General Solicitation and Other Changes to Regulation D: The Impact on Private Funds

Introduction

On July 10, 2013, the Securities and Exchange Commission adopted an amendment to Rule 506 of Regulation D ("Rule 506"), promulgated under Section 4(a)(2) (previously Section 4(2)) of the Securities Act of 1933 (the "Securities Act"), to allow issuers to engage in "general solicitation" and "general advertising" in certain offerings made under Rule 506, so long as all purchasers of the securities in such offerings are accredited investors and certain other conditions are met (the "General Solicitation Amendment"). Congress directed the SEC to adopt the General Solicitation Amendment last year as part of the Jumpstart Our Business Startups Act (the "JOBS Act"). In a separate release, the SEC also adopted amendments to Rule 506 to disqualify issuers and other market participants from relying on Rule 506 if "felons" and other "bad actors" participate in the Rule 506 offering (the "Bad Actor Amendment"). The General Solicitation Amendment[1] and the Bad Actor Amendment will go into effect 60 days from publication in the Federal Register, which is expected within the next few days. The SEC has also proposed new rules intended to enhance the SEC's ability to evaluate and monitor the development of market practices in Rule 506 offerings and address concerns that may arise in connection with allowing issuers to engage in general solicitation and advertising under Rule 506.

This client alert summarizes the General Solicitation Amendment, the Bad Actor Amendment, and the proposed rules, and analyzes the potential impact of these rules on future offerings of private equity funds, hedge funds and other private funds. The alert also identifies considerations outside of Rule 506 that may continue to constrain funds and fund sponsors from taking full advantage of the General Solicitation Amendment.

Removal of General Solicitation and General Advertising Restrictions in Certain Regulation D Offerings

Prior to the adoption of the General Solicitation Amendment, private fund offerings in the United States have typically been made in reliance on Rule 506(b), which effectively limits participation in most such offerings to "accredited investors,"[2] and requires that issuers satisfy certain other general conditions. Notably, Rule 502(c) prohibited an issuer relying on a Rule 506 exemption from using any form of "general solicitation" or "general advertising" to market the fund interests. Rule 502(c) does not define the terms "general solicitation" or "general advertising," but the rule states that these may include, but are not limited to, "any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and any seminar or meeting whose attendees have been invited by any general solicitation or general advertising." The SEC staff has periodically provided no-action and other guidance on the scope of these terms, including confirmation of the staff's view that the use of unrestricted websites to market private fund interests constitutes general solicitation and general advertising.

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[1] The adopting release notes that for ongoing offerings under Rule 506 that commenced before the effective date of new Rule 506(c), the issuer may choose to continue the offering after the effective date in accordance with either current Rule 506 or amended Rule 506.

[2] Technically, up to 35 non-accredited investors can purchase securities in a Regulation D offering under Rule 506(b). However, selling to non-accredited investors requires that fund sponsors confirm the knowledge and experience of such investors (or their purchaser representatives), and imposes burdensome information requirements on the fund sponsor.

Amended Rule 506 will now allow private funds to use general solicitation or general advertising to offer and sell fund interests under new Rule 506(c),[3] provided that:

1. the issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors;

2. all purchasers of securities are accredited investors, either because they come within one of the enumerated categories of persons that qualify as accredited investors or because the issuer reasonably believes that they do at the time of the sale of securities; and

3. all terms and conditions of Rule 501 and Rules 502(a) and 502(d) are satisfied (among other things, those rules establish when offers and sales must be integrated for purposes of Regulation D, and restrict the resale of securities acquired in a Regulation D offering).

An important question for fund sponsors in considering reliance on Rule 506(c) is what constitutes "reasonable steps to verify" for purposes of the first condition above. In the adopting release to the General Solicitation Amendment, the SEC described two procedures for verification. First, an issuer can follow a "facts and circumstances" approach. The SEC noted that "[w]hether the steps taken are 'reasonable' would be an objective determination, based on the particular facts and circumstances of each transaction."[4] The adopting release set forth the following factors as guidance for issuers to consider under a "facts and circumstances" approach determining the reasonableness of their verification procedures:

1. the nature of the purchaser and the type of accredited investor that the purchaser claims to be (for example, the SEC noted that more extensive verification would likely be required in the case of a natural person investor compared to a registered broker-dealer investor);

2. the amount and type of information that the issuer has about the purchaser (for example, the SEC suggested that less verification would be required with respect to an investor where the issuer has access to publicly available information about the investor, and suggested that third-party services might develop to facilitate verification for multiple issuers); and

3. the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount (for example, the SEC noted that less verification would be required where an issuer's minimum investment requirement was sufficiently high that only accredited investors could reasonably be expected to meet the requirement).

