

MEMO# 27370

July 12, 2013

SEC Lifts Ban on General Solicitation and Advertising for Private Funds and Proposes Related Investor Protection Measures; ICI Member Call Scheduled for August 14

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TO: SEC RULES COMMITTEE No. 29-13
SMALL FUNDS COMMITTEE No. 15-13
ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 15-13
INVESTMENT ADVISERS COMMITTEE No. 3-13 RE: SEC LIFTS BAN ON GENERAL SOLICITATION AND ADVERTISING FOR PRIVATE FUNDS AND PROPOSES RELATED INVESTOR PROTECTION MEASURES; ICI MEMBER CALL SCHEDULED FOR AUGUST 14

Last year, Congress enacted the Jumpstart Our Business Startups Act (the “JOBS Act”), which, among other things, repeals the ban on general solicitation and advertising in private securities offerings under Rule 506 of Regulation D. [\[1\]](#) On July 10, the Securities and Exchange Commission took three actions related to this statutory mandate. [\[2\]](#) First, it adopted amendments to Rule 506 and Rule 144A under the Securities Act of 1933 that permit an issuer to engage in general solicitation and advertising in offering and selling securities pursuant to those rules. [\[3\]](#) Second, the SEC adopted amendments to Rule 506 to disqualify issuers and other market participants from relying on Rule 506 if “felons and other ‘bad actors’” are participating in the Rule 506 offering. [\[4\]](#) Finally, the SEC published for comment a number of proposed amendments to Regulation D, Form D and Rule 156 under the Securities Act that are intended to enhance the SEC’s ability to evaluate the development of market practices in Rule 506 offerings and address certain comments, including those by ICI, made in connection with implementing this particular section of the JOBS Act. [\[5\]](#)

The two adopting releases are briefly summarized below. The third release, containing the proposed consumer protection amendments, is summarized in slightly greater detail. Comments will be due to the SEC on the proposal sixty days after its publication in the Federal Register, likely mid-September. We will have a call for ICI members to discuss the

Proposing Release and develop ICI comments at 2:00 p.m. Eastern time on Wednesday, August 14. If you would like to participate in the call, please RSVP to Helenia Walker at 202/326-5823 or helenia.walker@ici.org.

Background on ICI's Position on this Rulemaking

ICI submitted three letters related to this rulemaking. [6] In all of those letters, ICI focused on Rule 506 offerings by private funds (i.e., funds that rely on either Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940 to be excluded from the definition of "investment company" under that Act). [7]

Noting that permitting general solicitation and advertising is a significant change in the regulatory structure for private placements, ICI's letters made a number of recommendations that should accompany any such permission to mitigate potential investor protection concerns. The recommendations were based on the mutual fund industry's experience with general solicitations and the concern that misleading advertisements for funds of any type could erode investor confidence in funds of all types and fund investing more generally. These included:

- Imposing appropriate content restrictions on private fund advertising;
- Prohibiting performance advertising by private funds until the SEC can craft a rule that requires private funds to calculate performance based on standardized methodologies;
- Requiring certain disclosure in advertisements to ensure that all investors who may see a private fund advertisement—whether accredited or not—do not confuse the private fund for a mutual fund or other regulated, registered investment company;
- Directing the Financial Industry Regulatory Authority ("FINRA") to require private fund advertisements to be filed with and reviewed by FINRA; and
- Reconsidering the income and net worth thresholds in the definition of "accredited investor" to ensure that the definition appropriately defines a universe of investors that do not need the protections of the securities laws.

As described below, the rule amendments adopted by the SEC did not incorporate any of these recommendations. The SEC did, however, include proposals along the lines of the third (on legends) and fourth (on filing of materials) recommendations, and specifically recognized and requested further comment on the other three.

The General Solicitation and Advertising Adopting Release

The principal rules adopted by the SEC on July 10 relate to Rule 506 and Rule 144A.

