

# Proposed Rules

Federal Register

Vol. 77, No. 172

Wednesday, September 5, 2012

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 230 and 239

[Release No. 33-9354; File No. S7-07-12]

RIN 3235-AL34

### Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** We are proposing amendments to Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 to implement Section 201(a) of the Jumpstart Our Business Startups Act. The proposed amendment to Rule 506 would provide that the prohibition against general solicitation and general advertising contained in Rule 502(c) of Regulation D would not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors. The proposed amendment to Rule 506 would also require that, in Rule 506 offerings that use general solicitation or general advertising, the issuer take reasonable steps to verify that purchasers of the securities are accredited investors. The proposed amendment to Rule 144A(d)(1) would provide that securities may be offered pursuant to Rule 144A to persons other than qualified institutional buyers, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are qualified institutional buyers. We are also proposing to revise Form D to add a separate check box for issuers to indicate whether they are using general solicitation or general advertising in a Rule 506 offering.

**DATES:** Comments should be received on or before October 5, 2012.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-07-12 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-07-12. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549-1090 on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

#### FOR FURTHER INFORMATION CONTACT:

Charles Kwon, Special Counsel, or Ted Yu, Senior Special Counsel, Office of Chief Counsel, Division of Corporation Finance, at (202) 551-3500, or, with respect to privately offered funds, Holly Hunter-Ceci, Senior Counsel, Office of Chief Counsel, or Alpa Patel, Attorney-Adviser, Private Funds Branch, Office of Investment Adviser Regulation, Division of Investment Management, at (202) 551-6825 or (202) 551-6787, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

**SUPPLEMENTARY INFORMATION:** We are proposing amendments to Rule 144A,<sup>1</sup>

<sup>1</sup> 17 CFR 230.144A.

Form D,<sup>2</sup> and Rules 500,<sup>3</sup> 501,<sup>4</sup> 502<sup>5</sup> and 506<sup>6</sup> of Regulation D<sup>7</sup> under the Securities Act of 1933.<sup>8</sup>

#### Table of Contents

- I. Introduction
- II. Proposed Amendments to Rule 506 and Form D
  - A. Eliminating the Prohibition Against General Solicitation
  - B. Reasonable Steps to Verify Accredited Investor Status
  - C. Reasonable Belief that All Purchasers Are Accredited Investors
  - D. Form D Check Box for Rule 506(c) Offerings
  - E. Specific Issues for Privately Offered Funds
  - F. Technical and Conforming Amendments
  - G. Request for Comment
- III. Proposed Amendment to Rule 144A
  - A. Offers to Persons Other Than Qualified Institutional Buyers
  - B. Request for Comment
- IV. Integration With Offshore Offerings
- V. General Request for Comment
- VI. Paperwork Reduction Act
- VII. Economic Analysis
  - A. Background and Summary of Proposed Rule and Form Amendments
  - B. Baseline
  - C. Eliminating the Prohibition Against General Solicitation in Rule 506 Offerings and Rule 144A Offerings
  - D. Verifying Accredited Investor Status in Rule 506(c) Offerings
  - E. Form D Check Box for Rule 506(c) Offerings
  - F. Request for Comment
- VIII. Small Business Regulatory Enforcement Fairness Act
- IX. Initial Regulatory Flexibility Analysis
  - A. Reasons for, and Objectives of, the Action
  - B. Small Entities Subject to the Proposed Rule and Form Amendments
  - C. Projected Reporting, Recordkeeping and Other Compliance Requirements
  - D. Duplicative, Overlapping or Conflicting Federal Rules
  - E. Significant Alternatives
  - F. General Request for Comment
- X. Statutory Authority and Text of Proposed Rule and Form Amendments

#### I. Introduction

The Jumpstart Our Business Startups Act (the "JOBS Act") was enacted on April 5, 2012.<sup>9</sup> Section 201(a)(1) of the JOBS Act directs the Commission, not

<sup>2</sup> 17 CFR 239.500.

<sup>3</sup> 17 CFR 230.500.

<sup>4</sup> 17 CFR 230.501.

<sup>5</sup> 17 CFR 230.502.

<sup>6</sup> 17 CFR 230.506.

<sup>7</sup> 17 CFR 230.500 through 230.508.

<sup>8</sup> 15 U.S.C. 77a *et seq.*

<sup>9</sup> Public Law 112-106, 126 Stat. 306.

later than 90 days after the date of enactment, to amend Rule 506 of Regulation D<sup>10</sup> under the Securities Act of 1933 (the “Securities Act”) to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers of the securities are accredited investors. Section 201(a)(1) also states that “[s]uch rules shall require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission.” Section 201(a)(2) of the JOBS Act directs the Commission, not later than 90 days after the date of enactment, to revise Rule 144A(d)(1)<sup>11</sup> under the Securities Act to permit offers of securities pursuant to Rule 144A to persons other than qualified institutional buyers (“QIBs”),<sup>12</sup> including by means of general solicitation or general advertising, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

Rule 506 is a non-exclusive safe harbor under Section 4(a)(2) (formerly Section 4(2)) of the Securities Act,<sup>13</sup> which exempts transactions by an issuer “not involving any public offering” from the registration requirements of Section 5 of the Securities Act.<sup>14</sup> Under existing Rule 506, an issuer may offer and sell securities, without any limitation on the offering amount, to an unlimited number of “accredited investors,” as defined in Rule 501(a) of Regulation D,<sup>15</sup> and to no more than 35

non-accredited investors who meet certain “sophistication” requirements.<sup>16</sup> The availability of the Rule 506 safe harbor is subject to a number of requirements<sup>17</sup> and is currently conditioned on the issuer, or any person acting on its behalf, not offering or selling securities through any form of “general solicitation or general advertising.”<sup>18</sup> Although the terms “general solicitation” and “general advertising” are not defined in Regulation D, Rule 502(c) does provide examples of general solicitation and general advertising, including advertisements published in newspapers and magazines, communications broadcast over television and radio, and seminars whose attendees have been invited by general solicitation or general advertising.<sup>19</sup> By interpretation, the Commission has confirmed that other uses of publicly available media, such as unrestricted Web sites, also constitute general solicitation and general advertising.<sup>20</sup> In this release, we will refer to both general solicitation and general advertising as “general solicitation.”

Rule 144A is a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain “restricted securities”<sup>21</sup> to QIBs. Resales to QIBs in accordance with the conditions of Rule 144A<sup>22</sup> are exempt from registration

D [17 CFR 230.501(a)] and includes any person who comes within one of the definition’s enumerated categories of persons, or whom the issuer “reasonably believes” comes within any of the enumerated categories, at the time of the sale of the securities to that person.

<sup>16</sup> Under Rule 506(b)(2)(ii) [17 CFR 230.506(b)(2)(ii)], each purchaser in a Rule 506 offering who is not an accredited investor must possess, or the issuer must reasonably believe immediately before the sale that such purchaser possesses, either alone or with his or her purchaser representative, “such knowledge and experience in financial and business matters that he [or she] is capable of evaluating the merits and risks of the prospective investment.”

<sup>17</sup> Offerings under Rule 506 are subject to all the terms and conditions of Rules 501 and 502. If securities are sold to any non-accredited investors, specified information requirements apply. See Rule 502(b) [17 CFR 230.502(b)].

<sup>18</sup> Rule 502(c) of Regulation D [17 CFR 230.502(c)].

<sup>19</sup> *Id.*

<sup>20</sup> See *Use of Electronic Media for Delivery Purposes*, Release No. 33-7233 (Oct. 6, 1995) [60 FR 53458] at Ex. 20; *Use of Electronic Media*, Release No. 33-7856 (Apr. 28, 2000) [65 FR 25843] at footnotes 79–80 and accompanying text.

<sup>21</sup> “Restricted securities” are defined in Securities Act Rule 144(a)(3) [17 CFR 230.144(a)(3)] to include, in part, “[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a chain of transactions not involving a public offering.”

<sup>22</sup> In order for a transaction to come within existing Rule 144A, a seller must have a reasonable

pursuant to Section 4(a)(1) (formerly Section 4(1)) of the Securities Act,<sup>23</sup> which exempts transactions by any person “other than an issuer, underwriter, or dealer.” Although Rule 144A does not include an express prohibition against general solicitation, offers of securities under Rule 144A currently must be limited to QIBs, which has the same practical effect. By its terms, Rule 144A is available solely for resale transactions; however, since its adoption by the Commission in 1990, market participants have used Rule 144A to facilitate capital-raising by issuers. The term “Rule 144A offering” in this release refers to a primary offering of securities by an issuer to one or more financial intermediaries—commonly known as the “initial purchasers”—in a transaction that is exempt from registration pursuant to Section 4(a)(2) or Regulation S,<sup>24</sup> followed by the immediate resale of those securities by the initial purchasers to QIBs in reliance on Rule 144A.

Rule 506 offerings and Rule 144A offerings are widely used by U.S. and foreign issuers to raise capital. In 2011, the estimated amount of capital (including both equity and debt) raised in Rule 506 offerings and Rule 144A offerings was \$895 billion and \$168 billion, respectively, compared to \$984 billion raised in registered offerings. In 2010, the estimated amount of capital (including both equity and debt) raised in Rule 506 offerings and Rule 144A offerings was \$902 billion and \$233 billion, respectively, compared to \$1.07 trillion raised in registered offerings.<sup>25</sup>

basis for believing that the offeree or purchaser is a QIB and must take reasonable steps to ensure that the purchaser is aware that the seller may rely on Rule 144A. Further, only securities that were not, when issued, of the same class as securities listed on a U.S. securities exchange or quoted on a U.S. automated interdealer quotation system are eligible for resale under Rule 144A. Also, the seller and a prospective purchaser designated by the seller must have the right to obtain from the issuer, upon request, certain information on the issuer, unless the issuer falls within specified categories as to which this condition does not apply.

<sup>23</sup> 15 U.S.C. 77d(a)(1).

<sup>24</sup> Regulation S under the Securities Act [17 CFR 230.901 through 230.905] was adopted in 1990 as a safe harbor from the registration requirements of the Securities Act for any offer or sale of securities made outside the United States. It provides that any “offer,” “offer to sell,” “sell,” “sale” or “offer to buy” that occurs outside the United States is not subject to the registration requirements of Section 5. Regulation S does not limit the scope or availability of the antifraud or other provisions of the Securities Act to offers and sales made in reliance on Regulation S.

<sup>25</sup> These statistics are based on a review of Form D electronic filings with the Commission—specifically, the “total amount sold” as reported in Form D—and data regarding other types of offerings (e.g., public debt offerings and Rule 144A offerings) from Securities Data Corporation’s New Issues

Continued

<sup>10</sup> The Commission adopted Regulation D in 1982 as a result of the Commission’s evaluation of the impact of its rules on the ability of small businesses to raise capital. See *Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales*, Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251]. Over the years, the Commission has revised various provisions of Regulation D in order to address, among other things, specific concerns relating to facilitating capital-raising as well as abuses that have arisen under Regulation D. See, e.g., *Additional Small Business Initiatives*, Release No. 33-6996 (Apr. 28, 1993) [58 FR 26509] and *Revision of Rule 504 of Regulation D, the “Seed Capital” Exemption*, Release No. 33-7644 (Feb. 25, 1999) [64 FR 11090].

<sup>11</sup> 17 CFR 230.144A(d)(1).

<sup>12</sup> The term “qualified institutional buyer” is defined in Rule 144A(a)(1) [17 CFR 230.144A(a)(1)] and includes specified institutions that, in the aggregate, own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with such institutions. Banks and other specified financial institutions must also have a net worth of at least \$25 million. A registered broker-dealer qualifies as a QIB if it, in the aggregate, owns and invests on a discretionary basis at least \$10 million in securities of issuers that are not affiliated with the broker-dealer.

<sup>13</sup> 15 U.S.C. 77d(a)(2).

<sup>14</sup> 15 U.S.C. 77e.

<sup>15</sup> The definition of the term “accredited investor” is set forth in Rule 501(a) of Regulation

These data points underscore the importance of the Rule 506 and Rule 144A exemptions for issuers seeking access to the U.S. capital markets.

To implement Section 201(a) of the JOBS Act, we are proposing to amend Rule 506 to provide that the prohibition against general solicitation contained in Rule 502(c) shall not apply to offers and sales of securities made pursuant to Rule 506, as amended, provided that all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors. In addition, we are proposing to amend Form D, which is a notice required to be filed with the Commission by each issuer claiming a Regulation D exemption, to add a check box to indicate whether an offering is being conducted pursuant to the proposed amendment to Rule 506 that would permit general solicitation. We are also proposing to amend Rule 144A to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

We have considered comment letters received to date on Section 201(a) of the JOBS Act, and we are requesting comment on various issues relating specifically to the proposed amendments described above.<sup>26</sup> In this

database (Thomson Financial). See Vlad Ivanov and Scott Bauguess, *Capital Raising in the U.S.: The Significance of Unregistered Offerings Using the Regulation D Exemption* (Feb. 2012) (the "Ivanov/Bauguess Study"), available at: [http://www.sec.gov/info/smallbus/acsec/acsec103111\\_analysis-reg-d-offering.pdf](http://www.sec.gov/info/smallbus/acsec/acsec103111_analysis-reg-d-offering.pdf). The amount of capital raised through offerings under Regulation D may be considerably larger than what is reported on Form D because, although the filing of a Form D is a requirement of Rule 503(a) of Regulation D [17 CFR 230.503(a)], it is not a condition to the availability of the exemptions under Regulation D. Further, once a Form D is filed, the issuer is not required to file an amendment to the notice to reflect a change that occurs after the offering terminates or a change that occurs solely with respect to certain information, such as the amount sold in the offering. For example, if the amount sold does not exceed the offer size by more than 10% or the offer closes within a year, the filing of an amendment to the initial Form D is not required. Therefore, a Form D filed for a particular offering may not reflect the total amount of securities sold in the offering in reliance on the exemption.

