

Structuring Securities Offerings After the JOBS Act Private Placement Revisions

Leveraging Solicitation and Advertising Opportunities and
Navigating Stricter Rule 506 Safe Harbor Provisions

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Private Offering Reform

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Private Offering Reform

- New rules permitting general solicitation in certain Rule 506 offerings and in Rule 144A offerings (Release Nos. 33-9415 & 34-69959)
- New rules adopting bad actor disqualifications for Rule 506 offerings (Release No. 33-9414)
- Proposed rules relating to changes to Form D information and filing requirements, legend requirements for general solicitation materials and amendments to Rule 156 (Release Nos. 33-9416 & 34-69960)

Background – JOBS Act

- The Jumpstart Our Business Startups Act (JOBS Act) was enacted on April 5, 2012
- Section 201(a) of the JOBS Act directed the SEC, within 90 days of enactment, to:
 - amend Rule 506 to permit general solicitation provided all purchasers are accredited investors
 - require issuers to take reasonable steps to verify that purchasers are accredited investors
 - amend Rule 144A to permit offers to persons other than qualified institutional buyers (QIBs), including by means of general solicitation, so long as all purchasers in the offering are QIBs or reasonably believed to be QIBs

Background – Dodd-Frank Act

- The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was enacted on July 21, 2010
- Section 926 of Dodd-Frank required the SEC to adopt rules that disqualify securities offerings involving certain “felons” and “bad actors” from reliance on Rule 506 of Regulation D
 - Rules must be “substantially similar” to Rule 262 under Securities Act, which contains the disqualifications of Regulation A
 - Must also cover certain other matters enumerated in Section 926

Background – Proposing Rule Release for Advertised Private Placements

- SEC opened a site for comment before proposing the rule changes and received many comments
- SEC had planned to adopt an interim rule (rather than issue a rule proposal) but changed course at the last minute
 - Generated significant controversy
- SEC proposed rules on August 29, 2012 (Release No. 33-9354)
- Comment period ended on October 5, 2012

Background – Proposing Rule Release for Advertised Private Placements (cont'd)

- Over 225 comment letters received
 - Including from professional and trade associations, investor organizations, law firms, investment companies and investment advisers, members of Congress, the SEC's Investor Advisory Committee, state securities regulators, issuers and individuals
- Some comments supported the approach taken in the proposal, but a number of commenters sought more certainty on the process for verification of accredited status
- Significant number of commenters requested that the SEC add various additional investor protections
 - Included suggestions that the “bad actor” provisions required by Dodd-Frank be adopted before or at the same time
 - Many other investor protections suggested in the comments are included in the proposed changes to Rule 506

SEC Final Rules

- SEC adopted final rules on July 10, 2013
 - Adopted new paragraph (c) to Rule 506 as proposed with one modification
 - Adopted amendments to Rule 144A as proposed
 - Adopted amendments to Form D as proposed
 - Adopted “bad actor” provisions required by Dodd-Frank (in separate rule release)
- Final rules effective September 23, 2013
- Simultaneously the SEC proposed rule changes to Form D information and filing requirements, and legend and filing requirements for solicitation materials

Background – Current Rule 506

- Non-exclusive safe harbor exemption under Section 4(a)(2) for private placements
- Unlimited offering amount
- Unlimited number of accredited investors plus up to 35 non-accredited investors who meet certain sophistication requirements
- No general solicitation or general advertising permitted (“general solicitation”)
- In 2012, operating companies estimated to raise \$173 billion and pooled investment funds estimated to raise \$725 billion under Rule 506

Background – Current Rule 144A

- Non-exclusive safe harbor exemption under Section 4(a)(1) for resales of certain “restricted securities” to QIBs
- Rule 144A is used to facilitate capital raising by issuers
 - Primary offering to one or more financial intermediaries under Regulation S or Section 4(a)(2) of Securities Act, followed by immediate resales to QIBs under Rule 144A
- Does not include express prohibition against general solicitation but offers of securities under Rule 144A must be limited to QIBs
- In 2012, operating companies estimated to raise \$636 billion and pooled investment funds estimated to raise \$4 billion in non-asset-backed securities offerings under Rule 144A

Eliminating Prohibition Against General Solicitation

- Adds new paragraph (c) to Rule 506 where prohibition on general solicitation would not apply, provided:
 - All terms and conditions of Rule 501 and Rules 502(a) and 502(d) are satisfied
 - All purchasers are accredited investors
 - Issuer takes reasonable steps to verify all purchasers are accredited
- Note: Existing Rule 506(b) exemption prohibiting general solicitation remains unchanged

