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## SEC Update

September 2012

### SEC Proposes Rule to Allow General Solicitation in Rule 506 Securities Offerings

On August 29, 2012 the Securities and Exchange Commission (“Commission”) proposed a rule that will allow for general solicitation in private securities offerings conducted pursuant to Rule 506 under the Securities Act.

The proposed rule was directed by Congress in the JOBS Act enacted on April 5, 2012. The JOBS Act directs the Commission to amend Rule 506 to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers of the securities are accredited investors. Some commentators have worried that eliminating the prohibition on general solicitation will create opportunities for fraud. The JOBS Act attempts to alleviate this concern by directing the Commission to require issuers making offers and sales pursuant to Rule 506 to take “reasonable steps” to verify that purchasers of the securities are accredited investors.

#### The Proposed Rule

The Commission proposed adding Rule 506(c) to allow companies issuing securities in a private placement pursuant to Rule 506 to use general solicitation and general advertising to offer securities, provided that:

- The issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors; and
- All purchasers of securities are accredited investors, because either:
  - They come within one of the categories of persons who are accredited investors under existing Rule 501; or
  - The issuer reasonably believes that they meet one of the categories at the time of the sale of the securities.

The proposed rule would not remove the historical method under which Rule 506 offerings have generally been conducted. Issuers would still be able to conduct offerings without general solicitation under Rule 506(b). The benefit to preserving this option is that offerings under Rule 506(b) may include up to 35 non-accredited investors and issuers may be comfortable with this manner of complying with Rule 506. If the offering is conducted under proposed Rule 506(c), the issuer would be permitted to advertise or engage in general solicitation but it could not sell securities to any non-accredited investors. If enacted, any offerings under Rule 506(c) would also need to check a box on Form D to indicate that they are relying on the new rule and are engaging in general solicitation in connection with the offering. The Commission indicates that it intends to use this information to determine who is using proposed Rule 506(c) so they can distinguish the offerings under Rule 506 that are using general solicitation from those that are not.

#### Reasonable Steps

The key requirement in the proposed rule is that the issuer take reasonable steps to verify that purchasers of the securities are accredited investors. The JOBS Act gave the Commission the authority to determine what methods should be used to ensure that reasonable steps are taken to verify that purchasers are accredited investors. In the proposed rule, the Commission refrained from providing specific examples of what would constitute reasonable steps in determining an investor’s status. The Commission indicated that they were concerned that any examples it might list would be viewed as the only verification methods that could be relied upon. Instead, the Commission explains in the proposed rule that to form a reasonable basis about the investor’s accredited status the necessary methods will vary based on the facts and circumstances. In short, the rule would provide issuers with flexibility in selecting methods to verify investors’ status. Nevertheless, the Commission does stress the importance of issuers documenting the steps taken to verify that all purchasers are accredited investors.

Instead of providing specific procedures, the Commission laid out three general guidelines to consider when determining what reasonable steps must be taken to verify that the purchasers are accredited investors. These are:

- The nature of the purchaser;
- Information about the purchaser; and
- Nature and terms of the offering.

#### **Nature of the Purchaser**

An accredited investor can fit into one of several categories under Rule 501(a) and the nature of the purchaser will impact the method used to verify status. Methods used to verify whether a natural person is an accredited investor would need to be much different than those used for a bank or trust. For example, certain financial data necessary in the verification process (e.g., value of assets) may be more difficult to acquire from natural persons than entities that are already required to publicly disclose this information. Furthermore, the verification methods may need to vary based on the level of privacy that each investor requires.

#### **Information about the Purchaser**

When verifying accredited investor status, the information available would affect the steps the issuer would need to take. If information is not readily available about a potential investor, the issuer would need to do more work to obtain the information needed to form a reasonable basis that the investor is an accredited investor.

#### **Nature and Terms of the Offering**

The methods through which advertising is conducted or investors are contacted may also affect the steps needed to verify whether those responding to the solicitation are accredited investors. If a communication is transmitted broadly, then the issuer would be more likely to attract non-accredited investors and would need to have a stronger process in place to verify investors' accredited status than if they had directed their communication to a group of investors known to have previously satisfied the definition of an accredited investor. For example, if the offering is widely publicized the issuer may want to consider the need to obtain third party verification by requiring items such as tax returns, bank statements or similar items to confirm accredited investor status. In contrast, if communications were directed exclusively to a group of previously identified accredited investors, the issuer may be comfortable with only having the investors complete a questionnaire.

#### **Conclusion**

Although the proposed rule would give issuers the flexibility to decide what steps are appropriate to form a reasonable basis about a purchaser's status as an accredited investor, the rule does not provide examples of the steps an issuer should take. This will create some uncertainty in offerings of securities conducted under Rule 506.

If you have any questions about the Commission's proposed rule and how it may affect you, please contact any of the following members of the **Corporate Finance and Securities Group**.