<sup>26</sup>To facilitate public input on JOBS Act rulemaking before the issuance of rule proposals, the Commission has invited members of the public to make their views known on various JOBS Act initiatives in advance of any rulemaking by submitting comment letters to the Commission's Web site at <http://www.sec.gov/spotlight/jobsactcomments.shtml>. Comment letters received to date on Section 201(a) of the JOBS Act are available at [release, we are proposing only those rule and form amendments that are, in our view, necessary to implement the mandate in Section 201\(a\). We recognize that commentators have urged us to consider and propose other amendments to Regulation D or to Form D that they believe are appropriate in connection with implementation of the rule and form amendments proposed here. For example, several commentators have recommended that the Commission also amend the definition of "accredited investor" as it relates to natural persons.<sup>27</sup> Other commentators have suggested that we amend the Form D filing requirement, including conditioning the availability of the proposed Rule 506 exemption on the filing of Form D,<sup>28</sup> requiring the Form D to be filed in advance of any general solicitation,<sup>29</sup> and adding to the information requirements of Form D.<sup>30</sup>](http://www.sec.gov/comments/jobs-</a></p>
</div>
<div data-bbox=)

*title-ii/jobs-title-ii.shtml*, and we cite to many of them in this release. Comment letters on this release should be submitted as directed in "Addresses" above.

<sup>27</sup> See letters from Cambridge Innovation Center (suggesting that the Commission consider offering investor education classes whereby investors who meet a lower financial threshold but pass a qualifying test could be granted accredited investor status); Fund Democracy, Consumer Federation of America, Consumer Action, AFL-CIO, and Americans for Financial Reform ("Fund Democracy") (recommending higher financial thresholds for natural persons claiming to be accredited investors); Investment Company Institute ("ICI") (May 21, 2012) (recommending increased income and net worth thresholds in the accredited investor definition and inclusion of a new category of "accredited natural persons" in the accredited investor definition); Managed Funds Association ("MFA") (May 4, 2012) (recommending adding "knowledgeable employee" under the Investment Company Act to the definition of "accredited investor"); Public Citizen (recommending higher income and net worth thresholds in the accredited investor definition); Office of the Secretary of the Commonwealth of Massachusetts Securities Division ("Massachusetts Securities Division") (same); Ilan Moscovitz and John Maxfield ("Moscovitz and Maxfield") (same); Ohio Division of Securities ("Ohio Division") (same). One commentator opposed increasing the thresholds for accredited investor status. See letter from National Small Business Association ("NSBA") (June 12, 2012).

<sup>28</sup> See letters from Massachusetts Securities Division ("The filing of a Form D should be a condition of the availability of the new Rule 506 exemption."); North American Securities Administrators Association, Inc. ("NASAA") (July 3, 2012) (recommending that the failure to file a Form D prior to the use of general solicitation must result in the loss of the exemption and warning that without such a filing requirement, regulators would "have no way of knowing whether a promoter is legitimately trying to comply with Rule 506, so a fraudulent offering will be allowed to continue until the regulators have gathered sufficient evidence to prove fraud has already occurred").

<sup>29</sup> See letters from Fund Democracy; NASAA (July 3, 2012); Public Citizen.

<sup>30</sup> See, e.g., letters from NASAA (July 3, 2012) (listing a number of recommended amendments to Form D, such as the disclosure of the issuer's Web site address); Ohio Division (recommending that

Other commentators have suggested that we propose rules governing the content and manner of advertising and solicitations used in offerings conducted under the proposed Rule 506 exemption,<sup>31</sup> particularly with respect to privately offered funds.<sup>32</sup>

We appreciate the suggestions made by these commentators; however, at this time, we are not proposing these or any other amendments to Regulation D or to Form D.

## II. Proposed Amendments to Rule 506 and Form D

### A. Eliminating the Prohibition Against General Solicitation

Section 4(a)(2) exempts transactions by an issuer "not involving any public offering." An issuer relying on Section 4(a)(2) is restricted in its ability to make public communications to attract investors for its offering because public advertising is incompatible with a claim of exemption under Section 4(a)(2).<sup>33</sup> As noted above, Rule 506 currently conditions the availability of the safe harbor under Section 4(a)(2) on the issuer, or any person acting on its behalf, not offering or selling securities through any form of general solicitation.<sup>34</sup> Section 201(a)(1) of the JOBS Act directs the Commission to amend Rule 506 to provide that the prohibition against general solicitation contained in Rule 502(c) shall not apply to offers and sales of securities made pursuant to Rule 506, as so amended, provided that purchasers of the securities are accredited investors. This mandate affects only the Rule 506 safe harbor, and not Section 4(a)(2) offerings in general.<sup>35</sup>

Form D provide more background information to allow broker-dealers, regulators, and investors to assess whether an issuer has been disqualified from using Rule 506).

<sup>31</sup> Letters from NASAA (July 3, 2012) (stating that advertising materials used in Rule 506 offerings should include a "balanced presentation of risks and rewards" and be subject to a requirement that statements in the advertising materials are consistent with representations in the offering documents); Ohio Division (recommending that, among other things, the Commission adopt a uniform set of required disclosures and content restrictions for general solicitation materials, such as a mandatory legend disclosing those jurisdictions where the offering is being made (and disclaiming sales in any others) and a prohibition on financial projections or statements of future performance).

<sup>32</sup> See, e.g., letters from ICI (May 21, 2012); Moscovitz and Maxfield; and Fund Democracy (Aug. 16, 2012).

<sup>33</sup> See *Non-Public Offering Exemption*, Release No. 33-4552 (Nov. 6, 1962) [27 FR 11316].

<sup>34</sup> See Rule 502(c) and Rule 506(b)(1) of Regulation D [17 CFR 230.506(b)(1)].

<sup>35</sup> In this regard, we note that bills that would have amended Section 4(a)(2) itself to permit the use of general solicitation were introduced and considered by Congress but not enacted. See *Access*

To implement the mandated rule change, we are proposing new Rule 506(c), which would permit the use of general solicitation to offer and sell securities under Rule 506, provided that certain conditions are satisfied.<sup>36</sup> These conditions are:

- The issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors;
- All purchasers of securities must be accredited investors, either because they come within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they do, at the time of the sale of the securities;<sup>37</sup> and
- All terms and conditions of Rule 501 and Rules 502(a) and 502(d) must be satisfied.<sup>38</sup>

Offerings under proposed Rule 506(c) would not be subject to the requirement to comply with Rule 502(c), which contains the prohibition against general solicitation.<sup>39</sup>

While we are proposing Rule 506(c) to allow for Rule 506 offerings that use general solicitation, we are preserving, under existing Rule 506(b), the existing ability of issuers to conduct Rule 506 offerings without the use of general solicitation. We recognize that offerings under existing Rule 506 represent an important source of capital for issuers of all sizes and believe that the continued availability of existing Rule 506 will be important for those issuers that either do not wish to engage in general

to Capital for Job Creators, H.R. 2940, 112th Cong. (2011) (proposing to amend Section 4(a)(2) by adding the phrase “whether or not such transactions involve general solicitation or general advertising”); Access to Capital for Job Creators, S.1831, 112th Cong. (2011) (same).

<sup>36</sup> We note that broker-dealers participating in offerings in conjunction with issuers relying on proposed Rule 506(c) would continue to be subject to the rules of the Financial Industry Regulatory Authority (“FINRA”) regarding communications with the public. See FINRA Rule 2210.

<sup>37</sup> Rule 501(a) of Regulation D.

<sup>38</sup> Securities acquired under proposed Rule 506(c) would be subject to the resale limitations under Rule 502(d) [17 CFR 230.502(d)] and therefore would be “restricted securities” as defined in Rule 144(a)(3)(ii) [17 CFR 230.144(a)(3)(ii)]. Further, Section 201(b) of the JOBS Act added Section 4(b) of the Securities Act, which provides that “[o]ffers and sales exempt under [Rule 506 as amended pursuant to Section 201 of the JOBS Act] shall not be deemed public offerings under the Federal securities laws as a result of general advertising or general solicitation.” Thus, securities acquired under proposed Rule 506(c) would also meet the definition of “restricted securities” under Rule 144(a)(3)(i) [17 CFR 230.144(a)(3)(i)] (“[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering”).

<sup>39</sup> Offerings under proposed Rule 506(c) would also not be subject to the information requirements in Rule 502(b), because all purchasers in proposed Rule 506(c) offerings would be accredited investors.

solicitation in their Rule 506 offerings (and become subject to the new 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. Retaining the safe harbor under existing Rule 506 may also be beneficial to investors with whom an issuer has a pre-existing substantive relationship.<sup>40</sup> In this regard, we do not believe that Section 201(a) requires 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 amendments to Rule 506 we are proposing today would not amend or modify the requirements relating to existing Rule 506.

#### *B. Reasonable Steps to Verify Accredited Investor Status*

While Section 201(a)(1) of the JOBS Act mandates that our amendments to Rule 506 require issuers using general solicitation in Rule 506 offerings “to take reasonable steps to verify that purchasers of the securities are accredited investors,” it does not specify the methods necessary to satisfy this requirement and instead requires issuers to use “such methods as determined by the Commission.” We believe that the purpose of the verification mandate is to address concerns, and reduce the risk, that the use of general solicitation under Rule 506 may result in sales to investors who are not, in fact, accredited investors.<sup>41</sup>

<sup>40</sup> In a series of no-action and interpretive letters, the Commission staff has indicated that an issuer would not contravene Rule 502(c)’s prohibition against general solicitation if the issuer has a pre-existing substantive relationship with the offerees. See, e.g., *Mineral Lands Research and Marketing Corp.* (Nov. 3, 1985). The Commission staff has also addressed how an intermediary, such as a broker-dealer acting as a placement agent, can establish a sufficient pre-existing substantive relationship with its customers such that there would be no general solicitation when an issuer engages that intermediary to offer securities to the intermediary’s customers. See, e.g., *E.F. Hutton & Co.* (Dec. 3, 1985). The framework set forth by this staff guidance on pre-existing substantive relationships has also provided flexibility in the use of the Internet in Regulation D offerings. See, e.g., *IPONET* (July 26, 1996); *Lamp Technologies, Inc.* (May 29, 1998).

<sup>41</sup> See, e.g., *Markup of H.R. 2940, Access to Capital for Job Creators Act*, Subcommittee on Capital Markets and Government Sponsored Enterprises, House Financial Services Committee, 112th Cong. (Oct. 5, 2011) (remarks of Representative Waters, explaining that she is introducing the amendment that requires issuers to take reasonable steps to verify accredited investor status because “we must take steps to ensure that those folks are indeed sophisticated”); 157 Cong. Rec. H7291 (daily ed. Nov. 3, 2011) (remarks of Representative Maloney (same)); 157 Cong. Rec. H7294 (daily ed. Nov. 3, 2011) (remarks of Representative Lee (same)).

We also recognize, however, that it would be necessary that our proposed amendment to Rule 506 provide sufficient flexibility to accommodate the different types of issuers that would conduct offerings under proposed Rule 506(c) and the different types of accredited investors (such as natural persons, public and private for-profit and not-for-profit corporations, general and limited partnerships, business and other types of trusts, and funds and other types of collective investment vehicles) that may purchase securities in these offerings.

We are proposing a requirement in Rule 506(c) that issuers using general solicitation “take reasonable steps to verify” that the purchasers of the offered securities are accredited investors. Whether the steps taken are “reasonable” would be an objective determination, based on the particular facts and circumstances of each transaction.

Under this proposed approach, issuers would consider a number of factors when determining the reasonableness of the steps to verify that a purchaser is an accredited investor. Some examples of these factors include:

- The nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- The amount and type of information that the issuer has about the purchaser; and
- The nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

We discuss each of these factors in greater detail below.

*Nature of the Purchaser.* The definition of “accredited investor” in Rule 501(a) includes natural persons and entities that come within any of eight enumerated categories in the rule, or that the issuer reasonably believes come within one of those categories, at the time of the sale of securities to that natural person or entity. Some purchasers may be accredited investors based on their status, such as:

- A broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934 (the “Exchange Act”);<sup>42</sup> or
  - An investment company registered under the Investment Company Act of 1940 (the “Investment Company Act”) or a business development company as defined in Section 2(a)(48) of that Act.<sup>43</sup>
- Some purchasers may be accredited investors based on a combination of

<sup>42</sup> See 17 CFR 230.501(a)(1).

<sup>43</sup> See *id.*

their status and the amount of their total assets, such as:

- A plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5 million;<sup>44</sup> or

- An Internal Revenue Code (“IRC”) Section 501(c)(3) organization, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5 million.<sup>45</sup>

Natural persons may be accredited investors based on either their net worth or their annual income, as follows:

- A natural person whose individual net worth, or joint net worth with that person’s spouse, exceeds \$1 million, excluding the value of the person’s primary residence (the “net worth test”);<sup>46</sup> or

- A natural person who had an individual income in excess of \$200,000 in each of the two most recent years, or joint income with that person’s spouse in excess of \$300,000 in each of those years, and has a reasonable expectation of reaching the same income level in the current year (the “income test”).<sup>47</sup>

As Rule 501(a) sets forth different categories of accredited investors, we expect the steps that would be reasonable for an issuer to take to verify whether a purchaser is an accredited investor under proposed Rule 506(c) would likely vary depending on the type of accredited investor that the purchaser claims to be. For example, the steps that may be reasonable to verify that an entity is an accredited investor by virtue of being a registered broker-dealer—such as by going to FINRA’s BrokerCheck Web site<sup>48</sup>—would necessarily differ from the steps that would be reasonable to verify whether a natural person is an accredited investor.

