

## SEC Proposes Roadmap for Advertising in Securities Offerings

September 10, 2012

The US Securities and Exchange Commission ("SEC") has proposed rules eliminating the prohibition against general solicitation and general advertising in securities offerings exempt from SEC registration requirements under Rules 506 and 144A under the Securities Act of 1933 (the "Securities Act"). The rule changes are mandated under Section 201 (a) of the Jumpstart Our Business Startups (JOBS) Act which was signed into law in April and, if ultimately adopted, would represent substantial changes to those rules and greatly facilitate the process for carrying out private placements under those rules.

Proposed Rule 506(c) would permit issuers to use "general solicitation" and "general advertising" in Rule 506 offerings so long as the purchasers are "accredited investors," the issuer takes reasonable steps to verify the accredited investor status, and the offering complies with other existing conditions of Regulation D, of which Rule 506 is a part. Amended Rule 144A would require that securities be sold (instead of offered) exclusively to "qualified institutional buyers" ("QIBs") or to purchasers that the seller and any person acting on behalf of the seller reasonably believe are QIBs, which has the effect of permitting general solicitation and general advertising in Rule 144A resales as well.

### Proposed Amendment to Rule 506

The SEC's proposed Rule 506(c) would allow issuers conducting a Rule 506 offering to engage in general solicitation and general advertising, provided that (i) the issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors, (ii) all purchasers qualify as accredited investors, and (iii) all terms and conditions of Securities Act Rules 501, 502(a) and 502(d), including the restrictions on resale of securities, are satisfied. Currently, Rule 506 offerings are conditioned, among other things, on the absence of any form of general solicitation or general advertising in the offer and sale of the securities. Examples of general solicitation and general advertising include advertisements in newspapers and magazines, unrestricted websites, communications via television and radio, and seminars whose attendees were invited by means of general solicitation or general advertising.

### Reasonable Steps to Verify

The SEC release accompanying the rule proposal does not require issuers to follow specific procedures in order to verify that a purchaser is an accredited investor, but rather states that the reasonableness of the verification is an objective determination, based on the particular facts and circumstances of the transaction. In the proposing release, the SEC provides the following examples of facts and circumstances for issuers to consider when assessing the reasonableness of their procedures: the nature of the purchaser and the type of accredited investor that the purchaser claims to be, the amount and type of information that the issuer has about the purchaser, the nature of the offering (e.g., how the purchaser was solicited) and the terms of the offering (e.g., whether it was subject to a minimum investment amount).

For example, the verification procedures in the case of an entity that claims to qualify as an accredited investor by virtue of being a registered broker-dealer would likely be different from the procedures to verify the status of a natural person who claims to meet the net worth or annual income threshold. The more information an issuer has indicating that a person is an accredited investor, the fewer steps it would have to take to verify that status and vice versa. In the proposing release, the SEC provides that issuers may consider information about accredited investor status from sources such as (i) publicly available regulatory filings (e.g., SEC filings), (ii) third party documents that provide reasonably reliable evidence of accredited investor status (e.g., W-2's or trade publications that disclose average annual compensation) and (iii) third-party verification of accredited investor status, provided that the issuer has a reasonable basis to rely on such verification.

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Issuers should also consider the terms and manner of an offering when evaluating whether their verification steps are "reasonable." For example, an offering with a sufficiently high minimum investment amount so that it is reasonable to expect that only accredited investors could meet it, and in which investors do not finance their cash investments, would likely permit the issuer to take fewer verification steps than an offering with no minimum or in which investors rely on the issuer or third parties for financing. Furthermore, an issuer that solicits new investors through email or a publicly-accessible website would likely have to take greater measures to verify accredited investor status than an issuer relying solely on a registered broker-dealer's database of pre-screened accredited investors. The proposed rule's emphasis on verification underlines the importance for issuers of adequately recording the steps that they undertook to verify accredited investor status.

The SEC reasons in the proposing release that prescribing specific verification procedures would create too high of a burden in some cases and be ineffective in others, and that the proposed facts and circumstances analysis would permit issuers and market participants to adopt diverse, and sometimes innovative, approaches to verification and adapt to changing market practices. The SEC anticipates that many procedures that issuers currently use in their Rule 506 diligence would satisfy the proposed verification requirement under Rule 506(c). The SEC also suggests that third-party verification services may develop in the marketplace, as issuers seek to use cost-effective ways to meet the rule's requirements while expanding their investor base.

