WILMERHALE

SEC Adopts JOBS Act and Dodd-Frank Act Private Placement Provisions; Proposes Additional Requirements for Private Placement Market

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*A*t an open meeting on July 10, 2013, the Securities and Exchange Commission (SEC):

- approved final rules implementing Section 201(a)(1) of the Jumpstart Our Business Startups Act (the JOBS Act) to eliminate the prohibition on general solicitation and advertising for certain offerings made pursuant to Rule 506 of Regulation D of the Securities Act of 1933 (the Securities Act) and Rule 144A under the Securities Act;
- approved a final rule to disqualify securities offerings involving certain felons and other "bad actors" from reliance on Rule 506, as mandated by Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act); and
- proposed amendments to Regulation D, Form D and Rule 156 under the Securities Act intended to enhance the SEC's ability to evaluate changes in the market and to address the development of practices in Rule 506 offerings.

A summary of each of these items is set forth below.

Elimination of Prohibition on General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings

As required by Section 201(a)(1) of the JOBS Act, the SEC, by a 4-1 vote, adopted amendments to Rule 506 of Regulation D1 to enable issuers to use general solicitation and general advertising in offerings made in reliance on the rule, so long as all purchasers are accredited investors, as defined in Regulation D. In doing so, the SEC added a new paragraph (c) to Rule 506, while preserving in current Rule 506(b) the ability of issuers to conduct Rule 506 offerings subject to the prohibition on general solicitation and general advertising.

As the SEC proposed last summer, an issuer that seeks to use general solicitation and general advertising in a Rule 506(c) offering will be required to take reasonable steps to verify that all purchasers are accredited investors, either because the purchasers are included within one of the

categories of accredited investors in Rule 501 of Regulation D, or because the issuer reasonably believes that the purchaser falls within one of these categories at the time of sale. Although generally consistent with the proposing release, which provided a principles-based framework to verify accredited investor status, the final rule adds a non-exclusive, non-mandatory list of methods by which an issuer may verify accredited investor status of natural persons (provided that the issuer does not otherwise have knowledge that the purchaser is not an accredited investor). The list includes:

- Reviewing any IRS form that reports the purchaser's income for the two most recent years (*e.g.*, a Form W-2 or Form 1099, Schedule K-1 to Form 1065, or Form 1040) and obtaining a written representation from the purchaser that they have a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year.
- Reviewing specified types of documentation dated within the prior three months and obtaining a written representation from the purchaser that all liabilities necessary to make a determination of net worth have been disclosed. With regard to assets, the documentation could include bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments, and appraisal reports from independent third parties and, with regard to liabilities, a consumer report from at least one nationwide consumer reporting agency.
- Obtaining a written confirmation from a third party (a registered broker-dealer or investment adviser, a licensed attorney in good standing, or a certified public accountant who is duly registered and in good standing) that that person or entity has taken reasonable steps to verify the purchaser's accredited investor status within the prior three months and determined that the purchaser is an accredited investor.
- With regard to a prior purchaser in an offering made by the issuer pursuant to Rule 506(b), where that purchaser continues to hold the issuer's securities, obtaining a certification from the prior purchaser that he or she qualifies as an accredited investor.

The SEC makes clear in the rule text and the release discussion that issuers are not required to use any of the listed methods to verify accredited investor status of natural persons and that the methods are merely examples of methods that may be used.

Issuers that conduct offerings without general solicitation and general advertising under the existing exemption provided under Rule 506(b) are not subject to the new verification requirement.

The SEC also amended Form D to add a separate box for issuers to check if they are relying on the new Rule 506(c) exemption permitting general solicitation and general advertising.

Also as required by the JOBS Act, and as was proposed last summer, the SEC adopted amendments to Rule 144A to provide that securities sold in reliance on Rule 144A may be offered to persons other than qualified institutional buyers, or QIBs, including by means of general solicitation, provided that securities are sold only to QIBs or purchasers that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

The rule amendments become effective 60 days after publication in the Federal Register.

Adoption of Bad Actor Disqualification for Rule 506 Offerings

The SEC unanimously adopted amendments to Rule 506 of Regulation D to disqualify issuers in securities offerings involving certain "bad actors" from relying on Rule 506, as required by Section 926 of the Dodd-Frank Act. The final rule is generally consistent with the proposed rule published for comment by the SEC in 2011, but with a few changes that are discussed in more detail below—most significantly, the new disqualification provisions will apply only to triggering events that occur after effectiveness of the rule amendments.