We recognize that taking reasonable steps to verify the accredited investor status of natural persons poses greater practical difficulties as compared to other categories of accredited investors, and these practical difficulties likely would be exacerbated by natural persons’ privacy concerns about the disclosure of personal financial

information.<sup>49</sup> As between the net worth test and the income test for natural persons, we recognize that commentators have suggested that it might be more difficult for an issuer to obtain information about a person’s assets and liabilities than it would be to obtain information about a person’s annual income,<sup>50</sup> although there could be privacy concerns with respect to either test. The question of what type of information would be sufficient to constitute reasonable steps to verify accredited investor status under the particular facts and circumstances of each purchaser would also depend on other factors, as described below.

*Information about the Purchaser.* The amount and type of information that an issuer has about a purchaser would be a significant factor in determining what additional steps would be reasonable to verify the purchaser’s accredited investor status. The more information an issuer has indicating that a prospective purchaser is an accredited investor, the fewer steps it would have to take, and vice versa.<sup>51</sup> Examples of the types of information that issuers could review or rely upon—any of which might, depending on the circumstances, in and of themselves constitute reasonable steps to verify a

<sup>49</sup> See, e.g., letters from BrokerBank Securities, Inc. (“BrokerBank”) (“By the time most people accumulate a net worth of \$1,000,000+ not counting their principal residence, they usually really want to keep their financial information very close to the vest.”); Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association (“ABA”) (stating that “the Commission should be sensitive to the legitimate privacy concerns of purchasers” when considering the steps that issuers should take to verify accredited investor status); SecondMarket Holdings, Inc. (“SecondMarket”) (“In addition, legitimate privacy concerns may result in potential investors being unwilling to provide highly sensitive personal information outside of a clearly protective framework, which may cause such investors to avoid participating in Rule 506 offerings.”).

<sup>50</sup> See letters from NASAA (July 3, 2012) (“Verification of net worth is more challenging because an individual could provide proof of assets but not liabilities.”); SecondMarket (indicating that, in its experience, the majority of natural persons who indicated that they were accredited investors did so based on the income test of Rule 501(a)(6), which can be verified through tax returns, Form W-2, Form 1099, or other income documentation, in addition to a pay stub from the current year, whereas verifying that a purchaser satisfies the net worth test may be very difficult; therefore, this commentator recommended that a “substantial minimum investment requirement,” coupled with representations by the purchaser, should be deemed sufficient evidence to presume that a purchaser satisfies the net worth test without requiring additional verification of that purchaser’s accredited investor status).

<sup>51</sup> If an issuer has actual knowledge that the purchaser is an accredited investor, then the issuer would not have to take any steps at all.

purchaser’s accredited investor status—include, without limitation:

- Publicly available information in filings with a federal, state or local regulatory body—for example, without limitation:

- The purchaser is a named executive officer of an Exchange Act registrant, and the registrant’s proxy statement discloses the purchaser’s compensation for the last three completed fiscal years; or

- The purchaser claims to be an IRC Section 501(c)(3) organization with \$5 million in assets, and the organization’s Form 990 series return filed with the Internal Revenue Service discloses the organization’s total assets;<sup>52</sup>

- Third-party information that provides reasonably reliable evidence that a person falls within one of the enumerated categories in the accredited investor definition—for example, without limitation:

- The purchaser is a natural person and provides copies of Forms W-2; or

- The purchaser works in a field where industry or trade publications disclose average annual compensation for certain levels of employees or partners, and specific information about the average compensation earned at the purchaser’s workplace by persons at the level of the purchaser’s seniority is publicly available; or

- Verification of a person’s status as an accredited investor by a third party, such as a broker-dealer, attorney or accountant, provided that the issuer has a reasonable basis to rely on such third-party verification.<sup>53</sup>

<sup>52</sup> Such an organization is required to make the Form 990 series returns available for public inspection. See Internal Revenue Service, *Public Disclosure and Availability of Exempt Organizations Returns and Applications: Documents Subject to Public Disclosure*, <http://www.irs.gov/charities/article/0,,id=135008,00.html> (last updated Sept. 21, 2011).

<sup>53</sup> For example, in the future, services may develop that verify a person’s accredited investor status for purposes of proposed Rule 506(c) and permit issuers to check the accredited investor status of possible investors, particularly for web-based Rule 506 offering portals that include offerings for multiple issuers. This third-party service, as opposed to the issuer itself, could obtain appropriate documentation or otherwise verify accredited investor status. Several commentators, in fact, have recommended that the Commission take action to facilitate the ability of issuers to rely on third parties to perform the necessary verification. See letters from NASAA (July 3, 2012) (recommending that the Commission allow an issuer to obtain the necessary verification through registered broker-dealers, provided that there are independent liability provisions for failure to adequately perform the verification); Massachusetts Securities Division (urging the Commission to adopt as a safe harbor or best practice the use of an independent party, such as a broker-dealer, bank, or other financial institution, that would verify the accredited investor status of potential purchasers). One commentator, however, expressed

<sup>44</sup> See *id.*

<sup>45</sup> See 17 CFR 230.501(a)(3).

<sup>46</sup> See 17 CFR 230.501(a)(5).

<sup>47</sup> See 17 CFR 230.501(a)(6).

<sup>48</sup> This Web site is available at <http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/>.

*Nature and Terms of the Offering.* The nature of the offering—such as the means through which the issuer publicly solicits purchasers—may be relevant in determining the reasonableness of the steps taken to verify accredited investor status. An issuer that solicits new investors through a Web site accessible to the general public or through a widely disseminated email or social media solicitation would likely be obligated to take greater measures to verify accredited investor status than 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. In the case of the former, we do not believe that an issuer would have taken reasonable steps to verify accredited investor status if it required only that a person check a box in a questionnaire or sign a form, absent other information about the purchaser indicating accredited investor status. In the case of the latter, we believe an issuer would be entitled to rely on a third party that has verified a person's status as an accredited investor, provided that the issuer has a reasonable basis to rely on such third-party verification.

The terms of the offering would also affect whether the verification methods used by the issuer are reasonable. Some commentators have expressed the view that a purchaser's ability to meet a high minimum investment amount could be relevant to the issuer's evaluation of the types of steps that would be reasonable to take in order to verify that purchaser's status as an accredited investor.<sup>54</sup> We believe that there is merit

concerns that some of the Web sites that currently offer lists of accredited investors could be used to facilitate fraud, noting that some offer lists based on "ethnicity, gender, and lifestyle—presumably to make [it] easier for scammers to relate to marks—and ominously, 'seniors.'" Letter from Moscovitz and Maxfield.

<sup>54</sup> See, e.g., letters from MFA (May 4, 2012) (stating that many hedge funds managed by its members obtain further assurance that investors meet the qualification standards in the Investment Company Act or the Investment Advisers Act of 1940, as applicable, through minimum investment thresholds that meet or exceed the net worth test of the accredited investor definition); NASAA (July 3, 2012) ("For example, if an investor makes an investment of \$1 million in the issuer's securities, it would be reasonable for the issuer to assume that the investor has \$1 million in net worth, even though it is not necessarily a certainty. NASAA would not oppose the creation of this type of specific safe harbor, provided the factors used to demonstrate the requisite net worth are set sufficiently high."); SecondMarket (recommending that a "substantial minimum investment requirement," coupled with representations by the purchaser, should be deemed sufficient evidence to presume that a purchaser satisfies the net worth test without requiring additional verification of that

to this view. By way of example, the ability of a purchaser to satisfy a minimum investment amount requirement that is sufficiently high such that only accredited investors could reasonably be expected to meet it, with a direct cash investment that is not financed by the issuer or by any other third party, could be taken into consideration in verifying accredited investor status.

These factors are interconnected, and the information gained by looking at these factors would help an issuer assess the reasonable likelihood that a potential purchaser is an accredited investor, which would, in turn, affect the types of steps that would be reasonable to take to verify a purchaser's accredited investor status. After consideration of the facts and circumstances of the purchaser and of the transaction, if it appears likely that a person qualifies as an accredited investor, the issuer would have to take fewer steps to verify accredited investor status, and vice versa. For example, if an issuer knows little about the potential purchaser who seeks to qualify under the natural person tests for accredited investor status, but the terms of the offering require a high minimum investment amount, then it may be reasonable for the issuer to take no steps to verify accredited investor status other than to confirm that the purchaser's cash investment is not being financed by the issuer or by a third party, absent any facts that may indicate that the purchaser is not an accredited investor.

Regardless of the particular steps taken, it would be important for issuers to retain adequate records that document the steps taken to verify that a purchaser was an accredited investor. Any issuer claiming an exemption from the registration requirements of Section 5 has the burden of showing that it is entitled to that exemption.<sup>55</sup>

We are mindful of the differing views expressed by commentators to date on how the Commission should implement the verification mandate of Section 201(a). A number of commentators have cautioned that unduly prescriptive or burdensome rules for verifying a purchaser's accredited investor status would have the potential to result in

purchaser's accredited investor status). One commentator, however, disagreed with this approach, noting that "[w]hile a large investment amount may indicate that the investor is wealthy, it also might indicate that a non-wealthy investor is over-concentrated in the investment." Letter from Massachusetts Securities Division.

<sup>55</sup> *SEC v. Ralston Purina*, 346 U.S. 119, 126 (1953) ("Keeping in mind the broadly remedial purposes of federal securities legislation, imposition of the burden of proof on an issuer who would plead the exemption seems to us fair and reasonable.").

significant economic harm, could lead to reluctance on the part of issuers to access the relevant capital markets, or would contravene the purposes of the JOBS Act.<sup>56</sup> Some commentators recommended approaches based on current practices or standards.<sup>57</sup> One commentator, for example, stated that whether a purchaser is an accredited investor depends on the particular facts and circumstances, that the current practices already take these considerations into account, and that the Commission should therefore refrain from imposing any additional burdens on issuers or purchasers.<sup>58</sup> Another commentator expressed similar views, recommending that the Commission adopt a principles-based non-exclusive safe harbor that would be flexible enough to accommodate new offering techniques and that would build on existing practices (such as broker-

<sup>56</sup> See, e.g., letters from Committee on Securities Regulation of the New York City Bar Association ("NYC Bar Association") (stating that unduly detailed or prescriptive verification rules would "have the potential to result in significant economic harm"); SecondMarket (asserting that "[p]lacing too heavy a burden on issuers and investors could have the undesired effect of inhibiting private capital formation" and that "issuers are likely to be unwilling or unable to assume the liability and cost that would arise from a significant documentary verification requirement"); NSBA (Aug. 2, 2012) (stating that "imposing additional burdens on Rule 506 issuers who engage in general solicitation or general advertising would make it more difficult for small firms to raise capital"); Small Biotechnology Business Coalition ("SBBC") (stating that additional burdens on issuers seeking to utilize Rule 506 would make it more difficult for small firms to raise capital, and make it less likely that investors will invest in small firms); ABA (asserting that a verification requirement that imposes additional burdens on issuers or purchasers "would contravene the fundamental impetus for the JOBS Act"); MFA (June 26, 2012) (stating that "overly restrictive procedures \* \* \* would have the effect of thwarting the purposes of Title II of the JOBS Act").

<sup>57</sup> See, e.g., letters from BrokerBank (noting that self-certification of accredited investor status has been the "procedure that has been followed by the industry for decades" and urging the Commission to continue to allow self-certification of accredited status of individuals wishing to participate in Rule 506 offerings that utilize general solicitation); Phillip Goldstein, Bulldog Investors ("Goldstein") (July 18, 2012) (urging that the Commission "promptly create a simple form that an issuer can provide to an investor to certify that he or she is accredited"); MFA (May 4, 2012) (stating that methods similar to those currently used by hedge fund managers, which include the identification by the purchaser of the qualification standards that it meets and minimum investment thresholds, would achieve the objectives of Section 201(a)); Securities Industry and Financial Markets Association ("SIFMA") (urging that the requirement to take reasonable steps to verify should not impose a higher burden than the "reasonable belief" standard currently applicable to Rule 506 offerings and that an issuer should be deemed to have taken reasonable steps to verify if it has reasonable belief that the offeree is an eligible offeree).

<sup>58</sup> Letter from ABA.

dealers' account-opening and suitability procedures).<sup>59</sup>

Other commentators stated that the verification mandate of Section 201(a) requires the Commission to enhance the current standard under which issuers determine that purchasers are accredited investors.<sup>60</sup> In their view, the verification mandate of Section 201(a) calls for a standard that is higher than the current reasonable belief standard in the Rule 501(a) definition of accredited investor and such higher standard is needed in light of the greater likelihood of fraudulent activities resulting from the removal of the prohibition against general solicitation. Therefore, these commentators believe that the Commission must mandate the specific steps that issuers must take in order to form a reasonable belief that a purchaser is an accredited investor.<sup>61</sup>

We also received a number of comments on specific methods that should or should not be viewed as reasonable steps for verifying accredited investor status. For example, some viewed a representation from the purchaser that it is an accredited investor as sufficient,<sup>62</sup> while others asserted that such a representation alone would not be enough.<sup>63</sup> Several commentators stated that the verification of accredited investor status should require the production of documentary evidence.<sup>64</sup> One

commentator recommended that only registered broker-dealers, and not other intermediaries, be permitted to verify accredited investor status on behalf of issuers because registered broker-dealers are subject to existing regulatory schemes, including Commission oversight.<sup>65</sup> Other commentators recommended allowing issuers to rely on third-party firms to verify accredited investor status.<sup>66</sup> Some commentators suggested that purchasers be required to submit a letter from a third party with knowledge of the purchaser's financial status (such as a certified public accountant or attorney) indicating that the purchaser is an accredited investor,<sup>67</sup> while another commentator suggested that, in combination with an independent professional's certification as to the purchaser's accredited investor status, the purchaser be required to certify his or her accredited investor status under penalty of perjury.<sup>68</sup> Another commentator stated that issuers should be allowed to rely on basic information about a purchaser that they may already have (for example, that the purchaser is an officer of a Fortune 500 company).<sup>69</sup> One commentator

to be accredited investors, should review "regulatory letters or certificates approving or confirming the entity's status as a bank, insurance company, registered investment company, business development company, or small business investment company").