### **Accredited Investor Status**

Under the proposed rule, all purchasers must qualify as accredited investors. It is important to note that the proposed rule does not change the definition of "accredited investor" in Rule 501(a). As a result, a purchaser would qualify as an accredited investor for purposes of Rule 506(c) either because the purchaser came within any one of the categories of accredited investor listed in Rule 501(a) or because the issuer *reasonably believed* that they did, at the time of the sale. In the release accompanying the rule proposal, the SEC clarified that even if a person who does not meet the criteria for any category of accredited investor purchases securities in a Rule 506(c) offering, the issuer would still be able to rely on the new exemption provided that the issuer (i) took reasonable steps to verify that the purchaser was an accredited investor and (ii) had a reasonable belief that such purchaser was an accredited investor.

The proposed rule does not alter the availability of existing Rule 506(b), under which issuers can conduct Rule 506 offerings without the use of general solicitation and general advertising. Therefore, issuers who do not seek to engage in general solicitation or general advertising, who simply wish to sell privately to non-accredited investors meeting the existing Rule 506(b) sophistication requirements, or who have pre-existing substantive relationships with investors, can choose to rely on the existing requirements and would not be subject to the heightened verification standards. Issuers would be required to disclose on Form D, which they must file with the SEC in connection with the offering, whether they are issuing the securities under the new Rule 506(c) exemption or the existing Rule 506(b) exemption.

### **Privately Offered Funds**

Under proposed Rule 506(c), privately offered funds (including hedge funds, venture capital funds and private equity funds) also would be allowed to rely on the new rule in order to advertise or make general solicitations under Rule 506 without losing any exemptions for which they would need to qualify under the Investment Company Act of 1940.

### **Proposed Amendment to Rule 144A**

Financial intermediaries acting as initial purchasers in primary offerings of securities frequently rely on Rule 144A to resell those securities immediately after purchase from the issuer without the need for SEC registration. While current Rule 144A does not specifically prohibit general solicitation or general advertising, offers under the current rule only may be made to QIBs after a prior private placement from the issuer to the intermediary, which has the same effect. Under the proposal, Rule 144A would require only that the securities are sold to a QIB or to a purchaser that the seller (and anyone acting on behalf of the seller) reasonably believes is a QIB. References to "offer" and "offeree" would be eliminated.

### **Impact on Regulation S Offerings**

It is important to note that nothing in the proposal would affect the existing restrictions on publicity contained in the safe harbor for offerings of securities made outside the United States without registration under the Securities Act in accordance with Regulation S under that act. For instance, the proposal does not eliminate the prohibition on "directed selling efforts" in the United States included in Regulation S. The SEC did state in the release that concurrent offshore offerings conducted in compliance with Regulation S would not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or 144A, as proposed to be amended, as is the case under existing law.

### **Conclusion**

Until the SEC adopts final rules relating to the proposed amendments, issuers and anyone acting on their behalf should continue to refrain from activities that could be deemed general solicitation or general advertising in Rule 506

offerings and should offer securities only to QIBs in Rule 144A resales.

If the SEC adopts the rules as proposed, they could significantly affect the market for securities offerings. In the proposing release, the SEC stated that permitting general solicitation and general advertising in Rule 506(c) offerings would likely reduce search costs for issuers seeking accredited investors, enable issuers to reach a greater number of potential investors and increase competition among investors, thereby also lowering the cost of capital for issuers. Notably, a direct-to-investor model for financing could eliminate commissions and other costs to issuers associated with hiring broker dealers to place their securities. Investors would likewise be able to identify a greater number of diverse investment opportunities. The lower search costs for both issuers and investors may lead to a shift away from public offerings and other private placements to Rule 506(c) offerings. The proposed changes to Rule 144A would permit information vendors to provide more information about Rule 144A transactions, therefore potentially enhancing the efficiency of the Rule 144A market.

However, a proliferation of advertising for securities offerings could also open up new avenues for fraud, particularly in the case of Rule 506(c) offerings, and it will be important for investors to conduct additional diligence to verify the legitimacy of a Rule 506(c) offering and for issuers to conduct adequate diligence into the accredited investor status of a potential investor. All sales of securities, including those under the new rules, would remain subject to the antifraud provisions of the securities laws.

## **Solicitation of Comments**

The SEC will accept comments on the proposed rules until October 5, 2012. A complete copy of the proposal can be found on the SEC website, available at <http://www.sec.gov/rules/proposed/2012/33-9354.pdf>.

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