SUTHERLAND

LEGAL ALERT

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Private Offerings: The SEC Lifts Ban on General Solicitation But Proposes a Hefty Regulatory Burden in Return

During an open meeting of the U.S. Securities and Exchange Commission (the SEC) on July 10, 2013, the SEC adopted a rule that lifts the ban on general solicitation of unregistered securities offerings and paves the way for widespread advertising of private securities issuances, including sales of interests by private funds, such as hedge funds and private equity funds. The SEC also adopted a rule that prohibits certain "bad actors" from taking part in such offerings. Finally, the SEC proposed new rule and form amendments that seek to monitor the advertising practices of unregistered offerings. Combined, the new rules will have a lasting impact on the securities industry, and particularly, the private fund industry.

I. Lifting the Ban on General Solicitation

Background

Pursuant to Section 201(a) of the Jumpstart Our Business Startups Act (the JOBS Act), signed into law by President Obama on April 5, 2012, the SEC has amended Regulation D to add new Rule 506(c) under the Securities Act of 1933, as amended (the Securities Act).[1] After much debate in the industry, and nearly a year after its Congressionally mandated deadline, the SEC adopted new provisions that are substantially similar to those proposed by the SEC last year.[2] As the Adopting 506(c) Release notes, "commenters were sharply divided in their views" on the proposed changes to the general solicitation rules. Many viewed these rules as a welcome change that will foster economic growth in the United States. Others viewed them as a travesty, effectively gutting investor protection rules.[3] In the end, however, Chairman Mary Jo White urged passage of the new provisions given, in her words, "the explicit language of the JOBS Act as well as the statutory deadline that passed last July."[4]

What Changed

Section 201(a) of the JOBS Act directed the SEC to amend its rules to eliminate the ban on general solicitation in connection with privately offered securities. Previously, issuers that offered and sold unregistered securities in reliance on Regulation D were prohibited from engaging in general solicitation in connection with such sales. Rather, the issuers typically offered and sold securities to those persons with whom they had a pre-existing substantive relationship. As a result of these changes, issuers of

[1] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A offerings, SEC Rel. No. 33-9415 (July 10, 2013) (hereinafter, the Adopting 506(c) Release).
[2] *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, SEC Rel. No. 33-9354 (Aug. 29, 2012).
[3] For instance, SEC Commissioner Luis A. Aguilar stated during the open meeting: "Obviously, I am disappointed and saddened by the reckless adoption of the amendments to Rule 506 without appropriate safeguards. I know that many on the staff share my concerns. I want to encourage you to fight on behalf of investors. They will need you now more than ever."
[4] Chairman Mary Jo White, Statement at the Open Meeting, U.S. Securities and Exchange Commission, Washington, D.C. (July 10, 2013).

unregistered securities, including interests in private funds such as hedge funds and private equity funds, may engage in general solicitation and advertising when offering their securities, so long as purchasers of the securities are "accredited investors" and the issuer has taken reasonable steps to verify that the purchasers are indeed accredited investors.

Under new Rule 506(c) under the Securities Act, an issuer may engage in general solicitation or general advertising in connection with an offer of unregistered securities. In order to rely on Rule 506(c), (i) all investors in the offering must be "accredited investors," as defined in Rule 501, and (ii) the issuer must take reasonable steps to verify that such purchasers are accredited investors.[5] The new rule does not include an exception for up to 35 unaccredited investors (like that contained in Rule 506(b)).

In short, the lifting of the ban permits what was previously prohibited. Issuers relying on Rule 506(c) may now widely market their securities, via any source of media such as television, radio, print, and the Internet, without running afoul of the federal securities laws.

Importantly, the changes only affect Rule 506(c) offerings; Rule 506(c) was promulgated under Securities Act Section 4(a)(2), which provides an exemption from the registration of securities "not involving a public offering." Accordingly, issuers that elect to rely on Section 4(a)(2) outside of Rule 506(c) still are prohibited from engaging in general solicitation.