<sup>65</sup> Letter from SecondMarket (also suggesting that the Commission establish specific guidelines that registered broker-dealers must follow with respect to the verification process in order to be an approved "accreditation verification provider").

<sup>66</sup> See letters from National Investment Banking Association ("NIBA") (recommending that if a FINRA member firm is not involved in the offering, then the issuer could satisfy the verification mandate by relying on a third-party report obtained from an investigatory firm indicating that a purchaser is an accredited investor; if a broker-dealer is involved in the offering as a placement agent, the issuer could satisfy the verification mandate by obtaining and reviewing a form from the broker-dealer that describes the process undertaken by the broker-dealer to establish accredited investor status for a purchaser); NSBA (Aug. 2, 2012) (stating that "[r]equiring investors to provide to issuers an independent professional's certification as to the investor's accredited investor status and requiring the investor to certify his or her own status under penalty of perjury would provide a high degree of protection against non-accredited investors asserting accredited investor status in Regulation D offerings"); Sigelman Law Corporation (asserting that third-party verification of accredited investor status should not be limited to broker-dealers but that independent third-party professional intermediaries "registered with the Commission and sworn to follow the protocol rules" should be allowed to provide such services).

<sup>67</sup> See letters from Frank Nagy; Williams.

<sup>68</sup> Letter from NSBA (Aug. 2, 2012) (stating that Section 1746 of Title 28 of the United States Code authorizes this approach). One commentator stated that self-certification under penalty of perjury, in and of itself, should be sufficient. Letter from Nimmer.

<sup>69</sup> Letter from AngellList.

suggested that the Commission adopt an approach under which a minimum investment of 50% of the net worth or total assets requirement under the applicable category of accredited investor, coupled with a certification by the investor, would be deemed to constitute "reasonable steps" to verify accredited investor status.<sup>70</sup> Another commentator suggested that investors be permitted to self-certify their accredited investor status so long as at least 30 days have passed between the first date of public solicitation and the date of investment.<sup>71</sup>

We believe that the approach we are proposing appropriately addresses these concerns by obligating issuers to take reasonable steps to verify that the purchasers are accredited investors, as mandated by Section 201(a), but not requiring them to follow uniform verification methods that may be ill-suited or unnecessary to a particular offering or purchaser, given the facts and circumstances. We also expect that such an approach would 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 third-party databases of accredited investors. In addition, we anticipate that many practices currently used by issuers in connection with existing Rule 506 offerings would satisfy the verification requirement proposed for offerings pursuant to Rule 506(c).

We considered but have decided not to propose requiring issuers to use specified methods of verification. We believe that, at present, proposing to require issuers to use specified methods of verification would be impractical and potentially ineffective in light of the numerous ways in which a purchaser can qualify as an accredited investor, as well as the potentially wide range of verification issues that may arise, depending on the nature of the purchaser and the facts and circumstances of a particular Rule 506(c) offering. We are also concerned that a prescriptive rule that specifies required verification methods could be overly burdensome in some cases, by requiring issuers to follow the same steps, regardless of their particular circumstances, and ineffective in others, by requiring steps that, in the particular

<sup>70</sup> Letter from MFA (June 26, 2012).

<sup>71</sup> Letter from SBBC (noting that such a "cooling off" period will help discourage impulse investments and will permit the issuer and the investor to assess one another).

<sup>59</sup> Letter from NYC Bar Association. For example, in connection with complying with anti-money laundering requirements, broker-dealers already obtain certain identifying information about their customers.

<sup>60</sup> See letters from Fund Democracy; Moscovitz and Maxfield; NASAA (July 3, 2012); Ohio Division; Public Citizen.

<sup>61</sup> *Id.*

<sup>62</sup> Letters from Goldstein (June 3, 2012); Mona Shah & Associates; SIFMA; JC Williams II, Tucson Business Development Group ("Williams").

<sup>63</sup> Letters from Fund Democracy (stating that a representation from the purchaser that it is an accredited investor would not satisfy the statutory mandate that the issuer take steps to verify accredited investor status); John C. Nimmer ("Nimmer"); Ohio Division ("A 'check-the-box' approach to investor self-verification of accredited status will not suffice because the Title II issuer must have more than a belief that a prospective purchaser is accredited.').

<sup>64</sup> See letters from Massachusetts Securities Division (stating that verification should require issuers to determine whether investors are accredited based on documentary evidence, rather than just representations from potential investors); NASAA (July 3, 2012) (recommending that the Commission require issuers to obtain documents such as tax returns, recent pay stubs, brokerage statements, tax assessment valuations, appraisals, list of liabilities (including a sworn statement that all material liabilities have been disclosed), organizational documents, balance sheets, and quarterly statements); Ohio Division (recommending that the issuer should "review financial statements and/or tax returns evidencing actual satisfaction of accredited investor thresholds" and, with respect to entities claiming

circumstances, would not actually verify accredited investor status.

For similar reasons, we considered but have decided not to propose providing a non-exclusive list of specified methods for satisfying the verification requirement.<sup>72</sup> We are concerned that, in designating such a list—for example, by setting forth particular types of information that issuers may rely upon as conclusive means of verifying accredited investor status—there may be circumstances where such information would not actually verify accredited investor status or where issuers may unreasonably overlook or disregard other information indicating that a purchaser is not, in fact, an accredited investor. Indeed, a method that is reasonable under one set of circumstances may not be reasonable under a different set of circumstances. In addition, we are concerned that a non-exclusive list of specified verification methods could be viewed by market participants as the required verification methods, in which compliance with at least one of the enumerated methods could be viewed, in the practical application of the verification requirement, as necessary in all circumstances to demonstrate that the verification requirement has been satisfied, thereby eliminating the flexibility that proposed Rule 506(c) is intended to provide. Such flexibility is likely to mitigate the cost to issuers of complying with proposed Rule 506(c) because it would allow them to select the most cost-effective verification method for each offering, based on the particular facts and circumstances of the offering and of the investors.

We are soliciting comment on a variety of possible approaches to verification. In addition, following the completion of this rulemaking, we intend to monitor and study the development of verification practices by issuers, securities intermediaries and others as well as the impact of compliance with this requirement on investor protection and capital formation.

<sup>72</sup> See letters from MFA (June 26, 2012) (suggesting that the Commission publish a non-exclusive list of the types of third-party evidence that an investor could provide to establish accredited investor status, in conjunction with certifying that he or she is an accredited investor); NASAA (July 3, 2012) (recommending that the Commission set forth non-exclusive safe harbors to specify the types of actions that would be deemed “reasonable steps to verify” for three types of accredited investors: natural persons who purport to satisfy the income test; natural persons who purport to satisfy the net worth test; and entities who purport to meet one of the other tests set forth in Rule 501(a)).

### *C. Reasonable Belief That All Purchasers Are Accredited Investors*

A number of commentators have raised concerns that the language of Section 201(a) could be interpreted as precluding the use of the “reasonable belief” standard in Rule 501(a) in determining whether a purchaser is an accredited investor, such that an issuer’s determination as to whether a purchaser is an accredited investor is subject to an absolute, rather than a “reasonable belief,” standard.<sup>73</sup> Section 201(a)(2) of the JOBS Act, which calls for amendments to Rule 144A, specifically refers to a “reasonable belief” standard as to whether a purchaser is a QIB, whereas Section 201(a)(1) does not mention a similar “reasonable belief” standard with respect to the amendments to Rule 506.<sup>74</sup> From this, some commentators have requested that our proposed rule amendments “confirm” that the reasonable belief standard for accredited investor status in Rule 501(a) continues to apply.<sup>75</sup> In their view, issuers may be more reluctant to use general solicitation in Rule 506 offerings if their determinations as to whether a purchaser is an accredited investor are subject to an absolute standard. One commentator added that the Commission should adopt a safe harbor under which an issuer or broker-dealer would not be penalized if it took the steps required by the Commission to verify a purchaser’s accredited investor status, but later learned that the purchaser was not, in fact, an accredited investor.<sup>76</sup> Other commentators have interpreted this omission as indicating Congress’s intent that the Commission “raise the ‘reasonable belief’ standard for Rule 506 offerings. \* \* \* ”<sup>77</sup>

Both Rule 506 and Rule 144A currently provide for a reasonable belief standard regarding the eligibility of an investor to participate in an offering under the respective rules, but they reach that result in different ways. For Rule 506, the Commission chose to include the reasonable belief standard within the Rule 501(a) definition of

<sup>73</sup> See, e.g., letters from ABA; BlackRock, Inc. (“BlackRock”); NYC Bar Association; William K. Sjostrom, Jr.

<sup>74</sup> See, e.g., letters from ABA; Fund Democracy; NYC Bar Association.

<sup>75</sup> See, e.g., letter from ABA.

<sup>76</sup> Letter from NIBA. To facilitate third-party verification of accredited investor status, another commentator requested clarification that a third party providing verification services for issuers would not incur any liability as long as it had a reasonable belief that a purchaser was an accredited investor, based on its knowledge of the investor. Letter from AngelList.

<sup>77</sup> Letter from Fund Democracy. See also letter from Massachusetts Securities Division.

“accredited investor”; for Rule 144A, the Commission chose to include the standard as a condition, in paragraph (d)(1), to the use of the exemption.<sup>78</sup> The definition of accredited investor remains unchanged with the enactment of the JOBS Act and includes persons that come within any of the listed categories of accredited investors, as well as persons that the issuer reasonably believes come within any such category. In our view, the difference in the language between Section 201(a)(1) and Section 201(a)(2) reflects only the differing manner in which the reasonable belief standard was included in the respective rules at the time they were adopted, and does not represent a Congressional intent to eliminate the existing reasonable belief standard in Rule 501(a) or for Rule 506 offerings.

We recognize that a person could provide false information or documentation to an issuer in order to purchase securities in an offering made under proposed Rule 506(c). Thus, even if an issuer has taken reasonable steps to verify that a purchaser is an accredited investor, it is possible that a person nevertheless could circumvent those measures.<sup>79</sup> If a person who does not meet the criteria for any category of accredited investor purchases securities in a Rule 506(c) offering, we believe that the issuer would not lose the ability to rely on the proposed Rule 506(c) exemption for that offering, so long as the issuer took reasonable steps to verify that the purchaser was an accredited

<sup>78</sup> Regulation S also has a reasonable belief standard with respect to the requirement that the offer or sale be made to a person outside the United States. See Rule 902(h)(1)(ii)(A) [17 CFR 230.902(h)(1)(ii)(A)] (“At the time the buy order is originated, the buyer is outside the United States, or the seller and any person acting on its behalf reasonably believe that the buyer is outside the United States.”).

<sup>79</sup> We note that several federal courts have been unsympathetic to attempts by investors who represented that they were accredited investors at the time of the sale of securities to subsequently disavow those representations in order to pursue a cause of action under the federal securities laws. See, e.g., *Wright v. Nat'l Warranty Co.*, 953 F.2d 256 (6th Cir. 1991) (rejecting the plaintiffs’ argument that Rule 505 was unavailable because the plaintiffs “specifically warranted and represented in the subscription agreement \* \* \* that they were accredited investors”); *Goodwin Properties, LLC v. Acadia Group, Inc.*, 2001 U.S. Dist. LEXIS 9975 (D. Me. 2001) (noting that the plaintiffs “provided the defendants with reason to believe that they were accredited investors as defined by 17 C.F.R. § 230.501(a)” and stating that therefore “[t]hey cannot now disavow those representations in order to support their claims against the defendants”); *Faye L. Roth Revocable Trust v. UBS Painewebber Inc.*, 323 F. Supp. 2d 1279 (S.D. Fla. 2004) (stating that the plaintiffs “cannot disavow their representations that they were accredited investors” and concluding that there was no material dispute that the offering complied with Regulation D).

investor and had a reasonable belief that such purchaser was an accredited investor.<sup>80</sup>

#### *D. Form D Check Box for Rule 506(c) Offerings*

Form D is the notice of an offering of securities made without registration under the Securities Act in reliance on an exemption provided by Regulation D.<sup>81</sup> Under Rule 503 of Regulation D, an issuer offering or selling securities in reliance on Rule 504, 505 or 506 must file a notice of sales on Form D with the Commission for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering. Form D is currently organized around 16 numbered “items” or categories of information. The information required to be provided in a Form D filing includes basic identifying information, such as the name of the issuer of the securities and the issuer’s year and place of incorporation or organization; information about related persons (executive officers, directors, and promoters); identification of the exemption or exemptions being claimed for the offering; and factual information about the offering, such as the duration of the offering, the type of securities offered, and the total offering amount.

We are proposing a revision to Form D to add a separate field or check box for issuers to indicate whether they are claiming an exemption under Rule 506(c). Item 6 of Form D currently requires the issuer to identify the claimed exemption or exemptions for the offering from among Rule 504’s paragraphs and subparagraphs, Rule 505, Rule 506 and Section 4(5), as applicable. A new check box in Item 6 of Form D would require issuers to indicate specifically whether they are

relying on the proposed Rule 506(c) exemption. In addition, the current check box for “Rule 506” would be renamed “Rule 506(b),” and the current check box for “Section 4(5)” would be renamed “Section 4(a)(5)” to update the reference to former Section 4(5) of the Securities Act.

