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

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August 5, 2013

On July 10, 2013, the Securities and Exchange Commission adopted final rules amending Rule 506 of Regulation D to permit general solicitation and to disqualify felons and other "bad actors" from participating in certain offerings, thereby implementing aspects of the Jumpstart Our Business Startups Act (JOBS Act) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (see our July 2013 alerts: click here and here).

Many observers believe that the SEC is concerned about the effects of new Rule 506(c), which permits general solicitation in Regulation D transactions. We agree. The SEC has now proposed rules that, if adopted in their current form, would likely inhibit the use of new Rule 506(c) by issuers. For its part, the SEC says it is merely trying to "enhance [its] ability to evaluate the development of market practices in Rule 506 offerings and to address concerns that may arise in connection with permitting issuers to engage in general solicitation and general advertising" under Rule 506(c).

Form D – Filing and Content Changes; Disqualification

Under Rule 503 of Regulation D, any issuer that offers or sells securities in reliance on Regulation D must file a notice of sales on Form D for each new offering of securities within 15 calendar days from the first sale of securities in the offering. Rule 503 also requires the filing of an annual amendment to Form D for ongoing offerings.

However, compliance with the Form D filing requirement is not a condition to obtaining a Regulation D exemption, and non-compliance will not result in a violation of the Securities Act. Rule 507 of Regulation D states that an issuer will be disqualified from using Regulation D if it is enjoined by a court for failure to comply with Rule 503, but such injunctions are rare. As a result, some issuers make offerings in reliance on Regulation D without filing and amending Form D.

The SEC has now proposed a number of amendments to Regulation D and Form D. These amendments would:

- require the *advance filing of Form D for offerings made by means of general solicitation* under Rule 506(c)
- *automatically disqualify issuers from using Rule 506 for future offerings of any kind under Regulation D* until one year has elapsed after the required Form D filings are made, if the issuer or its predecessors or affiliates failed to comply with the Form D filing requirements for a Rule 506 offering during a five year "look-back" period
- require the filing of a "closing" amendment to Form D after termination of a Rule 506 offering
- expand the information requirements in Form D for Rule 506 offerings.

Advance Filing

The proposed amendments would require the issuer to file an Advance Form D at least 15 calendar days before commencing general solicitation for a Rule 506(c) offering. The Advance Form D would cover information about the issuer, related parties, the exemption being claimed for the offering, and similar details.

After filing the Advance Form D, the issuer would be required to file an amendment containing the remaining information required by Form D within 15 calendar days after the date of first sale of securities in the offering, as currently required by Rule 503.

By having issuers file an Advance Form D for each Rule 506(c) offering, the SEC expects to gain visibility into offerings that are ultimately unsuccessful in selling any securities (as Rule 503 currently does not provide for a Form D filing until securities are sold in an offering). In addition, issuers could file an Advance Form D without contemplating a specific offering, in order to have the flexibility to conduct an offering using general solicitation.

Disqualification from Future Access to Regulation D

As noted above, Rule 507 currently only disqualifies an issuer from using Regulation D if the issuer has been enjoined by a court for violating the filing requirements in Rule 503 – something the SEC readily admits is a rare occurrence.

The proposed amendment, Rule 507(b), would further disqualify an issuer, automatically, from using Rule 506 in any new offering for one year if the issuer, or its predecessor or affiliate, failed to comply with Form D filing requirements in a Rule 506 offering within the past 5 years. The one-year disqualification would not commence until after the filing of all required Form D filings or, if the offering was terminated, following the filing of a closing amendment (discussed below). However, issuers would not be responsible for non-compliance that occurred prior to the effectiveness of a new Rule 507(b). Moreover, issuers would be granted a one-time, 30-day "cure period" in which to detect a failure to file or amend a Form D and make the requisite filing. The SEC would continue to have authority to waive a violation.

