Clients&FriendsMemo

SEC Adopts Significant Amendments to Private Placement Rules: JOBS Act Rules Eliminate Ban on General Solicitation and Dodd-Frank Mandate Disqualifies Bad Actors

August 13, 2013

I. Introduction

On July 10, 2013, the U.S. Securities and Exchange Commission (**"SEC"**) adopted rule changes that will permit "general solicitation and general advertising" (**"GSGA"**) in "private" securities offerings effected under either Rule 506 of Regulation D under the Securities Act of 1933 (the **"Securities Act"**) or Rule 144A under the Securities Act.[1] The SEC's rule changes – which fulfill rulemaking requirements imposed on the SEC by the Jumpstart Our Business Startups Act (the **"JOBS Act"**) – will become effective on September 23, 2013; i.e., 60 days after publication of the rule changes in the Federal Register (the **"Effective Date"**).

At that same July 10, 2013 meeting, the SEC adopted rule changes (the **"Bad Actor Rules"**) to disqualify offerings from relying on the Rule 506 exemption from Securities Act registration if felons and other "bad actors" are associated with or participate in the offering.[2]

In conjunction with its approval of GSGA, the SEC also **proposed** certain disclosure and Form D filing rules relating to securities offerings effected under Rule 506, as well as certain other rules designed to enhance the SEC's information gathering on, and thus understanding of, the Rule 506 market and to protect investors (collectively, the **"Proposed Amendments"**).[3]

---

1 *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, 78 FR 44771, 44771 - 44805 (July 24, 2013) (the **"GSGA Adopting Release"**), available at http://www.gpo.gov/fdsys/pkg/FR-2013-07-24/pdf/2013-16883.pdf

2 *See* Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings, 78 FR 44729, 44729 - 44771 (July 24, 2013) (the **"Bad Actor Adopting Release"**), available at http://www.gpo.gov/fdsys/pkg/FR-2013-07-24/pdf/2013-16983.pdf

3 *See* Amendments to Regulation D, Form D and Rule 156, 78 FR 44806, 44806 - 44855 (July 24, 2013) (the "**Proposed Amendments Release**"), available at http://www.gpo.gov/fdsys/pkg/FR-2013-07-24/pdf/2013-16884.pdf

A. Executive Summary of the GSGA Changes

The SEC adopted the GSGA amendments to Rule 506 and Rule 144A to comply with Section 201(a) of the JOBS Act, which requires the SEC to remove the prohibition on GSGA for securities offered under those rules. While the new GSGA rules permit issuers and their agents to solicit potential investors through GSGA materials (including mass mailings, newspaper advertisements, unrestricted websites, television spots and social media), issuers should understand the requirements, restrictions and legal implications of the GSGA rules before using them. Certain issuers will likely find it easier to rely on traditional private placement methods, which will continue to be available, although the new Bad Actor Rules will be relevant.

Pursuant to newly-added paragraph (c) of Rule 506, an issuer can offer securities through GSGA methods if: (1) the issuer continues to satisfy all terms and conditions of Rules 501, 502(a) and 502(d) of Regulation D; (2) all purchasers of the securities are "accredited investors," as defined in Rule 501(a) of Regulation D (subject to the "reasonable belief" standard in Rule 501(a)); and (3) the issuer takes "reasonable steps to verify" that the purchasers are accredited investors.

Rule 506(c) identifies certain non-exclusive and non-mandatory methods of verifying that natural persons who purchase securities are accredited investors.

In addition, the issuer will be required to indicate on the amended Form D that the offering is being effected pursuant to Rule 506(c).

Pursuant to Rule 144A, as amended, securities may be offered and resold through GSGA methods, provided the securities are sold only to qualified institutional buyers (**"QIBs"**) (as defined in Rule 144A) or to purchasers the seller reasonably believes are QIBs.

B. Executive Summary of the Bad Actor Rules

The SEC also adopted a new paragraph (d) to Rule 506, which disqualifies securities offerings from relying on Rule 506 if certain felons and other "bad actors" are associated with the issuer, any investment manager or any paid solicitor for the offering. This rule change was mandated by Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (**"Dodd-Frank"**) and applies regardless of whether an offering is effected pursuant to paragraph (c) or paragraph (b) of Rule 506.

A paragraph (d) disqualification will be triggered if an enumerated disqualifying event occurs on or after the Effective Date with respect to a varied range of persons associated with the issuer or the offering (as further enumerated in the body of this Memorandum).

The disqualifying events include certain criminal convictions, certain orders by courts or regulators (at the state or federal level), or suspension or expulsion from securities self-regulatory organizations.

A disqualifying event that occurred prior to the Effective Date will not result in disqualification under Rule 506. However, pursuant to newly-added paragraph (e) of Rule 506, a disqualifying event occurring prior to the Effective Date must be disclosed by the issuer at a reasonable time prior to any sale, unless the issuer did not know, and in the exercise of reasonable care, could not have known, of the event.