Reasonable Steps to Verify Accredited Investor Status

- New Rule 506(c) requires issuers using general solicitation to “take reasonable steps to verify” that the purchasers of the offered securities are accredited investors
 - Verification is required even if all purchasers are in fact accredited
- SEC adopted a “principles-based approach” for reasonableness, which is an objective determination by the issuer in the context of the particular facts and circumstances of each purchaser and transaction
- Intended to address concerns and reduce risk that general solicitation will result in sales to non-accredited investors

Reasonable Steps to Verify Accredited Investor Status (cont'd)

- SEC also adopted a non-exclusive list of methods that issuers may use to verify accredited investor status of natural persons
- Intended to maintain flexibility of the verification standard while providing clarity and certainty that the requirement has been satisfied if a specified method is used
- Note: Release indicates that a questionnaire or accredited investor representation, absent other information about the purchaser indicating accredited status, would not constitute reasonable steps to verify accredited status

Principles-Based Approach to Determining Reasonable Verification of Accredited Status

- Issuer should consider a number of factors, including:
 - Nature of purchaser and type of accredited investor that purchaser claims to be
 - Amount and type of information that the issuer has about the purchaser
 - Nature of the offering (*e.g.*, manner of solicitation, terms of offering, etc.)
- Factors help issuer assess reasonable likelihood that the potential purchaser is an accredited investor and therefore affects the types of steps that would be reasonable to take to verify a purchaser's accredited investor status
 - More likely the purchaser qualifies as an accredited investor → fewer verification steps
- Note: Important for issuers to retain adequate records regarding verification process

Factors Considered in Reasonable Verification Process

- Nature of the Purchaser
 - Eight enumerated categories of “accredited investors” in Rule 501(a)
 - Some categories based on status only, status + financial test, etc.
 - Reasonable steps to verify status will vary based on the type of investor (*e.g.*, registered broker-dealer can be checked through FINRA BrokerCheck website)
 - Verification for natural persons may pose greater practical difficulties (especially net worth), exacerbated by privacy concerns

Factors Considered in Reasonable Verification Process (cont'd)

- Information About the Purchaser
 - Amount and type of information that an issuer has is a significant factor
 - More information an issuer has → fewer steps to verify status
 - Types of information an issuer may rely upon that, alone, may constitute reasonable steps to verify a purchaser's accredited investor status:
 - Publicly available information in filings with federal, state or local regulatory body (*e.g.*, named executive officer compensation in SEC filing)
 - Third party information that provides reasonably reliable evidence that a person falls within the definition of accredited investor (*e.g.*, copies of pay stubs for two most recent years and current year)
 - Verification of a person's status as an accredited investor by a third party, if the issuer has a reasonable basis to rely on such third party verification

Factors Considered in Reasonable Verification Process (cont'd)

- Nature and Terms of Offering
 - Consider means through which an investor was solicited
 - Greater the general solicitation → greater the measures to verify status
 - Consider terms of offering, like minimum investment amount
 - Ability to meet high investment amount, with a direct cash investment that is not financed, could be taken into consideration

Non-Exclusive Safe Harbor for Verifying Accredited Investor Status

- Four specific non-exclusive methods of verifying accredited investor status for natural persons that, if used, are deemed to satisfy the verification requirement:
 1. Documentation & certification to verify status on basis of income
 2. Documentation & certification to verify status on basis of net worth
 3. Written confirmation from certain third parties of verification of purchaser's accredited status
 4. Certification by previous accredited investors who invested in issuer
- In order to rely on safe harbor, issuer or its agent cannot have knowledge that the purchaser is not an accredited investor

Non-Exclusive Safe Harbor for Verifying Accredited Investor Status (cont'd)

1. Verifying status on basis of income: reviewing copies of IRS forms that report income (*e.g.*, Form W-2 or 1099 for two most recent years, along with obtaining a written representation that the person has a reasonable expectation of reaching requisite income level during current year)
2. Verifying status on basis of net worth: reviewing types of documents listed below for assets and liabilities, and obtaining a written representation from such person that all liabilities necessary to make a determination of net worth have been disclosed
 - Assets: bank statements, brokerage statements, certificates of deposit, tax assessments and appraisal reports issued by independent third parties
 - Liabilities: consumer report (aka credit report) from at least one of the nationwide consumer reporting agencies

Non-Exclusive Safe Harbor for Verifying Accredited Investor Status (cont'd)

3. Obtaining written confirmation from a registered broker-dealer, an SEC-registered investment advisor, a licensed attorney or a certified public accountant that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the prior three months and has determined that such purchaser is an accredited investor
4. Certification of accredited investor status by a natural person who previously invested in an issuer's Rule 506(b) offering as an accredited investor prior to the effective date of Rule 506(c) and remains an investor of the issuer
 - Does not extend to existing investors who were not accredited investors in a Rule 506(b) offering prior to the new rule