We are proposing to require this additional information in order to assist our efforts to monitor the use of general solicitation in Rule 506(c) offerings and the size of this offering market. This information would also help us to look into the practices that would develop to satisfy the verification requirement, which would help us assess the effectiveness of various verification practices in identifying and excluding non-accredited investors from participation in proposed Rule 506(c) offerings.

#### *E. Specific Issues for Privately Offered Funds*

Privately offered funds, such as hedge funds, venture capital funds and private equity funds, typically rely on Section 4(a)(2) and the Rule 506 safe harbor to offer and sell their interests without registration under the Securities Act.<sup>82</sup> In addition, privately offered funds generally rely on one of two exclusions from the definition of “investment company” under the Investment Company Act, which enables them to be excluded from the regulatory provisions of that Act. Privately offered funds are precluded from relying on either of the two exclusions set forth in Section 3(c)(1)<sup>83</sup> and Section 3(c)(7)<sup>84</sup> of the Investment Company Act if they make a public offering of their securities.<sup>85</sup> Section 3(c)(1) excludes from the definition of “investment company” any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than 100 beneficial owners,<sup>86</sup> and which is not making and does not presently

propose to make a public offering of its securities. Section 3(c)(7) excludes from the definition of “investment company” any issuer whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are “qualified purchasers,”<sup>87</sup> and which is not making and does not at that time propose to make a public offering of its securities.

The JOBS Act directs the Commission to eliminate the prohibition against general solicitation for a new subset of Rule 506 offerings, and makes no specific reference to privately offered funds. Section 201(b) of the JOBS Act also provides that “[o]ffers and sales exempt under [Rule 506, as revised pursuant to Section 201(a)] shall not be deemed public offerings under the Federal securities laws as a result of general advertising or general solicitation.” We historically have regarded Rule 506 transactions as non-public offerings for purposes of Sections 3(c)(1) and 3(c)(7).<sup>88</sup> We believe the effect of Section 201(b) is to permit privately offered funds to make a general solicitation under amended Rule 506 without losing either of the exclusions under the Investment Company Act.

#### *F. Technical and Conforming Amendments*

We are proposing a number of technical and conforming amendments to Rules 502 and 506 of Regulation D. We are proposing amendments to various provisions in Rule 502(b) to clarify that the references to sales to non-accredited investors under Rule 506, and the corresponding informational requirements, would be applicable to offerings under Rule 506(b) and not to offerings under proposed Rule 506(c). We are also proposing an amendment to Rule 502(c) to clarify that Rule 502(c)’s prohibition against general solicitation would not apply to offerings under proposed Rule 506(c).

<sup>87</sup> See Section 2(a)(51) of the Investment Company Act [15 U.S.C. 80a–2(a)(51)] and the rules thereunder. See also Rule 3c–5 under the Investment Company Act (excluding “knowledgeable employees” from the determination of whether all of the outstanding securities of the Section 3(c)(7) fund are owned exclusively by qualified purchasers).

<sup>88</sup> See Release No. 33–6389 (noting that the “Commission regards rule 506 transactions as non-public offerings for purposes of the definition of ‘investment company’ in section 3(c)(1) of the Investment Company Act”); *Privately Offered Investment Companies*, Release No. IC–22597 (Apr. 3, 1997) [62 FR 17512], at n.5 (noting that the “Commission believes that section 3(c)(7)’s public offering limitation should be interpreted in the same manner as the limitation in section 3(c)(1)’”).

<sup>80</sup> Our views regarding an issuer’s ability to maintain the exemption for a proposed Rule 506(c) offering notwithstanding the fact that not all purchasers are accredited investors are consistent with our views regarding the effect of attempts by prospective investors to circumvent the requirement in Regulation S that offers and sales be made only to non-U.S. persons. See *Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore*, Release No. 33–7516 (Mar. 23, 1998) [63 FR 14806] (“In our view, if a U.S. person purchases securities or investment services notwithstanding adequate procedures reasonably designed to prevent the purchase, we would not view the Internet offer after the fact as having been targeted at the United States, absent indications that would put the issuer on notice that the purchaser was a U.S. person.”).

<sup>81</sup> Form D also applies to offerings conducted using the Section 4(a)(5) exemption. The Commission adopted Form D when it adopted Regulation D in 1982. Release No. 33–6389 (adopting Form D as a replacement for Forms 4(6), 146, 240 and 242).

<sup>82</sup> See, e.g., *Implications of the Growth of Hedge Funds, Staff Report to the Securities and Exchange Commission* (Sept. 2003), available at: <http://www.sec.gov/news/studies/hedgefunds0903.pdf>.

<sup>83</sup> 15 U.S.C. 80a–3(c)(1).

<sup>84</sup> 15 U.S.C. 80a–3(c)(7).

<sup>85</sup> See also Section 202(a)(29) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–2(a)(29)] (defining a “private fund” as an issuer that would be an investment company under the Investment Company Act, but for Sections 3(c)(1) and 3(c)(7) of that Act). Many issuers of asset-backed securities (“ABS”) also rely on the exclusions contained in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. These ABS issuers frequently participate in Rule 144A offerings.

<sup>86</sup> See also Rule 3c–5 under the Investment Company Act [17 CFR 270.3c–5] (providing that the section’s limit of 100 beneficial owners does not include “knowledgeable employees,” as defined in the rule).

As Section 201(c) of the JOBS Act renumbered Section 4 of the Securities Act, we are also proposing amendments to Regulation D and Rule 144A to update the references to Section 4. We are also proposing to update references to Section 2 of the Securities Act in these rules as some of the references have not been updated to reflect the current numbering scheme in Section 2.

### G. Request for Comment

1. Will the Commission's proposed approach to implementing the verification mandate of Section 201(a) be effective in limiting issuers' sales to only accredited investors in Rule 506 offerings that use general solicitation? Should the Commission adopt a rule that specifies the methods that issuers must use or could use to verify accredited investor status? Would such an approach provide greater certainty for issuers than the approach that we are proposing? Would the inclusion of a specified list result in an assumption or practice that the listed methods are "de facto" requirements, thereby inappropriately reducing flexibility and effectiveness of the new rule? What are the benefits and costs of each approach? In the case of the latter, if the Commission were to adopt such a rule, should it be in the form of a safe harbor for compliance with the verification requirement? What would be examples of the types of methods that issuers could use to verify accredited investor status, and what would be the merits of each such method?

2. Some commentators have recommended that the Commission look to current market practices in determining the methods that should be required or permitted for verifying accredited investor status. As noted above, we anticipate that many practices currently used by issuers in connection with existing Rule 506 offerings would satisfy the verification requirement proposed for offerings pursuant to Rule 506(c). How effective have these practices been in assessing the eligibility of purchasers to participate in an offering made under Regulation D? Are certain practices more effective than others? If so, please describe these practices with specificity. What are the costs and benefits of these practices (to issuers, investors and other market participants)?

3. Under what circumstances, if any, should an issuer be deemed to have taken "reasonable steps to verify" if the only action taken by the issuer is to request a representation from a purchaser that it is an accredited

investor, as some have suggested?<sup>89</sup> Should the Commission provide that an issuer is deemed to have taken "reasonable steps to verify" if the issuer "reasonably believes" that such a purchaser is an accredited investor, as some have suggested?<sup>90</sup> What are the potential benefits and potential harms of such an approach?

4. As we noted above, depending on the facts and circumstances, we believe there is merit to the view that the ability of a purchaser to satisfy the high minimum investment amount required to participate in an offering may be a relevant factor in determining whether that purchaser is an accredited investor. At the same time, we also believe that issuers must be mindful of any indications that the purchaser, despite the ability to provide the funds needed to satisfy a high minimum investment amount requirement, may not actually be an accredited investor. We have noted that the financing of a purchaser's cash investment by the issuer or a third party is a factor that an issuer should consider. Are there other factors? In light of these considerations, should the Commission specifically provide that a high minimum investment amount is sufficient, in and of itself, to satisfy the requirement that the issuer has taken reasonable steps to verify a purchaser's accredited investor status, provided that the high minimum investment amount is not being financed by the issuer or any third party? If so, should the rule specify an amount, and, if so, what amount would be appropriate?

5. Are there certain types of issuers (e.g., shell companies, blank check companies or issuers of penny stock, as defined by Exchange Act Rule 3a51-1<sup>91</sup>) that would present heightened investor protection concerns as a result of the removal of the prohibition against general solicitation? If so, what actions should the Commission take to address these concerns? Should these issuers be subject to a different verification standard for offerings made under proposed Rule 506(c)?

6. Verification methods could include obtaining information from prospective purchasers, such as Forms W-2, personal bank and brokerage account statements and similar documentation. We are cognizant that prospective purchasers may have privacy concerns when undergoing a verification process by issuers.<sup>92</sup> Do any other concerns in addition to privacy concerns arise from a requirement to provide such

information? How, if at all, could the Commission address these concerns?<sup>93</sup> What other documentation could be used to verify accredited investor status while minimizing privacy concerns? Does use of a reasonably reliable third party to provide this information respond to those concerns?

7. Currently, Rule 508 of Regulation D<sup>94</sup> provides that the exemption in Rule 506 will not be lost due to an "insignificant" deviation from a term, condition, or requirement of Regulation D. Should Rule 508 be amended to include any additional provisions specifically related to proposed Rule 506(c)?

8. Should the Commission amend Form D to include a check box for issuers to indicate whether they are claiming an exemption under Rule 506(c), as proposed? If not, why not?

9. Are there any other rule amendments necessary or appropriate to implement the statutory mandate of Section 201(a) of the JOBS Act? Are there any other measures that the Commission should consider taking in connection with the removal of the prohibition against general solicitation?

### III. Proposed Amendment to Rule 144A

#### A. Offers to Persons Other Than Qualified Institutional Buyers

Section 201(a)(2) of the JOBS Act directs the Commission to revise Rule 144A(d)(1) under the Securities Act to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, provided that securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe is a QIB. In the amendment to Rule 144A that we are proposing, we would amend Rule 144A(d)(1) to eliminate the references to "offer" and "offeree." As amended, the rule would require only that the securities are sold to a QIB or to a purchaser that the seller and any person acting on behalf of the seller reasonably believe is a QIB.<sup>95</sup> Under this proposed amendment, resales of securities pursuant to Rule 144A could be conducted using general solicitation, so long as the purchasers are limited in this manner.

#### B. Request for Comment

10. Rule 144A currently provides a list of non-exclusive methods of

<sup>89</sup> See, e.g., letter from SIFMA.

<sup>90</sup> See *id.*

<sup>91</sup> 17 CFR 240.3a51-1.

<sup>92</sup> See, e.g., letter from ABA.

<sup>93</sup> See, e.g., letter from NASAA (July 3, 2012) (recommending that the Commission require issuers to maintain the confidentiality of any information received for the purpose of verifying accredited investors status).

<sup>94</sup> 17 CFR 230.508.

<sup>95</sup> Proposed Rule 144A(d)(1).

establishing a prospective purchaser's ownership and discretionary investments of securities for purposes of determining whether the prospective purchaser is a QIB.<sup>96</sup> How has this non-exclusive list worked in practice? Do issuers favor a non-exclusive list? Why or why not? Has the non-exclusive list resulted in an assumption or practice that the listed methods are "de facto" requirements?

#### IV. Integration with Offshore Offerings

Regulation S provides a safe harbor for offers and sales of securities outside the United States and includes an issuer and a resale safe harbor. Two general conditions apply to both safe harbors: (1) The securities must be sold in an offshore transaction and (2) there can be no directed selling efforts<sup>97</sup> in the United States.<sup>98</sup> The safe harbors are important when U.S. and foreign companies engage in global offerings of securities in which the U.S. portion of the offering is conducted in accordance with Rule 144A or Rule 506 and the offshore portion is conducted in reliance on Regulation S.

The mandate in Section 201(a) that the Commission amend Rule 506 and Rule 144A to permit the use of general solicitation in transactions under those rules has raised questions from some commentators regarding the impact of the use of general solicitation on the availability of the Regulation S safe harbors for concurrent unregistered offerings inside and outside the United States.<sup>99</sup> One commentator recommended that the Commission reexamine the directed selling efforts concept in light of the terms and policy objectives of Section 201 of the JOBS Act, as well as evolving technology and offering techniques.<sup>100</sup> Another recommended that, although the JOBS Act does not explicitly address Section 4(a)(2) or the definition of directed selling efforts in Regulation S, there is no policy reason for distinguishing between the various exemptions and

maintaining a prohibition against general solicitation in some but not others.<sup>101</sup> We also received requests that the Commission confirm that the use of general solicitation in offerings conducted pursuant to Rule 506 or Rule 144A, as amended, would not be deemed to constitute directed selling efforts by that issuer in connection with a contemporaneous offering under Regulation S.<sup>102</sup> One commentator asked for clarification that the limitations in Securities Act Rule 135c<sup>103</sup> do not apply to offerings pursuant to Rule 506 or Rule 144A where general solicitation is permitted,<sup>104</sup> while another commentator suggested that the information on Regulation S offerings that is permitted to be communicated in the United States continue to be limited to the information permitted under Rule 135c, but regardless of whether the issuer meets the eligibility criteria in Rule 135c.<sup>105</sup>

In the adopting release for Regulation S, the Commission stated that "[o]ffshore transactions made in compliance with Regulation S will not be integrated with registered domestic offerings or domestic offerings that satisfy the requirements for an exemption from registration under the Securities Act."<sup>106</sup> We believe that this approach continues to apply. Consistent with the historical treatment of concurrent Regulation S and Rule 144A/Rule 506 offerings, concurrent offshore offerings that are conducted in compliance with Regulation S would not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A, as proposed to be amended.