The prospective loss of access to Regulation D could have negative effects on the private placement market, but for now the SEC believes this measure − which also enhances data gathering − is appropriate to strengthen the incentives for issuers to comply with Rule 503. The SEC has also taken care to clarify that, because compliance with Rule 503 would not become a condition of Rule 506 in a validly commenced offering, non-compliance at any stage of an offering will not result in a violation of Section 5 of the Securities Act or other applicable state securities laws, or give investors a right to rescind their purchases.

Closing Amendment

In order to track the number of offerings made under Rules 506(b) and 506(c), as well as the total capital raised under such offerings, the SEC has proposed amending Rule 503 to require the filing of a Form D "closing amendment" marking the termination of an offering. This closing amendment would be made within 30 calendar days after the termination of any Rule 506 offering, unless an issuer has already provided the required information and "checked the box" for a closing filing in a previous Form D filing. Because the SEC would consider any offering to be ongoing until the closing amendment is filed, issuers failing to file a closing amendment would remain responsible for annual Form D amendments and amendments to update or correct information in previous filings. As discussed earlier, failure to comply with the Form D filing requirements may have serious consequences for issuers seeking to take advantage of Regulation D.

Content Changes

The SEC has also proposed revisions to Form D that are intended to enhance the SEC's (and investors') ability to evaluate the use of Rule 506(c) by requiring information in Form D on the types of investors that participate in Rule 506(c) offerings, the issuer's plans to engage in general solicitation, and the methods used to satisfy the "accredited investor" verification requirement in Rule 506(c). (Some of the proposed revisions are also applicable to offerings made under Rules 504 and 505 and Section 4(a)(5) of the Securities Act.)

Proposed new items of Form D would require issuers to provide the additional information with respect to Rule 506 offerings, including, if the issuer used a broker-dealer, whether any general solicitation materials were filed with the Financial Industry Regulatory Authority (FINRA), and the types of general solicitation materials used or to be used in Rule 506(c) offerings.

Legends and Other Disclosures

In lights of issuers' ability to solicit generally in Rule 506(c) offerings, the SEC has also proposed requirements for issuers to better inform potential investors 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. Proposed Rule 509 of Regulation D would require all issuers to include prominent cautionary legends in all written general solicitation materials.

Private funds (such as hedge funds, venture capital funds and private equity funds), which could also benefit from Rule 506(c) offerings, would be required to include a legend on any written general solicitation materials noting that the securities offered are not subject to the Investment Company Act protections offered to mutual fund investors. Further, because of the emphasis that investors place on fund

performance when selecting investments, proposed Rule 509(c) would require any private fund written general solicitation materials that include performance data to include additional cautionary legends.

As is the case with respect to Form D filing requirements, failure to include the legends and other disclosure required under proposed Rule 509 would not render Rule 506(c) unavailable for an ongoing offering, or otherwise result in violations of federal or state securities laws. Non-compliance with Rule 509 would not result in disqualification from reliance on Rule 506 without SEC action or a court-ordered injunction.

Temporary Submission of Written General Solicitation Materials

If the proposed rules are adopted, Rule 510T of Regulation D (a temporary rule that would expire two years after its effective date), would require issuers conducting an offering in reliance on Rule 506(c) to submit electronically to the SEC any written general solicitation materials used in such offering no later than the date the materials are used in the offering. Such solicitation materials would not be publicly available, and would not be treated as "filed" or "furnished" for purposes of the federal securities laws.

As with proposed Rule 509, compliance with Rule 510T is not a condition to conducting a Rule 506(c) offering, absent an injunction for failure to comply.

Rule 156 Amendment

Rule 156 sets forth interpretive guidance on the type of information mutual funds include in their sales literature; the SEC is now proposing applying the guidance in Rule 156 to the sales literature of private funds. While the adoption of Rule 506(c) was the impetus for proposing this amendment to Rule 156, the SEC has proposed extending the Rule 156 guidance to all private funds, whether or not such funds are engaged in the general solicitation activity contemplated by Rule 506(c).

Definition of "Accredited Investor"

Many practitioners have stated, and the SEC agrees, that it is time to review the definition of "accredited investor" as it relates to natural persons. The SEC has not proposed any amendments to the accredited investor definition at this time, but is accepting related comments and considering modifications.

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