Reasonable Belief that All Purchasers are Accredited Investors

- SEC confirmed that an issuer will not lose its ability to rely on Rule 506(c) so long as the issuer took *reasonable steps to verify* that the purchaser was an accredited investor and had a *reasonable belief* that such purchaser was an accredited investor at the time of sale
- Not an absolute standard that all investors must be accredited

Form D Changes

- Form D currently requires an indication of exemption claimed
- New rules change current “Rule 506” option to “Rule 506(b)” and add a new option to select “Rule 506(c)”
- Note: An issuer may not check both “Rule 506(b)” and “Rule 506(c)” exemptions

Transition Matters – Rule 506

- For Rule 506 offerings ongoing when the new rules become effective, an issuer may choose to continue under Rule 506(b) or new Rule 506(c)
- If an issuer chooses to continue an offering in accordance with Rule 506(c), any general solicitation that occurs after the effective date will not affect the exempt status of offers and sales prior to effective date in reliance on Rule 506(b)

Specific Issues for Private Funds

- Private funds generally rely on either the Section 3(c)(1) or Section 3(c)(7) exclusion from the definition of “investment company” under the Investment Company Act, which exclusions are not available if an issuer makes a public offering of its securities
- Section 201(b) of the JOBS Act provides that offers and sales exempt under revised Rule 506 shall not be deemed public offerings under the federal securities laws as a result of general solicitation
- SEC affirmed in rule release that the effect of Section 201(b) of the JOBS Act is to permit private funds to engage in general solicitation in compliance with Rule 506(c) without losing either of the exclusions under the Investment Company Act

Amendment to Rule 144A

- Current Rule 144A requires that offers be limited to QIBs or persons reasonably believed to be QIBs
- Amended rule eliminates references to “offer” and “offeree” in Rule 144A(d)(1)
- In effect, securities may be offered to persons other than QIBs, including by use of general solicitation
- However, all purchasers must be QIBs or reasonably believed to be QIBs

Transition Matters – Rule 144A

- For Rule 144A offerings ongoing when the new rules become effective, an issuer will be permitted to conduct the portion of the offering following the effective date using general solicitation, without affecting the availability of Rule 144A for the portion of the offering that occurred prior to the effective date

Integration with Offshore Offerings

- Concurrent offshore offerings conducted in compliance with Regulation S will not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A, as amended

Practical Considerations

- Unclear whether issuers will be comfortable using new rule, especially in light of proposed changes, and whether general solicitation will aid in raising capital
- Anti-fraud prohibitions and FINRA rules still in effect
- General solicitation flexibility does not extend to Section 4(a)(2) offerings
 - Use of general solicitation may eliminate fallback federal and blue sky exemptions
- Plan for flexibility in Rule 506(b) offerings
 - Inadvertent conversion to Rule 506(c) offering may not be permitted if proposed rules are adopted
 - Conversion from Rule 506(c) to Rule 506(b) offering likely will not work
- Regulation FD concerns for public companies
- Private funds must consider other regulatory requirements and fund managers may not utilize ‘prior investor’ safe harbor for new funds

Bad Actor Disqualification

- Bad Actor provisions prevent felons and other “bad actors” from relying on Rule 506
- Mandated by Section 926 of Dodd-Frank and required to be substantially similar to Rule 262 under the Securities Act, which contains the disqualification provisions for Regulation A
- Changes are also effective on September 23, 2013

Executive Summary

- Bad Actor changes prevent an issuer from using Rule 506, if the issuer, or specified persons or entities associated with the issuer (covered persons), are felons or other bad actors (Bad Actors)
 - Implemented through new paragraph (d) of Rule 506
- Bad Actor provisions come into play when a covered person has a disqualifying event (summarized in this executive summary portion and explained in more detail later in the program)
- In a very significant change from the existing rule and the proposed rule release, disqualifying events that took place before the effective date of the Bad Actor rules result in mandatory disclosure rather than an inability to use Rule 506
 - Implemented through new paragraph (e) of Rule 506

Covered Persons

The following are the persons or entities that are “covered persons” under the Bad Actor provisions:

- the issuer
 - any director, executive officer or other officer of the issuer participating in the offering
 - any general partner or managing member of the issuer
- any beneficial owner of 20% or more of the issuer’s outstanding voting equity securities, based on the total voting power

Covered Persons (cont'd)

- any investment manager of a pooled investment vehicle
 - any director, executive officer or other officer participating in the offering, general partner or managing member of the investment manager of a pooled investment vehicle, as well as any director, executive officer or officer participating in the offering of any such general partner or managing member
- any promoter connected with the issuer in any way at the time of sale
- any paid solicitor
 - any director, executive officer, other officer participating in the offering, general partner, or managing member of a paid solicitor

Disqualifying Events

The following is a list of the types of events that are disqualifying:

- criminal convictions
- court injunctions and restraining orders
- final orders of certain regulators
- SEC disciplinary orders
- SEC cease and desist orders
- suspension or expulsion from membership in a self-regulatory organization (SRO) or association with an SRO member
- stop orders and orders suspending a Regulation A exemption
- U.S. Postal Service false representation orders

More information about these disqualifying events is contained in the detailed discussion that will follow.

