

Practice Update

SEC Proposes Amendments to Regulation D, Form D, and Rule 156

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On July 10, 2013, the U.S. Securities & Exchange Commission (Commission) adopted rules eliminating the ban on general solicitation and advertising in certain private offerings, as required by Section 201(a)(1) of the Jumpstart Our Business Startups Act (JOBS Act), and rules that disqualify felons and other “bad actors” from participating in private placements under certain circumstances. The final rules become effective on September 23, 2013. Our client alert providing information about these final rules can be found [here](#).

Simultaneously, the Commission proposed amendments to Regulation D, Form D, and Rule 156 under the Securities Act of 1933, as amended (the Securities Act), that, if adopted, will subject companies engaged in Rule 506 private offerings (particularly those private offerings that involve general solicitation and advertising (collectively, general solicitation) to additional filings and disclosure requirements. These proposed rules, which can be found [here](#), are the subject of this client alert.

Background

Rule 506 was originally adopted as a safe harbor under Section 4(a)(2) under the Securities Act, which

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exempts transactions “not involving any public offering” from the Securities Act’s registration requirements. The final rules, as adopted, amend Rule 506 to add new Rule 506(c), which permits issuers to use general solicitation when conducting a private offering pursuant to the new rules, so long as all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that all such purchasers are accredited investors.

In response to the release on the rules proposing the elimination of the prohibition on general solicitation for certain private offerings, a large number of commenters, including the Investor Advisory Committee organized by the Commission in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), raised concerns that general solicitation in private offerings could result in an increase in fraudulent activity, and recommended that additional changes be made to Regulation D and Form D simultaneously with the elimination of the prohibition on general solicitation in private offerings to deal with those concerns. While such issues were not addressed in the final rules, in response to those concerns the Commission has proposed these amendments to Regulation D, Form D and Rule 156.

Comments on the proposed rules are due by September 23, 2013. In the proposing release, the Commission not only laid out the proposed rules, but also asked commentators to respond to more than 100 questions about both the proposed rules and about other alternative rules that the Commission might consider adopting (either in lieu of or in addition to the rules proposed). In light of significant interest in this subject from many quarters, it is highly likely that a very large number of comments will be received by the Commission about the proposed rules from those on all sides of these issues.

Highlights of the Proposed Rules

The proposed amendments to Regulation D would make a number of changes to Regulation D and Form D, particularly with respect to offerings involving general solicitation under new Rule 506(c). Among these proposed changes are the following:

- amendments to Rule 503 of Regulation D to require: (i) 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 (ii) the filing of a closing Form D amendment within 30 calendar days of the termination of all Rule 506 offerings;
- amendments to Form D significantly expanding the information required to be included in a Form D with respect to the issuer and its offering;
- the adoption of new Rule 509 of Regulation D that will require (i) issuers to include prescribed legends in any written communication that constitute a general solicitation in any offering conducted in reliance on Rule 506(c), and (ii) private funds to include an additional legend disclosing that the securities being offered are not subject to the protections of the Investment Company Act of 1940; and
- amendments to Rule 507 of Regulation D to disqualify an issuer from relying on Rule 506 in future offerings during the one year period after the filing of all delinquent Form D filings 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 prior Rule 506 offering.

The Commission has also proposed an amendment to Rule 156 under the Securities Act with respect to private funds. Rule 156 interprets the antifraud provisions of the federal securities laws in connection with sales literature used by investment companies. The proposed amendments to Rule 156 would apply this same guidance to the sales literature of private funds.

Finally, the proposal includes new temporary Rule 510T under Regulation D, which would require issuers, on a temporary basis (for two years from the effective date of the new rules) to file any general solicitation materials used in their Rule 506 offerings with the Commission no later than the date of their first use. Such materials would be submitted to the Commission on a non-public basis.

Proposed amendments to Form D filing requirements and to Form D

Offerings of securities conducted under Rule 504, 505 or 506 of Regulation D must currently be reported on a Form D. Under Rule 503 of Regulation D, a notice of sale under Form D must be filed within fifteen days of the first sale made in reliance on Rule 504, 505 or 506. Under the current rule, reliance on the safe harbor from the registration requirements of the Securities Act that is contained in Rules 504, 505, and 506 is not conditioned on the filing of the Form D.

The Commission is proposing that Rule 503 be amended to require issuers that use general solicitation under Rule 506(c) to file an initial Form D in advance of any sales. Specific parts of Form D would have to be filed at least fifteen calendar days before commencing sales. After the filing of this advance Form D, an issuer would be required to file an amendment providing the remaining information, and updating any previous information, within fifteen (15) days after the date of the first sale of securities in the offering, as is currently required under Rule 503. The Commission stated that while not every advance filing will be reviewed, they believe the advance filings will be useful for investors in gathering information about issuers, as well as to state securities departments who may review these filings as part of their efforts to protect investors in their state.

