

**SEC PROPOSES RULES TO ELIMINATE THE PROHIBITION AGAINST
GENERAL SOLICITATION AND GENERAL ADVERTISING IN
RULE 506 AND RULE 144A OFFERINGS**

October 2, 2012

The Securities and Exchange Commission (the “SEC”) recently proposed rules to amend Rule 506 of Regulation D and Rule 144A,¹ as required by Section 201(a) of the Jumpstart Our Business Startups Act (the “JOBS Act”) enacted earlier this year. The proposed amendments would permit general solicitation and advertising in unregistered offerings made pursuant to Rule 506 of Regulation D, provided all purchasers are accredited investors, and resales of securities pursuant to Rule 144A so long as purchasers are qualified institutional buyers (“QIBs”). The proposed amendments are intended to increase issuer access to capital.

Rule 506 and Rule 144A offerings play an important role in raising capital. The SEC estimates that issuers raised approximately \$895 billion and \$168 billion in 2011 using Rule 506 and Rule 144A transactions, respectively. In comparison, \$984 billion was raised through registered offerings in 2011. The comment period for the new proposed rules expires October 5, 2012, with final (albeit potentially modified) SEC rules certain to follow, as required by the JOBS Act.

Rule 506 Offerings

- **Current Rule.** Current Rule 506 provides a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act of 1933, as amended (the “Securities Act”), from registration under Section 5 of the Securities Act for issuances of securities “not involving any public offering.” Under this rule, issuers may offer and sell securities in unlimited amounts to an unlimited number of accredited investors and/or up to 35 non-accredited investors that meet certain sophistication standards. To be eligible for the safe harbor, among other conditions, the issuer, or any person acting on its behalf, must refrain from using general solicitation or advertising in offering the securities. While the terms “general solicitation” and “general advertising” are not defined by the SEC, examples include newspaper and magazine ads, radio and TV announcements, publicly advertised seminars and advertisements on unrestricted websites. “Accredited investor” is defined in Rule 501(a) as any natural person or entity that qualifies, or the issuer reasonably believes qualifies, under certain listed categories including: (1) banks and savings and loan associations; (2) broker dealers; (3) investment companies; (4) 501(c)(3) non-profits, corporations, partnerships and Massachusetts business trusts having total assets in excess of \$5 million that were not formed for the purpose of acquiring the securities offered; and (5) natural persons who individually, or jointly with a spouse, have a net worth greater than \$1 million (excluding

¹ Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33-9354 (August 29, 2012), available at <http://www.sec.gov/rules/proposed/2012/33-9354.pdf>. Our earlier client alert describing these and other JOBS Act provisions can be found at: <http://www.wcsr.com/resources/pdfs/cs040612.pdf>.

principal residence) or who have had income greater than \$200,000 (or \$300,000 if combined with a spouse's income) in each of the last two years and expect to maintain such income in the current year.

- **Proposed Amendment.** As proposed, the amendment to Regulation D would eliminate the prohibition against general solicitation and advertising found in Rule 502(c) for securities offerings made pursuant to Rule 506 so long as all purchasers are accredited investors (or the issuer reasonably believes that all purchasers are accredited). Issuers would therefore be able to advertise in newspapers or magazines or on websites accessible to the general public, among other options. However, under new proposed Rule 506(c), issuers would be required to take reasonable steps to verify that such purchasers are accredited investors. The SEC does not define "reasonable steps" but indicates that the necessary steps would be based upon an objective determination based on the particular facts and circumstances of the transaction. Example factors for consideration include: (1) the nature of the person and type of accredited investor status claimed; (2) the amount and type of information that the issuer has about the purchaser; and (3) the character of the offering, including the manner of solicitation and offering terms, such as any minimum investment amounts. For example, it would be sufficient for an issuer to confirm that a registered broker-dealer is an accredited investor by checking FINRA's BrokerCheck website; however, confirmation that a natural person is an accredited investor would likely be more involved.

The SEC indicates that the greater the information the issuer possesses about the person, the less diligence that would be required to confirm accredited investor status. As proposed, documentation that may help to establish accredited investor status includes SEC filings, Form W-2s, trade publications that disclose annual average compensation or specific compensation levels at the purchaser's workplace and verification by a third party such a broker-dealer, attorney or accountant.

The type of solicitation should also be considered in determining what steps are reasonable to confirm accredited investor status. For example, advertising on a website that is accessible by the general public would require greater diligence in confirming accredited investor status than soliciting investors from a list of pre-screened potential purchasers provided by a registered broker-dealer. In the latter case, having the purchaser complete a questionnaire indicating its relevant accredited investor category under Rule 501(a) of the Securities Act would provide a sufficient basis to confirm accredited investor status; however, such certification would not be sufficient for screening purchasers derived from a wider public solicitation, such as a newspaper advertisement.

Under the amendments, all other conditions of Rules 501, 502(a) and 502(d) would still apply. Further, Rule 506 offerings as presently allowed without general solicitation and advertising (e.g., with sales to up to 35 non-accredited investors) would still be permitted.

Form D

In light of the amendments to Regulation D, the SEC has also proposed to update Form D accordingly to add a check box for issuers to indicate whether they are using general solicitation or general advertising in their offering.

Considerations for Privately Offered Funds

The SEC's release reaffirms that privately offered funds, such as hedge funds, venture capital funds and private equity funds, would be able to use general solicitation and advertising to raise capital under proposed Rule 506(c) without running afoul of restrictions under the Investment Company Act of 1940.

No Changes to Policy Regarding Offshore Offerings

The SEC's release also states that the SEC's long standing policy that offshore offerings under Regulation S should not be integrated with domestic offerings under Regulation D is not altered by the JOBS Act or the related proposed rule amendments.

Rule 144A

- **Current Rule.** Rule 144A provides a non-exclusive safe harbor under Section 4(a)(1) of the Securities Act from registration under the Securities Act for resales of certain restricted securities to QIBs. Although Rule 144A does not expressly prohibit general solicitations, it has the same practical effect since offers of securities under Rule 144A are currently limited to QIBs. Rule 144A(a)(1) provides a list of methods for establishing that a prospective purchaser is a QIB. To qualify as a QIB, the entity must fall within enumerated categories and own and invest at least \$100 million in securities of non-affiliates.
- **Proposed Amendment.** The proposed amendment to Rule 144A would permit resales of securities through the use of general solicitation so long as purchasers are reasonably believed to be QIBs, even if offers (vs. sales) are made to persons other than QIBs.

Contact

We will continue to monitor the SEC's rulemaking in this area. If you have any questions regarding the SEC's proposed rules, please contact Janet Lowder (<http://www.wcsr.com/lawyers/janet-d-lowder>), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: <http://www.wcsr.com/profSearch?team=corporateandsecurities>.

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