Reasonable Care Exception

- The final rule includes an exception from disqualification where the issuer did not know, and in the exercise of reasonable care could not have known, about the disqualifying event relating to another covered person
- Factual inquiry is required to support this exception

Waivers

- Waivers can be granted by the Director of the Division of Corporation Finance of the SEC, rather than requiring consideration by all SEC commissioners
- The Bad Actor provisions will apply to all private placements under Rule 506

What Should Issuers Do Now?

Determine if Disclosure is Needed

- Because the existence of disqualifying events before the effective date results in mandatory disclosure, issuers who are in the process of raising capital in a Rule 506 offering, or who may do so in the future, need to determine if any applicable covered persons have disqualifying events that will require disclosure
- If there are any disqualifying events before the effective date of the rule, the issuer should begin preparing the disclosure materials that will be needed

What Should Issuers Do Now?

Revise Due Diligence Procedures and Placement Agreements

- In an effort to ensure that no disqualifying events exist with respect covered persons, including the issuer's or investment manager's relevant principals, any promoters and any paid solicitors or their relevant principals:
 - Issuers should revise their due diligence procedures in connection with proposed Rule 506 offerings
 - Issuers should enhance disclosures in placement agent, finders or similar agreements

Revise Subscription Documents

- Issuers may want to revise their subscription documents to capture information that would result in a disqualification if the purchaser becomes a 20% beneficial owner

What Should Issuers Do Now?

Work Out Procedures For Continuous Offerings

- For private placements using Rule 506 that are ongoing after the effective date of the new rules, it will be necessary for the issuer to have “update” procedures in place to make sure that the issuer has not been disqualified during the offering

Detailed Description of Bad Actor Provisions

The new Bad Actor disqualification provisions prevent the use of Rule 506 if the issuer, or others associated with the issuer (such as directors, certain officers and significant shareholders) or the offering (such as underwriters and placement agents) have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of certain laws

Covered Persons

Bad Actor disqualification comes into play when the issuer or certain persons or entities associated with the issuer or the offering have disqualifying events. These “covered persons” are as follows:

Issuer & Predecessors of the Issuer

- In addition to the issuer, includes predecessors of the issuer

Directors, Executive Officers and Officers of the Issuer Participating in the Offering

- Marks a change from the proposed rule release in which the SEC had proposed that all officers be covered persons
- Change limits coverage to situations where the risks are most acute: when Bad Actors are personally involved in an offering or are performing policy making functions

Covered Persons (cont'd)

Managers of the Issuer

- In many situations, the issuer is run by a manager or general partner, rather than a board of directors and officers
- Includes the general partner and managing member of the issuer

20% Beneficial Owners

- Includes beneficial owners of 20% or more of the issuer's total outstanding voting equity securities, calculated on the basis of voting power
- Marks a change from the proposed rule release in which the SEC had proposed to cover 10% beneficial owners of any class of securities

Covered Persons (cont'd)

20% Beneficial Owners (cont'd)

- No specific definition for the term “voting securities” was adopted but it is intended to be applied where the securityholder has or shares, either currently or on a contingent basis, the ability to control or significantly influence the management and policies of the issuer through the exercise of a voting right
 - Securities that confer the right to elect or remove directors (or equivalent controlling persons of the issuer), or to approve significant transactions such as acquisitions, dispositions or financings, would be considered voting securities
 - Securities that confer voting rights limited solely to approval of changes to the rights and preferences of their class would not be considered voting securities

Covered Persons (cont'd)

Investment Manager of Pooled Investment Vehicles & Certain Related Persons

- Includes investment managers of issuers that are pooled investment funds and their directors, executive officers, and other officers participating in the offering
- Includes general partners and managing members of these types of investment managers, the directors and executive officers of such general partners and managing members and their other officers participating in the offering

Covered Persons (cont'd)

Promoters

- This category is broad, and captures all individuals and entities that have the relationship with the issuer or to the offering specified in Rule 405 of the Securities Act
- Rule 405 defines a promoter as any person – individual or legal entity – that either alone or with others, directly or indirectly takes the initiative in founding the business or enterprise of the issuer, or in connection with such founding or organization, directly or indirectly receives 10% or more of any class of issuer securities or 10% or more of the proceeds from the sale of any class of issuer securities (other than securities received solely as underwriting commission or solely in exchange for property)

