

CORPORATE & SECURITIES

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SEC Final Rule Eliminates Advertising Ban in Rule 506 Offerings

By Irvin Brum



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On July 10, 2013, the Securities and Exchange Commission ("SEC") released its long-awaited rules ending an 80-year ban on "general solicitation" by issuers conducting private placements. The rules, contained in an amendment to Rule 506 under Regulation D ("Amendment"), were enacted to implement Section 201(a) of the Jumpstart Our Business Startups Act. Issuers are now free to raise unlimited amounts of capital by advertising their securities offerings anywhere, including newspapers, Twitter and Facebook, so long as all investors are accredited and so long as issuers follow new SEC requirements by confirming the accredited investor status of all investors participating in the offering.

Issuers must confirm accredited investor status by taking "reasonable steps to verify" this status either by applying a "principles-based approach" or through a non-exclusive list of methods established by the Amendment. Issuers relying on the principles-based approach need to consider various factors to help them determine the reasonableness of the steps they can take to verify the investor's accredited status. These factors include the following:

- 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, including 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.

In its release, the SEC noted that no one factor weighs heavier than others in determining the steps to be taken by an issuer in

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confirming an investor's accredited status; rather the factors work as "one cohesive unit" in helping issuers determine what steps are appropriate to be taken under the circumstances.

For those issuers that prefer greater certainty, the Amendment also offers four non-exclusive methods of verifying accredited investor status for natural persons. The SEC makes it clear that an issuer is not required to use any of these four methods to satisfy the verification requirement. Instead, the issuer may apply the principles-based method of the reasonableness standard, discussed above, directly to the facts and circumstances presented by the offering and investors.

The first non-exclusive method that can be used in verifying whether a natural person is an accredited investor relates to the investor's income. This method can be satisfied by reviewing copies for the two most recent years of IRS forms that report income, including Forms W-2, 1099, and 1040, and Schedule K-1. In addition, the issuer must obtain a written representation that the investor has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor for the current year.

The second method relates to a natural person's net worth. An issuer can satisfy this method by reviewing documentation, dated within three months of the offering, and obtaining a written representation from the investor that all liabilities necessary to make a determination of net worth have been disclosed. Review of the following documentation will suffice. For assets: 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: a credit report from at least one of the nationwide major consumer reporting agencies.

The third method is achieved by obtaining 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 within the prior three months to verify that the purchaser is an accredited investor and has determined that the purchaser is an accredited investor.

Finally, the last method relates to accredited investors that have participated in an issuer's prior Rule 506(b) offering. If an investor invested in an issuer's Rule 506(b) offering before the effective date of the new Amendment and is still an investor of the issuer, then the verification requirement is deemed satisfied. The investor must also provide a written certification that at the time of sale he or she qualifies as an accredited investor.

It is important to note that issuers wishing to sell securities under the old regime will not be required to make the extra efforts required by the Amendment to ensure that purchasers are accredited investors. Thus, issuers not engaging in general solicitation will be exempt from the new verification requirements.

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The SEC has not disturbed the status quo for issuers that do not wish to advertise.

The SEC, in its release, noted that in 2012, the estimated capital raised in Rule 506 offerings by operating companies was \$173 billion. Pooled investment funds, such as venture capital funds, private equity funds and hedge funds, accounted for an additional \$725 billion of capital raised through Rule 506 offerings. This suggests that Rule 506 can operate effectively without general solicitation. Nevertheless, the new rules offer issuers much of the flexibility of a public offering under the guise of what is still, technically, a private offering. Whether issuers decide to advertise or not, they still must be cognizant of the new rules and requirements when making the decision to raise capital through a private placement.

Ron Ben-Bassat and Jon Ruiss, Jr., Associates at Ruskin Moscou Faltischek, assisted in the preparation of this article.

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