

Avoiding Problems with Investor Questionnaires

Investor questionnaires are crucial for private placement offerings. Each type of offering has its own requirements for investors. An offering company must have a reasonable belief that the potential investors meet those requirements. That determination must be made before the potential investor can be given offering documents (PPM, business plan, term sheet, etc.) or specifics regarding the offering. This is done by having potential investors complete an investor questionnaire.

The Securities & Exchange Commission (SEC) has made it clear that a minimal “check the box” approach is not sufficient. In other words, you cannot have an investor questionnaire that merely asks “Are you an accredited investor?” and then “yes” and “no” check boxes. What the SEC wants is a questionnaire that requests specific information concerning such things such as the respondent’s investment experience, investment goals, age, employment history, education, income and net worth.

Top management of the offering company must review the questionnaire responses and determine whether the potential investor meets the qualifications for that particular offering. The good news is that management is entitled to rely on the responses unless they have some reason to doubt them. This is so even if the answers later turn out not to be true.

(This is one thing that will change when the portion of the recent JOBS Act allowing public advertising of Rule 506 offerings goes into effect. In exchange for using public advertising, the offeror will have to verify that each investor is accredited. The SEC has not yet issued regulations stating what will be required for verification. For additional information on the JOBS Act, see the previous posts.)

On the other hand, if there is reason to doubt one or more responses, management must ask further questions or must reject that potential investor. For example, if a potential investor appears to be accredited but someone at the offering company has heard that his company just went out of business last week, there is a duty to investigate further.

A number of exemptions allow a class of investors who are not accredited but are sophisticated in terms of investments. Determining whether a potential investor is sophisticated is somewhat subjective compared to the net worth and income requirements for an accredited investor. If an offeror is not sure that a potential investor is sophisticated, the smart approach is to reject that investor.

Finally, because peoples’ circumstances change, investor questionnaires are only good for a year. If an existing investor wants to invest additional money and more than a year has passed, that investor needs to complete a new questionnaire and management needs to review it before allowing the additional investment.

--Bruce E. Methven

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