Covered Persons (cont'd)

Paid Solicitors & Certain Related Persons

- Includes any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with sales of securities in the offering (“Paid Solicitor”)
- Includes any director, executive officer or other officer of a Paid Solicitor participating in the offering, as well as the general partner or managing member of a Paid Solicitor

Covered Persons (cont'd)

Affiliated Issuers

- Affiliated issuers are generally covered persons
- However, events that pre-date affiliation will not cause disqualification if, at the time of the event, the affiliated issuer is not:
 - in control of the issuer; or
 - under common control, together with the issuer, by a third party that controlled the affiliated issuer at the time of the event
- SEC did not adopt specific exceptions for issuers that have had a change of control
 - SEC expects this situation, under appropriate circumstances, to be dealt with in the waiver process

Description of Disqualifying Events

Criminal Convictions

- Disqualification if a covered person has been convicted of any felony or misdemeanor:
 - In connection with the purchase or sale of any security;
 - Involving the making of any false filing with the SEC; or
 - Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities
- Includes look-back periods of five years for criminal convictions of issuers (including predecessors and affiliated issuers) and ten years for other covered persons (look-back provisions correspond to Rule 262)

Description of Disqualifying Events (cont'd)

Court Injunctions and Restraining Orders

- Disqualification if any covered person is subject to any order, judgment or decree of any court of competent jurisdiction:
 - That, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice in connection with the purchase or sale of any security;
 - Involving the making of any false filing with the SEC; or
 - Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities
- Five-year look-back for these types of events

Description of Disqualifying Events (cont'd)

Final Regulatory Orders

- Disqualification results from certain final orders (described below) of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the CFTC; or the National Credit Union Administration.
- Final orders of these regulators that are based on a violation of any law or regulation which prohibits fraudulent, manipulative, or deceptive conduct entered within ten years before such sale, result in disqualification

Description of Disqualifying Events (cont'd)

Final Regulatory Orders (cont'd)

- Final orders of these regulators also result in disqualification if at the time of such sale, they *bar* a covered person from:
 - Association with an entity regulated by such regulator;
 - Engaging in the business of securities, insurance or banking ;or
 - Engaging in savings association or credit union activities

An order that has one of these effects is a “bar” even if it does not use the word “bar.”

- A “bar” is disqualifying only for so long as it has continuing effect

Description of Disqualifying Events (cont'd)

Final Regulatory Orders (cont'd)

- A person who is barred indefinitely, with the right to reassociate after a specified period, is disqualified until he or she is permitted to reassociate, if the bar has no continuing impact after reassociation
 - Persons who are subject to an indefinite bar who do not reassociate, but wish to participate in Rule 506 offerings, will need to seek a waiver
- Marks a significant change from the proposed rule by adding the CFTC to the list of regulators whose regulatory bars and other final orders will trigger disqualification

Description of Disqualifying Events (cont'd)

Final Regulatory Orders (cont'd)

- “Final order” means a written directive or declaratory statement by a federal or state agency described in Rule 506(d)(1)(iii) under applicable statutory authority that provides for notice and an opportunity for a hearing, which constitutes a final disposition or action by that federal or state agency
 - Under this definition, ex parte orders issued under statutory authority that do not provide for notice and an opportunity for a hearing, do not trigger disqualification
 - There is no requirement that a final order be non-appealable

Description of Disqualifying Events (cont'd)

SEC Disciplinary Orders

- Disqualification if a covered person is subject to an SEC order (under certain provisions of the Exchange Act and the Investment Advisers Act which are described in the next slide), that, at the time of sale:
 - suspends or revokes the person's registration as a broker, dealer, municipal securities dealer or investment adviser;
 - places limitations on the activities, functions or operations of the person; or
 - bars the person from being associated with any entity or from participating in the offering of any penny stock

Description of Disqualifying Events (cont'd)

SEC Disciplinary Orders (cont'd)

- Operative provisions include Section 15(b) or 15B(c) of the Exchange Act and Section 203(e) or (f) of the Investment Advisers Act
- Under the operative provisions, the SEC has the authority to impose a variety of sanctions against registered brokers, dealers, municipal securities dealers and investment advisers and their associated persons, including suspension or revocation of registration, censure, placing limitations on their activities, imposing civil money penalties and barring individuals from being associated with specified entities and from participating in the offering of penny stock

Description of Disqualifying Events (cont'd)

