

SEC Approves Advertised Rule 506 Offerings – Bruce E. Methven

Yesterday, July 10, the SEC announced final regulations finally allowing advertised Rule 506 offerings. It is a big change, because since 1933 private-placement offerings have not been allowed public advertising.

Publicly advertised Rule 506 offerings are not allowed yet, though. The SEC specified that the new regulations will go into effect 60 days after the regulations appear in the Federal Register. That should happen any day.

There are some additional restrictions with advertised Rule 506 offerings. Traditional Rule 506 offerings are allowed an unlimited number of accredited investors and up to 35 investors who are non-accredited but sophisticated (in terms of investing). Advertised Rule 506 offerings are limited to accredited investors only. That's a high standard: For individuals it's either \$1 million in net assets excluding the primary residence, or \$200,000 in annual income for the past two years and expected for the current year. (\$300,000 if the spouse's income is included.)

Also, with traditional Rule 506 offerings, the offering company can rely on the investor's responses to an investor questionnaire unless the offering company has some reason to doubt the answers are accurate.

With advertised Rule 506 offerings, the offering company must take reasonable steps under the circumstances to verify that an individual purchaser is an accredited investor. In determining what are reasonable steps, the offeror is to consider:

- 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; and
- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

Those are pretty subjective factors, so the SEC has also designated certain "safe harbor" methods that if followed definitely count as reasonable verification. The individual safe harbors for verification of accredited status are satisfied if the issuer does any one of the following:

- Obtains any IRS form that reports income including but not limited to Form W-2 ("Wage and Tax Statement"), Form 1099 (report of various types of income), Schedule K-1 of Form 1065 ("Partner's Share of Income, Deductions, Credits, etc."), or a copy of a filed Form 1040 ("U.S. Individual Income Tax Return") for the two most recent years, **along with** obtaining a written representation from such person that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year.
- Reviews one or more of the following types of documentation for assets and for liabilities, dated within the prior three months, **and** obtains a written representation from

that person that all liabilities necessary to make a determination of net worth have been disclosed. For assets this is bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments and appraisal reports issued by independent third parties. For liabilities this is a consumer report (also known as a credit report) from at least one of the nationwide consumer reporting agencies **and** a written representation from such person that all liabilities necessary to make a determination of net worth have been disclosed.

- Obtains a written confirmation from a registered broker-dealer, an SEC-registered investment adviser, a licensed attorney, or a certified public accountant that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the prior three months and has determined that such purchaser is an accredited investor.
- With respect to any natural person who invested in the issuer's Rule 506(b) offering as an accredited investor prior to the effective date of the new regulations and remains an investor of the issuer, obtains a certification by such person at the time of the new sale that he or she qualifies as an accredited investor.

The new SEC regulations also provide a nice option for those who want to start (or have already started) a traditional Rule 506 offering. Essentially the offeror can convert the offering to an advertised Rule 506 offering once the new regulations go into effect without affecting the exemption for sales of securities that have already happened. If it were not for this provision, an offeror would probably have to stop its existing traditional Rule 506 offering and then wait six months before starting an advertised Rule 506 offering.

One practical question is whether advertised Rule 506 offerings will result in too many of these offerings chasing too few accredited investors. Only time will tell. Some offerors may want to still use the traditional Rule 506 offering (rather than the advertised version) so that they can have up to 35 non-accredited investors.

--Bruce E. Methven

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