

## JOBS Act is Not a Regulatory Cure-All for Private Funds

by Kimberly V. Mann

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*The Jumpstart Our Business Startups Act (JOBS Act or Act), which was signed into law on April 5, 2012, could improve substantially the fundraising prospects for private funds. Elimination of the prohibition against general solicitation and general advertising will increase exposure for private funds and, consequently, the pool of prospective investors. Although the JOBS Act and rules to be adopted in connection with the Act will in some ways revolutionize private offerings, it is important for private funds to keep in mind the restrictions on U.S. private offerings that are unaffected by the JOBS Act.*

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General partners, managers and sponsors of private funds often struggle with the prohibition against general solicitation and general advertising as they raise new capital. Non-U.S. private funds, in particular, which may not be subject to similar restrictions under local law, must navigate gingerly around the cumbersome prohibitions. Those funds will enjoy benefits of relaxed offering rules, but should not forget the applicable restrictions that remain for private funds that offer interests in and into the United States.

### Summary of JOBS Act Revisions Directly Affecting Private Offerings by Private Funds

Below is a summary of the revisions mandated by the JOBS Act that directly affect private offerings by private funds.

- Section 201(a) of the JOBS Act directs the U.S. Securities and Exchange Commission (SEC) to revise Rule 506 of Regulation D under the Securities Act of 1933 (Securities Act) by July 4, 2012 to provide that the prohibition against general solicitation and general advertising does not apply to offers and sales of securities made under Rule 506, provided that all purchasers of the securities are accredited investors. The JOBS Act also directs the SEC to devise methods to be used by issuers to verify whether purchasers of securities are accredited investors, and to require issuers to take reasonable steps using those methods to verify that the purchasers of securities in the offering are accredited investors.

- Section 201(b) of the JOBS Act amended Section 4 of the Securities Act to provide that offers and sales of securities that are exempt under Rule 506 will not be deemed public offerings under the federal securities laws as a result of general advertising or general solicitation. The amendment to Section 4 will be important to private funds that advertise because it will help to preserve the availability of exceptions under Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act, which are relied upon for exemption from registration under the Investment Company Act of 1940.
- Section 201(c) of the JOBS Act provides that, in connection with securities offered and sold in compliance with Rule 506, registration as a broker or dealer under Section 15(a)(1) of the Securities Exchange Act of 1934 (Exchange Act) will not be required solely because a person (or such person's associates):
  - operates data bases, websites or other platforms or mechanisms that (A) permit the offer, sale and purchase of securities or the negotiation of or with respect to securities, or (B) permit general solicitation and general advertising,
  - co-invests in the securities or
  - provides ancillary services relating to the securities (such as due diligence or standardized documentation).

In each case, the exemption from registration is available only if such person and any associated person (1) receive no compensation in connection with the purchase and sale of the securities, (2) do not have possession of customer funds or securities in connection with the purchase and sale of securities and (3) are not subject to statutory disqualification.

- Section 501 of the JOBS Act increases from 500 to 2,000 the limit on the number of record holders of equity securities that an issuer may have before the issuer is required to register under Section 12(g) of the Exchange Act, so long as the number of record holders that are not accredited investors does not exceed 499.

### Summary of Restrictions on Private Fund Offerings Not Affected by the JOBS Act

Below is a summary of restrictions on private offerings by private funds that must be considered and complied with, notwithstanding the liberalizations under the JOBS Act.

- **Registration under the Investment Advisers Act of 1940.** The exemptions from registration under the Investment Advisers Act of 1940 (Advisers Act) were not liberalized as a result of enactment of the JOBS Act. Consequently, any investment adviser that relies on an exemption from registration under the Advisers Act will need to consider the effect that any increases in the number of clients and investors in the U.S. and assets under management that may result from general advertising and general solicitation would have on the availability of such exemptions. For example, a foreign private adviser that relies on the exemption from registration contained in Section 203(b)(3) of the Advisers Act would not be eligible to utilize the exemption if it attains more than 14 clients and investors in the U.S. in private funds or aggregate assets under management of \$25 million or more attributable to its clients in private funds. Investment advisers to private funds that engage in general advertising and general solicitation should plan accordingly.
- **Registration of Brokers and Dealers under the Exchange Act.** A general partner, manager, fund sponsor or any other person that solicits investors on behalf of a private investment fund must register with the SEC as a broker or dealer, absent an exemption from registration. Section 201(c) of the JOBS Act provides a limited exemption for offerings under Rule 506; however, that exemption will be useful

only in a very discrete set of circumstances that currently are not widely applicable. Even though general solicitation and general advertising in connection with the placement of securities in Rule 506 offerings will be permitted, brokers and dealers that sell securities in those offerings will still be required to be registered with the SEC, absent an available exemption.

- **Registration under the Investment Company Act.** Although the JOBS Act amended Section 4 to provide that offers and sales exempt from registration under Rule 506 will not be deemed public offerings under the federal securities laws by virtue of the use of general advertising and general solicitation, the exception from the definition of “investment company” provided in Section 3(c)(1) of the Investment Company Act will continue to apply only to private funds whose outstanding securities are beneficially owned by 100 or fewer persons. If an investment fund exceeds 100 beneficial owners as a result of its success with general advertising or general solicitation, the fund must find another available exception or register under the Investment Company Act.
- **Anti-fraud Provisions.** The anti-fraud provisions of the federal securities laws will continue to apply to all private placements conducted in or into the United States. Private funds that use general solicitation or general advertising in connection with a Rule 506 offering should establish processes and procedures to ensure that advertising and solicitation materials and presentations contain full and fair disclosure, are consistent with other disclosure documents and comply with applicable laws. Litigation and enforcement risks will likely be significantly elevated as a result of increased public exposure.
- **Other Considerations.** Private funds (and those acting on their behalf) engaging in general solicitation and general advertising in connection with offers and sales under Rule 506 must continue to consider and comply with advertising and disclosure rules applicable to registered advisers and members of the Financial Industry Regulatory Authority. General partners, managers and fund sponsors should note that the changes effected by the JOBS Act do not apply to any offerings under Section 4(2) of the Securities Act, other than those exempt under Rule 506, or to offerings exempt from registration pursuant to Regulation S under the Securities Act. For example, non-U.S. funds that rely on the exemption available under Regulation S will not be permitted to make directed selling efforts in connection with such offerings, despite the ability to advertise an offering conducted under Rule 506.

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If you have questions, please contact the Pillsbury attorney with whom you regularly work or the author:

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