C. Executive Summary of the Proposed Amendments

In that same July 10, 2013 meeting, the SEC, in a 3-2 vote, proposed additional amendments to Regulation D, Form D and Rule 156 under the Securities Act. With respect to offerings conducted with GSGA pursuant to Rule 506(c), the timing of the Form D filing would change, as would its content. More significantly, an issuer would be disqualified from relying on the Rule 506 safe harbor for future offerings if it (or any of its predecessors or affiliates) fails to comply with the Form D filing requirements. With respect to GSGA materials, the SEC proposed that certain legends or cautionary statements be included and that such materials be submitted to the SEC on a temporary basis, via a portal on the SEC website.

In the Proposed Amendments Release, the SEC also proposed extending the antifraud guidance contained in Rule 156 under the Securities Act – which currently is applicable only to SEC-registered investment companies – to sales literature of private funds. In addition, the SEC solicited comments regarding the restrictions on the content of performance information in GSGA materials used by private funds, as well as regarding the Rule 501(a) definition of "accredited investor."

II. The GSGA Changes

A. Conditions for Utilizing GSGA

1. In a Rule 506(c) Offering

If an issuer wishes to utilize GSGA, as permitted under new paragraph (c) of Rule 506, the following conditions must be met:

1) the issuer must satisfy all terms and conditions of Rules 501, 502(a) and 502(d) of Regulation D;

2) all purchasers of the offered securities must be "accredited investors" or are reasonably believed to be such;[4] and
3) the issuer must take "reasonable steps to verify" that the purchasers of the securities are accredited investors.

The GSGA Adopting Release emphasizes that the "reasonable steps" requirement is in addition to the requirement that sales be limited to accredited investors. That is, an issuer that fails to take "reasonable steps" of verification will not have complied with the GSGA requirements even if the ultimate purchasers turn out to be accredited investors. However, footnote 111 of that release notes that, "[i]f an issuer has actual knowledge that the purchaser is an accredited investor, then the issuer will not have to take any steps at all."

An issuer conducting an offering pursuant to Rule 506(c) must indicate its reliance on Rule 506(c) in a new check box on the amended Form D.

2. In a Rule 144A Offering

Under revised Rule 144A – which provides a non-exclusive safe harbor from registration under the Securities Act for resales of certain restricted securities to QIBs – resales can be conducted using GSGA, provided the securities are sold only to QIBs or to purchasers the seller reasonably believes are QIBs. Footnote 172 of the GSGA Adopting Release confirms that the general solicitation that is permitted in connection with Rule 144A resales will not affect the availability of the Section 4(a)(2) exemption or Regulation S for the initial sale of securities by the issuer to the initial purchasers.

B. Accredited Investor Verification Methods for Rule 506(c) Offerings

1. Principles-Based Verification Approach

As noted, issuers that utilize GSGA methods in reliance upon Rule 506(c) must take "reasonable steps" to verify that the purchasers of the securities are "accredited investors." The SEC stated that it will take a principles-based approach to determining reasonableness, in light of the facts and circumstances. In the GSGA Adopting Release, the SEC noted that relevant factors for issuers to consider include: (1) the nature of the purchaser and type of accredited investor the purchaser claims to be; (2) the amount and type of information the issuer has about the purchaser; and (3) the nature of the offering, such as the manner in which the purchaser was solicited to participate, as

[4] Although Rule 506(c) states that all purchasers must be accredited investors, that status is subject to the reasonable belief standard contained in Rule 501(a) (e.g., to accommodate instances in which an investor may provide false information as to its status).

well as the terms of the offering, such as minimum investment amount. That release indicates that, the more likely it appears, after consideration of the facts and circumstances, that the purchaser is an accredited investor, the fewer steps the issuer will have to take to verify accredited investors status. The SEC specifically declined to prescribe uniform verification methods, concluding that those "may be ill-suited or unnecessary to a particular offering or purchaser." Rather, it emphasized that market participants have the flexibility to adopt different verification approaches depending on the circumstances. The GSGA Adopting Release notes that the types of information regarding a purchaser that can be reviewed include publicly available information in regulatory filings and information obtained from a reliable third-party service that verifies accredited investor status for purposes of Rule 506(c). Regardless of the particular verification methods undertaken, the GSGA Adopting Release emphasizes that issuers and their agents should retain adequate records regarding the steps taken.

With respect to the nature of the offering itself, the GSGA Adopting Release acknowledges that less due diligence may be required with respect to a purchaser that was solicited based upon inclusion in a database of pre-screened accredited investors than with respect to a purchaser solicited through less selective means (e.g., through a widely-disseminated email or a newspaper ad). Additionally, a less extensive verification process may be reasonable where a high minimum investment is required. However, if an issuer intends to utilize minimum investment amount as the primary method of verifying accredited investor status, it may be appropriate (depending upon the facts) to confirm that the purchaser's investment is not being financed by a third party.

The GSGA Adopting Release states that an issuer will be entitled to rely on a third party that has verified a purchaser's accredited investor status, so long as the issuer has a reasonable basis for this reliance. That release emphasizes that merely requiring a purchaser to self-identify as an accredited investor (e.g., by checking a box or signing a form) does not, in and of itself, constitute a reasonable step to verify accredited investor status.