Second, bowing to public comment on the original proposing release, the SEC added to Rule 506(c) the following non-exclusive methods for verifying the accreditation status of natural persons that, if used, would

[3] Rule 506(c) is in addition to, rather than in place of, existing Rule 506(b). As a result, issuers can elect to comply with Rule 502(c) and choose not to engage in general solicitation or general advertising and, by so doing, retain the ability to sell interests to up to 35 non-accredited investors (subject to compliance with the other requirements of Regulation D) and to forego the verification requirement set forth in Rule 506(c).

[4] The SEC noted that taking "reasonable steps to verify" that investors are accredited is a requirement separate and independent of the requirement that a sale of securities be limited to accredited investors. Thus, the fact that all purchasers in an offering are accredited investors would not by itself satisfy the issuer's obligation to take "reasonable steps to verify" accredited investor status.

satisfy the verification requirement[5] [6]:

1. Income Verification - an issuer reviews copies of any Internal Revenue Service ("IRS") form that reports income (including, without limitation, Form W-2, Form 1099, Schedule K-1 of Form 1065 and a copy of a filed Form 1040), for the two most recent years, along with obtaining a written representation from such person that he or she has a reasonable expectation of reaching the required income level to qualify as an accredited investor during the current year.

2. Net Worth Verification - an issuer reviews certain types of documentation relating to such person's net worth, dated within the prior three months. Examples of such documentation with respect to a person's assets include bank statements, brokerage statements and other statements of security holdings and certificates of deposit. To review a person's liabilities, an issuer must review a consumer report from at least one nationwide consumer reporting agency (i.e., a credit report). To adequately assess a person's net worth, the issuer must also obtain a written representation from such person that all liabilities necessary to make a determination of net worth have been disclosed to the issuer.

3. Third-Party Verification - an issuer obtains written confirmation from certain third parties, including a registered broker-dealer, an SEC-registered investment adviser, 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 that such third party made a determination that such purchaser is an accredited investor.[7]

The adopting release also included a fourth category of verification that will essentially grandfather a natural person who previously invested in an issuer's 506(b) offering as an accredited investor prior to the effective date of Rule 506(c) and is currently an investor in the issuer. If, following the effective date of Rule 506(c), the same issuer conducts a 506(c) offering, the issuer is deemed to satisfy the verification requirement of a current investor by obtaining a certification by such person at the time of sale that he or she qualifies as an accredited investor (for instance, via a representation in a subscription document).[8]

In connection with Rule 506(c), the SEC also adopted a revision to Form D to add a new check box in Item 6 for issuers to indicate whether they are relying on the exemption in Rule 506(c). The SEC adopted this revision to Form D to allow it to monitor the use of the Rule 506(c) exemption, including the verification methods used by issuers relying on this exemption. Fund sponsors will be required to check either Rule

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[5] The SEC clarified that the non-exclusive methods for verifying accredited investor status would not provide protection if an issuer or its agent had or has actual knowledge that the purchaser is not an accredited investor. Additionally, the SEC stated that "it will be important for issuers and their verification service providers to retain adequate records regarding the steps taken to verify that a purchaser was an accredited investor."

[6] Without comment, the SEC extended the non-exclusive methods only to natural persons and not entities. Issuers will therefore need to rely on the "facts and circumstances" method of verification for entity investors, although certain of the methods set forth in Rule 506(c) would presumably also be reasonable methods to verify entity investors.

[7] The adopting release clarified that the list of third parties who may provide satisfactory verification is not an exclusive list. An issuer may be entitled to rely on verification of accredited investor status by a person or entity other than those listed in the adopting release, provided that any third party takes reasonable steps to verify that purchasers are accredited investors and has determined that such purchasers are accredited investors, and the issuer has a reasonable basis to rely on such verification.

[8] The General Solicitation Amendment does not clarify whether this fourth category is applicable to offerings made to investors by related serial issuers (e.g., an investor in a sponsor's private equity fund that wishes to invest in that sponsor's next private equity fund).