<sup>101</sup> Letter from SIFMA.

<sup>102</sup> Letters from ABA; SecuritiesLawUSA.

<sup>103</sup> 17 CFR 230.135c.

<sup>104</sup> Letter from SecuritiesLawUSA.

<sup>105</sup> Letter from Neumann.

<sup>106</sup> See *Offshore Offers and Sales*, Release 33-6863 (Apr. 24, 1990) [55 FR 18306], at Section III.C.1. In addressing the offshore transaction component of the Regulation S safe harbor, the Commission stated, "Offers made in the United States in connection with contemporaneous registered offerings or offerings exempt from registration will not preclude reliance on the safe harbors." *Id.* at fn. 36. Likewise, in addressing directed selling efforts, the Commission stated, "Offering activities in contemporaneous registered offerings or offerings exempt from registration will not preclude reliance on the safe harbors." *Id.* at fn. 47. See also Rule 500(g) of Regulation D [17 CFR 230.500(g)] (formerly Preliminary Note No. 7 to Regulation D) ("Regulation S may be relied upon for such offers and sales even if coincident offers and sales are made in accordance with Regulation D inside the United States.").

#### V. General Request for Comment

We request and encourage any interested person to submit comments regarding the proposed rule and form amendments, specific issues discussed in this release, and other matters that may have an effect on the proposed rules. We request comment from the point of view of issuers, investors and other market participants. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. Commentators are urged to be as specific as possible.

#### VI. Paperwork Reduction Act

The proposed amendment to Form D contains a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>107</sup> The title of this requirement is: "Form D" (OMB Control No. 3235-0076).<sup>108</sup> We adopted Regulation D and Form D as part of the establishment of a series of exemptions for offerings and sales of securities under the Securities Act. We are submitting this requirement to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA and its implementing regulations.<sup>109</sup>

The information collection requirements related to the filing of Form D with the Commission are mandatory to the extent that an issuer elects to make an offering of securities in reliance on the relevant exemption. Responses are not confidential. The hours and costs associated with preparing and filing forms and retaining records constitute reporting and cost burdens imposed by the collection of information requirements. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number.

The Form D filing is required to be made by issuers as a notice of sales without registration under the Securities Act based on a claim of exemption under Regulation D or Section 4(a)(5) of the Securities Act. The Form D is required to include basic information about the issuer, certain related persons, and the offering. This information is needed for implementing the exemptions and monitoring their use.

<sup>107</sup> 44 U.S.C. 3501 *et seq.*

<sup>108</sup> Form D was adopted pursuant to Sections 2(a)(15), 3(b), 4(a)(2), 19(a) and 19(c)(3) of the Securities Act (15 U.S.C. 77b(a)(15), 77c(b), 77d(a)(2), 77s(a) and 77s(c)(3)).

<sup>109</sup> 44 U.S.C. 3507(d); 5 CFR 1320.11.

<sup>96</sup> Rule 144A(d)(1).

<sup>97</sup> Rule 902(c)(1) [17 CFR 230.902(c)(1)] broadly defines "directed selling efforts" as: any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities offered in reliance on Regulation S. Such activity includes placing an advertisement in a publication "with a general circulation in the United States" that refers to the offering of securities being made in reliance upon Regulation S.

<sup>98</sup> See Rules 903 [17 CFR 230.903] and 904 [17 CFR 230.904] under the Securities Act.

<sup>99</sup> See, e.g., letters from ABA; Lee D. Neumann ("Neumann"); NYC Bar Association; SecuritiesLawUSA, PC ("SecuritiesLawUSA"); SIFMA.

<sup>100</sup> Letter from NYC Bar Association.

We are proposing to amend Form D to add a check box to indicate an offering relying on the Rule 506(c) exemption. We believe this proposed change would have a negligible effect on the paperwork burden of the form. Accordingly, we estimate that under the proposed amendment to Form D, the burden for responding to the collection of information in Form D would be substantially the same as before the proposed amendment to Form D because the additional information required in the form is minimal.

However, we believe that the proposed amendment to Rule 506 would increase the number of Form D filings that are made with the Commission.

The table below shows the current total annual compliance burden, in hours and in costs, of the collection of information pursuant to Form D. For purposes of the PRA, we estimate that, over a three-year period, the average burden estimate will be 4 hours per Form D. Our burden estimate represents the average burden for all issuers. This burden is reflected as a one hour burden

of preparation on the company and a cost of \$1,200 per filing. In deriving these estimates, we assume that 25% of the burden of preparation is carried by the issuer internally and that 75% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of \$400 per hour. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours.

TABLE 1—ESTIMATED PAPERWORK BURDEN UNDER FORM D, PRE-AMENDMENT TO RULE 506

	Number of responses (A) <sup>110</sup>	Burden hours/ form (B)	Total burden hours (C) = (A)*(B)	Internal issuer time (D)	External pro- fessional time (E)	Professional costs (F) = (E)*\$400
Form D .....	25,000	4	100,000	25,000	75,000	\$30,000,000

According to our Division of Risk, Strategy, and Financial Innovation, in 2011, 15,930 companies made 18,174 new Form D filings. The annual number of new Form D filings rose from 13,764 in 2009 to 18,174 in 2011, an average increase of approximately 2,205 Form D filings per year, or approximately 15%. Assuming the number of Form D filings continues to increase by 2,205 filings per year for each of the next three years, the average number of Form D filings in each of the next three years would be approximately 22,584.

We estimate that the proposed amendment to Rule 506 would result in an even greater annual increase in the number of Form D filings. As a reference point, we use the impact of a past rule change on the market for Regulation D offerings. In 1997, the Commission

amended Rule 144(d) under the Securities Act <sup>111</sup> to reduce the holding period for restricted securities from two years to one year, <sup>112</sup> thereby increasing the attractiveness of Regulation D offerings to investors and to issuers. There were 10,341 Form D filings in 1996. This was followed by a 20% increase in the number of Form D filings in each of the subsequent three calendar years, reaching 17,830 by 1999. Although it is not possible to predict with any degree of accuracy the increase in the number of Rule 506 offerings following the elimination of the prohibition against general solicitation, we anticipate that there would be a similarly significant increase. For purposes of the PRA, we estimate that the proposed amendment to Rule 506 would result in a 20% increase in Form

D filings relying on the Rule 506 exemption, or approximately 5,000 filings, based on the number of responses as reported in the OMB's Inventory of Currently Approved Information Collections. <sup>113</sup> We also assume that the number of Form D filings would increase by approximately 5,000 in each year following the adoption of the rule.

Based on this increase, we estimate that the annual compliance burden of the collection of information requirements for issuers making Form D filings after Rule 506 is amended to eliminate the prohibition against general solicitation would be an aggregate 30,000 hours of issuer personnel time and \$36,000,000 for the services of outside professionals per year.

TABLE 2—ESTIMATED PAPERWORK BURDEN UNDER FORM D, POST-AMENDMENT TO RULE 506

	Number of responses (A) <sup>114</sup>	Burden hours/ form (B)	Total burden hours (C) = (A)*(B)	Internal issuer time (D)	External pro- fessional time (E)	Professional costs (F) = (E)*\$400
Form D .....	30,000	4	120,000	30,000	90,000	\$36,000,000

We request comment on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission solicits comments to: (1) Evaluate whether the collection of information is necessary for the proper performance of the

functions of the agency, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of burden of the collection of information; (3) determine whether

there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collection of information on those who are required to respond, including

<sup>110</sup> The information in this column is based on the number of responses for Form D as reported in the OMB's Inventory of Currently Approved Information Collections, available at <http://www.reginfo.gov/public/do/PRAMain.jsessionid=D37174B5F6F9148DB767D63DF6983A65>.

<sup>111</sup> 17 CFR 230.144(d).

<sup>112</sup> See *Revision of Holding Period Requirements in Rules 144 and 145*, Release No. 33-7390 (Feb. 20, 1997) [62 FR 9242].

<sup>113</sup> Based on the 18,174 new Form D filings that were actually made in 2011, the annual increase would be 3,635 filings.

<sup>114</sup> The information in this column is based on the 25,000 filings reported in the OMB's Inventory of Currently Approved Information Collections, plus the additional 5,000 filings we estimate would be filed as result of proposed Rule 506(c).

through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090, with reference to File No. S7-07-12. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-07-12, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street NE., Washington, DC 20549-1090. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

## VII. Economic Analysis

### A. Background and Summary of Proposed Rule and Form Amendments

We are proposing amendments to Rule 506 and Rule 144A to implement the requirements of Section 201(a) of the JOBS Act. Section 201(a)(1) directs the Commission to revise Rule 506 to provide that the prohibition against general solicitation contained in Rule 502(c) shall not apply to offers and sales of securities made pursuant to Rule 506, as amended, provided that all purchasers of the securities are accredited investors. Section 201(a)(1) also provides that “such rules shall require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission.” Section 201(a)(2) of the JOBS Act directs the Commission to revise Rule 144A(d)(1) to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, provided that securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

We are mindful of the costs imposed by and the benefits obtained from our rules. The discussion below attempts to address the economic effects of the proposed amendments, including the

likely costs and benefits of the amendments as well as the effect of the amendments on efficiency, competition and capital formation.<sup>115</sup> Some of the costs and benefits stem from the statutory mandate of Section 201(a), while others are affected by the discretion we exercise in implementing this mandate. These two types of costs and benefits may not be entirely separable to the extent our discretion is exercised to realize the benefits that we believe were intended by Section 201(a). We request comment on all aspects of the economic effects, such as the costs and benefits, of the amendments that we are proposing. We particularly appreciate comments that distinguish between the economic effects that are attributed to the statutory mandate itself and the economic effects that are the result of policy choices made by the Commission in implementing the statutory mandate.

### B. Baseline

The baseline for our economic analysis is the market for Rule 506 offerings and the market for Rule 144A offerings, as they exist today.

The Regulation D market is large compared to other markets, and offerings claiming the Rule 506 exemption are by far the dominant type of offering in the Regulation D market. In 2011, 2010 and 2009, issuers raised an estimated \$895 billion, \$902 billion and \$581 billion, respectively, in transactions claiming the Rule 506 exemption.<sup>116</sup> These amounts represent approximately 99% of the capital reported as raised under Regulation D during this period and approximately 93% of the number of Regulation D offerings during this period. In 2011 and 2010, the estimated amounts raised in Regulation D offerings exceeded the amounts raised in all other private offerings (Rule 144A offerings, Regulation S offerings, and other Section 4(a)(2) offerings), public debt and public equity offerings, combined. In 2009, the estimated amounts raised in Regulation D offerings were second only

<sup>115</sup> Section 2(b) of the Securities Act requires the Commission, when engaging in rulemaking that requires it to consider whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. 15 U.S.C. 77b(b).

<sup>116</sup> The statistics in this section are based on a review of Form D electronic filings with the Commission—specifically, the “total amount sold” as reported in Form D—and data regarding other types of offerings (e.g., public debt offerings and Rule 144A offerings) from Securities Data Corporation’s New Issues database (Thomson Financial). See note 25, supra.

to the amounts raised in public debt offerings.

The Rule 144A market is also an important market for raising capital. In 2011 and 2010, the estimated amount of capital (including both equity and debt securities) raised in Rule 144A offerings was \$168 billion and \$233 billion, compared to \$984 billion and \$1.07 trillion, respectively, raised in registered offerings.

### C. Eliminating the Prohibition Against General Solicitation in Rule 506 Offerings and Rule 144A Offerings

The elimination of the prohibition against general solicitation for a subset of Rule 506 offerings would likely have a number of effects on issuers and investors. When using general solicitation, issuers would be able to reach a greater number of potential investors, thus increasing their access to capital. The proposed amendment to Rule 506 would likely reduce search costs associated with finding accredited investors who may be interested in a particular private offering, thus enhancing efficiency. The increase in the number of potential investors could result in greater competition among investors interested in investing in an issuer, which may result in a lower cost of capital for issuers. We expect these benefits to issuers to generally be lower for Rule 144A offerings because QIBs, who are the investors in Rule 144A offerings, are generally fewer in number, known by market participants, and better networked than accredited investors. Thus, the elimination of the prohibition against general solicitation for Rule 144A offerings is unlikely to dramatically increase issuers’ access to QIBs in such offerings or to have a meaningful effect on the cost of capital in Rule 144A offerings.

When using general solicitation, issuers may be able to reach investors directly, without the need of an intermediary, which could result in lower transaction costs, and perhaps a lower cost of capital, for issuers. An analysis of all Form D filings on EDGAR made during the period from 2009 to 2011 shows that approximately 11% of all new offerings reported sales commissions of greater than zero because the issuers used intermediaries.<sup>117</sup> The average commission paid to these intermediaries was 5.7% of the offering size, with the median commission being approximately 5%. For a \$5 million offering, which was the median size of a Regulation D offering with a commission during this period, an

<sup>117</sup> Ivanov/Bauguess Study.

issuer could potentially save up to \$250,000 if the issuer reaches investors directly rather than through an intermediary, minus the cost of its own solicitation efforts and the cost associated with verifying accredited investor status.<sup>118</sup> This potential benefit would likely be larger for smaller issuers. Based on the analysis of these Form D filings as described above, issuers reporting annual revenues up to \$25 million pay on average a 6.4% commission, while issuers with annual revenues over \$100 million pay approximately a 3.3% commission and hedge funds and other privately offered funds pay approximately a 2.7% commission.