2. Non-Exclusive Verification Methods for Natural Person Investors

The GSGA Adopting Release acknowledges that verifying the accredited investor status of natural persons may pose greater practical difficulty than verifying the accredited investor status of certain institutional investors, particularly those as to which there is publicly available information. Accordingly, in the case of natural person investors, Rule 506(c) identifies certain "non-exclusive and non-mandatory" methods that are deemed to satisfy the accredited investor verification requirement. (Note that Rule 506(c) does not suggest any specific verification methods for institutional accredited investors.)

Rule 506(c) indicates that an issuer can verify that a natural person is an accredited investor on the basis of income by:

1) reviewing copies of any IRS form that reports income (e.g., Form W-2 or Form 1099) for the two most recent years; and

2) obtaining a written representation from the investor that he or she has a reasonable expectation of reaching the necessary income level in the current year.

Rule 506(c) specifies that an issuer can verify that a natural person is an accredited investor on the basis of net worth by:

1) obtaining information dated within the prior three months with respect to both the person's assets and the person's liabilities; and

2) obtaining a written representation from the person that all liabilities necessary to determine net worth have been disclosed.

For purposes of the asset side of the new worth test, the issuer can review a person's bank statements, brokerage or other securities holdings statements, certificates of deposit, tax assessments and/or appraisal reports by independent third parties. With respect to liabilities, the issuer can review a consumer report from at least one national consumer reporting agency.

Rule 506(c) also indicates that an issuer can verify a natural person's accredited investor status by obtaining a written confirmation from an SEC-registered broker-dealer, an SEC-registered investment adviser, a licensed attorney or a certified public accountant to the effect that the confirming party has taken reasonable steps to verify that the natural person is an accredited investor within the prior three months and has determined that the person is an accredited investor. The GSGA Adopting Release notes that an issuer also may be entitled to rely on accredited investor verification conducted by other types of third parties, provided the issuer has a reasonable basis for such reliance.

Rule 506(c) further provides that, if a natural person purchased securities in an issuer's Rule 506 offering prior to the Effective Date as an accredited investor and remains an investor of the issuer, that person may invest in any Rule 506(c) offering conducted by the same issuer by providing an accredited investor certification at the time of sale. The issuer need not undertake reasonable steps to verify the "accredited investor" status of such prior investors.

C. Amendments to Form D

The SEC also adopted amendments to Form D requiring an issuer to designate the type of exemption being relied upon by the issuer; i.e., Rule 506(b) or Rule 506(c). Note that, in conjunction with the Bad Actor Rules discussed below, Form D also includes an issuer certification that the issuer is not disqualified by Rule 506(d) from relying on Rule 506.

D. Legal Implications of GSGA

1. Relating to the Investment Company Act

The GSGA Adopting Release clarifies that private funds that engage in GSGA in reliance upon Rule 506(c) may continue to rely upon the exclusions from the definition of "investment company" set forth in Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act of 1940, even though those exclusions specify that an issuer relying upon them is "not making and does not [currently] propose to make a public offering of its securities." The SEC reached this conclusion because Section 201(b) of the JOBS Act provides that offers and sales pursuant to Rule 506 "shall not be deemed public offerings under the Federal securities laws" as a result of GSGA.

2. Relating to Regulation S

The GSGA Adopting Release makes clear that offshore offerings that are conducted in compliance with Regulation S under the Securities Act will continue to benefit from that safe harbor and will not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A, even if those offerings involve GSGA.

3. Relating to Section 4(a)(2) and Blue Sky Laws

The GSGA Adopting Release emphasizes that Section 4(a)(2) of the Securities Act exempts from registration "transaction(s) by an issuer not involving any public offering" and issuers that do not intend to engage in GSGA may continue to rely on Section 4(a)(2) or Rule 506(b). Issuers that rely on Section 4(a)(2) or Rule 506(b) exemptions need not take the Rule 506(c)- prescribed steps to verify the "accredited investor" status of purchasers. Additionally, as set forth in the GSGA Adopting Release, securities offered in compliance with Rule 506(c) will be deemed to be "covered securities" for purposes of Section 18(b)(4)(E) of the Securities Act and, thus, will not be subject to state blue sky registration requirements. However, securities that are offered solely pursuant to Section 4(a)(2) are not "covered securities" and may be subject to state blue sky regulations.

4. Relating to the Investment Advisers Act

The GSGA Adopting Release notes that GSGA materials produced by SEC-registered investment advisers to private funds are subject to the antifraud provisions of Rule 206(4)-8 of the Investment Advisers Act of 1940. That release indicates that investment advisers to private funds should carefully review their policies and procedures to determine whether those materials are reasonably designed to prevent the use of fraudulent or materially misleading private fund advertising and should make appropriate amendments if the private fund intends to engage in GSGA.

5. Relating to the Broker-Dealer Registration

The relief from the pre-existing private placement requirements provided by the GSGA Adopting Release does not provide any exemption from the "broker" registration requirement under the Securities Exchange Act. In light of the SEC's recent disciplinary action and statements on the broker registration requirement as to private funds and investment advisers, private funds and investment advisers should be mindful of the permissible conduct of their personnel, whether or not they are using GSGA.

6. Relating to FINRA Rules

The GSGA Adopting Release notes that SEC-registered broker-dealers participating in offerings relying on Rule 506(c) continue to be subject to FINRA rules regarding communications with the public. In particular, FINRA Rule 2210 and the FINRA interpretations thereunder need to be taken into consideration.

