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July 22, 2013
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SEC Adopts General Solicitation and Advertising in Certain Private Offerings

On July 10, 2013 and unprecedented change to the 1982 securities law that prohibited general solicitation and advertisement was adopted by the Securities and Exchange Commission. This change in law is different to the Acts of 1933 and '34 for Title III under the Jumpstart Our Business Startup Act (the "JOBS Act") which changes laws that existed for almost 80 years will allow for unaccredited investor to invest in small and medium enterprises via the internet.

The new SEC rules allow an issuer to engage in general solicitation in the private offer and sale of securities as long as (i) all purchasers of the securities are "accredited investors" and (ii) the issuer takes reasonable steps to verify each purchaser's status as such. The SEC provided a non-exclusive list of specific verification methods that an issuer may use to determine whether or not a purchaser qualifies as an accredited investor. If an issuer relies upon one of these methods, it will generally be deemed to have taken reasonable steps to verify a purchaser's accredited investor status.

The SEC also amended its rules concerning the resale of private securities to qualified institutional buyers ("**QIBs**") in order to permit the use of general solicitation by the seller as long as such securities are sold only to persons that the seller reasonably believes are QIBs. Concurrently, the SEC adopted rules that disqualify bad actors from relying on the private placement exemptions afforded by Regulation D under the Securities Act of 1933 (the "**Securities Act**").

Finally, the SEC proposed amendments to the Form D information requirements applicable to private offerings under Regulation D.

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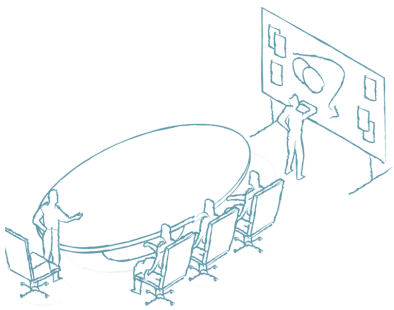
Effective Date. The prohibition against general solicitation and advertising will be effective 60 days after publication to the Federal Register. This may not occur until the public comment period for the Amendment to Regulation D, Form D and Rule 156 concludes; which will be 60 days after publication in the Federal Register, which posted on July 10, 2013. The Commission was explicit in mandating that all the three rules, (i) general solicitation and advertising; (ii) bad actor disqualification rule; (iii) and the amendment to Regulation Form D; must be adopted as a package. This might suggest a November 2013 go-live date.



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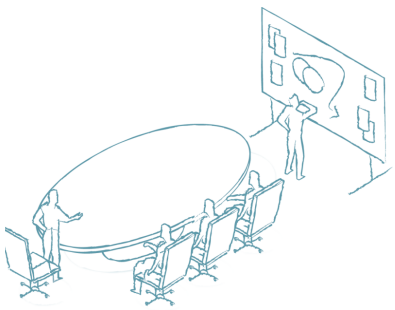
Rule 506 (Rule 506(b)). Will be preserved.
Issuers will continue to have the ability under Rule 506(b) to conduct Rule 506 offerings subject to the prohibition against general solicitation. Offerings under existing Rule 506(b) represent an important source of capital for issuers of all sizes. Retaining the safe harbor under existing Rule 506(b) may also be beneficial to investors with whom an issuer has a pre-existing substantive relationship. Therefore Section 201(a) does not require the Commission to modify Rule 506 to impose any new requirements on offers and sales of securities that do not involve general solicitation. Therefore, the amendment to Rule 506 being adopted does not amend or modify the requirements relating to existing Rule 506(b).

Rule 144A. The SEC amended Rule 144A, which governs institutional resales of private securities, to permit offers of private securities to persons other than QIBs, including by means of general solicitation. However, the offered securities may only be sold to persons whom the seller and any person acting on behalf of the seller reasonably believe to be QIBs. Unlike new Rule 506(c), amended Rule 144A does not contain a separate requirement that the seller take reasonable steps to verify a person's status as a QIB.

