would be required for offerings made in reliance on Rules 504, 505 or 506(b). Advance Form D would require the following information from the full Form D:

- Item 1. Basic identifying information on the issuer;
- Item 2. Information on the issuer's principal place of business and contact information;
- Item 3. Information on related persons;

⁴ Rule 504 exempts the offer and sale of up to \$1 million of securities in a 12-month period by issuers that are not subject to reporting requirements under the Securities Exchange Act of 1934 (Exchange Act). Rule 505 exempts offerings by issuers of up to \$5 million of securities in a 12-month period. Rule 506 exempts offerings by issuers for an unlimited amount of money to "accredited investors" and up to 35 non-accredited investors. Form D also applies to offerings of securities without registration in reliance on the exemption contained in Section 4(a)(5) of the Securities Act.

⁵ Note, however, that under Rule 507, an issuer may be disqualified from using Regulation D if the issuer, or any predecessor or affiliate, is enjoined by a court for failure to comply with Rule 503.

- Item 4. Information on the issuer's industry group;
- Item 6. Identification of the exemption or exemptions being claimed for the offering;
- Item 7. Indication of whether the filing is a new filing or an amendment;
- Item 9. Information on the type(s) of security to be offered;
- Item 10. Indication of whether the offering is related to a business combination;
- Item 12. Information on persons receiving sales compensation; and
- Item 16. Information on the use of proceeds from the offering.⁶

Then, in compliance with current Rule 503, the issuer would be required to file an amendment in order to provide the remaining information on Form D within 15 calendar days after the date of the first sale of securities in the offering. In addition, issuers would continue to be required to file amendments annually or more frequently if certain information becomes materially inaccurate.

Given the breadth of what constitutes general solicitation, in many cases there would be great uncertainty as to when these filings would need to be made.

The SEC is also proposing to amend Rule 503 to require issuers to file a closing Form D amendment within 30 calendar days after the termination of any Rule 506 offering.

Additions to Form D

If adopted, the Proposed Rules would amend Form D to include the following additional information:⁷

- *Website* – the issuer's Internet website address, if applicable;
- *Information about Controlling Persons* – for Rule 506(c) offerings, the name and address of any person who directly or indirectly controls the issuer;
- *Clarifying Information on Industry Classification* – further description regarding the issuer's industry group, if not listed in the current Form D group classification;
- *Information on Issuer Size* – an option to list information on issuer size as "Not Available to Public." If adopted, the Proposed Rules would change the final option in Item 5 from "Decline to Disclose" to "Not Available to Public." Thus, an issuer could continue to opt not to disclose this information, but only if it does not otherwise make this information available to the public;
- *Security Identifier* – information on the trading symbol or generally available security identifier, if any, for the offered securities;
- *Types of Investors in the Offering* – for Rule 506 offerings, in a table format: (i) the number of accredited investors and non-accredited investors that have purchased the offered securities; (ii)

⁶ An issuer who files an Advance Form D is not required to subsequently make a 506(c) offering. Therefore, an issuer may want to consider filing an Advance Form D under Rule 506(c) even if it does not intend to conduct a 506(c) offering, in order to mitigate the risk of inadvertent use of general solicitation.

⁷ This disclosure applies to all offerings under Rule 504, Rule 505, Rule 506 and Section 4(a)(5) unless otherwise noted.

whether the purchasers are natural persons or legal entities; (iii) the basis for qualification as accredited investors; and (iv) the amount of capital raised from each category of investors;

- *Use of Proceeds* – for Rule 506 offerings by issuers that are not pooled investment funds, the percentage of offering proceeds that was or will be used: (i) to repurchase or retire the issuer’s existing securities; (ii) to pay offering expenses; (iii) to acquire assets, other than in the ordinary course of business; (iv) to finance acquisitions of other businesses; (v) for working capital; and (vi) to discharge indebtedness;
- *Use of Broker-Dealers and Investment Advisers* – for Rule 506 offerings, if the issuer used a registered broker-dealer in connection with the offering, whether general solicitation materials were filed with the Financial Industry Regulatory Authority (FINRA);
- *Promoters* – in the case of a pooled investment fund in a Rule 506 offering, identifying information regarding any investment adviser who is considered a promoter⁸ of the issuer; and
- *Additional Required Form D Information for Rule 506(c) Offerings* – the types of general solicitation to be used (e.g., mass mailings, emails and public websites) and 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 reliance on verification by a third party).

Disqualification of Rule 506(b) and Rule 506(c) Issuers Who Fail to Comply with Form D Filing Requirements

The Proposed Rules seek to amend Rule 507 of Regulation D⁹ and automatically 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 with the requisite Form D filing requirements in a Rule 506 offering within the last five years.