7. Relating to the Commodity Exchange Act, Commodity Futures Trading Commission ("CFTC") Rules and NFA Rules

Managers of "commodity pools" that are offered pursuant to Rule 506 who are currently relying on the exemption under CFTC Rule 4.7 from certain disclosure, reporting and record keeping requirements otherwise applicable to registered commodity pool operators (**"CPOs"**), or an exemption under CFTC Rule 4.13(a)(3) from registration as a CPO, must consider whether GSGA methods are available for offerings of those commodity pool interests. A condition of CFTC Rule 4.7(b) is that commodity pool interests be offered and sold solely to "qualified eligible persons" (as defined in CFTC Rule 4.7). Based upon the language of the rule and other applicable guidance, it is unclear whether this condition permits the use of GSGA given that offers would not be so limited even if sales were. CFTC Rule 4.13(a)(3) requires that commodity pool interests be "offered and sold without marketing to the public in the United States." The CFTC has yet to harmonize these

CFTC rules with Rule 506(c) or otherwise to clarify its approach to the use of GSGA offering methods for these types of pools.[5]

Further, GSGA materials must be reviewed and considered under CFTC Rule 4.41, which relates to advertising by commodity pool operators and commodity trading advisors, as well as under NFA Rule 2-29, which relates to communications with the public and promotional materials.

8. Relating to Non-U.S. Private Placements of Fund Interests

Managers to private funds that offer interests in non-U.S. jurisdictions also should consider whether the use of GSGA is compatible with the private placement requirements of those jurisdictions. Note, as well, that the Alternative Investment Fund Managers Directive (**"AIFMD"**) came into effect on July 22, 2013 in the European Union (**"EU"**). The AIFMD is a new regime that regulates managers who market to investors in the EU. The AIFMD defines "marketing" as any "direct or indirect offering or placement at the initiative of the [Alternative Investment Fund Manager (**"AIFM"**)] or on behalf of the AIFM of units or shares of an [Alternative Investment Fund] it manages to or with investors domiciled or with a registered office in the Union." It is generally understood that reverse solicitation is excluded from the definition of "marketing"; however, very little guidance has been provided with respect to the types of interactions that fall outside the definition of "marketing." Moreover, EU member states may permit non-EU AIFMs (who cannot initially participate in the passport regime that is available to EU AIFMS under the AIFMD) to market only to "professional investors" if certain requirements are fulfilled under the AIFMD. Issuers therefore should be aware of the scope of their advertising efforts to ensure they are complying with all relevant private placement regimes in non-U.S. jurisdictions and should consider relevant guidance with respect to non-U.S. and AIFMD implementation as it becomes available.

E. Certain Practical Considerations relating to Private Fund Use of GSGA

Private fund managers intending to offer fund interests under Rule 506(c) must consider their policies and procedures with respect to the offering process and the documentation provided to investors. With respect to offering documents, certain standard selling restriction legends should be removed. In addition, subscription documents should be updated to assist with the process of verifying "accredited investor" status and to remove outmoded representations regarding selling restrictions.

---

[5] In the CFTC's final rule-making release entitled "Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators" (issued on August 13, 2013), the CFTC acknowledged the disparity between the two regimes but did not address the issue. The CFTC did direct its staff to evaluate the issue and make recommendations for future action regarding harmonization. See Harmonization of Compliance Obligations for Registered Investment Companies Required to Register as Commodity Pool Operators, (Aug. 13, 2013), available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister081213.pdf

Note also that if a fund manager intends to remove any restrictions on its website, such as password protection, its fund offerings may be deemed to be under Rule 506(c) (depending upon the content of its website) and the measures discussed in Section II.A. above may need to be taken with respect to its offerings. Private fund managers that intend to rely on Rule 506(b) should not remove these website restrictions and should continue to rely on SEC guidance regarding a true private placement (see, for example, Lamp Technologies, Inc., SEC No-Action Letter (May 29, 1998)).

III. The Bad Actor Rules

A. Overview

New paragraph (d) of Rule 506 – which was adopted to implement Section 926 of Dodd-Frank – disqualifies a securities offering from relying upon Rule 506 (even for a traditional private placement not using GSGA) if a felon or other "bad actor" is associated with the issuer, any investment manager or a paid solicitor. Disqualification will apply only for triggering events that occur on or after the Effective Date. Triggering events occurring prior to the Effective Date require written disclosure under new paragraph (e) of Rule 506. Sales made before the Effective Date will not be affected by any disqualification or disclosure requirement, even if the sales are part of an offering that continues after the Effective Date.

B. Covered Persons Generally

The disqualification provisions apply to triggering events relating to the following categories of persons (referred to herein as "covered persons"):

- The issuer (including any predecessor) and affiliated issuers;[6]
- The issuer's directors and executive officers, as well as non-executive officers who participate in the offering;[7]
- Beneficial owners of 20% or more of the issuer's outstanding voting equity securities, calculated based on voting power;
- Promoters connected with the issuer in any capacity at the time of sale;
- Investment managers of the issuer, if the issuer is a pooled investment fund;
- Persons paid for soliciting purchasers in the offering (referred to herein as **"paid solicitors"**);

[6] The term "affiliate" is defined in Rule 501(b) of Regulation D.