SEC Cease and Desist Orders

- Disqualification if a covered person is subject to an SEC order, which requires the person to cease and desist from committing or causing a violation or future violation of:
 - any scienter-based antifraud provision of the federal securities laws; or
 - the registration requirements of the Securities Act
- Five-year look-back period

Description of Disqualifying Events (cont'd)

Suspension or Expulsion From SRO Membership or Association with an SRO Member

- Disqualification if a covered person is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange, or a registered national or affiliated securities association, for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade

Description of Disqualifying Events (cont'd)

Stop Orders and Orders Suspending the Regulation A Exemption

- Disqualification if any covered person has filed (as a registrant or issuer), or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the SEC within five years before the sale, which was the subject of a refusal order, stop order or order suspending the Regulation A exemption, or is at the time of sale, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued

Description of Disqualifying Events (cont'd)

U.S. Postal Service False Representation Orders

- Disqualification if any covered person is subject to a United States Postal Service false representation order entered within five years before the sale, or is, at the time of the sale, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations

Reasonable Care Exception

- Exception from disqualification where the issuer establishes that it did not know, and in the exercise of reasonable care, could not have known, that a disqualification existed because of the presence or participation of another covered person
- An issuer will not be able to establish that it has exercised reasonable care unless it made a factual inquiry into whether any disqualifications existed
 - Nature and scope of the inquiry necessary to exercise reasonable care will vary based on the circumstances of the issuer and the other offering participants
- SEC did not provide specific guidance on the types of inquiry needed to establish reasonable care

Reasonable Care Exception (cont'd)

- Adopting release states that the SEC believes that issuers may have “in-depth” knowledge relating to their executive officers and officers participating in an offering and that, in such circumstances, further steps may not be required for these persons in a specific offering
- The adopting release also states that:

“Factual inquiry by means of questionnaires or certifications, perhaps accompanied by contractual representations, covenants and undertakings, may be sufficient in some circumstances, particularly if there is no information or other indicators suggesting bad actor involvement.”

Reasonable Care Exception (cont'd)

- In the case of a registered broker-dealer acting as a placement agent in a Rule 506 offering, the adopting release states that it may be sufficient to make inquiry of the employing entity concerning the relevant set of covered officers and controlling persons, and to consult publicly available databases concerning past disciplinary history of the relevant persons
- In the case of continuous, delayed or long-lived offerings, the SEC expects that reasonable care will include updating the factual inquiry “on a reasonable basis”
 - Frequency and degree of updating depends on the circumstances relating to the issuer, the offering and offering participants
 - Periodic updating will generally be sufficient

Reasonable Care Exception (cont'd)

- However, more frequent monitoring will be required in special circumstances, such as where a covered person is subject to a judicial or regulatory proceeding
- Issuers are expected to use a combination of the following for updating, depending on the circumstances:
 - bring downs of representations, questionnaires and certifications;
 - negative consent letters; and
 - periodic rechecking of public databases
- Under the new provisions, the disqualification is on a sale-by-sale basis and a disqualifying event that takes place after a sale does not impact that past sale

Waivers

- New rule includes waiver provisions
- Waivers can be granted by the Director of the Division of Corporation Finance (rather than requiring consideration by all the SEC commissioners, which would have been required under the proposed rules)
- SEC did not provide guidance on the circumstances that would give rise to a waiver, or articulate standards for granting waivers

Waivers (cont'd)

- However, the adopting release identifies a number of circumstances that would, depending on the specific facts, be relevant to the evaluation of a waiver request, including:
 - a change of control;
 - a change in supervisory personnel;
 - absence of notice and opportunity for a hearing; and
 - relief from a permanent bar for a person who does not intend to apply to reassociate with a regulated entity
- Disqualification does not apply if the regulator issuing the relevant decision determines that Rule 506 disqualification is not necessary under the circumstances
 - In the absence of action by the state regulator, the SEC may grant a waiver on its own

Disqualifying Events That Take Place Before the Effective Date

- Disqualification applies only to triggering events that take place after effectiveness of the rule amendments
- Mandatory disclosure is required for triggering events that predate the effectiveness of the rule amendments
- SEC expects that issuers will give reasonable prominence to this disclosure to ensure that information is appropriately presented in the total mix of information available to investors
- Disclosure requirement in new Rule 506(e) will apply to all offerings under Rule 506, regardless of whether purchasers are accredited investors
- Issuers will be required to provide the disclosure “a reasonable time” before sale, which is the same timing that currently applies to disclosures to non-accredited investors under Rule 502(b)(1)

Disqualifying Events That Take Place Before the Effective Date (cont'd)