The Commission is also proposing an amendment to Rule 503 to require the filing of an amendment to

Form D within 30 days after the termination of any offering conducted in reliance on Rule 506 (whether or not such offering involves general solicitation). In the proposing release, the Commission stated its belief that this amendment will give the Commission a greater ability to analyze the Regulation D offering market, especially since the overwhelming majority of Regulation D offerings are conducted under Rule 506. The filing would be required whether the offering completes its sale or whether it is terminated by the issuer for other reasons. Until the closing amendment is filed, the issuer would remain subject to the current Rule 503 requirement that an annual amendment to Form D be filed, and any filings made otherwise as needed, to reflect changes in previously filed information and to correct material mistakes and errors.

Finally, the Commission is proposing content changes to the information required to be provided in a Form D. In the release adopting Rule 506(c), the Commission adopted a revision to Form D to add a separate check box for issuers to indicate whether they are relying on Rule 506(b), which does not allow for general solicitation, or Rule 506(c), which does. In this release, the Commission is proposing to require more information about the issuer and the offering in the Form D, including information about the types of general solicitation used in the offering and the methods used by the issuer to verify accredited investor status. Some of this new information would be sought from issuers making any offering under Regulation D (not only offerings utilizing general solicitation under Rule 506(c)). The Commission expressly stated in the proposing release that it believes that such information will assist the Commission in evaluating the impact of Rule 506(c) on the existing Rule 506 market and may also be useful to state securities regulators and investors.

Required Legends in Written Material Used in a Rule 506(c) Offering

The Commission proposal includes new requirements to better inform potential investors as to whether they are qualified to participate in Rule 506(c) offerings, the type of offerings being conducted, and the risks associated with such offerings. The new proposals, if adopted, would be codified in a new Rule 509 of Regulation D and would require issuers to include the legends enumerated, in a prominent place, in any Rule 506(c) general solicitation materials. With respect to offerings by private funds, if such offering materials include performance data, under the proposed rules such offering materials will need to include disclosures similar to those required by Rule 482 under the Securities Act for advertisements and other sales materials of registered investment companies. Finally, the Commission expressly provided in the release that “compliance with the proposed legend requirements...does not relieve an issuer from the requirement to take reasonable steps to verify that purchasers in Rule 506(c) offerings are accredited investors.”

Rule 507 Disqualification

The Commission is proposing amendments to Rule 507 of Regulation D in order to improve Form D filing compliance with respect to Rule 506 offerings. Currently, Rule 507 only disqualifies an issuer from using Regulation D if the issuer, or a predecessor or affiliate, has been enjoined by a court for violating the filing requirements of Rule 503. The proposal states that, in addition to those disqualification rules, an issuer would be disqualified automatically from using Rule 506 in any future offering (whether or not using general solicitation) for one year if the issuer, or any predecessor or affiliate of the issuer, did not comply, within the past five years, with the Form D filing requirements in a Rule 506 offering. The one-year period would commence following the filing of all required Form D filings or, if the offering has been terminated, following the filing of a closing amendment, and issuers would be regarded as having complied with the Rule 503 filing deadlines

for a Form D or a Form D amendment if they filed the relevant filing within a 30-day cure period after the filing is due (which cure period would only be available for the first failure to file a timely Form D or Form D amendment). Further, the disqualification could be waived by the Commission upon a showing of good cause.

Disqualification would only apply to future offerings (and such noncompliance would not affect the availability of the safe harbor from registration provided in Regulation D for the offering in which the issuer did not make the required filing(s) under Rule 507) and would only apply to non-compliance with Rule 503 that occurs after the effectiveness of the new rule.

The failure to comply with the legend requirements of new Rule 509 would only result in disqualification from future reliance on Rule 506 if the issuer, or any of its predecessors or affiliates, has been subject to an order judgment or court decree enjoining such persons for failure to comply with Rule 509. The difference in treatment of failures to file Form D compared to the disqualification for failure to comply with the Rule 509 reflect the Commission's concern that the disqualification provisions not result in disproportionate consequences for inadvertent errors and omissions, particularly in light of the large amounts of written communications that many issuers may use in the course of a Rule 506(c) offering that might be viewed as written general solicitation materials triggering the requirement for the inclusion of legends under proposed Rule 509.

Amendments to Rule 156

The Commission is proposing amendments to Rule 156 under the Securities Act to apply the requirements of that rule to the sales literature of private funds. Rule 156 currently provides guidance on the types of information in investment company sales literature that could be misleading for

purposes of the securities laws, including Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act), and Rule 10b-5 thereunder. The new rule would apply the guidance in Rule 156 to offerings by private funds, whether or not such funds use general solicitation in their private offerings, and reflects the view of the Commission that statements or representations in sales literature have the potential to mislead investors regardless of the type of offering, investors' levels of sophistication or whether such materials are used in a general solicitation.