[7] The term "executive officer" is defined in Rule 501(f) of Regulation D.

- General partners or managing members of the issuer, any investment manager or any paid solicitor; and
- Directors and executive officers of an investment manager, a paid solicitor or the general partners or managing members thereof, as well as non-executive officers of each of the foregoing who participate in the offering.

The Bad Actor Adopting Release notes that identifying any non-executive officers participating in an offering will be a question of fact, but that involvement will have to be more than transitory or incidental. Examples of activities that could constitute participation in an offering include participation in due diligence activities or the preparation of disclosure documents and communication with the issuer, prospective investors or other offering participants.

With respect to 20% owner status, the Bad Actor Adopting Release indicates that whether securities are "voting securities" should be determined based upon whether security holders "have or share the ability . . . to control or significantly influence the management and policies of the issuer through the exercise of a voting right."

The release also notes that the category of "promoter" is broad and captures all individuals and entities that have the relationship with the issuer or to the offering specified in Rule 405 under the Securities Act. The release notes, in particular, that the definition of promoter requires issuers to look through entities.

Note that Rule 506(d)(3) provides that events relating to certain affiliated issuers will not be considered disqualifying if they pre-date the affiliate relationship.

C. Triggering Events

Events relating to a covered person that will disqualify an offering from relying upon Rule 506 include:

- Certain felony and misdemeanor convictions involving the purchase or sale of a security, the making of a false filing with the SEC or the conduct of certain securities-related businesses, as well as certain court injunctions and restraining orders relating to the foregoing types of activities.

- Certain final orders[8] from the CFTC, state securities commissions, state and federal banking regulators, state insurance commissions or the National Credit Union Administration that bar a

[8] The SEC amended Rule 501 of Regulation D to define "final order."

person from engaging in certain regulated activities or from associating with certain regulated entities, or that are based on violation of any antifraud law or regulation.

- Certain SEC disciplinary orders suspending or revoking the person's SEC registration, limiting the person's activities or barring the person from being associated with any entity or participating in penny stock offerings.

- Certain SEC cease-and-desist orders ordering the person to refrain from violating any scienter-based antifraud provision of the federal securities laws or Section 5 of the Securities Act.

- Certain suspensions or expulsions from membership in, or suspensions or bars from association with a member of, a securities self-regulatory organization.

- Having filed (as a registrant or issuer), or being named an underwriter in, a registration statement or Regulation A offering statement that was or is the subject of certain SEC orders, investigations or proceedings.

- United States Postal Service false representation orders or preliminary injunctions or temporary restraining orders relating to conduct alleged to constitute a scheme or device for obtaining money through the mail by means of false representations.

Certain triggering events are subject to a look-back period of either five or ten years from the time of the sale. However, certain of such orders are disqualifying only if they continue to be in effect at the time of sale. For example, court injunctions and restraining orders that are no longer in effect are not disqualifying even if they were issued within the applicable look-back period.

Rule 506(d)(2) provides a "reasonable care" exception from disqualification for an issuer that can establish that it "did not know and, in the exercise of reasonable care, could not have known that a disqualification existed…." The Instruction to paragraph (d)(2) states that an issuer will not be able to establish that it has exercised reasonable care unless it has made factual inquiry into whether any disqualifications exist. However, that Instruction makes clear that the nature and scope of the factual inquiry will vary based on the facts and circumstances. The Bad Actor Adopting Release accordingly does not prescribe particular steps as being necessary or sufficient to establish reasonable care. However, it indicates that factual inquiries of covered persons (which may involve questionnaires or certificates accompanied by contractual representations, covenants and undertakings) may be sufficient in some circumstances and that consulting publicly available databases (such as FINRA's BrokerCheck website) concerning past disciplinary history may be sufficient in other cases. That release cautions that circumstances that raise doubt as to the

accuracy of information received by an issuer would require further steps or additional inquiry. For continuous, delayed and long-lived offerings, the Bad Actor Adopting Release indicates that reasonable care will require updating factual inquiries on a reasonable basis. However, the frequency and degree of updating will depend on the circumstances.

Moreover, Rule 506(d) disqualification may be waived by the SEC upon a showing of good cause. The standards for obtaining such a waiver are not specified, although the Bad Actor Adopting Release notes that a change in control or in supervisory personnel are among the circumstances that may be relevant to evaluating a waiver request. In the interests of efficiency, the SEC has delegated the authority to grant waivers of Rule 506 disqualification to the Director of the Division of Corporation Finance.

Further, disqualification will not apply if, before the relevant sale, the court or regulatory authority that entered an order, judgment or decree advises in writing that disqualification under Rule 506 should not arise as a result of such order, judgment or decree.

