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SEC Announces Major Changes to Private Offering Rules

General Solicitation Now Permitted

Last month, the Securities and Exchange Commission (SEC) voted to allow companies to use general solicitation and advertising (i.e. in a newspaper or on the Internet) when they raise funds in a private offering. The new regulations will take effect in September. The vote implements provisions of the Jumpstart Our Business Startups Act (JOBS Act) which was enacted in 2012.

By allowing general solicitation and advertising (which had been prohibited), the SEC cleared an obstacle to issuing regulations for crowdfunding, which was another initiative included in the JOBS Act. Crowdfunding is a financing strategy, typically conducted through the Internet, which allows companies to raise funds by issuing stock to a large number of investors who invest small amounts of money in the company. The ability to use general solicitation and advertising will help companies raise critically needed funds, particularly during the start-up phase, from a pool of potential investors beyond those who have pre-existing relationships with company directors or advisors.

The new Rules do create some hurdles that companies must address. Under Rule 506(d), a company cannot make a Rule 506(c) offering if the company or certain participants such as its executive officers or directors are the subject of a "disqualifying event", such as a securities fraud conviction. Also, a company using general solicitation must demonstrate that it is taking "reasonable steps to verify" that the purchasers meet certain income or net worth minimums, qualifying them as “accredited investors”. These steps will vary depending on the circumstances, but could include reviewing tax forms or conducting the offering through an online platform which has a suitable method of verifying that potential investors qualify as accredited investors under the Rules.

To provide increased information to better address concerns relating to the use of general solicitation, the SEC has proposed new filing regulations for general solicitation offerings. Under these proposed regulations, at least 15 days before engaging in general solicitation, companies would be required to file an “Advance Form D” in addition to the usual Form D that must be filed within 15 days of the first sale of securities. If conducting a Rule 506(c) offering, companies would disclose on their Form D what types of general solicitation they are using, how they would verify that investors are accredited, and the identity of significant shareholders (10% or more). Once the offering ends, the company would file an updated Form D within 30 days. Noncompliance with the proposed filing requirements would result in a company being banned from making future Rule 506 offerings. Companies that subsequently file all missed forms would have their bans reduced to one year.

As is often the case, new regulations come with new questions and considerations that should be examined by company management and their advisors if a private offering is on the horizon.
