

SEC Lifts Ban on General Solicitation for Rule 506 Offerings

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On July 10, 2013, the SEC amended Rule 506 of Regulation D as required by Section 201(a) of the JOBS Act, allowing companies to openly advertise the sale of their securities in private offerings.

Under new Rule 506(c), an issuer can offer securities by way of general solicitation, provided that it satisfies the following conditions:

- all terms and conditions of Rule 501;¹ Rule 502(a),² and 502(d);³
- all purchasers of securities must be accredited investors, either because they in fact fall within one of the enumerated categories of persons that qualify as accredited investors or because the issuer reasonably believes that they are accredited investors at the time of the sale of the securities; and
- the issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors.

The Rule 506(c) “reasonable steps” due diligence requirement, as the SEC warns, may require some potential investors to “provide more information to issuers than they currently provide” and issuers “may have to apply a stricter and more costly process to verify accredited investor status than what they currently use.” The term “reasonable” is an objective determination by the issuer based on the particular facts and circumstances of each purchaser and transaction. In clarifying what steps if taken would be reasonable, the SEC also provided a nonexclusive list of four methods for verifying if natural persons are accredited investors. These methods include:

- For accreditation on the basis of income, verification by reviewing copies of the two most recent years’ IRS tax forms that report income;
- For accreditation on the basis of assets, verification by reviewing (1) supporting asset documentation such as bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments and appraisal reports issued by independent third parties; and (2) a written representation by the person dated within the prior three months stating that all liabilities necessary to make a determination of net worth have been disclosed.
- 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 to verify that the purchaser is an accredited investor within the prior three months and has determined that such purchaser is an accredited investor.
- Any natural person who invested in an issuer’s Rule 506(b) offering as an accredited investor prior to the effective date of Rule 506(c) and remains an investor of the issuer, for any Rule 506(c) offering conducted by the same issuer, the issuer is deemed to satisfy the verification requirement in Rule 506(c) with respect to any such person by obtaining a certification by such person at the time of sale that he or she qualifies as an accredited investor.

Rule 506(c) does not impose any formal record keeping requirements but issuers are expected to document the steps taken to verify that purchasers are accredited investors. Such record keeping is necessary because the issuer has the burden of demonstrating that its offering is entitled to an exemption from the registration requirements of Section 5 of the Securities Act.

If the verification of purchasers presents difficulties and issuers do not wish to engage in general solicitation, such issuers still continue to have the ability under Rule 506(b) to conduct Rule 506 offerings subject to the prohibition against general solicitation. The SEC noted that Rule 506(b) represents an important source of capital for issuers of all sizes, and maintains Rule 506(b) availability “for issuers that either do not wish to engage in general solicitation in their Rule 506 offerings (and become subject to the requirement to take reasonable steps to verify the accredited investor status of purchasers) or wish to sell privately to non-accredited investors who meet Rule 506(b)’s sophistication requirements.”

The new Rule 506(c) will become effective 60 days after publication in the Federal Register.

Footnotes

¹Definitions and terms used in Regulation D.

²All sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D.

³Securities cannot be resold without registration under the Securities Act or an exemption, and issuers must exercise reasonable care to assure that the purchasers of the securities are not underwriters.