D. Bad Actor Disclosures

As noted, disqualifying events that occurred prior to the Effective Date will not result in disqualification under Rule 506. However, pursuant to paragraph (e) of Rule 506, those events must be disclosed in writing to each purchaser, at a reasonable time prior to the sale, unless the issuer establishes that it did not know and, "in the exercise of reasonable care, could not have known," of the undisclosed matter. The Instruction to paragraph (e) provides that an issuer will not be able to establish reasonable care unless it has made factual inquiry into whether any disqualifications exist, but states that the nature and scope of this inquiry will depend upon the facts and circumstances. The Bad Actor Adopting Release notes that such disclosure should be given "reasonable prominence" to ensure appropriate presentation in the total mix of information available to investors.

E. "Bad Actor" Issues Specific to Private Funds

In order to comply with Rule 506(d), a private fund wishing to engage in a Rule 506(b) or 506(c) offering must first identify all covered persons. In addition to the fund itself, covered persons for private funds typically will include:

- Affiliated Funds of the Issuer: other funds that have the same general partner, managing member, directors or investment manager as the issuer.
- Controlling Entities of an Issuer: for a limited liability company or partnership, the managing member or general partner, as applicable.

- Investment Managers and their Controlling Entities: the investment managers, as well as any general partner or managing member of the investment managers.
- Placement Agents and their Controlling Entities: each placement agent or other person that is paid to solicit purchasers for securities sold in the offering, as well as any general partner or managing member of such entities.
- Promoters of an Issuer: persons or entities that are captured by the definition of "promoters" under Rule 405, which includes persons or entities that, directly or indirectly, take initiative in founding or organizing the business of the issuer or receive 10% or more of any class of issuer securities in connection with such founding or organization. This definition of promoter, which is broad and imprecise, may encompass the officers, directors and direct or indirect control persons of entities that participate in the launch of a private fund.
- Directors, Executive Officers and Participating Officers of an Issuer, Investment Manager or Solicitor: for issuers, investment managers and paid solicitors, any director or executive officers, as well as any non-executive officer who participates in the offering.
- Directors, Executive Officers and Participating Officers of Investment Manager and Paid Solicitor Controlling Entities: for the controlling entities of investment managers and paid solicitors, any director or executive officer, as well as any non-executive officer who participates in the offering.

Once the scope of covered persons has been determined, a private fund must exercise reasonable care in investigating whether a disqualifying event has occurred. A private fund should develop standard due diligence policies and procedures for different categories of covered persons and should adjust those policies and procedures in response to specific facts and circumstances. Private funds generally should inform themselves with any publicly available information regarding covered persons. In addition, private funds should consider requiring covered persons to sign pre-offering certificates containing representations, warranties and certificates that will serve as a reasonable basis for the private fund to conclude that no disqualifying events have occurred. To reduce the scope of the required due diligence, a private fund may wish to implement policies limiting which officers of its investment managers and paid solicitors may participate in a Rule 506(c) offering.

Because most private funds are continuously engaged in the offering of their interests, due diligence should be updated periodically. A private fund may wish to establish procedures for periodically checking FINRA's BrokerCheck and other publicly available databases. In addition, a private fund might include covenants in pre-offering certificates that require covered persons to notify the private fund if specified events occur or may require certain covered persons to sign and deliver new certificates periodically.

Finally, a private fund engaged in a Rule 506(b) or Rule 506(c) offering will be required to furnish to each investor, a reasonable time prior to the sale of fund interests, a written description of any disqualifying events that occurred prior to the Effective Date. A private fund may consider including such description in its offering documents, in supplemental disclosure provided along with its offering documents and/or in marketing and solicitation materials that are broadly distributed, in order to give the disclosure reasonable prominence within the total mix of information made available to investors.

IV. The Proposed Amendments

A. Proposed Amendments to Form D

1. Advance Form D in Rule 506(c) Offerings

Pursuant to the Proposed Amendments, Rule 503 under Regulation D would be amended to require an issuer intending to rely on Rule 506(c) to file a Form D (the "Advance Form D") at least 15 calendar days prior to the first use of GSGA. That Advance Form D would require that information be provided with respect to the following items of Form D:

- Item 1: issuer's identity;
- Item 2: principal place of business and contact information;
- Item 3: related persons;
- Item 4: industry group;
- Item 6: federal securities law exemption(s) and exclusions being claimed;
- Item 7: type of filing;
- Item 9: type(s) of securities offered;
- Item 10: whether related to a business combination transaction;
- Item 12: persons receiving sales compensation; and
- Item 16: use of proceeds.

The Proposed Amendments also would require an issuer that has filed an Advance Form D to file an amended Form D no later than 15 days after the first sale of securities as is currently required by Rule 503. The amended Form D would respond to the remaining items of Form D (including any information regarding Items 9 or 12 that may not have been known when the Advance Form D was filed). Note that, if an issuer already has filed a complete Form D before it commences GSGA, it would not be required to file an Advance Form D. Similarly, if the issuer has provided all the

information required by the Form D in the Advance Form D, it would not be required to file an amended Form D.

2. Closing Amendments for Rule 506 Offerings

Pursuant to the Proposed Amendments, a "closing amendment" to the relevant Form D would be due no later than 30 days after termination of a Rule 506 offering (whether effected under Rule 506(c) or Rule 506(b)). Until the issuer has filed a closing amendment, the offering would be deemed to be ongoing and the issuer would be subject to the current Rule 503 requirements to file amendments to Form D: (1) at least annually (as Rule 503 currently requires with respect to ongoing offerings); and (2) as otherwise needed to reflect changes in previously filed information (as Rule 503 currently requires with respect to ongoing offerings) and to correct material mistakes and errors.