Amendments to Rule 506. The amendments to Rule 506 were adopted as proposed, with one modification. The amendments add new paragraph (c), which allows an issuer to engage in general solicitation and advertising in offering and selling securities pursuant to Rule 506 provided that all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that such purchasers are accredited investors. The one change from the proposal is the inclusion of a non-exclusive list of methods that issuers may use to satisfy the verification requirement for purchasers who are natural persons.

Amendments to Rule 144A. The amendment to Rule 144A provides 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.

Revisions to Form D. The SEC revised Form D to require issuers to indicate whether they are relying on the provision that permits general solicitation or general advertising in a Rule 506 offering.

The Bad Actor Adopting Release

Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) requires the SEC to adopt rules to disqualify certain securities offerings from reliance on Rule 506. As part of the current rulemaking, the SEC adopted rule amendments to implement Section 926 of the Dodd-Frank Act.

The amendments include changes to Rule 501, Rule 506, and Form D. Under the final “bad actor” disqualification rule approved by the SEC, an issuer cannot rely on the Rule 506 exemption if the issuer or any other person covered by the rule had a “disqualifying event.” Disqualifying events include certain criminal convictions and other violations in connection with the purchase or sale of a security, final orders from regulators, certain SEC disciplinary and other orders, and suspension or expulsion from membership in a self-regulatory organization.; The rule will apply only to triggering events occurring after effectiveness of the rule amendments (with pre-existing events subject to mandatory disclosure).

The Proposing Release

In each of the releases, the SEC recognizes the concerns raised by a number of commenters, including ICI, that “a general solicitation for a Rule 506(c) offering would attract both accredited and non-accredited investors and could result in an increase in fraudulent activity in the Rule 506 market, as well as an increase in unlawful sales of securities to non-accredited investors.” [\[8\]](#) In response to these concerns, the SEC proposed a number of measures.

Revisions to Form D and Regulation D as it Relates to Form D. The SEC proposed to:

- Amend Rule 503 of Regulation D to require: (1) the filing of a Form D no later than 15 calendar days in advance of the first use of general solicitation in a Rule 506(c) offering; and (2) the filing of a closing Form D amendment within 30 calendar days after the termination of a Rule 506 offering;
- Amend Form D to require additional information primarily in regard to offerings conducted in reliance on Rule 506; and
- Amend Rule 507 of Regulation D to disqualify an issuer from relying on Rule 506 for one year for future offerings if the issuer, or any predecessor or affiliate of the issuer, did not comply, within the last five years, with all of the Form D filing requirements in a Rule 506 offering.

Legends and Other Mandatory Disclosure. In light of the ability of issuers to publicly advertise Rule 506(c) offerings, the SEC explained that it is concerned “that prospective investors may not be sufficiently informed as to whether they are qualified to participate in these offerings, the type of offerings being conducted and certain potential risks associated with such offerings.” To address these concerns, the SEC proposed new Rule 509, which would require issuers to include prescribed legends in any written communication that

constitutes a general solicitation in any Rule 506(c) offering (“written general solicitation materials”). For example, private funds would be required to include a legend disclosing that the securities being offered are not subject to the protections of the Investment Company Act and additional disclosures in written general solicitation materials that include performance data so that potential investors are aware that there are limitations on the usefulness of such data and provide context to understand the data presented.

Applicability of Rule 156 to Private Funds. The SEC proposed to amend Rule 156 under the Securities Act, which interprets the antifraud provisions of the federal securities laws in connection with sales literature used by investment companies, to apply to private fund sales literature. The Proposing Release explains that this is necessary “because we [the SEC] believe it is important for private funds to consider the Commission’s views on the applicability of the antifraud provisions to their sales literature.” In that regard, the Proposing Release states that “we [the SEC] are of the view that private funds should now be considering the principles underlying Rule 156 to avoid making fraudulent statements in their sales literature.” [\[9\]](#)

Performance Advertising and Other Content Restrictions. The SEC did not propose any specific content restrictions, but rather asks for comment on a recommendation made by ICI and others to mandate additional manner and content restrictions on written general solicitation materials used by private funds, including with respect to the calculation and presentation of performance information.

