



ANGEL CAPITAL ASSOCIATION

New SEC Rules on General Solicitation, Bad Actors, and Proposed Form D

August 6, 2013



Agenda and Presenters

- **Welcome and Moderator:** *Mike Eckert, ACA Vice Chair & Public Policy Chair*
- **Overview of Rules:** *Joe Wallin, Davis Wright Tremaine LLP*
- **What ACA is Doing:** *Jean Peters, ACA Board*
- **Answers to Questions from ACA Members:** *Marianne Hudson, Joe Wallin, Jean Peters, Mike Eckert and:*
 - *Kristen Young, Sullivan & Worcester LLP*
 - *Dan Rosen, ACA Board*
 - *Lori Smith, White and Williams LLP*
- **Audience Q&A**



Technical Stuff

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(*We recommend you use the phone.*)
- Everyone is muted during the presentation
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 - Use the text chat forum for the live Q&A portion of the program. (You can enter a question any time.)
- This program is being recorded and will be archived for viewing



Final Rules: General Solicitation & Bad Actors

- Rules Lifting Ban on General Solicitation, mandated by JOBS Act
 - Rules: www.sec.gov/rules/final/2013/33-9415.pdf
 - Become effective on September 23.
- Rules Prohibiting Bad Actor Participation (required by Dodd-Frank)
 - Rules: www.sec.gov/rules/final/2013/33-9414.pdf
 - Become effective on September 23.



New Rules Permit Both Advertised & “Quiet Deals”

- In the old days, all types of private securities offering were prohibited from using general solicitation
 - “Quiet deals” continue to be allowed under Rule 506(b)
- The SEC added a second type:
 - Generally Solicited Offerings – under Rule 506(c)



Non-Generally Solicited 506(b) “Quiet Deals”

- No general solicitation
- Self-certification by questionnaire or written representation is allowed
 - No additional verification requirements
- The trouble:
 - Some common startup activities and practices may fall under 506(c)
 - Demo days, pitch competitions, blogs, websites, etc.
 - Inadvertent general solicitation puts 506(b) offering into 506(c) arena



Generally Solicited Offerings Require

- All purchasers must be accredited investors
 - Old rule allowing up to 35 non-accredited investors does not apply
- The issuer must take “reasonable steps to verify” that all purchasers are accredited.
 - Check the box self-certification no longer works.
 - SEC: *“We do not believe that an issuer will have taken reasonable steps to verify accredited investor status if it, or those acting on its behalf, required only that a person check a box in a questionnaire or sign a form, absent other information about the purchaser indicating accredited investor status.”*
- Issuers must note on Form D whether they relying on 506(b) or 506(c)



Method for Verification is Principles-Based

- Whether the steps taken are "reasonable" is "an objective determination in the context of the particular facts and circumstances of each transaction," including:
 - nature of the purchaser and the type of accredited investor the purchaser claims to be;
 - amount and type of information the issuer has about the purchaser; and
 - the nature of the offering
 - manner in which the purchaser was solicited
 - terms, such as minimum investment amount.
- Verification standard requires issuer to establish a "reasonable belief" that purchaser is accredited
 - "Absolute proof" is not the standard



SEC Added Four Non-Exclusive “Safe Harbors”

- Issuer *may* use any one of four non-exclusive, non-mandatory methods of verifying a natural person is an accredited investor.
- Issuer will be *deemed* to have taken reasonable steps to verify accredited investor status using any of these options, provided the issuer does not have knowledge that the person is not accredited.
- These safe harbor methods are not required.
 - Safe harbors are non-exclusive and non-mandatory
 - Added only after extensive public comment when rule was proposed
 - SEC emphasizes objective of maintaining “flexibility” in the rule under the principles-based approach