What Did Not Change

The SEC retained existing Rule 506(b), which prohibits general solicitation. Accordingly, issuers may now (i) continue to rely on Rule 506(b) and refrain from making a general solicitation, or (ii) rely on new Rule 506(c), which permits general solicitation, so long as the issuer takes reasonable steps to verify that all purchasers are accredited investors. Thus, issuers are presented with a choice: to advertise, or not to advertise. Issuers that believe they do not need to engage in widespread marketing efforts to sell their securities may elect to rely on Rule 506(b), which does not require them to take steps to verify the accredited investor status of investors. Alternatively, those issuers that believe there is a benefit to public marketing may elect to rely on Rule 506(c), and subject themselves to the verification requirements (and the additional requirements as set forth in the Proposing Release, discussed below). Additionally, to the extent an issuer wishes to sell interests to a small number of unaccredited investors, it may only rely on the Rule 506(b) exemption.[6] Importantly, once an issuer begins to engage in a general solicitation under Rule 506(c), it may not elect to rely on Rule 506(b) at a later point in time.

Reasonable Steps to Verify Accredited Investor Status

As noted above, an issuer relying on the new rule must take "reasonable steps to verify" that purchasers of the securities are accredited investors. In response to a number of commenters requesting the SEC to provide examples of "reasonable steps," the SEC took a two-fold approach to the issue. The Adopting 506(c) Release states that an issuer may either (i) take a principles-based approach to verify accredited investor status, or (ii) rely on a non-exclusive list of four enumerated methods of verification that are

[5] An accredited investor is any person who the issuer reasonably believes comes within one of several enumerated categories including registered broker-dealers, entities having total assets in excess of $5 million, natural persons whose individual net worth, or joint net worth with a spouse, exceeds $1 million, and natural persons who had individual income in excess of $200,000 in each of the most recent two years or joint income with that person's spouse in excess of $300,000 in each of those years and have a reasonable expectation of reaching the same income level in the current year. *See* 17 C.F.R. § 230.501.

[6] As noted above, Rule 506(b) permits an issuer to issue its interests to up to 35 unaccredited investors.

included in the final rule. The SEC refused to adopt the suggestions of some commenters that the SEC provide specific methods of verification.[7] Accordingly, issuers have some degree of discretion in determining what is "reasonable."

1. Principles-Based Approach

In determining what is reasonable, the Adopting 506(c) Release noted that an issuer must make an objective determination considering the facts and circumstances of the particular offering. Among the factors that should be evaluated, an issuer should consider:

- The nature of the purchaser;
- The amount and type of information the issuer has about the purchaser; and
- The nature and terms of the offering.

The Nature of the Purchaser. The Adopting 506(c) Release states that whether the steps taken to verify the investor are reasonable depends on the type of accredited investor that the purchaser claims to be. For example, certain investors may be accredited investors simply by reason of their status as a broker-dealer or an investment company registered under the Investment Company Act of 1940, as amended (the Company Act). Others may be accredited due to total net worth or annual income. Accordingly, it may be reasonable to verify an entity claiming to be a broker-dealer by reviewing the Financial Industry Regulatory Authority's (FINRA) BrokerCheck website. However, where the purchaser is a natural person, it may be more difficult to verify the person's accredited investor status, and more diligence may be required on the part of the issuer.

Information About the Purchaser. In general, the more information an issuer has about a purchaser regarding its accredited investor status, the fewer steps will be required to verify such status. Thus, if an issuer has actual knowledge that a purchaser is an accredited investor, then the issuer will not need to take any steps to verify this status.[8] The Adopting 506(c) Release suggests that (i) obtaining information from publicly available filings with governmental or regulatory agencies, (ii) obtaining information from third-party sources related to one of the enumerated categories of accredited investor status such as pay stubs for natural persons, and (iii) verification by a third-party upon whom the issuer has a reasonable basis to rely, are examples of the type of information that issuers could review and rely upon. Of note, the SEC suggests that in the future an industry of service providers providing third-party accreditation services, as well as "web-based Rule 506 offering portals," may develop.