A number of commentators have raised concerns about whether eliminating the prohibition against general solicitation will create more opportunities for private funds to distribute misleading and fraudulent information, particularly in the area of performance data. However, while the Commission discussed the issue in its proposing release, it elected not to include new restrictions or prohibitions on the use of performance data in the proposed rules.

Proposed Rule 510T

The Commission is proposing to add temporary Rule 510T to Regulation D. Rule 510T, if adopted, will require that an issuer conducting an offering in reliance on Rule 506(c) submit to the Commission any written general solicitation materials prepared by or on behalf of an issuer and used in a Rule 506(c) offering. Under the proposed rule, the written general solicitation materials would have to be submitted no later than the date of their first use. The proposed rule would expire two years after its effective date.

The Commission stated its belief that it is important, in evaluating early general solicitation offerings, that it have access to the market practices through which issuers solicit purchasers. The materials would be submitted through an intake page on the

Commission's website, and would not be made publicly available. Since the filings would not be under the EDGAR system, the materials would not be considered as being "filed" or "furnished" for purposes of the Securities Act or the Exchange Act. Oral communications would not be subject to Rule 510T.

In conjunction with the temporary rule, Rule 507(a) would be amended to state that the exemption from registration provided in Rule 506 would be unavailable to an issuer if that issuer, or any of its predecessors or affiliates, has been subject to any order, judgment or decree enjoining such person for failure to comply with Rule 510T.

Accredited Investor Definition

While not expressly part of the proposed rules, the Commission raised in its proposing release the issue of studying the definition of "accredited investor" as it relates to natural persons. Under the Dodd-Frank Act, the Commission is required to review the definition of "accredited investor" as it relates to natural persons every four years (with the next review to take place in July 2014). Further, the Government Accountability Office (GAO) recently issued its report, as required by the Dodd-Frank Act, setting forth its views on the appropriate criteria for determining the financial thresholds and other criteria for individuals qualifying as "accredited investors."

In the proposing release, the Commission stated that it has begun its review of the definition of "accredited investor" as it relates to natural persons and stated that its review will encompass both the question of whether net worth and annual income should continue to be the tests used to determine which natural persons are "accredited investors," as well as the question of what the thresholds should be for those and other potential tests. To facilitate its review of this subject, the Commission asked

commentators to respond to several questions about these issues.

The Landscape

One of the issues on the table at the open meeting of the Commission at which these final and proposed rules were adopted was whether adopting a final rule eliminating the prohibition against general solicitation in certain private offerings while not simultaneously adopting additional investor protection measures was appropriate. There were also issues on the table as to whether the proposed rules would inhibit capital formation, a key purpose of the JOBS Act.

On one side of the table, Commissioner Luis Aguilar, who voted against the final rules adopting Rule 506(c), stated that the new rules should only be adopted concurrently with rules that promote investor protection and provide regulators with the tools they need to police the market effectively. On the other side of the table, Commissioners Daniel Gallagher and Troy Paredes voted against the proposed amendments to Regulation D, Form D and Rule 156. In their comments made at the open meeting, they stated their belief that the proposed rules changes go too far and would discourage the use of Rule 506, potentially thwarting the purpose of JOBS Act. Commissioner Gallagher stated his fear that the proposed rules would lead to a smaller, more burdened private market, mirroring problems with public markets that he believes have become too costly and burdensome for all but the largest companies. Commissioner Gallagher also encouraged commenters to provide the Commission with “blunt feedback” on all aspects of the proposed rules.

In addition to the policy concerns above, there are also other activities going on at the Commission that may affect the timing of the Commission’s consideration of the proposed rules described in this client alert. First, in the final rules adopting release

eliminating the prohibition against general solicitation in certain private offerings, the Commission directed the Staff to execute a comprehensive work plan to review the effectiveness of Rule 506(c) and to analyze the use of Rule 506(c). Also, as discussed above, the Commission has begun its long awaited review of the definition of “accredited investor” as to natural persons. It is possible that the Commission may elect to defer consideration of the proposed rules until one or both of these projects are completed.

Further, the Commission has an extensive agenda of regulatory projects to complete under the JOBS Act and the Dodd-Frank Act, and while these proposed rules are likely to be considered a high priority by the Commission, there are other initiatives that are likely to have a higher priority than these proposed rules.

Finally, as of August 15, 2013, the composition of the Commission has changed. Commissioners Kara Stein and Dr. Michael Piwowar were recently sworn in to replace Commissioners Elisse Walter and Troy Paredes. The viewpoints of the new Commissioners on the proposed rules will add a further level of uncertainty to this process, and, at the very least, will likely slow down the process of adoption of the new rules until the new Commissioners get up to speed with the issues on the table.

In light of all of these factors, it will surprise us to see the proposed rules considered for enactment until sometime early next year (at the earliest). We will, of course, keep you advised as these matters develop. Further, those with an interest in the issues raised in the proposing release should consider making their thoughts known to the Commission through the comment process.

If you have any questions, please contact the authors or another member of the Securities practice.

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