Rule 156. Proposed Amendments to Rule 156 under the Securities Act to apply the guidance contained in the rule to the sales literature of private funds. While the adoption of Rule 506(c) is the impetus for proposing amendments to Rule 156 to extend its guidance to private funds, the proposed amendments would apply to all private funds, including private funds engaged in general solicitation activity under Rule 506(c).

Accredited Investor Verification. The SEC has provided a non-exclusive list of methods (in effect, safe harbors) by which an issuer may verify a natural person's accredited investor status. The approach being adopted appropriately addresses the concerns underlying the verification mandate by obligating issuers to take reasonable steps to verify that the purchasers are accredited investors, but not requiring them to follow uniform verification methods that may be ill-suited or unnecessary to a particular offering or purchaser in light of the facts and circumstances. It is expected that such an approach will give issuers and market participants the flexibility to adopt different approaches to verification depending on the circumstances, to adapt to changing market practices, and to implement innovative approaches to meeting the verification requirement, such as the development of reliable third-party databases of accredited investors and verification services. In addition, it is anticipated that many practices currently used by issuers in connection with existing Rule 506 offerings will satisfy the verification requirement for offerings pursuant to Rule 506(c).

Nature and Terms of the Offering. The nature and terms of the offering may be relevant in



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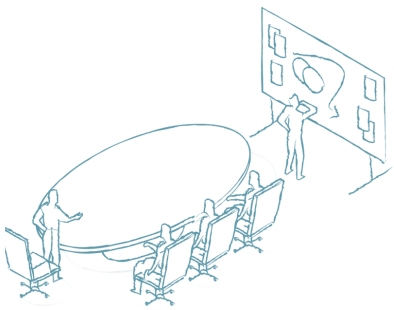
determining the reasonableness of the steps taken to verify accredited investor status.
When an issuer solicits new investors through a website accessible to the general public or through a widely disseminated email or social media solicitation, the issuer would have to take additional steps to verify a purchaser's status. Conversely, an issuer that solicits new investors from a database of pre- screened accredited investors created and maintained by a reasonably reliable third party, such as a registered broker-dealer, would not have to take such measures. An issuer may rely on such verification provided that the issuer has a reasonable basis to rely on such third-party verification.

Form D. In connection with the other amendments to Regulation D, the SEC also proposed to amend Form D, which is the notice that issuers file with the SEC to indicate they have sold securities under Regulation D. As revised, Form D will now require an issuer to disclose whether it has engaged in Rule 506(c) general solicitation activities during its private offering.

Private funds and other issuers who engage in general solicitation in reliance on the Rule 506(c) exemption may not later switch to the Rule 506(b) exemption. In essence, once an issuer chooses general solicitation for an offering, the issuer is precluded from relying on Rule 506(b), which prohibits such activities. However, the reverse is possible, so that private funds and other issuers that are unsure whether they want to adopt the additional compliance measures associated with a Rule 506(c) offering should be able to select the Rule 506(b) exemption at the outset of their offering and subsequently switch to a Rule 506(c) offering if they later determine to engage in general solicitation activities.

Timing for Filing of Form D. This is currently a proposed rule.
The proposal is to amend Rule 503 to require issuers that intend to engage in general solicitation for a Rule 506(c) offering to file an initial Form D in advance of conducting any general solicitation activities. Currently, Rule 503 requires an issuer to file a Form D not later than 15 calendar days after the first sale of securities in a Regulation D offering. Under the proposed amendment, if an issuer has not otherwise filed a Form D for a Rule 506(c) offering, it would be required, at least 15 calendar days before commencing general solicitation for the offering, to file an initial Form D that includes the information required by the following items of Form D (the "Advance Form D").

Fund Integration Issues. The SEC reaffirmed that it will not integrate simultaneous domestic and offshore private offerings even if the issuer engages in general solicitation. However, private fund advisers seeking to sell interests in concurrent offshore and domestic offerings (e.g., the sale of interests in an onshore/offshore master-feeder structure) should be careful to comply with the requirements of Regulation S with respect to the offshore offering and Rule 506 with respect to the domestic offering in order for both offerings to be exempt from registration under the Securities Act.