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Optional Safe Harbor	Steps Required for Issue to Verify Accredited Investor (Establish a "Reasonable Belief")
(A) Income Test	<ul style="list-style-type: none">• Review of documents including:<ul style="list-style-type: none">○ IRS Form W-2, 1099, 1040, Schedule K-1, etc.• Written representation from purchaser that he has a reasonable expectation of reaching the income level necessary to qualify in the current year.
(B) Net Worth Test	<ul style="list-style-type: none">• Review of one or more documents that is current within prior 3 months, including:<ul style="list-style-type: none">○ Assets: bank statements, statements of securities holdings, tax assessments, third party appraisals, certificates of deposit, etc.○ Liabilities: consumer credit report from national reporting agency• Written representation from purchaser that all liabilities have been disclosed.
(C) Third-Party Verification	<ul style="list-style-type: none">• Written confirmation from permitted third party that purchaser is an accredited investor• Issuer must take "reasonable steps to verify" that the third party has taken "reasonable steps to verify" the purchaser is accredited.• Permitted 3rd parties: CPA, attorney, registered broker-dealer or investment advisor.• Certification lasts for three months. Any new investments after then need new cert.
(D) Previous Purchaser	<ul style="list-style-type: none">• Written representation from purchaser that she is an accredited investor at the time of sale.



Bad Actor Rule Disqualifies Certain Issuers

- Rule: <http://www.sec.gov/news/press/2013/2013-124-item2.htm>
- Multiple “disqualifying events”
 - Securities-related criminal convictions, injunctions, disciplinary orders, etc.
- No grandfather period (effective 09/23)
 - Issuers in the middle of an offering should start start compliance now
- Issuer must certify there are no bad actors in offering (on Form D)
- Required bad actor diligence may be difficult and cumbersome
 - Issuer must determine who are covered persons
 - Issuer must interview or investigate covered persons, or use other reasonable methods to confirm they are not bad actors
 - Questionnaires, with contractual representations etc., may be a method



New Rule Reg D / Form D Proposed

- Purpose: Enable SEC to monitor market developments re: general solicitation www.sec.gov/rules/proposed/2013/33-9416.pdf
- Requires 15-day advance filing before any general solicitation begins
- Missed deadline must be cured within 30 days; can only do this once
- If missed filing isn't cured, issuer can't reuse any 506 exemption for a year
- All written solicitation material must be furnished to SEC prior to public use
- Legends must be placed on all written general solicitation material
 - Lengthy – longer than a “tweet”
- Extensive additional disclosure required on Form D filing
- Must file terminating Form D within 30 days of the closing of the offering



Proposed Rules Are Highly Problematic

- Highly complex and difficult for startups – probably unworkable
- If startup participates an open pitch day (and must use 506(c))
 - Must file Advance Form D 15 days prior to the event
 - If company fails to file, it is out of compliance
- Can only cure once, and must occur within 30 days
- If not cured, company may not again use Rule 506 for one year



New and Proposed Rules are Not in Sync

- General Solicitation and Bad Actor rules effective 09/23
- Proposed Reg D/Form D rules is still in comment period until 09/23
 - Implementation, if it occurs, will be somewhat later.
 - Commission may extend comment period
- Issuers may choose not to use 506(c) during gap, due to uncertainty
 - Issuers may have no choice if they have participated in a public event or any other form of general solicitation



What is ACA doing?

- Campaign to raise awareness of harm to startup capital formation
 - Media release and extensive coverage of potential for harm to angel group activity
 - WSJ Op-Ed, multiple blogs and media interviews
 - ACA Member Flash Alerts and call to action (ongoing)
 - Templates & means for ACA members, startups and support community to write concern to elected officials, regulators, etc. (WILL BE AVAILABLE THIS WEEK)
- Working with SEC to gain guidance that would establish “Angel Group Membership” as a valid verification standard
- Enlisting support of multiple key federal legislators
- Attending and presenting at multiple administrative and regulatory meetings in August and September
- Preparing comment letter on proposed Form D rules



Key Points

- Angel Group Membership provides better verification than safe harbors
 - Members are known to each other and privately invited or referred
 - Groups emphasize education and best practices, ensuring higher sophistication levels (versus no indication of sophistication from any of the safe harbors)
- Angel Group Membership protects investor privacy and is less costly
 - Alleviates concern about privacy or potential misuse of data
 - Investors do not incur high costs to provide verification
 - Issuers do not need costly procedures to protect confidential financial data
- Angel Group Membership better protects investor suitability
- Angel Group Membership prevents potential disruption of the issuer-purchaser relationship



Your Comments Are Needed!

- SEC comment period on Proposed Rule Form D
 - Open until September 23, 2013: buff.ly/12YAldN
- The SEC proposed these rules based on prior comments received on other proposed rules
- **Your comments are important!**
 - More than 30 comments already received by SEC
 - Startups and other issues are panicked



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Questions Submitted in Advance

We'll follow with your additional questions during the program.