3. Form D Content Requirements

The Proposed Amendments would require certain additional Form D disclosures, particularly for Rule 506 offerings. Among other things, the Proposed Amendments would: (1) require an issuer to include its website address; (2) require an issuers conducting a Rule 506(c) offering to identify its control persons; (3) require an issuer relying upon Rule 506 to provide detailed information regarding the nature and number of its accredited investors and non-accredited investors and the amount raised from each of those investor categories; (4) require an issuer relying on Rule 506 (other than pooled investment funds) to provide a more detailed break-out regarding use of proceeds; (5) in the event a registered broker-dealer was used in connection with the offering, require an issuer to indicate whether any GSGA materials were filed with FINRA; (6) require a pooled investment fund to provide information regarding each SEC-registered investment adviser or "exempt reporting adviser" that functions as a promoter of the issuer; and (7) require an issuer relying upon Rule 506(c) to identify the types of GSGA materials used or to be used, as well as the methods used or to be used to verify accredited investor status. See Appendix A for a summary of those changes.

B. Proposed Amendment to Rule 507

The filing of a Form D is not a condition to relying upon Rule 506 or any other Regulation D exemption. The Proposed Amendments Adopting Release notes that some issuers therefore do not make the Form D filings prescribed in Rule 503. Rule 507 currently only disqualifies an issuer from relying upon Regulation D if the issuer (or a predecessor or affiliate) has been enjoined by a court for violating the Form D filing requirements. However, the Proposed Amendments would

amend paragraph (b) of Rule 507 to automatically disqualify an issuer from relying upon Rule 506 in any future offering if the issuer (or any predecessor or affiliate) did not comply, within the previous five years, with all applicable Form D filing requirements in connection with a Rule 506 offering. This disqualification would be lifted one year after all required Form D notices and amendments have been filed or, if the offering has been terminated, a closing amendment has been filed. This need to start the one-year disqualification period running would thus provide an incentive to make all required filings, even if on an untimely basis. Under the proposal, disqualification would arise only with respect to noncompliance with Rule 503 that occurred after the effectiveness of proposed Rule 507(b). Note that the SEC has not proposed to make compliance with Rule 503 a condition of relying upon Rule 506. Disqualification thus would not affect any offerings that are ongoing at the time of noncompliance. Rather, the SEC has proposed to encourage compliance with Rule 503 by having disqualification apply to an issuer's future offerings.

In recognition of the potential effect on capital raising, the SEC is proposing a 30-day cure period, which would be available in the case of an issuer's failure to file a Form D or Form D amendment on a timely basis. The proposed cure period would be available only for the issuer's first failure to file on a timely basis in connection with a particular offering. It could not be repeatedly invoked in the same offering.

The Proposed Amendments Adopting Release notes that under Rule 507(b) (which would be redesignated paragraph (c)), issuers may request waiver, upon good cause shown, of disqualification for failure to comply with Rule 503.

C. Proposed Amendments Relating to GSGA Materials

1. Mandated Legends and Other Disclosures for Written GSGA Materials

Proposed Rule 509 would require all issuers to include the following prominent legends in all written GSGA materials used in Rule 506(c) offerings:

- The securities may be sold only to accredited investors, which for natural persons, are investors who meet certain minimum annual income or net worth thresholds;
- The securities are being offered in reliance on an exemption from the registration requirements of the Securities Act and are not required to comply with specific disclosure requirements that apply to registration under the Securities Act;
- The SEC has not passed upon the merits of or given its approval to the securities, the terms of the offering or the accuracy and completeness of any offering materials;

- The securities are subject to legal restrictions on transfer and resale and investors should not assume they will be able to resell their securities; and
- Investing in securities involves risk, and investors should be able to bear the loss of their investment.

In addition to the foregoing proposed legend requirements, private funds engaging in 506(c) offerings would be required to include the following legend in all written GSGA materials:

- The securities offered are not subject to the protections of the Investment Company Act.
- For any GSGA materials that contain performance information, private funds also would be required to include the following:
- A legend disclosing that: (1) the performance data represents past performance; (2) past performance does not guarantee future results; (3) current performance may be lower or higher than the performance data presented; (4) the private fund is not required by law to follow any standard methodology when calculating and representing performance data; and (5) the performance of the private fund may not be directly comparable to the performance of other funds.
- A legend identifying either a telephone number or a website where an investor may obtain current performance data.
- The period for which performance is presented.
- If the performance presentation does not include the deduction of fees and expenses, disclosure that the presentation does not reflect the deduction of fees and expenses and that, if such fees and expenses had been deducted, performance may be lower than presented.

Proposed Rule 509 would require all performance data to be as of the most recent practicable date, considering the type of private fund and the media through which the data would be conveyed.

The Rule 509 legend and disclosures requirements would not be a condition to relying upon the Rule 506(c) exemption. However, the SEC is proposing to amend existing Rule 507(a) so that Rule 506 would be unavailable for future offerings if an issuer (or any of its predecessors or affiliates) has been subject to any order, judgment or court decree enjoining such person for failure to comply with Rule 509.