- If disclosure is required and not adequately provided to an investor, relief will not be available under Rule 508 as an “insignificant deviation” from the Regulation D requirements that does not necessarily result in loss of the Securities Act exemption
- Rule 506(e) provides, however, that the failure to furnish required disclosure on a timely basis will not prevent an issuer from relying on Rule 506 if the issuer establishes that it did not know, and in the exercise of reasonable care could not have known, of the existence of the undisclosed matter or matters
 - Similar to the “reasonable care” exception to disqualification
 - Includes an instruction clarifying that reasonable care requires factual inquiry (similar to the reasonable care disqualification exception)

Proposed Amendments to Regulation D, Form D and Rule 156

- On July 10, 2013, the SEC proposed amendments to Regulation D, Form D and Rule 156 to enhance the SEC's 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 under new Rule 506(c)
- Comment period ends September 23, 2013
- Proposed changes include:
 - New Form D filing requirements and disqualification for noncompliance
 - Expansion of information requirements of Form D
 - Requirements for written general solicitation materials
 - Submission to SEC of written general solicitation materials used in Rule 506(c) offerings, on a temporary basis

Proposed Form D Filing Requirements for Advertised Private Placements

- New Advance Filing Requirement for Rule 506(c) Offerings
 - Current requirement is to file Form D within 15 calendar days of first sale in offering
 - Amends Rule 503 to require filing of Form D at least 15 calendar days before first use of general solicitation in Rule 506(c) offering
 - Information required on initial Form D filing includes:

Item	Description	Item	Description
1	Basic identification information	7	New filing or amendment
2	Address and issuer contact	9	Type of security offered
3	Related persons	10	Business combination
4	Industry group	12	Persons receiving sales comp
6	Exemptions claimed	16	Use of proceeds from offering

- Remaining information to be included in Form D amendment within 15 calendar days of first sale

Proposed Form D Filing Requirements for Advertised Private Placements (cont'd)

- New Closing Filing Requirement for Rule 506 Offerings
 - Amends Rule 503 to require filing of Form D amendment within 30 calendar days after termination of a Rule 506 offering
 - Applicable in both Rule 506(b) and Rule 506(c) offerings
 - Applicable for any termination of the offering, even abandoned offerings
 - Not required if all information required in such amendment has already been provided in previous Form D filing and issuer checked the box for a closing filing
 - Until closing amendment is filed, offering is deemed ongoing and subject to annual and other amendment filing requirements

Proposed Additional Information on Form D

- Requires additional information on Form D, primarily for Rule 506 offerings
- Revisions to the following existing items on Form D:
 - Item 2 – disclosure of the issuer’s website*
 - Item 3 – disclosure of controlling persons
 - Item 4 – clarity on issuer industry group for “other” classification*
 - Item 5 – information on issuer size if publicly available*
 - Item 7 – indication of whether the filing is an advance or closing filing
 - Item 9 – trading symbol & generally available securities identifier, if applicable*
 - Item 14 – whether purchasers are natural persons or entities and amounts raised from each category

* Also applicable to offerings under Rule 504, Rule 505 and Section 4(a)(5)

Proposed Additional Information on Form D (cont'd)

- Revisions to the following existing items on Form D (cont'd):
 - Item 16 – percentage of offering proceeds that has or will be used:
 - to repurchase or retire the issuer’s existing securities
 - to pay offering expenses
 - to acquire assets, otherwise than in the ordinary course of business
 - to finance acquisitions of other businesses
 - for working capital
 - to discharge indebtedness
- (new Item 16 requirements not applicable to pooled investment funds)

Proposed Additional Information on Form D (cont'd)

- Adds new Items 17-22 to Form D, for Rule 506 offerings, requiring disclosure of:
 - number and type of accredited investors that purchased securities in the offering (*e.g.*, natural persons who qualified as accredited investors on the basis of income or net worth)
 - name of national securities exchange, ATS or trading venue on which the issuer's securities are trading, if applicable, and/or the Exchange Act file number, if issuer is registered under the Exchange Act, 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
 - if the issuer used a registered broker-dealer in connection with the offering, whether any general solicitation materials were filed with FINRA

Proposed Additional Information on Form D (cont'd)

- Adds new Items 17-22 to Form D, for Rule 506 offerings, requiring disclosure of (cont'd):
 - in the case of a pooled investment fund advised by investment advisers registered with, or reporting as exempt reporting advisers to, the SEC, the name and SEC file number for each investment adviser who functions (directly or indirectly) as a promoter of the issuer
 - for Rule 506(c) offerings, the types of general solicitation used or to be used (*e.g.*, mass mailings, public websites, social media, etc.)
 - for Rule 506(c) offerings, the 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, reliance on verification by a third party, etc.)