506(b) or Rule 506(c) on revised Form D, meaning sponsors must declare at the time of the offering whether they are engaged in general solicitation and general advertising in connection with the offering.[9]

Effect of Rule 506(c) on Private Fund Offerings

Verification Steps for Private Funds

In the adopting release, the SEC warned that any issuer claiming reliance on Rule 506(c) has the burden of showing that it is entitled to that exemption. Private fund sponsors intending to rely on Rule 506(c) will need to consider whether their current practices for verifying accredited investor status, including standard representations and questionnaires included in subscription documents, should be modified or augmented. Private fund sponsors may also wish to weigh the costs and risks of such changes against the benefits of being able to conduct a general solicitation.

Effect of Rule 506(c) on Sections 3(c)(1) and 3(c)(7)

Congress did not make specific reference to privately offered funds or to exemptions from registration under the Investment Company Act of 1940 (the "1940 Act") in drafting the JOBS Act's directive to remove the prohibitions on general solicitation and general advertising in Regulation D. However, Section 201(b) of the JOBS Act provides that "[o]ffers and sales exempt under [Rule 506] (as revised pursuant to [the JOBS Act]) shall not be deemed public offerings under the Federal securities laws as a result of general advertising or general solicitation." The SEC has affirmed that it interprets Section 201(b) of the JOBS Act to permit private funds to use general solicitation and general advertising in connection with the offer and sale of securities under Rule 506(c) and that any such offer and sale would satisfy a non-public offering condition in Sections 3(c)(1) and 3(c)(7) under the 1940 Act.

Effect of Rule 506(c) on Regulation S Offshore Offerings

The SEC's original rule proposal under the JOBS Act created some uncertainty as to whether an issuer could use general solicitation or general advertising in a U.S. offering in reliance on Rule 506(c) while simultaneously offering securities outside the U.S. under Regulation S, and the adopting release did not provide additional clarity. Regulation S provides a safe harbor for offers and sales of securities outside of the United States provided that (1) the securities are sold in an offshore transaction, and (2) there are no directed selling efforts in the United States. In the proposing release, the SEC merely reiterated prior guidance (provided by the SEC staff under a regime where "general solicitation" and "directed selling efforts" were often viewed as functional equivalents) that so long as foreign offerings and sales are made in compliance with Regulation S, such offerings and sales will not be integrated for the purpose of Regulation S with domestic offerings and sales made under Rule 506(c). While we believe it is unlikely that the SEC will take the position that general solicitation in a Rule 506(c) offering necessarily constitutes "directed selling efforts" that would disqualify a fund sponsor from making a simultaneous Regulation S offering, the adopting release for rule 506(c) has failed to dispel this uncertainty.

[9] If certain proposed amendments (described later in this alert) are adopted, such declaration would need to occur before the commencement of the general solicitation.

Rule 206(4)-8 of the Investment Advisers Act

In response to concerns that private funds engaging in general solicitation in reliance on Rule 506(c) may raise investor protection issues, in the adopting release the SEC reminded investment advisers to private funds that they are subject to Rule 206(4)-8 under the Investment Advisers Act of 1940, which prohibits an investment adviser to a pooled investment vehicle from making any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in the light of the circumstances in which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle, or from engaging in any other act, practice, or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.[10] The SEC added that investment advisers to private funds "should carefully review any such policies and procedures that have been implemented to determine whether they are reasonably designed to prevent the use of fraudulent or materially misleading private fund advertising and make appropriate amendments to those policies and procedures particularly if the private funds intend to engage in general solicitation activity."

Separate Restrictions May Be Imposed by Rules Under the Commodity Exchange Act

Potential friction exists between Rule 506(c) and CFTC rules under the Commodity Exchange Act, which does not constitute a "federal securities law" for purposes of the exemption from public offerings under the JOBS Act. Accordingly, CFTC rules may continue to constrain certain private fund sponsors from engaging in general advertising or general solicitation, even where Rule 506(c) and Sections 3(c)(1) or 3(c)(7) of the Investment Company Act would otherwise permit them to do so. For example, CFTC Rule 4.13(a)(3), which provides a "de minimis" exemption from registration as a commodity pool operator for fund sponsors engaged in swaps trading and other commodity interest transactions below certain thresholds, requires that interests in the applicable pool "are offered and sold without marketing to the public in the United States." Therefore, fund sponsors relying on Rule 4.13(a)(3) for exemption from CPO registration likely cannot use general solicitation or general advertising (which would presumably constitute "marketing to the public" for purposes of Rule 4.13(a)(3)) even if the issuer can rely on Rule 506(c) for an exemption from registration under the Securities Act and, by extension, under the 1940 Act. We understand that the CFTC is pursuing an initiative to conform CFTC rules to the terms of the General Solicitation Amendment.

