

CHANGES TO SEC REGULATION D – DISQUALIFICATION OF BAD ACTORS AND LIFTING OF THE BAN ON GENERAL SOLICITATION

FREQUENTLY ASKED QUESTIONS

1. Where can one find information as to the events that disqualify a person from being able to rely on Rule 506, and the persons to whom these rules apply?

The events that disqualify a person from being able to rely on Rule 506, and the persons to whom these rules apply are set forth in new Rule 506(d) of Regulation D.

2. Can Broker-Dealers use 506(c) to generally solicit the sale of securities?

Yes. Broker-Dealers may generally solicit under new Rule 506(c), provided that the following conditions are satisfied:

- a. all terms and conditions of Rule 501 and Rules 502(a), which relates to integration of offerings, and 502(d), which relates to resale restrictions, must be satisfied;
- b. all purchasers of securities must be accredited investors; and
- c. the issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors.

Broker-dealers participating in offerings in conjunction with issuers relying on Rule 506(c) continue to be subject to FINRA rules regarding communications with the public, which, among other things, (1) generally require all member communications to be based on principles of fair dealing and good faith, to be fair and balanced, and to provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service; and (2) prohibit broker-dealers from making false, exaggerated, unwarranted, promissory or misleading statements or claims in any communications. *See* FINRA Rule 2210.

3. Are there any special implications for a broker-dealer and its salespersons that participate in an offering exempt under Rule 506(c)?

FINRA members that sell securities in an offering exempt from registration under Rule 506(c) must “(i) submit to FINRA a copy of any private placement memorandum, term sheet or other offering document, including any materially amended versions thereof, used in connection with such sale within 15 calendar days of the date of first sale; or (ii) notify FINRA that no such offering documents were used.” FINRA Rule 5123. Further, salespersons of broker-dealer firms must ensure their firm has authorized their participation in the offering.

4. Are securities sold under new Rule 506(c) considered covered securities?

Yes. New Rule 506(c) offerings are considered covered securities under the National Securities Markets Improvement Act (“NSMIA”). However, issuers must look to each state where they offer or sell their securities to determine any applicable notice filing requirement(s). Issuers should also be aware that fraudulent representations would still make them subject to state law.

5. Can Issuers relying on Rule 506(c) allow investors to “check the box” indicating that they are an accredited investor?

No. New Rule 506(c) permits issuers and broker-dealers to use general solicitation and general advertising to offer their securities provided that (1) the issuer takes reasonable steps to verify that the investors are accredited investors **and** (2) all purchasers of the securities fall within one of the categories of persons who are accredited investors under an existing rule (Rule 501 of Regulation D) or the issuer reasonably believes that the investors fall within one of the categories at the time of the sale of the securities. The determination of the reasonableness of the steps taken to verify an accredited investor is an objective assessment by an issuer. An issuer is required to consider the facts and circumstances of each purchaser and the nature of the offering.

6. Are there any approved methods of verifying an investor’s status as an accredited investor?

The SEC has specified four specific non-exclusive methods of verifying accredited investor status for natural persons that, if used, are deemed to satisfy the verification requirement in Rule 506(c). These methods will not be deemed to satisfy the verification requirement, however, if the issuer or its agent has knowledge that the purchaser is not an accredited investor. These methods of verification are set forth in Rule 506(c)(2)(ii).

7. Can an Investment Adviser offer the same fund via new Rule 506(c) and traditional Rule 506(b) so long as they ensure that any investor contacted through general solicitation is an accredited investor?

No. An issuer must either check the box for a Rule 506(b) offering or a Rule 506(c) offering, but not both. Under new Rule 506(c) all purchasers of the securities must fall within one of the categories of persons who are accredited investors under an existing rule (Rule 501 of Regulation D) or the issuer must reasonably believe that the investors fall within one of the categories at the time of the sale of the securities. Once a general solicitation has been made to the purchasers in an offering, an issuer is not able to rely on Rule 506(b). Accordingly, a fund must either be sold in compliance with 506(b) or new Rule 506(c).

8. Will investment advisers to private funds be allowed to generally solicit their new funds under new Rule 506(c)?

Yes. Section 201(b) of the JOBS Act permits offers and sales of securities under Rule 506(c) by private funds relying on the exclusions from the definition of “investment company” under Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. Accordingly, starting September 23, 2013, private fund advisers may generally solicit the sale of interests in their newly formed funds.

However, please note that private funds engaged in activities regulated by the U.S. Commodity Futures Trading Commission (the “CFTC”), will need to examine whether there are available exemptions before engaging in a Rule 506(c) offering. The CFTC has not yet reconciled their rules, which affect whether certain commodity pool operators (CPOs) will be deemed to be “marketing to the public” as contemplated in certain CPO regulations and exemptions, with the new Rule 506(c).

9. How does the lifting of the ban on general solicitation apply with respect to Rule 144A offerings?

Pursuant to amendments to Rule 144A, securities offered pursuant to Rule 144A are permitted to be offered to persons other than qualified institutional buyers, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are qualified institutional buyers.

10. We have had an ongoing offering under the prior version of Rule 506. Can we now expand the offering to include general solicitation under Rule 506(c)?

Yes. For an ongoing offering under Rule 506 that commenced before September 23, 2013, the issuer may choose to continue the offering in accordance with the requirements of either Rule 506(b) or Rule 506(c). If an issuer chooses to continue the offering in accordance with the requirements of Rule 506(c), any general solicitation that occurs after September 23, 2013 will not affect the exempt status of offers and sales of securities that occurred prior to September 23, 2013 in reliance on Rule 506(b).

11. Can an issuer rely on a third party to verify a person’s status as an accredited investor?

Yes, an issuer will be entitled to rely on a third party that has verified a person’s status as an accredited investor, provided that the issuer has a reasonable basis to rely on such third-party verification.