Proposed Disqualification for Noncompliance with Form D Filing Requirements

- Amends Rule 507 to disqualify an issuer from relying on Rule 506 for future offerings for a period of one year if the issuer did not comply, within the past five years, with Form D filing requirements in a Rule 506 offering
 - Disqualification for an issuer is also triggered by noncompliance by predecessors and affiliates of the issuer
 - Current rules only disqualify an issuer if the issuer (or predecessor or affiliate) has been enjoined by a court for violating filing requirements of Rule 503
- One-year disqualification period commences following the filing of all required Form D filings, or if offering is terminated, following the filing of a closing amendment

Proposed Disqualification for Noncompliance with Form D Filing Requirements (cont'd)

- Five-year look-back period would not extend past the effective date of the rule
- Does not affect offerings that are ongoing at the time of noncompliance, including the offering for which issuer failed to make a required filing
- Filings made during a 30-day cure period after a timely filing is missed will not trigger disqualification
 - Only available for an issuer's first failure to file timely a Form D or Form D amendment in connection with a particular offering
- Disqualification may be waived by SEC if issuer can demonstrate good cause that it is not necessary to deny the exemption

Proposed Legend Requirements for Advertising Materials

- New Rule 509 requiring issuers to include the following prominent legends in all written general solicitation materials:
 - 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 Commission has not passed upon the merits of or given its approval to the securities, the terms of the offering, or the accuracy or completeness of any offering materials

Proposed Legend Requirements for Advertising Materials (cont'd)

- New Rule 509 requiring issuers to include the following prominent legends in all written general solicitation materials (cont'd):
 - The securities are subject to legal restrictions on transfer and resale and investors should not assume they will be able to resell their securities
 - Investing in securities involves risk, and investors should be able to bear the loss of their investment
- Legends may be combined and different wording may be used
- Failure to include legends does not render Rule 506(c) unavailable unless issuer has been subject to order, judgment or court decree enjoining issuer for failure to comply with Rule 509

Proposed Additional Disclosures for Private Funds

- Requires additional legend that the securities offered are not subject to the protections of the Investment Company Act
- Requires legend in any written solicitation materials that include performance data disclosing:
 - Performance data represents past performance
 - Past performance does not guarantee future results
 - Current performance may be lower or higher than the performance data presented
 - Private fund is not required by law to follow any standard methodology when calculating and representing performance data
 - Performance of the fund may not be directly comparable to the performance of other private or registered funds
 - Phone number or website where investor may obtain current performance data

Proposed Additional Disclosures for Private Funds (cont'd)

- If written general solicitation materials include performance data:
 - Such data must be as of the most recent practicable date considering the type of private fund and the media through which the data will be conveyed
 - Must disclose period for which performance is presented
 - If performance data does not reflect the deduction of fees and expenses, must disclose that fact and that if such fees and expenses had been deducted, performance may be lower than presented

Proposed Amendments to Rule 156

- Rule 156 is an interpretive rule that provides guidance on types of information in investment company sales literature that could be misleading for purposes of the federal securities laws
- Under Rule 156, whether a statement is misleading depends on the context, and the rule outlines several circumstances that might result in misleading advertising material
 - Does not prohibit or permit any particular representations or presentations
- Proposal amends Rule 156 to extend to the sales literature of all private funds (not just those engaged in general solicitation)

Proposed Mandatory Submission of Written Solicitation Materials

- New Rule 510T requires that an issuer conducting an offering under Rule 506(c) submit to SEC any written general solicitation materials prepared by or on behalf of issuer and used in connection with such offering
- Must be submitted no later than date of first use of materials
- Temporary rule would expire two years after its effective date
- Voluntary submission permissible before rule is effective

Proposed Mandatory Submission of Written Solicitation Materials (cont'd)

- Materials would not be treated as “filed” or “furnished” under federal securities laws
 - Not submitted via EDGAR
 - Not made publicly available
- Failure to comply does not render Rule 506(c) unavailable unless issuer has been subject to order, judgment or court decree enjoining issuer for failure to comply with Rule 510T

Requests for Comment

- SEC has requested comments on the proposed rules previously discussed
- SEC staff has begun a review of the definition of accredited investor as it relates to natural persons, and has requested comments in that regard
- SEC has requested comment on whether a purchaser's receipt of an offering document containing specified information should be a condition of Rule 506(c)
- SEC has requested comment on whether an issuer not current in its reporting obligations under Section 13 or 15(d) of the Exchange Act should be permitted to use Rule 506(c)

Practical Considerations

- Mandatory submission of materials to SEC may deter use of Rule 506(c)
- Advance Form D filing requirement limits the issuer's ability to conduct a Rule 506(c) offering on short notice
- Disqualification provisions could create significant consequences for an issuer's capital raising activities

Questions or Comments?

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