Nature and Terms of the Offering. The means of communication may be relevant. For example, an Internet solicitation accessible by anyone likely requires that an issuer take greater measures to verify accredited investor status. In this case, a questionnaire, such as a standard subscription agreement of a private fund, would not suffice. Alternatively, a solicitation through a pre-screened data base hosted by a third-party may suffice provided that the issuer has a reasonable basis to rely on the third-party.

Likewise, the terms of the offering will affect the degree of verification required. For example, in the case of a private fund that requires a minimum investment amount that is sufficiently high so that only

[7] Adopting 506(c) Release at note 115.
[8] *Id.* at note 111.

a person who is accredited could make the investment, it may be reasonable for the issuer not to take steps to verify, other than to confirm that the cash investment is not being financed by a third party (unless there are other facts that indicate the investor is not an accredited investor).

In sum, after taking into account the facts and circumstances of the investor and the transaction, if it appears likely the investor is accredited, the issuer would need to take fewer steps to verify the investor's status, and vice versa.

2. Non-Exclusive Methods of Verifying Accredited Investor Status

In addition to the principles-based method of verification, the new rule provides four non-exclusive methods of verification that, if satisfied, will be deemed to satisfy the verification requirement of Rule 506(c). However, the Adopting 506(c) Release cautions that if the issuer has actual knowledge that the investor is not an accredited investor, the four methods may not be relied upon.

Natural Person Income Test. An issuer may verify whether a natural person meets the income test for the accredited investor standard by: (i) reviewing copies of any IRS form that reports income including, but not limited to, a W-2, Form 1099, K-1 and a copy of a filed Form 1040, for the most recent two years; and (ii) obtaining a written representation from such person that he or she has a reasonable expectation of reaching such income level during the upcoming year. When relying upon spousal income, the issuer should review such documents and receive representations from both spouses.

Natural Person Net Worth Test. When determining accredited status based on a natural person's net worth, an issuer is deemed to have satisfied the verification requirement by (i) reviewing one or more types of documents (which are listed in the rule) evidencing assets, dated within the prior three months, (ii) reviewing a consumer report from at least one of the nationwide consumer reporting agencies, dated within the prior three months, and (iii) obtaining a written representation from the prospective investor that he or she has disclosed all liabilities necessary to establish the net worth requirement. The types of documents that satisfy the asset portion of this verification method include bank statements, brokerage statements, and other statements of securities holdings; certificates of deposit; tax assessments; and appraisal reports by independent third parties. To determine accredited investor status by way of joint net worth with a spouse, the issuer should review such documentation and receive representations from both spouses.[9]

Third-Party Certificate. The third enumerated method for meeting the verification requirement is to obtain a written confirmation from (i) a broker-dealer, (ii) an SEC registered investment adviser, (iii) a licensed attorney, or (iv) a certified public accountant, that such entity has taken reasonable steps to verify that the investor is accredited within the last three months and has determined that the person is indeed an accredited investor. Notably, the Adopting 506(c) Release states that a representation from a third-party not included in one of the four categories also may satisfy the verification requirement, provided the third-party took reasonable steps to verify the accredited status of the prospective investor, and the issuer has a reasonable basis to rely on such verification.

[9] The SEC conceded that privacy concerns may hamper collection of personal documents such as tax returns, income statements and bank statements. Accordingly, the Adopting 506(c) Release notes that a prospective investor may provide redacted versions of such documents. See Adopting 506(c) Release at notes 120 -21.

Existing Investors. Any natural person who has invested in an offering prior to the effective date of the new rule, and who was required to be an accredited investor in such offering, will be deemed to be an accredited investor for any Rule 506(c) offering for the same issuer so long as such person provides a certification that he or she is an accredited investor at the time of the subsequent sale.