The elimination of the prohibition against general solicitation also would reduce the uncertainty for issuers as to whether a Rule 506 offering can be completed in certain situations, and would eliminate the costs of complying with the prohibition.<sup>119</sup> Under existing Rule 506, an inadvertent leak of information about an offering to entities or persons with whom the issuer does not have a pre-existing substantive relationship has been viewed by some as raising questions about the issuer's ability to rely on the exemption for the entire offering.<sup>120</sup> In addition, some privately offered funds have been reluctant to respond to press inquiries or to correct inaccurate reports due to concerns about these discussions being misconstrued as a general solicitation.<sup>121</sup> Under proposed Rule 506(c), any such uncertainty as to the availability of the exemption would likely be reduced, so long as issuers take reasonable steps to verify that they are selling only to accredited investors.

From the standpoint of investors, accredited investors who previously have found it difficult to identify investment opportunities in Rule 506

offerings would be able to identify, and potentially invest in, a larger and more diverse pool of potential investment opportunities. In addition, the elimination of the prohibition against general solicitation in some Rule 506 offerings would likely increase the flow of information about issuers to investors that may not have been publicly available previously, thereby potentially leading to more efficient pricing for the offered securities.<sup>122</sup> Thus, the proposed rule amendment may increase capital formation and at the same time improve its allocative efficiency.<sup>123</sup> With respect to privately offered funds in particular, eliminating the prohibition would allow accredited investors to gather information about privately offered funds at relatively lower costs and to allocate their capital more efficiently.<sup>124</sup> Increased information about privately offered fund strategies, management fees and performance information would likely lead to greater competition among privately offered funds for investor capital.

Although proposed Rule 506(c) would directly affect the private offering market, it could also have an indirect effect on other markets. The elimination of the prohibition against general solicitation for a subset of Rule 506 offerings may lower the degree of information asymmetry between Rule 506 issuers and potential investors. The lower search costs associated with finding Rule 506(c) offerings may cause some investors that currently invest in public equity and debt markets or other private offering markets to reallocate capital to the offerings made under proposed Rule 506(c). If a significant number of investors make a greater proportion of their investments in the Rule 506(c) market, such investor behavior may have a negative effect on the supply of capital and prices in the public equity and debt markets and in other non-registered offering markets. For example, issuers currently using the exemptions in Regulation A<sup>125</sup> and in Rule 504(b)(1)(i)–(iii) to solicit investors could prefer to rely on the exemption under proposed Rule 506(c) because

they would be able to raise unlimited amounts of capital under proposed Rule 506(c) and state blue sky securities registration requirements would not apply to these offerings. While it is difficult to estimate how many of these issuers would choose to rely on proposed Rule 506(c) in lieu of the other available exemptions from registration, we believe that it is likely that Rule 506(c) would have a larger impact on issuers using Rule 504 rather than Regulation A, mainly because very few issuers have been using the Regulation A exemption in recent years.<sup>126</sup> In addition, to the extent that accredited investors have invested in registered investment companies instead of privately offered funds because of information asymmetry between privately offered funds and registered investment companies, it is possible that registered investment companies' assets may be negatively affected if these investors now transfer their assets to privately offered funds.

We believe that retaining the existing Rule 506 as Rule 506(b) would generate benefits for both issuers and investors. It would allow issuers that do not wish to generally solicit in their private offerings to avoid the added expense of complying with the rules applicable to Rule 506(c) offerings. It would also allow issuers to continue selling privately to up to 35 non-accredited investors who meet existing Rule 506's sophistication requirements. The continued availability of Rule 506(b) may also be beneficial to investors with whom the issuer has a pre-existing substantive relationship and who do not wish to bear additional verification costs that may be associated with participation in Rule 506(c) offerings.

On the other hand, eliminating the prohibition against general solicitation could make it easier for promoters of fraudulent schemes to reach potential investors through public solicitation and other methods previously not allowed. This could result in an increase in the level of due diligence conducted by investors in assessing proposed Rule 506(c) offerings, and in the event of fraud, would likely lead to costly lawsuits for investors seeking damages. In general, an increase in fraud in this market would harm investors who are defrauded, would undermine investor confidence in Rule 506 offerings and could negatively affect

<sup>118</sup> We recognize, of course, that the involvement of an intermediary can provide benefits in addition to locating investors. For example, an intermediary may be able to help an issuer obtain better pricing and terms or provide access to investors that can provide strategic or other advice to the issuer.

<sup>119</sup> Letter from MFA (May 4, 2012).

<sup>120</sup> See, e.g., letter from Simon M. Lorne and Joseph McLaughlin (Aug. 5, 2008) on *Revisions of Limited Offering Exemptions in Regulation D*, Release No. 33-8828 (Aug. 3, 2007) [72 FR 45116] (“On occasion, the prohibition forces issuers to delay or even cancel offerings because of communications—sometimes inadvertent—that could be viewed in hindsight as a solicitation. The need to police communications by transaction participants, and to analyze and remedy inadvertent communications, also adds significantly to the cost of effecting private placements.”).

<sup>121</sup> See, e.g., letters from D.E. Shaw & Co. (Apr. 3, 2006) on *Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies*, Release No. 33-8666 (Feb. 28, 2006); MFA (May 4, 2012).

<sup>122</sup> This may not be applicable with respect to every issuer (e.g., certain privately offered funds that offer their shares continuously at net asset value).

<sup>123</sup> Allocative efficiency is a condition that is reached when resources are allocated in a way that allows the maximum possible net benefit from their use. In this context, it means the right number of dollars from the right types of investors going to the most suitable investments on efficient terms.

<sup>124</sup> See, e.g., letter from MFA (May 4, 2012) and *Managed Funds Association, Petition for Rulemaking on Rule 502 of Regulation D under the Securities Act of 1933*, File No. 4-643 (Jan. 9, 2012).

<sup>125</sup> 17 CFR 230.251 through 17 CFR 230.263.

<sup>126</sup> From 2009 to 2011, based on our review of Form D filings and Forms 1-A, 1,735 issuers relied on the Rule 504 exemption, and 10 issuers relied on Regulation A. The number of issuers using Regulation A to raise capital may increase once the Commission adopts rules implementing Title IV of the JOBS Act.

capital-raising by legitimate issuers—for example, by reducing investor participation in Rule 506 offerings—thus inhibiting capital formation and reducing efficiency. Further, one commentator is concerned that investors may confuse privately offered funds with registered investment companies.<sup>127</sup> In such cases, fraud that occurs with privately offered funds may cause investors to associate the wrongdoing with registered investment companies, and therefore refrain from investing in registered investment companies. In addition, some issuers with publicly-traded securities may use general solicitation for a purported Rule 506 offering to generate investor interest in the secondary trading markets, especially in the over-the-counter markets, which could be used by insiders to resell securities at inflated prices. This “pump and dump” activity would impose costs to investors in these secondary markets, as well as investors in Rule 506 offerings, and could erode investor confidence in Rule 506 offerings, thus potentially raising the cost of capital for issuers in this market.

The risks to investors of fraudulent offerings conducted under proposed Rule 506(c) may be mitigated to some extent by the requirement that issuers sell only to accredited investors (with reasonable steps to verify such status), who may be better able to assess their ability to take financial risks and bear the risk of loss than investors who are not accredited. In addition, issuers would still be subject to the antifraud provisions under the federal securities laws, and the public nature of these solicitations may facilitate detection of fraudulent activity.

We expect that there would be fewer occurrences of general solicitation-facilitated fraud in Rule 144A offerings, as compared to Rule 506(c) transactions. Unlike most Rule 506 transactions, Rule 144A offerings always include a financial intermediary. The due diligence conducted by these intermediaries is an additional layer of protection against fraud. Also, Rule 144A investors are generally large institutions, which are better able to identify fraudulent activities than smaller institutions and retail investors.

In regard to Rule 144A, we anticipate that eliminating the prohibition against general solicitation would significantly affect private trading systems by

permitting information vendors to provide more information about Rule 144A securities. Indeed, since offers could be made to the public, the information on private trading systems for Rule 144A securities could be made available to all investors, even though sales would be limited to QIBs.<sup>128</sup> In addition, currently there is no public dissemination through Trade Reporting and Compliance Engine (“TRACE”) of transactions in Rule 144A securities.<sup>129</sup> Once Rule 144A is amended to permit offers to be made to persons other than QIBs, FINRA may decide to amend its rules to permit public dissemination of transaction information with respect to Rule 144A securities. Such improvements in the information available to potential investors could enhance efficiency in this market.

#### *D. Verifying Accredited Investor Status in Rule 506(c) Offerings*

The requirement in proposed Rule 506(c) for issuers to take reasonable steps to verify that purchasers are accredited investors would likely make it more difficult for those issuers whose existing practices do not already satisfy the verification requirement to sell securities to non-accredited investors, thereby lessening the likelihood that fraudulent offerings would be completed because those who are eligible to purchase are more likely to be able to protect their interests than investors who are not accredited investors. Preserving the integrity of the Rule 506 market and reducing the incidence of fraud would benefit investors by giving them greater assurance that they are investing in legitimate issuers. In turn, issuers would also benefit from measures that improve the integrity and reputation of the Rule 506 market because they would be able to attract more investors and capital. Issuers would benefit as well from the additional certainty that the Rule 506 safe harbor is available for an offering when this verification requirement is met.

Our proposal not to specify the verification methods that an issuer must use or could use in taking reasonable steps to verify accredited investor status would provide issuers with flexibility to use methods that are appropriate, given the facts and circumstances of each offering and each purchaser. Such

flexibility is likely to mitigate the cost to issuers of complying with proposed Rule 506(c) because it would allow them to select the most cost-effective verification method for each offering.

The verification requirement in proposed Rule 506(c) would impose costs as well. Some potential investors likely would have to provide more information to issuers than they currently provide, while some issuers may have to apply a stricter and more costly process to determine accredited investor status than what they currently use. While it is reasonable to expect that the costs associated with the verification requirement could be offset somewhat by its benefits, it is also reasonable to expect that some accredited investors who would participate in existing Rule 506(b) offerings would decline to participate in proposed Rule 506(c) offerings. Compared to an alternative that prescribes specific verification methods or provides a non-exclusive list of verification methods, the greater flexibility of the proposed verification standard could result in less rigorous verification, thus allowing some unscrupulous issuers to more easily sell securities to purchasers who are not accredited investors and perpetrate fraudulent schemes. In addition, a flexible “reasonableness” verification approach may create or promote legal uncertainty about the availability of the exemption from Section 5 registration, which may cause some issuers to interpret “reasonable steps to verify” in a manner that is more burdensome than if specific verification methods were prescribed, thus incurring higher cost. Similarly, some issuers may decide to use additional internal or external resources (e.g., retaining lawyers, soliciting opinions, etc.) that they would not have used if specific verification methods were prescribed or if a non-exclusive list of methods was provided, in order to make sure they are compliant with the rule, which would also increase their costs.

To the extent that issuers require investors to provide personally identifiable information (e.g., Social Security numbers, tax information, bank or brokerage account information) in order to verify their accredited investor status, these investors may be reluctant to do so in the context of making an investment in an issuer, particularly an issuer with which they may have no prior relationship.<sup>130</sup> In addition to concerns about maintaining personal privacy, investors may be concerned that their personally identifiable information could be stolen or accessed

<sup>127</sup> See letter from ICI re: Rulemaking Petition File No. 4-463; Request by MFA for Rulemaking to Amend Rule 502(c) of Regulation D to Eliminate the Prohibition on Offers or Sales of Securities by General Solicitation or Advertising With Respect to Private Funds (Feb. 7, 2012); and letter from ICI (May 21, 2012).

<sup>128</sup> Under the PORTAL Trading System developed by the Nasdaq Stock Market for trading Rule 144A securities, access is restricted to QIBs. Other privately developed Rule 144A trading systems, such as Portal Alliance, have similar restrictions.

<sup>129</sup> See FINRA Rule 6750. There is mandatory reporting of over-the-counter trades in fixed income securities.

<sup>130</sup> Letter from SecondMarket.

by third parties or used by unscrupulous issuers in various ways (e.g., identity theft, which could impose costs to investors that go well beyond the costs typically associated with investing). As a consequence, some potential investors may elect not to participate in this market, thus impeding capital formation to some extent.

As there is no information available to us on the costs currently incurred by issuers to form a reasonable belief that a purchaser in a Rule 506 offering is an accredited investor, we are unable to quantify the estimated costs and benefits of the verification requirement in proposed Rule 506(c). We are requesting comment from the public on this issue.

#### *E. Form D Check Box for Rule 506(c) Offerings*

Much of what we know about the size and characteristics of the private offering market comes from Form D filings. The information collected to date and described in this release illustrates and underscores the importance of the private offering market in the U.S. economy. The continued collection of this information following the elimination of the prohibition against general solicitation in Rule 506(c) and Rule 144A offerings will be an important monitoring tool in assessing the ongoing economic impact of the new rules. We are proposing to amend Form D to add a new check box in Item 6 of Form D, which would require an issuer to indicate whether it is relying on Rule 506(c) in conducting its offering. This information would assist the Commission in monitoring the use of proposed Rule 506(c), and the marginal cost to issuers of providing this information is likely to be low because Form D already requires issuers to identify the exemption on which they are relying.

#### *F. Request for Comment*

11. Are there other benefits and costs associated with the elimination of the prohibition against general solicitation that should be considered? Are those more pertinent to proposed Rule 506(c) offerings or Rule 144A offerings?

12. Is it likely that the removal of the prohibition against general solicitation would increase fraudulent activity in these markets? If so, to what extent, and what form is this fraudulent activity likely to take? Please provide data where possible.

13. How costly is it to comply with the existing requirements of Rule 506(b)? What would the incremental cost be to comply with the proposed

requirements of Rule 506(c)? What would be the impact, if any, of the proposed Rule 506(c) check box on Form D? Please provide data where possible.