Under the final rule, the Rule 506 exemption will not be available for an offering of securities that involves any of the following Covered Persons with respect to whom a specified disqualifying event has occurred. Covered Persons are:

- the issuer, including any predecessor of the issuer and any affiliated issuer;
- directors, executive officers, other officers participating in the offering, general partners or managing members of the issuer;
- any beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;
- any promoter connected with the issuer in any capacity at the time of the sale;
- any investment manager of an issuer that is a pooled investment fund;
- any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with the sale of securities;
- any general partner or managing member of any such investment manager or solicitor; or
- any director, executive officer or other officer participating in the offering of any such investment manager or solicitor or general partner or managing member of any such investment manager or solicitor.

In a departure from the proposal, the SEC limited the application of the rule to executive officers and other officers who participate in the offering of securities, instead of all officers. In addition, although the SEC had proposed that the rule cover beneficial owners of 10 percent or more of any class of the issuer's securities, the final rule instead covers beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities. The final rule also added investment managers of pooled investment funds to the list of Covered Persons.

Under the final rule, disqualifying events include significant disciplinary events such as criminal convictions, court injunctions and restraining orders, and most types of suspensions and bars from securities self-regulatory organizations, as well as certain SEC disciplinary and cease-and-desist orders and certain types of orders issued by state and federal securities and banking regulators. The final list of disqualifying events is consistent with the rule proposal, except that the SEC has included in the final rule additional disqualifying events for certain orders of the US Commodity Futures Trading Commission and for SEC cease-and-desist orders arising out of scienter-based anti-fraud violations and violations of Section 5 of the Securities Act.

As noted above, disqualifying events that occurred prior to the effective date of the new rules will not

be subject to the disqualification rules. However, the SEC adopted a new requirement that issuers provide written disclosure to investors of matters that would have triggered disqualification, except that they occurred before the effective date of the rules.

The final rule includes, as proposed, a reasonable care exception from disqualification that will apply if an issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of a Covered Person. Consistent with the proposal, the SEC will permit issuers to seek waivers from disqualification upon a showing of good cause and without prejudice to any other SEC action. In addition, under the final rule, disqualification will not apply if the authority issuing the relevant judgment or order determines and advises the SEC that disqualification should not arise.

The rule amendments become effective 60 days after publication in the Federal Register.

Proposals to Enhance the SEC's Ability to Assess Developments in the Private Placement Market

By a 3-2 vote, the SEC proposed new regulations related to private offerings. The proposing release stated that the proposed regulations are intended to enhance the SEC's ability to evaluate the development of market practices in Rule 506 offerings, and to address concerns that may arise in connection with permitting issuers to engage in general solicitation and general advertising under new Rule 506(c).

The proposed regulations would require issuers relying on new Rule 506(c) to file a Form D no later than 15 calendar days before conducting any general solicitation activities. In addition, all issuers relying on Rule 506(b) or (c) would be required to file a Form D no later than 30 calendar days after the termination of the offering. The proposal also would expand the information required to be provided on Form D, including, for Rule 506(c) offerings, the types of general solicitation used and the methods used to verify the accredited investor status of purchasers. The SEC also proposed an amendment to Rule 507 that would disqualify issuers that did not comply with the Form D filing requirements within the preceding five years from using Rule 506 until one year after the required Form D filing(s) are made.

In addition, the SEC proposed a new Rule 509 to require legends in any written general solicitation materials used in an offering relying on Rule 506(c) and additional disclosures for private funds if such materials include performance data. The SEC also proposed to extend to the sales literature of private funds the guidance contained in Rule 156, currently applicable only to investment companies, which addresses when information in sales literature could be fraudulent or misleading for purposes of the federal securities laws. Finally, the SEC proposed a new temporary Rule 510T that would require, for the two years following its adoption, that issuers relying on Rule 506(c) submit soliciting materials to the SEC no later than the date of first use of such materials.

The comment period will be open for 60 days from publication of the proposing release in the Federal Register.

We will follow this Client Alert with a more comprehensive discussion of the new and proposed rules in the near future.

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