Importantly, the grandfathering provision only applies to the same issuer. Thus, in the case of an investment adviser that advises multiple private funds, the adviser could not rely upon this method when an investor who has invested in "Fund A" seeks to invest in "Fund B." However, in the case of a private fund that offers multiple share classes (for example, a hedge fund that offers (i) a Class A option, which invests only publicly-traded securities, and (ii) a Class B option, which includes a 10% allocation to private investments), the adviser could rely on this verification method when an investor who invested in Class A prior to the effective date of Rule 506(c) (and was required to be an accredited investor at such time) seeks to invest in Class B pursuant to a 506(c) offering.

Reasonable Belief Standard

The SEC retained the "reasonable belief" standard of Rule 501(a) in determining whether an investor is an accredited investor. The Adopting 506(c) Release states that the SEC did not believe Congress intended to eliminate this standard when it passed the JOBS Act. The Adopting 506(c) Release goes on to note that so long as the issuer took reasonable steps to verify the accredited investor status of a prospective investor and the issuer had a reasonable belief that such person was accredited, the fact that the issuer later learns the person was not accredited does not preclude the issuer from relying upon Rule 506(c).

Private Funds

Although the JOBS Act does not specifically address the lifting of the prohibition of general solicitation by private funds, the Adopting 506(c) Release makes clear that private funds (including those relying on Sections 3(c)(1) and 3(c)(7) of the Company Act) may engage in general solicitation without running afoul of those exclusions. The SEC reasoned that the language of Section 201(b) of the JOBS Act, which provides that offers and sales under Rule 506 will not be deemed public offerings under the federal securities laws, granted the SEC the authority to extend this relief from the prohibition against general solicitation to the Company Act. Accordingly, private funds may rely on new Rule 506(c).

The SEC received comments voicing concern over the ability of private funds to engage in general solicitation. The SEC appears to have sought to assuage concerns by issuing the Proposing Release (discussed below) and reminding advisers to private funds that such funds remain subject to Rule 206(4)-8 under the Investment Act of 1940, as amended, which prohibits fraudulent behavior of pooled investment vehicles. Finally, the Adopting 506(c) Release suggested that advisers to private funds should review their policies and procedures to ensure they are reasonably designed to prevent fraudulent or misleading fund advertising.

Changes to Rule 144A

Rule 144A was revised to permit offers to be made to persons who are not Qualified Institutional Buyers ("QIBs") so long as the securities sold pursuant to Rule 144A are purchased only by QIBs. Previously, offers and sales of Rule 144A securities could only be made to QIBs.

Changes to Form D

Form D was updated to include a new box to check for issuers relying on Rule 506(c). The Adopting 506(c) Release makes clear that an issuer may not check both the Rule 506(b) box and the Rule 506(c) box for the same offering. The practical result is that issuers should decide prior to making an offering whether they intend to rely on Rule 506(b) (and not engage in general solicitation) or rely on Rule 506(c) (which permits general solicitation so long as the issuer takes reasonable steps to verify that purchasers are accredited investors and reasonably believes such investors are accredited).

Implications for Private Funds

Advisers to private funds now have the option of publicly marketing their private funds. However, before doing so, they must consider whether the administrative burden of taking reasonable steps to verify accredited investor status outweighs the potential appeal of widespread marketing. Some fund sponsors may still wish to rely on the "old rules" for business or other reasons and refrain from general solicitation. This analysis is complicated by the fact that the SEC has proposed additional rules that will add to the administrative burden of those relying on Rule 506(c), such as submitting advertising materials to the SEC, as discussed below.