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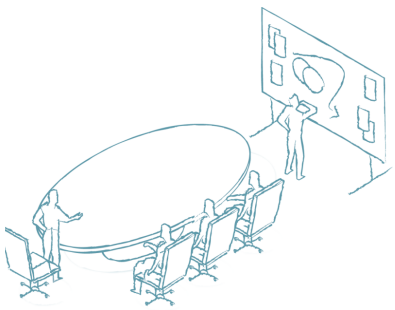
Bad Actors and Disqualification of Felons from Rule 506 Offerings. The SEC adopted amendments that disqualify issuers and market participants from relying on Rule 506 if "felons and other 'bad actors'" participate in the private offering. "Bad actor" disqualification requirements, commonly called "bad boy" provisions, disqualify securities offerings from the Regulation D safe harbor, if the issuer or other relevant persons ("**Covered Persons**") have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws.

The SEC has included within the definition of Covered Persons: (i) any beneficial owner of 20% or more of the issuer's outstanding voting securities; (ii) placement agents and finders; (iii) investment managers to pooled investment funds; and (iv) any general partner, managing member, executive officer and director of any such placement agent or investment manager. The foregoing provisions should be of interest to private fund managers and warrant enhanced due diligence procedures (and possibly additional contractual representations) with respect to new management personnel and placement agents retained by a private fund so as not to render such fund ineligible for the Regulation D exemption.

Implications of New Rules for Private Funds. The SEC's final rules and the corresponding amendments to Regulation D have a number of practical implications for private fund managers:

1. New Rule 506(c) does not contain any restrictions on the forms of general solicitation in which a fund manager can engage. Internet, social media, TV, email, blogs, seminars, press releases and interviews, etc. are all permitted subject to the SEC's general antifraud rules. Once a manager elects to engage in general solicitation activity with respect to an existing fund, it will need to amend the fund's existing Form D to indicate that it is relying on the new Rule 506(c) exemption.
2. Once a manager elects to engage in general solicitation activity in reliance on the new Rule 506(c) exemption, it will need to implement enhanced compliance policies and recordkeeping to document that it is taking "reasonable steps" to ensure that each new investor is an accredited investor. (By contrast existing investors that reinvest only need to self-certify as to their accredited investor status.)
3. Some third party services providers may develop online accredited investor screening platforms which will collect and review required documentation and take other measures to develop a database of pre-screened accredited investors. Fund managers choosing to utilize such a third-party service must obtain a written confirmation of such verification measures from the third party vendor in accordance with the rule.
4. Due to the SEC's heightened focus on the risks and consequences of the new rule, fund managers should carefully review their compliance policies and procedures to ensure that



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they are designed to prevent the use of fraudulent or materially misleading private fund advertising, particularly if the funds intend to engage in general solicitation activity.

5. Many funds that trade commodities rely on the de minimis trading exemption from Commodities Futures Trading Commission (the **"CFTC"**) registration as a commodity pool operator under CFTC Rule 4.13(a)(3), which contains a requirement that the fund not be publicly offered. The CFTC is considering harmonizing Rule 4.13(a)(3) with the SEC's new rules to clarify that general solicitation, as permitted by new Rule 506(c), will not cause a fund to be in violation of the private offering requirement of CFTC Rule 4.13(a)(3). Because the CFTC has not yet issued any guidance or clarification on this issue, it would be prudent for fund managers who rely on the Rule 4.13(a)(3) exemption to wait for CFTC clarification of this issue before engaging in any general solicitation activity with respect to their funds.

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Kim Wales is the founder of Wales Capital, (www.walescapital.com), a strategic business development and technology consultancy that works at the intersection of finance, innovation and entrepreneurship movements related to the JOBS Act, Titles II and III and other global initiatives. She is the a founding member and Executive Board Member of the Crowdfund Intermediary Regulatory Advocates (www.CFIRA.com), Founding Executive of CF50 (www.CF50.com) and former Chairwoman and founding member of the Crowdfunding Professional Association (www.CfPA.org).