Filing of Solicitation or Advertising Material. The SEC proposed new Rule 510T of Regulation D to require that an issuer conducting a Rule 506(c) offering submit to the Commission any written general solicitation materials prepared by or on behalf of the issuer and used in connection with the Rule 506(c) offering. Under the proposed rule, the written general solicitation materials would have to be submitted no later than the date of first use of such materials in the offering. The filings would not be publicly available.; The SEC proposed the rule as a temporary rule that would expire two years after its effective date.

Request for Comment on Possible Adjustments to the Definition of Accredited Investor. The SEC did not propose any changes to the definition of accredited investor. The Proposing Release does, however, indicate that the SEC agrees with many commenters, including ICI, who argued that the definition should be reviewed and, if necessary or appropriate, amended. It states that the SEC “staff has begun a review of the definition of accredited investor as it relates to natural persons, including the need for any changes to this definition following the effectiveness of Rule 506(c). This review, which we [the SEC] anticipate will be completed in a timely manner, will encompass, among other things, both the question of whether net worth and annual income should be used as the tests for determining whether a natural person is an accredited investor and the question of what the thresholds should be for those and other potential tests.” [\[10\]](#) Accordingly, the Proposing Release requests comment on various aspects of the definition of accredited investor.

Next Steps

Comments will be due to the SEC on the proposal sixty days after its publication in the Federal Register, likely mid-September. All of the final rules and amendments in the two adopting releases also take effect at that same time, sixty days after publication of those releases in the Federal Register.

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endnotes

[1] See Memorandum No. [26174](#), dated May 22, 2012.

[2] See SEC Approves JOBS Act Requirement to Lift General Solicitation Ban, Securities and Exchange Commission press release no. 2013-124 (July 10, 2013), available at <http://www.sec.gov/news/press/2013/2013-124.htm>.

[3] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release Nos. 33-9415 and IA-3624 (July 10, 2013), available at <http://www.sec.gov/rules/final/2013/33-9415.pdf> (the “General Solicitation and Advertising Adopting Release”).

[4] Disqualification of Felons and Other “Bad Actors” from Rule 506 Offerings, Release No. 33-9414 (July 10, 2013), available at <http://www.sec.gov/rules/final/2013/33-9414.pdf> (the “Bad Actors Adopting Release”).

[5] Amendments to Regulation D, Form D and Rule 156 under the Securities Act, Release Nos. 33-9416, 34-69960, and IC-30595 (July 10, 2013), available at <http://www.sec.gov/rules/proposed/2013/33-9416.pdf> (the “Proposing Release”).

[6] See Letters from Paul Schott Stevens, President and CEO of the Investment Company Institute, dated May 21, 2012, available at <http://www.sec.gov/comments/jobs-title-ii/jobstitleii-13.pdf> (making initial pre-proposal comments), dated August 17, 2012, available at <http://www.sec.gov/comments/jobs-title-ii/jobstitleii-66.pdf> (urging the SEC to propose rules for public comment, rather than adopting interim final rules without the benefit of comment), and Letter from Karrie McMillan, General Counsel, Investment Company Institute, dated October 5, 2012, available at <http://www.sec.gov/comments/s7-07-12/s70712-133.pdf> (commenting on proposed rules).

[7] As explained in the Proposing Release, the vast bulk of capital raised in Rule 506 offerings is for private funds, rather than operating companies. In fact, over 80% of the capital raised in 2012 through such offerings was for private funds (\$725 billion of the \$898 billion raised in 2012). See Proposing Release, at 111.

[8] See, e.g., Proposing Release, at 7-8.

[9] Proposing Release, at 78.

[10] Proposing Release, at 95.