Private fund sponsors may now be exposed to greater regulatory risk. For example, if private fund sponsors relying Rule 506(c) must submit marketing materials to the SEC, then there is a greater risk that the SEC could find discrepancies between the marketing materials submitted to the SEC and a fund's offering documents. Furthermore, this requirement and potential risk would apply to investment advisers not registered with the SEC. Likewise, nothing in the Proposing Release (discussed below) prevents the SEC staff from sharing such materials with the Division of Enforcement. Private fund sponsors also must consider updating the risk factors section of offering materials to address the new method of offering and the potential risks involved. At a minimum, private fund sponsors should consider updating offering documents to disclose the exemption that the issuer is relying upon (i.e, 506(b) or 506(c)).

Private fund sponsors should analyze these considerations prior to the offering process because, as noted above, once a sponsor engages in general solicitation with respect to a particular offering, it may no longer rely on Rule 506(b) for that offering. Although not explicitly addressed in the Adopting 506(c) Release, it would seem, however, that a sponsor could begin offering a fund under 506(b) and convert it to a 506(c) offering if it determines during the offering that it will engage in general solicitation (if, for example, the sponsor is having difficulties raising capital).

Private fund sponsors that rely on Rule 506(c) should consider updating their subscription documents to include, among other things, certifications that are required as part of the non-exclusive list of verification methods. For example, subscription documents for 506(c) issuances might now need to contain a new section that instructs prospective investors to represent whether they intend to supply the information required in one of the four enumerated verification categories. Subscription documents may also contain another box to be checked by those persons that do not fall under one of the four non-exclusive

enumerated categories. In such cases, the sponsor will need to take reasonable steps to verify the accredited investor status of such persons.

Finally, if a private fund sponsor elects to rely on new Rule 506(c), it should review its existing policies and procedures to ensure they are reasonably designed to prevent fraudulent or misleading fund advertising. Furthermore, sponsors should update their policies and procedures to account for Rule 506(c) offerings if they intend to engage in such offerings. These policies and procedures should include steps the sponsor intends to take to ensure verification of accredited investor status.

II. Final Rule Disqualifying Bad Actors From Participating in Private Placement Offerings

On July 10, 2013, the SEC adopted final rules disqualifying securities offerings involving certain "felons and other 'bad actors'" from relying on the registration exemption provided by Rule 506 of Regulation D. The bad actor disqualification provisions disqualify securities offerings from reliance on Rule 506 if the issuer or other relevant persons (discussed below) have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws. Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act required the SEC to issue disqualification rules for Rule 506 that are "substantially similar" to Rule 262 of Regulation A's bad actor disqualification provisions and to provide an expanded list of disqualifying events. Under the final disqualification provisions adopted by the SEC, codified as a new paragraph (d) of Rule 506, an issuer cannot rely on the exemption provided by Rule 506 if the issuer, or any other person covered under the rule, has a disqualifying event.

The new disqualification provisions are generally consistent with the SEC's proposal,[10] with the following key differences: (a) disqualification will apply only to triggering events occurring after the amendments' effective date while pre-existing matters are subject to mandatory disclosure; (b) there are additional disqualifying events for certain Commodity Futures Trading Commission (CFTC) orders and SEC cease-and-desists orders; and (c) the disqualification now covers a 20% beneficial owner of the issuer's outstanding voting equity securities.

Coverage. The disqualification provisions generally apply to the following categories of persons:

- The issuer and any predecessor of the issuer or affiliated issuer;
- Directors and certain officers, general partners, and managing members of the issuer;
- Any 20% beneficial owner of the voting securities of the issuer;
- Certain promoters;
- Any investment manager of pooled investment funds, and general partners, managing members, and certain officers and directors of such manager, general partner, or managing member; and
- Persons compensated for soliciting investors as well as the general partners, directors, officers, and managing members of any compensated solicitors.

Disqualifying Events. Some of the "bad acts" disqualifying actors from the Rule 506 exemption for a sale of securities are:

[10] Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, SEC Rel. No. 33-9414 (July 10, 2013).