HUDSON



What is the definition of General Solicitation?

What is included and what is not?

- The terms “general solicitation” and “general advertising” are not specifically defined in Regulation D.
- Rule 502(c) provides examples, including
 - Advertisements published in newspapers and magazines;
 - Communications broadcast over television and radio; and
 - Seminars where invitation is by general solicitation advertising.
- SEC interpretative guidance has confirmed that other media qualify
 - Includes unrestricted websites and other social media



Are pitch competitions okay under 506(b)?

- Questions: We are involved with a statewide venture forum
 - What do we need to do differently in our participation?
 - What documentation should entrepreneurs provide?
 - What other preparation should entrepreneurs do?
 - Should participating entrepreneurs file an advance Form D even before 09/23?
- Response: If the general public is invited:
 - Advise companies pitching they are putting themselves into 506(c) box.
 - Advise them to consult with counsel regarding filing of appropriate securities filings.



Which activities are general solicitation? *(This is an evolving gray area)*

- Demo day or pitch contest open to public?
- Startup posts business profile on non-restricted sections of:
 - AngelList, CrunchBase, Gust, Funders Club, etc.?
- Interview about business model with Pando Daily, TechCrunch or other media that routinely cover startups and fundraising?
- Issuer wins a pitch competition, gets accepted by an accelerator, but does not yet have any formal deal terms
 - (Is this “conditioning the market”?)



The Broader the Solicitation, the More Steps Needed to Verify Purchasers are Accredited

- An issuer soliciting investors through a website accessible to the general public, through
 - Widely disseminated email or social media
 - Print media, such as a newspaper
- “Will likely be obligated to take greater measures to verify accredited investor status than an issuer that solicits new investors from a database of pre-screened accredited investors created and maintained by a reasonably reliable third party.”



Are angel group meetings general solicitation?

- They might be. It depends.
 - Any seminar or meeting whose attendees have been invited by any general solicitation or general advertising
 - Angel groups are typically private, and notice provided only on members' password protected website
 - Invited guests may raise issue of whether the meeting is "open."



How can my group just do quiet deals?

- Our group would like to invest in only “quiet” 506(b) deals in the future. What practical steps should we take as a group?
- Is there certain advice or requirements we should provide to entrepreneurs?
 - Do not put notices of meeting dates on an unrestricted website, or emails to non-members
 - Give notice to issuers that your group will only consider 506(b) deals



Is verification requirement different for angel funds?

- It depends on how the fund raises money. An investor in an angel fund would need to provide information necessary to reasonably verify he/she is an accredited investor if the fund invests in 506(c).
- Rules for funds are different than for individuals
 - Information required depends on type of accredited investor the fund is.
- Even if a fund is accredited based on all its investors being accredited, issuers must take reasonable steps to verify from fund that it has taken reasonable steps to verify.
- Reasonable steps will depend on the issuer and type of security
 - May require certification from the fund manager



What should angel group leaders do?

- Angel groups should take extra precautions to advise companies about securities law requirements of 506(c) offerings
- Groups should advise members about potential for additional verification requirements and consequences if they are not met
- Funds raising funds face same rules as other issuers
 - Conduct in 506(c) offers requires additional verification of investors
 - Conduct offerings only under 506(b) and self-certification applies
- Under proposed rules, capital calls pursuant to commitments made upon subscription do not require amendments to Forms D



Summary: What should angel groups do?

- Advise members that additional documentation, potentially including personal financial data, may be required for generally solicited 506(c) offerings
- Encourage members to comment on SEC's proposed rules. See www.saveregd.org
- Use ACA-provided templates (available this week) to comment to regulators, legislators, entrepreneurs and support community
- If guests are invited to your meeting, advise companies this may trigger a general solicitation event, potentially imposing 15-day advance Form D filing under proposed rules



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Q & A

Your Additional Questions

ECKERT



Call to Action

- Please comment on the proposed rules to the SEC
 - ACA will provide groups with template materials this week
- This impacts
 - Entrepreneurs
 - Startup support community
 - Accelerators
 - Incubators
 - Economic development groups
- Get the word out!
- Urge entrepreneurs and the startup support community to review the new and proposed rules, and also to comment to the SEC.