In applying proposed Rule 507, issuers who intend to engage in a Rule 506 offering would be required to look back to the later of (i) five years prior to the initial offer or (ii) the effective date of the changes to Rule 507. In addition, this disqualification would not apply to offerings of an issuer or an affiliate ongoing at the time of the non-compliance, including the offering for which the issuer failed to make a required Form D filing. Only future offerings would be affected.

If adopted, under amended Rule 507, should an issuer, any predecessor or any one of the issuer’s affiliates, fail with respect to one of their respective Form D requirements,¹⁰ the issuer would be required to correct

⁸ The definition of “promoter” in Rule 405 under the Securities Act “includes any person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes initiative in founding and organizing the business or enterprise of an issuer, or any person who, in connection with the founding and organizing of the business or enterprise of an issuer, directly or indirectly receives in consideration of services or property, or both services and property, 10 percent or more of any class of securities of the issuer or 10 percent or more of the proceeds from the sale of any class of such securities. However, a person who receives such securities or proceeds either solely as underwriting commissions or solely in consideration of property shall not be deemed a promoter... if such person does not otherwise take part in founding and organizing the enterprise.”

⁹ Rule 507 of Regulation D in its current form disqualifies an issuer from using Regulation D if a court enjoins the issuer, its predecessor or an affiliate for failure to comply with Rule 503.

¹⁰ The Proposed Rules would provide a limited opportunity to cure a missed filing and avoid the one-year disqualification period. If an issuer fails to comply with the Form D requirements but cures this deficiency by filing within 30 days after the deadline to file its required Form D filings, the issuer will be deemed having complied with Rule 503, undoing the disqualification under the proposed amended Rule 507. However, the cure period would only be available for an issuer’s initial failure to file a timely required Form D filing, meaning that an issuer can only use the cure period provision once. The SEC may also waive the disqualification under current Rule 507 provisions upon a showing of good cause.

such non-compliance and would then be unable to rely on Rule 506 for one year for future offerings. Accordingly, if Rule 507 is amended as proposed, any issuer who wishes to engage in a Rule 506(c) offering should review its internal procedures to ensure Form D filings are made in a timely fashion.

The proposed disqualification for issuers whose affiliates have failed to comply with their own Form D requirements could prove problematic for issuers that are part of a large business complex with operationally independent affiliates. Such issuers will need to determine how they will coordinate with their affiliates to make sure that all companies within the complex have adequate procedures in place to ensure compliance with their respective Form D requirements or risk the potential consequence of being disqualified from raising new funds in reliance on Rule 506 for the next year due to what is typically an administrative oversight by an affiliate.

New Required Disclosures in General Solicitation Materials

In the Proposing Release, the SEC expressed concern that prospective investors may not know whether they are qualified to participate in private offerings, the types of offerings and the potential risks associated with each type of offering. To address this concern, the SEC proposed new Rule 509 under the Securities Act. If adopted, Rule 509 would require all issuers conducting an offering in reliance on Rule 506(c) to include the following prominent legends on all written general solicitation materials:

- The securities may be sold only to accredited investors, which, for natural persons, are investors who meet certain minimum annual income or net worth thresholds;
- The securities are being offered in reliance on an exemption from the registration requirements of the Securities Act and are not required to comply with specific disclosure requirements that apply to registration under the Securities Act;
- The Commission has not passed upon the merits of or given its approval to the securities, the terms of the offering, or the accuracy or completeness of any offering materials;
- The securities are subject to legal restrictions on transfer and resale and investors should not assume they will be able to resell their securities; and
- Investing in securities involves risk, and investors should be able to bear the loss of their investment.

Written general solicitation materials may use any wording that clearly communicates the required disclosures and may combine several of the statements, provided that the information is easy to understand. In addition, materials used in connection with the offering of pooled investment vehicles must also contain a legend stating that the securities offered are not subject to the protections of the Investment Company Act of 1940.

Private Fund Legends – Performance Data

Rule 509(c) would require any written general solicitation materials containing performance data relating to a private fund to include a legend disclosing:

- Performance data represents past performance;
- Past performance does not guarantee future results;
- Current performance may be lower or higher than the performance data presented;

- The private fund is not required by law to follow any standard methodology when calculating and representing performance data; and
- The performance of the fund may not be directly comparable to the performance of other private or registered funds.

There would also be a requirement to include a legend providing a telephone number or a website where an investor may request current performance data.

In addition, Rule 509(c) would require the performance data to be as of the most recent practicable date considering the type of private fund and the media through which the data is conveyed, and would require disclosure of the period for which the performance is presented.

If a fund shows gross performance data (that is, without deducting fees or expenses) in the fund's general written solicitation materials, the fund must disclose that (i) fees and expenses have not been deducted and (ii) if such fees and expenses had been deducted, performance might have been lower than presented. Interestingly, the SEC Staff had previously taken the position that sales literature that does not show net performance equally prominently along with gross performance would be misleading, but the SEC has not proposed to require disclosure of net performance in Rule 509(c).