- Criminal convictions, within 10 years before such sale (or five years in the case of issuers, their predecessors and affiliated issuers) in connection with the purchase or sale of any security, making any false filing with the SEC, or arising out of the conduct of certain types of financial intermediaries such as underwriters and broker-dealers;

- Court restraining orders and injunctions (entered within five years before such sale) in connection with the purchase or sale of any security, making any false filing with the SEC, or arising out of the conduct of certain types of financial intermediaries such as underwriters and broker-dealers; and

- Final orders from the CFTC, federal banking agencies, the National Credit Union Administration, or state regulators of securities, insurance, banking, savings associations, or credit unions that:
    - Bar the issuer from associating with a regulated entity, engaging in the business of securities, insurance or banking, or engaging in savings association or credit union activities, or
    - Are based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct entered within 10 years before such sale.

Pre-Existing Event Disclosure. An issuer must provide each purchaser, within a reasonable time prior to the sale, a written description of any matters that would have triggered disqualification under the amendments but occurred before their effective date. Failing to provide such information shall not prevent an issuer from relying on Rule 506 if the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known of the existence of the undisclosed matter(s). The issuer will not be able to establish that it exercised reasonable care unless it made, in light of the circumstances, a factual inquiry into whether any disqualifications exist.

Effective Date. The rule amendments will become effective within 60 days after publication in the Federal Register.

III. Proposed Changes to Private Offering Rules

In a series of changes intended to enhance the SEC's ability to evaluate market practices in Rule 506 offerings and to address issues that may arise with general solicitations and general advertising the SEC proposed a third set of rule and form amendments (the Proposal).[11] In addition, the SEC staff has begun a review of the definition of "accredited investor" to see if it should be updated. Various aspects of the Proposal are discussed below.

Temporary Requirement to Submit General Solicitation Materials to the SEC

Under the Proposal, issuers conducting offerings in reliance on Rule 506(c) under the Securities Act would be required to submit to the SEC any written general solicitation materials prepared by or on behalf of the issuer and used in connection with the offering. The written general solicitation materials would be required to be submitted no later than the date of the first use of such materials in the offering. Materials

[11] *See* Amendments to Regulation D, Form D and Rule 156 under the Securities Act, SEC Rel. No. 33-9416 (July 10, 2013) (the Proposing Release).

submitted to the SEC would not be available to the general public. The SEC is proposing this requirement as a temporary rule that would expire two years after its effective date.

Compliance with the submission requirement would not be a condition of Rule 506(c). Instead, the Proposal would make Rule 506 unavailable for an issuer if such issuer (or any predecessor or affiliate) has been subject to any order, judgment or court decree enjoining such person for failure to comply with this requirement.

Notably, this requirement also applies to private fund sponsors that are not registered as investment advisers with the SEC because they lack sufficient assets or are otherwise exempt. For example, "exempt reporting advisers" that rely on Section 506(c) would be required to file marketing materials. Furthermore, this requirement applies to private fund sponsors that are registered with the securities authority of one or more states, or not registered with any regulatory authority. Thus, the SEC has gained some degree of regulatory oversight over advisers that are not registered with the agency. Such sponsors should carefully consider this regulatory oversight prior to electing to engage in a Section 506(c) offering.

Disqualification of Rule 506(b) and Rule 506(c) Issuers Who Fail to File Form D

Under the Proposal, an issuer of either a Rule 506(b) or Rule 506(c) offering would be disqualified automatically from relying on the Rule 506 exemption in any new offering for one year if the issuer or any predecessor or affiliate[12] did not comply, within the past five years, with the Form D filing requirements. This one-year disqualification period would commence following the filing of all required Form D filings or, if the offering has been terminated, following the filing of a closing amendment.