14. Are there any other benefits or costs associated with the accredited investor verification requirement in proposed Rule 506(c) that the Commission has not identified?

15. Do the types, or extent, of any benefits or costs from the proposed amendments to Rule 506 and Rule 144A differ depending on the type of issuer, other than as described above? If so, please explain.

16. Are there any additional economic effects related to efficiency, capital formation, or competition that the Commission has not identified?

#### **VIII. Small Business Regulatory Enforcement Fairness Act**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (“SBREFA”),<sup>131</sup> the Commission must advise the OMB as to whether a proposed regulation constitutes a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

If a rule is “major,” its effectiveness will generally be delayed for 60 days pending Congressional review.

We request comment on whether our proposed amendments would be a “major rule” for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment or innovation.

We request those submitting comments to provide empirical data and other factual support for their views to the extent possible.

#### **IX. Initial Regulatory Flexibility Analysis**

The Commission has prepared this Initial Regulatory Flexibility Analysis (“IRFA”) in accordance with Section 603 of the Regulatory Flexibility Act.<sup>132</sup>

<sup>131</sup> Public Law 104–121, Tit. II, 110 Stat. 857 (1996).

<sup>132</sup> See 5 U.S.C. 603.

This IRFA relates to the amendments to Rules 500, 501, 502 and 506 of Regulation D, Form D and Rule 144A that we are proposing in this release.

#### *A. Reasons for, and Objectives of, the Action*

The primary reason for, and objective of, the proposed amendments to Rule 502 and Rule 506 is to implement the statutory requirements of Section 201(a)(1) of the JOBS Act, which directs the Commission to revise Rule 506 to provide that the prohibition against general solicitation in Rule 502(c) shall not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors. Consistent with the language in Section 201(a), the proposed amendments to Rule 506 require issuers to take reasonable steps to verify that purchasers in any Rule 506 offering using general solicitation are accredited investors. The primary reason for, and objective of, the proposed amendment to Form D is to assist our efforts to monitor the use of general solicitation in Rule 506(c) offerings and the size of this offering market.

The primary reason for, and objective of, the proposed amendment to Rule 144A is to implement the statutory requirements of Section 201(a)(2) of the JOBS Act, which directs the Commission to revise Rule 144A(d)(1) to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, provided that securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

#### *B. Small Entities Subject to the Proposed Rule and Form Amendments*

For purposes of the Regulatory Flexibility Act, under our rules, an issuer, other than an investment company, is a “small business” or “small organization” if it has total assets of \$5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed \$5 million.<sup>133</sup> For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>134</sup>

<sup>133</sup> 17 CFR 230.157.

<sup>134</sup> 17 CFR 270.0–10(a).

Proposed Rule 506(c) would affect small issuers (including both operating businesses and investment funds that raise capital under Rule 506) relying on this safe harbor from Securities Act registration. All issuers that sell securities in reliance on Regulation D are required to file a Form D with the Commission reporting the transaction. For the fiscal year ended December 31, 2011, 18,174 issuers filed an initial notice on Form D, of which 16,692 relied on the Rule 506 exemption. Based on information reported by issuers on Form D, there were 3,823 small issuers<sup>135</sup> relying on the Rule 506 exemption in 2011. This number likely underestimates the actual number of small issuers relying on the Rule 506 exemption, however, because over 50% of issuers declined to report their size.

The proposed amendment to Rule 144A would affect small entities that engage in Rule 144A offerings.<sup>136</sup> Unlike issuers that use Regulation D, issuers conducting Rule 144A offerings are not required to file any form with the Commission. This lack of data significantly limits our ability to assess the number and the size of issuers that use Rule 144A offerings. Still, we are able to obtain some data on Rule 144A offerings during the 2009 to 2011 period from two commercial databases.<sup>137</sup> Based on these data, we identified 681 offerings involving 607 issuers from 2009 to 2011. Of these 607 issuers, only 316 provided information on their total assets. With respect to these 316 issuers, we identified 42 issuers with total assets of less than \$50 million.

### C. Projected Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendments to Rule 506 would impose certain reporting and compliance requirements on issuers that engage in general solicitation in Rule 506 offerings. As discussed above, issuers taking advantage of proposed Rule 506(c) to engage in general solicitation in Rule 506 offerings would be required to take reasonable steps to verify that the purchasers of the

securities are accredited investors. The steps required would vary with the circumstances, but we anticipate that some potential investors may have to provide more information to issuers than they currently provide, while issuers may have to apply a stricter and more costly process to verify accredited investor status than what they currently use. We expect that the costs of compliance would vary depending on the size and nature of the offering, the nature and extent of the verification methods used, and the number and nature of potential purchasers in the offering. Proposed Rule 506(c) does not impose any recordkeeping requirements. However, we anticipate that issuers would document the steps they take to verify that purchasers are accredited investors in Rule 506 offerings involving general solicitation.

The proposed amendment to Form D would also impose an information requirement with respect to Rule 506 offerings that use general solicitation. Each issuer submitting a Form D for a Rule 506 offering would be required to check a box on the form to indicate whether the issuer is relying on the proposed Rule 506(c) exemption. We do not believe that this proposed revision to Form D would increase in any material way the time or information required to complete the Form D that must be filed with the Commission in connection with a Rule 506 offering.

The proposed amendment to Rule 144A contains no reporting, recordkeeping or compliance requirements for issuers that engage in Rule 144A offerings.

### D. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap or conflict with the proposed amendments to Rule 144A, Form D, and Rules 500, 501, 502 and 506 of Regulation D.

### E. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives of our amendments, while minimizing any significant adverse impact on small entities. In regard to the proposed amendment to Rule 144A and the proposed amendment to Rule 506 to remove the prohibition against general solicitation in Rule 506 offerings where all purchasers are accredited investors, there are no significant alternatives to these amendments that would accomplish the stated objectives of Section 201(a) of the JOBS Act.

In connection with the proposed amendment to Form D and the proposed

amendment to Rule 506 that requires issuers to take reasonable steps to verify that purchasers of securities are accredited investors, the Commission considered the following alternatives: (1) Establishing different compliance or reporting standards that take into account the resources available to small entities; (2) clarifying, consolidating or simplifying compliance requirements under the rule; (3) using design rather than performance standards; and (4) exempting small entities from coverage of all or part of the proposed amendment to Rule 506.

With respect to using design rather than performance standards, we note that the “reasonable steps to verify” requirement in proposed Rule 506(c) is a performance standard. We believe that the flexibility of a performance standard accommodates different types of offerings and purchasers without imposing overly burdensome methods that may be ill-suited or unnecessary to a particular offering or purchaser, given the facts and circumstances. The Commission is not proposing the establishment of different compliance or reporting requirements or timetables for the rule, as proposed, for small entities. The particular steps necessary to meet the proposed requirement to take reasonable steps to verify that purchasers are accredited investors would vary according to the circumstances. Different compliance requirements for small entities may create the risk that the requirements may be too prescriptive or, alternatively, insufficient to verify a purchaser’s accredited investor status. Special requirements for small entities may also lead to investor confusion or reduced investor confidence in Rule 506 offerings if they create the impression that small entities have a different standard of verification than other issuers of securities. As the verification requirement is intended to protect investors by limiting participating in unregistered offerings to those who are most able to bear the risk, we are preliminarily of the view that a flexible standard applicable to all issuers better accomplishes the goal of investor protection that this requirement is intended to serve. The Commission is not proposing a different reporting requirement for small entities because the additional information that would be required in the Form D is minimal and should not be unduly burdensome or costly for small entities.

We similarly believe that it does not appear consistent with the objective of the proposed amendments or the considerations described above regarding investor confusion and

<sup>135</sup> Of this number, 3,344 of these issuers are not investment companies, and 479 are investment companies.

<sup>136</sup> While it may be theoretically possible for a small entity to meet one part of the definition of “qualified institutional buyer” (e.g., an “entity, all of the equity owners of which are qualified institutional buyers, acting for its own account or the accounts of other qualified institutional buyers”), we do not have any information to suggest that there are such small entities. Accordingly, the regulatory flexibility analysis in regard to Rule 144A is focused on small issuers that engage in Rule 144A offerings.

<sup>137</sup> Thomson Financial’s SDC Platinum Service and Sagient Research System’s Placement Tracker database.

investor confidence to further clarify, consolidate or simplify the amendments for small entities. With respect to exempting small entities from coverage of these proposed amendments, we believe such an approach would be contrary to the requirements of, and the legislative intent behind, Section 201(a), as evidenced by the plain language of the statute.

#### F. General Request for Comment

The Commission is soliciting comments regarding this analysis. The Commission requests comment on the number of small entities that would be subject to the rules and whether the proposed rules would have any effects that have not been discussed. The Commission requests that commentators describe the nature of any effects on small entities subject to the rules and provide empirical data to support the nature and extent of the effects.

#### X. Statutory Authority and Text of Proposed Rule and Form Amendments

The amendments contained in this release are being proposed under the authority set forth in Sections 4(a)(1), 4(a)(2) and 19 of the Securities Act, as amended, and Section 201(a) of the JOBS Act.

#### List of Subjects in 17 CFR Parts 230 and 239

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, the Commission proposes to amend Title 17, chapter II of the Code of Federal Regulations, as follows:

#### PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The general authority citation for Part 230 is revised to read as follows:

**Authority:** 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, § 201(a), 126 Stat. 313 (2012), unless otherwise noted.

\* \* \* \* \*

2. Amend § 230.144A by:

- a. Removing the reference to “section 4(2)” and adding in its place “section 4(a)(2)” in Preliminary Note 7;
- b. Removing the reference to “section 2(13)” and adding in its place “section 2(a)(13)” in paragraph (a)(1)(i)(A);
- c. Removing the reference to “sections 2(11) and 4(1)” and adding in its place “sections 2(a)(11) and 4(a)(1)” in paragraph (b);
- d. Removing the references to “section 4(3)(C),” “section 2(11)” and

“section 4(3)(A)” and adding in their place “section 4(a)(3)(C),” “section 2(a)(11)” and “section 4(a)(3)(A),” respectively, in paragraph (c);

e. Removing the phrase “offered or” after the phrase “The securities are” in paragraph (d)(1); and

f. Removing the phrase “an offeree or” after the phrase “a qualified institutional buyer or to” and adding in its place “a” in paragraph (d)(1).

\* \* \* \* \*

3. Amend § 230.500(c) by removing the reference to “section 4(2)” and adding in its place “section 4(a)(2)”.

\* \* \* \* \*

4. Amend § 230.501 by:

a. Removing the reference to “section 2(13)” and adding in its place “section 2(a)(13)” in paragraph (a)(1); and

b. Removing the reference to “section 2(4)” and adding in its place “section 2(a)(4)” in paragraph (g).

\* \* \* \* \*

5. Amend § 230.502 by:

a. Removing the reference to “§ 230.506” and adding in its place “§ 230.506(b)” in paragraph (b)(1);

b. Removing the reference to “§ 230.506” and adding in its place “§ 230.506(b)” in paragraph (b)(2)(iv);

c. Removing the reference to “§ 230.506” and adding in its place “§ 230.506(b)” in paragraph (b)(2)(v);

d. Removing the reference to “§ 230.506” and adding in its place “§ 230.506(b)” in the first sentence of paragraph (b)(2)(vii);

e. Adding to the first sentence of paragraph (c) the phrase “or § 230.506(c)” after the phrase “Except as provided in § 230.504(b)(1)”;

f. Removing the reference to “section 4(2)” and adding in its place “section 4(a)(2)” in paragraph (d); and

g. Removing the reference to “section 2(11) of the Act” and adding in its place “section 2(a)(11) of the Act” in paragraph (d).

\* \* \* \* \*

6. Amend § 230.506 by:

a. Adding to paragraph (a) the phrase “or paragraph (c)” after the phrase “satisfy the conditions in paragraph (b)”;

b. Removing the reference to “section 4(2)” and adding in its place “section 4(a)(2)” in paragraph (a);

c. Adding to paragraph (b) the phrase “in offerings not using general solicitation or general advertising” after the phrase “Conditions to be met”;

d. Removing the reference to “this section” and adding in its place “§ 230.506(b)” in the note to paragraph (b)(2)(i); and

e. Adding paragraph (c).

The addition reads as follows:

#### § 230.506 Exemption for limited offers and sales without regard to dollar amount of offering.

\* \* \* \* \*

(c) *Conditions to be met in offerings using general solicitation or general advertising.*

(1) *General conditions.* To qualify for exemption under this section, sales must satisfy all the terms and conditions of §§ 230.501 and 230.502(a) and (d).

(2) *Specific conditions.*

(i) *Nature of purchasers.* All purchasers of securities sold in any offering under this § 230.506(c) are accredited investors.

(ii) *Verification of accredited investor status.* The issuer shall take reasonable steps to verify that purchasers of securities sold in any offering under this § 230.506(c) are accredited investors.

#### PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

7. The authority citation for Part 239 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78o-7 note, 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

8. Amend Form D (referenced in § 239.500) by:

a. Removing the phrase “Rule 506” and adding in its place “Rule 506(b)” next to the appropriate check box;

b. Removing the phrase “Securities Act Section 4(5)” and adding in its place “Securities Act Section 4(a)(5)” next to the appropriate check box; and

c. Adding a check box that reads “Rule 506(c)” between the revised “Rule 506(b)” check box and the revised “Securities Act Section 4(a)(5)” check box.

**Note:** The text of Form D does not, and the amendments will not, appear in the Code of Federal Regulations.

Dated: August 29, 2012.

By the Commission.

**Elizabeth M. Murphy,**  
*Secretary.*

[FR Doc. 2012-21681 Filed 9-4-12; 8:45 am]

**BILLING CODE 8011-01-P**