The Proposing Release does not require that the legends be included as part of a condition to use the Rule 506(c) safe harbor, suggesting that failure to do so would not automatically render Rule 506(c) unavailable.¹¹

The Proposing Release leaves unclear what constitutes written general solicitation materials that must include the enumerated legends. The SEC has historically interpreted "general solicitation" broadly to include, among others, unsolicited mass mailings and emails, articles that reference a specific offering, and discussion of an offering at seminars open to the general public. However, it is not clear whether all of these types of materials must include the required legends and whether individual follow-up communications to prospective investors must also include such legends.

Guidance as to Sales Literature of Private Funds

In its current form, Rule 156 provides guidance as to when information in sales literature by registered investment companies such as mutual funds could be fraudulent or misleading under federal securities laws. The Proposed Rules would amend Rule 156 to also apply to the sales literature of private funds, regardless of whether the offering is effected through general solicitation. The SEC suggested in the Proposing Release that this new requirement is intended to address the concern that the permission of general solicitation for private funds may increase misleading and fraudulent information. The SEC is seeking comment on whether it should mandate additional manner and content restrictions on written general solicitation materials used by private funds. The SEC stated in the Proposing Release that private funds should apply the current principles underlying Rule 156 as part of such funds' efforts to avoid making fraudulent statements in their sales literature.¹²

¹¹ Note, however, that failure to comply with these disclosure rules could result in a court enjoining the issuer, any predecessor or affiliate, from relying on Rule 506 for future offerings.

¹² Rule 156 applies to sales literature distributed by SEC-registered investment companies. The Rule generally prohibits the use of "materially misleading" sales literature, and notes, among other things, that inclusion of past or future investment performance could be misleading under certain circumstances (including, for example, in literature

Temporary Requirement to Submit General Solicitation Materials to the SEC

In the Proposing Release, the SEC expressed its desire to monitor the effectiveness of new Rule 506(c). To address its efforts to monitor Rule 506(c), the SEC proposed new Rule 510T under the Securities Act, which would require issuers to submit any written general solicitation materials used in a Rule 506(c) offering to the SEC no later than the date of first use.

If adopted, Rule 510T would require that all issuers who conduct an offering in reliance on Rule 506(c) and distribute any written general solicitation material prepared by or on behalf of the issuer, must submit these materials on an intake page on the SEC website.¹³ This temporary rule would expire two years after its effective date.

Compliance with this submission requirement is not proposed as a condition precedent to reliance on Rule 506(c). Thus, non-compliance with Rule 510T would not automatically disqualify an issuer from using Rule 506(c).¹⁴

Additional Requests for Comments

In the Proposing Release, the SEC stated that the definition of “accredited investor” for natural persons should be reviewed. The SEC is seeking comments on whether, among other things, net worth and annual income should be used as the fundamental tests to determine whether a natural person is considered an accredited investor. In addition, the SEC is considering the thresholds for net worth and annual income, should those tests continue to be used, as well as other validating tests and their thresholds.

Conclusion

Allowing general solicitation under Rule 506(c) permits private funds to market to a host of new potential investors. However, the new and amended rules in the Proposing Release may discourage issuers from enduring the regulatory burden and significant legal uncertainty to engage in offerings under Rule 506(c) and instead encourage such Funds to continue with familiar practices and utilize existing Safe Harbor Rules not involving the use of general solicitations or advertisements. In addition, further guidance is needed regarding the legend requirements, as discussed above.

The SEC is soliciting comments on the proposed rules, and comments are due by September 23, 2013.



that directly or indirectly suggests that an investor’s capital is secure or that past performance is indicative of future investment results).

¹³ In the Proposing Release, the SEC indicated that it does not intend to subject the submitted written general solicitation materials to a Staff review similar to that conducted with respect to Securities Act registration statements. The submitted materials would not be “filed” through the SEC EDGAR system and therefore would not be available on the SEC’s website.

¹⁴ Note, however, that proposed Rule 510T would authorize a court to enjoin an issuer, predecessor or affiliate from making future 506 offerings, for failure to comply with such Rule.



This update was authored by:



David A. Vaughan
Washington, D.C.
+1 202 261 3355
david.vaughan@dechert.com



Michael L. Sherman
Washington, D.C.
+1 202 261 3449
michael.sherman@dechert.com



Steven P. Kirberger
New York
+1 212 698 3698
steven.kirberger@dechert.com



Michelle E. Peters
London
+1 44 20 7184 7382
michelle.peters@dechert.com



Kenneth Rasamny
Orange County
+1 949 442 6040
kenneth.rasamny@dechert.com



Michelle Wong
Boston
+1 617 728 7100
michelle.wong@dechert.com



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