The proposed disqualification would not affect offerings of an issuer or an affiliate that are ongoing at the time of the filing non-compliance, including the offering for which the issuer failed to make a required filing; these offerings could continue to rely on Rule 506 as long as the conditions of Rule 506 continue to be met. Disqualification would apply only to future offerings and only with respect to non-compliance with the Form D filing requirement that occurs after the effectiveness of the new disqualification rule. In addition, the five-year look-back period would not extend prior to the effective date of the rule, so that issuers seeking to conduct a Rule 506 offering would assess compliance with the Form D filing requirement by looking back only to the effective date of the disqualification rule. Because the disqualification would be triggered automatically by a failure by the issuer or any predecessor or affiliate to comply with the filing requirement, issuers would need to take special care to verify that predecessors and affiliates have complied with the requirement during the previous five years before engaging in a Rule 506(c) offering.

Issuers would be able to rely on a 30-calendar day cure period that would allow issuers to correct a failure to file a Form D or Form D amendment on a timely basis. However, the proposed cure period would be available only for an issuer's initial failure to file timely a Form D or Form D amendment in connection with a particular offering. The SEC staff can waive a disqualification, but only if the issuer can demonstrate good cause that it is not necessary to deny the exemption.

[12] Pursuant to Rule 501(b), an affiliate of, or person affiliated with, a specified person means 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.

Expansion of Information Requested by Form D

Currently, Form D requires identifying information about the issuer, any related persons, the exemption the issuer is relying on to conduct the offering, and certain other factual information about the issuer and the offering.

Under the Proposal, issuers of both Rule 506(b) and Rule 506(c) offerings would be required to provide substantially more information pursuant to Form D, including the following:

- Information About Controlling Persons. For issuers of Rule 506(c) offerings, Item 3 would be amended to require the name and address of any person who directly or indirectly controls the issuer (in addition to the information currently required for "related persons"). According to the Proposing Release, control persons would include owners of 10% or more of a class of the issuer's equity securities.

- Information on Issuer Size. For issuers of Rule 506(c) offerings, Item 5, which requires information on issuer size, would be amended to replace the "Decline to Disclose" option with a "Not Available to Public" option. The amendment also would effectively prevent any issuers that make information about their revenues or net asset values available in general solicitation materials or other publicly available materials from choosing the "Not Available to Public Option."

- Types of Investors in the Offering. For issuers of Rule 506(b) and Rule 506(c) offerings, Item 14 would be amended to add a table requiring information on the number of natural person and legal entity accredited investors and non-accredited investors that purchased securities in the offering, and the amount raised from each listed category of investors. In addition, new Item 17 would require disclosure of the types of accredited investors that purchased securities in the Rule 506(b) or Rule 506(c) offering, as well as the number of investors within each group of accredited investors.

- Use of Proceeds by Non-Private Fund Issuers. For non-private fund issuers of Rule 506(b) and Rule 506(c) offerings, Item 16 would be amended to require information on 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, otherwise 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 issuers of Rule 506(b) and Rule 506(c) offerings, Item 19 would require disclosure of whether any general solicitation materials were filed with FINRA pursuant to FINRA Rules 5122 and 5123 (where a registered broker-dealer was used in connection with the offering). Moreover, in the case of private fund issuers advised by SEC-registered investment advisers or exempt reporting advisers, Item 20 would require disclosure of the name and SEC file number for each adviser that functions directly or indirectly as a promoter of the issuer.[13]

[13] The definition of promoter in Rule 405 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% or more of any class of securities of the issuer or 10% 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

- Types of General Solicitation. For issuers of Rule 506(c) offerings, Item 21 would require information regarding the types of general solicitation used or to be used (e.g., mass mailings, emails, public websites, social media, print media and broadcast media).

- Methods Used to Verify Accredited Investor Status. For issuers of Rule 506(c) offerings, Item 22 would require information regarding the methods used or to be used to verify accredited investor status (e.g., the principles-based method using publicly available information, documentation provided by the purchaser or a third party, reliance on verification by a third party, or other sources of information; one of the non-exclusive methods listed in Rule 506(c)(2)(ii); or another method).