2. Proposed Amendments to Rule 156

The SEC also is proposing to amend Rule 156 under the Securities Act to apply the antifraud guidance contained in that rule to the sales literature of private funds (whether or not involved in a

506(c) offering). Rule 156 currently provides guidance on the types of SEC-registered investment company sales literature that could be misleading for purposes of the federal securities laws, including Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Under those provisions, whether a statement involving a material fact is misleading depends on evaluating the context in which it is made. Rule 156 outlines certain situations in which a statement could be misleading. Note that, in a Rule 156 context, "sales literature" includes "any communication (whether in writing, by radio, or by television) used by any person to offer to sell or induce the sale of securities. . . ."

3. Request for Comment on Manner and Content Restrictions for Private Funds

The SEC is requesting comment as to whether it should apply any content restrictions to performance advertisements used by private funds and whether a private fund using performance claims in its GSGA materials should be subject to audit by an independent public accountant.

4. Proposed Temporary Rule for Mandatory Submission of Written GSGA Materials.

The SEC also is proposing a new Rule 510T of Regulation D to require an issuer that is conducting a Rule 506(c) offering to submit to the SEC, no later than the date of first use, any written GSGA materials prepared by or on behalf of the issuer and used in connection with the offering. As proposed, this rule would be temporary, expiring two years after its effective date.

The submitted materials would not be publicly available on the SEC's website and would not be treated as being "filed" or "furnished" for purposes of the Securities Act or Exchange Act, including the liability provisions of those Acts. Compliance with proposed Rule 510T would not be a condition to relying upon Rule 506(c). Instead, the SEC is proposing to amend existing Rule 507(a) so that Rule 506 would be unavailable for any future offerings if an issuer (or any of its predecessors or affiliates) has been subject to any order, judgment or court decree enjoining such person for failure to comply with Rule 510T.

D. Request for Comment on the Rule 501 Definition of "Accredited Investor"

The SEC is further requesting comments as to whether net worth and annual income should be used as the Rule 501(a) tests for determining if a natural person is an accredited investor and is reviewing the thresholds for the other enumerated categories of accredited investors. The Proposed Amendments Adopting Release expresses the view that it would be appropriate to coordinate the foregoing review with: (1) the SEC review and consideration of the accredited investor definition required by Section 413(b) of Dodd-Frank; and (2) the General Accounting

Office study mandated by Section 415 of Dodd-Frank regarding the appropriate criteria for determining the financial thresholds or other criteria for qualifying as an accredited investor.

* * * * *

Please feel free to contact any of the following Cadwalader attorneys if you have any questions regarding this Memorandum.

Maurine Bartlett	+1 212 504 6218	maurine.bartlett@cwt.com
Steven Lofchie	+1 212 504 6700	steven.lofchie@cwt.com
Brian Foster	+1 212 504 6736	brian.foster@cwt.com
Dorothy Mehta	+1 212 504 6846	dorothy.mehta@cwt.com
Brandon Clar	+1 212 504 6738	brandon.clar@cwt.com
Andrew Lom	+1 212 504 6143	andrew.lom@cwt.com
Theresa Perkins	+1 212 504 6076	theresa.perkins@cwt.com

APPENDIX A

Proposed Form D Content Requirements

All Offerings	Offerings Pursuant to 504, 505 and 4(a)(5)	Offerings Pursuant to 506	Offerings Pursuant to 506(c)
Website address (if any) Industry group (if not already one of the pre-established list of industry groups) Type of Form D: Advance Form D, initial Form D, amendment to Form D, and closing amendment to Form D.	Offering size: the option "Decline to Disclose" would be replaced with "Not Available to Public."	Number of accredited investors, non-accredited investors, and investors that are natural persons or legal entities and the amount raised for each category of investor 506 offerings by issuers that are not pooled investment funds: percentage of offering proceeds used: (1) to repurchase or retire the issuer's existing securities; (2) to pay offering expenses; (3) to acquire assets, otherwise than in the ordinary course of business; (4) to finance acquisitions of other businesses; (5) for working capital; and (6) to discharge indebtedness. If a class of the issuer's securities is traded on a national securities exchange, ATS or other organized trading venue and/or is registered under the Exchange Act, name of exchange, ATS or trading venue and/or the Exchange Act file number and whether the securities being offered under Rule 506 are of the same class or are convertible into or exercisable or exchangeable for such class In the case of a pooled investment fund advised by SEC-registered investment advisers or exempt reporting advisers, the name and SEC file number for each investment adviser who functions directly or indirectly as a promoter of the issuer.	Related persons to include name and address of any person who directly or indirectly controls the issuer If a broker-dealer is involved, whether GSGA materials were filed with FINRA. Types of GSGA materials used or to be used (e.g., mass mailings, emails, public Web sites, social media, print media and broadcast media) Methods used or to be used to verify accredited investor status (e.g., principles-based method using publicly available information, documentation provided by the purchaser or a third party, reliance on verification by a third party, questionnaire, one of the non-exclusive methods listed in Rule 506(c)(2)(ii) or another method)