Private Placements Under Non-U.S. Laws

The private placement regimes of many non-U.S. jurisdictions continue to prohibit activities analogous to general solicitation and general advertising. Therefore, funds offered outside the U.S. should not use general solicitation for their offerings without first considering the effects of their marketing efforts on offerings and sales of fund interests in non-U.S. countries. In certain circumstances, general solicitations intended to be directed to U.S. investors may be regarded as constituting general solicitations in other countries under the offering rules in such countries, for example where the general solicitation has been conducted through an unrestricted website accessible to non-U.S. investors. The extent to which U.S. general solicitation and general advertising activities may imperil non-U.S. private fund offerings is likely to be an area of considerable focus following the effective date of Rule 506(c).

[10] It is worth noting that the SEC has taken into account the sophistication of an investor in determining whether advertising is misleading or deceptive.

Effect of Rule 506(c) on Parallel 4(a)(2) Offerings

In the adopting release, the SEC confirmed that the general solicitation mandate affects only Rule 506, and not offerings under Section 4(a)(2) of the Securities Act, which means that an issuer relying on Section 4(a)(2) outside of the Rule 506(c) exemption will be restricted in its ability to make public communications to solicit investors.[11] Fund sponsors that manage a fund intending to rely on Rule 506(c) and a parallel fund relying on Section 4(a)(2) should consider whether the two offerings may be integrated, which would likely have the effect of disqualifying the offerings.[12]

State Securities Law

State regulation of Rule 506(c) offerings would be preempted by provisions of the National Securities Markets Improvement Act of 1996 ("NSMIA"). However, under NSMIA, the states still retain authority to require that Form D "notice filings" be made and corresponding fees be paid. Most states contain alternative exemptions that an issuer may rely on to avoid these notice filing requirements, but these exemptions often include a prohibition on general solicitation or general advertising. Accordingly, such alternative exemptions may be unavailable for Rule 506(c) offerings.

Additionally, funds relying on Rule 506(c) should carefully consider requirements in New York state that, depending on the circumstances, may require substantial additional filings to be made pre-offer with the state.

The adopting release for the General Solicitation Amendment is available here.

Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings

As mandated by Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC adopted amendments to Rule 506 to disqualify securities offerings involving certain "felons" and other "bad actors" from reliance on the exemption from Securities Act registration pursuant to Rule 506.[13] Covered persons (i.e., persons who could be considered "bad actors" under the rule) include:

- Investment managers of issuers that are pooled investment funds; the directors, executive officers, other officers participating in the offering, general partners and managing members of such investment managers; and the directors and executive officers of such general partners and managing members and their other officers participating in the offering;
- The issuer (i.e, in the case of a pooled investment fund, the fund itself), its predecessors and affiliate issuers;[14]

[11] Section 4(a)(2) permits unregistered offerings "not involving a public offering", and, unlike Rule 506, does not require any particular level of investor sophistication.
[12] Parallel fund structures are common for fund sponsors that advise a "main fund" relying on Rule 506 and a parallel "friends and family" fund relying on Section 4(a)(2).
[13] The disqualification applies to Rule 506 and not just the newly adopted Rule 506(c).
[14] Rule 501(b) defines "affiliate" as follows: An 'affiliate' of, or person 'affiliated' with, a specified person shall mean a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified. The rule uses the term "affiliate issuer." As "issuer" is defined in Rule 501(g) to include any entity that issues or proposes to issue any security, "affiliate issuer" could arguably include a wide array of affiliates.

- Directors, executive officers, other officers participating in the offering, general partners or managing members of the issuer;
- 20% beneficial owners of the issuer measured by voting power;[15]
- Promoters connected with the issuer in any capacity at the time of sale; and
- Persons compensated for soliciting investors (e.g., placement agents) as well as the general partners, directors, executive officers, other officers participating in the offering, and managing members of any compensated solicitor.