New Required Legends and Disclosures in General Solicitation Materials

Under the Proposal, issuers would be required to include certain prominent legends in any written general solicitation materials used in a Rule 506(c) offering. In addition, private fund issuers would be required to include certain additional legends and cautionary statements in their general solicitation materials.

The required prominent legends that all issuers must include in their general solicitation materials must state that:

- 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 securities registered under the Securities Act;

- The SEC 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.

Furthermore, the following additional legends would be required for private fund written general solicitation materials:

- A legend on any written general solicitation materials that the securities offered are not subject to the protections of the Company Act;

- With respect to any private fund written general solicitation materials that contain performance data, a legend disclosing that:

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underwriting commissions or solely in consideration of property is not a promoter for these purposes if such person does not otherwise take part in founding and organizing the enterprise.

- 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;
- The performance of the fund may not be directly comparable to the performance of other private or registered funds; and
- Investors may obtain current performance data[14] at either a specified telephone number or website.

Further, if a private fund's written general solicitation materials include performance data, then the Proposal would require such data to be as of the most recent practicable date considering the type of private fund and the media through which the data will be conveyed, and the private fund would be required to disclose the period for which performance is presented.[15]

The requirement to include these legends and disclosures would not be a condition of the Rule 506(c) exemption. Therefore, the failure to include a required legend or disclosure in any written general solicitation materials would not automatically render Rule 506(c) unavailable for the offering. However, Rule 506 would be unavailable for an issuer if it, or any predecessor or affiliate, has been subject to any order, judgment or court decree enjoining such person for failure to comply with these disclosure rules.

Timing of the Filing of Form D

Today, an issuer issuing securities under Rule 506 is required to file a Form D no later than 15 calendar days after the first sale of securities in the offering. Under the Proposal, issuers would have the option of either: (i) filing a preliminary Form D containing only certain information at least 15 calendar days before engaging in general solicitation for a Rule 506(c) offering, and then filing the complete Form D in a subsequent amendment to be filed no later than 15 calendar days after the first sale of securities, or (ii) filing a complete Form D at least 15 calendar days before engaging in general solicitation for a Rule 506(c) offering.

The Proposal also would require filing a final amendment to Form D within 30 calendar days after the termination of any offering conducted in reliance on Rule 506(b) or Rule 506(c). In the Proposing Release, the SEC clarifies that the "termination of an offering" occurs when the final sale of securities in the offering has been made or upon the issuer's determination to abandon the offering. Until the closing amendment is filed, the offering is deemed to be ongoing, and the issuer would be subject to the current Rule 503 requirements to file amendments to Form D at least annually and otherwise as needed.

Extension of Guidance About Misleading Statements to Private Funds

Currently, Rule 156 under the Securities Act provides guidance on when information in sales literature by registered investment companies could be fraudulent or misleading for purposes of the federal securities laws. Under the Proposal, Rule 156 would be extended to the sales literature of private funds. It would apply to all private funds whether or not they are engaged in general solicitation activities. In the

[14] According to the Proposing Release, current performance data would be performance as of the last date on which the private fund customarily determined the valuation of its portfolio securities.
[15] The Proposing Release notes that private funds would not be expected to value their portfolios for the sole purpose of providing updated current performance under these disclosure rules.

Proposing Release, the SEC expressed its view that private funds should now begin considering the principles underlying Rule 156.

Review of the Definition of "Accredited Investor"

The SEC stated in the Proposing Release that the definition of accredited investor for natural persons should be reviewed and, if necessary or appropriate, amended. Accordingly, the SEC staff has begun reviewing the definition of accredited investor relating to natural persons. This review will encompass, among other things, both the question of whether net worth and annual income should be used as the tests for determining whether a natural person is an accredited investor and the question of what the thresholds should be for those and other potential tests.

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