The final rule includes a number of disqualifying events. The disqualifying events most likely to apply to covered persons of private funds in connection with a sale of interests in any such private fund are as follows:[16]

1. SEC cease-and-desist orders barring or limiting such person from engaging in certain activities under the federal securities laws;[17]

2. SEC cease-and-desist orders entered into within the last five years in connection with violations of anti-fraud provisions of the federal securities laws;

3. Criminal convictions in connection with the purchase or sale of a security, involving the making of a false filing with the SEC, or arising out of the conduct of certain financial intermediaries. The criminal conviction must have occurred within ten years of the sale of private fund interests (or five years in the case of the issuer and its predecessors and affiliated issuers);

4. Court injunctions and restraining orders entered into within five years before any such sale that, at the time of such sale, restrain or enjoin such person from engaging or continuing to engage in any conduct or practice in connection with the purchase or sale of a security, involving the making of a false filing with the SEC, or arising out of the conduct of certain financial intermediaries; and

5. Final orders from certain state and federal regulators (i) that bar a person from associating with a regulated entity in the business of securities, insurance or banking and that were in effect at the time of the sale of private fund interests, or (ii) that find a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct and that were entered within ten years before such sale.[18]

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[15] The Bad Actor Amendment limits coverage of security holders to those having voting rights. Funds making Regulation D offerings following the effective date of the Bad Actor Amendment will need to consider whether investors in the funds hold "voting securities" for purposes of Rule 506.

[16] Other disqualifying events include (1) suspension or expulsion from membership in a self-regulatory organization (SRO) or from association with an SRO member, (2) certain SEC orders suspending the Regulation A exemption, and (3) U.S. Postal Service false representation orders issued within five years before the proposed sale of securities.

[17] In the adopting release, the SEC stated that disqualification will "continue only for as long as some act is prohibited or required to be performed pursuant to the order (with the consequence that censures and orders to pay civil monetary penalties, assuming the penalties are paid in accordance with the order, are not disqualifying, and a disqualification based on a suspension or limitation of activities expires when the suspension expires)."

[18] The adopting release notes that the final rules do not include a definition of "fraudulent, manipulative or deceptive conduct" and do not limit "fraudulent, manipulative or deceptive conduct" to matters involving scienter.

An issuer will be disqualified only for disqualifying events that occur after the effective date of the rule. If an event that would otherwise be a disqualifying event occurs before the effective date, the issuer is required to provide investors with written disclosure of the event.

In connection with the Bad Actor Amendment, the SEC also adopted a revision to Form D to add a new certification to the signature block, whereby issuers claiming a Rule 506 exemption will be required to confirm that the offering is not disqualified from reliance on Rule 506 for "bad actor" reasons.

Finally, the Bad Actor Amendment includes a waiver provision, under which the SEC may grant a waiver of disqualification if it determines that an issuer has shown good cause that it is not necessary under the circumstances that the registration exemption be denied. The adopting release identifies a number of circumstances that could, depending on the specific facts, be relevant to the evaluation of a wavier request.

The adopting release for the Bad Actor Amendment is available here.

Implications of the Bad Actor Amendment for Private Funds

Due Diligence Requirement

The final rule provides an exception from disqualification when the issuer can show it did not know and, in the exercise of reasonable care, could not have known that a covered person with a disqualifying event participated in the offering.[19] Therefore, the SEC suggests that fund sponsors consider distribution of "questionnaires or certifications, perhaps accompanied by contractual representations, covenants and undertakings," to, among others, investment manager personnel and placement agents.[20] Fund sponsors may also wish to add appropriate provisions to placement agent contracts to address a situation in which a placement agent becomes a bad actor during an offering. As the SEC declined to adopt a compliance date, fund sponsors will need to conduct this due diligence prior to the effective date of the rule (i.e., 60 days following publication of the rule in the Federal Register).

Employability Considerations

In light of the seriousness of the Bad Actor Amendment, a "bad actor" finding applicable to an investment manager could constitute a form of commercial "death penalty" for the firm and/or its personnel. Therefore, to the extent enforcement actions are brought against a fund manager, the Bad Actor Amendment should be taken into account in settlement negotiations.[21] Additionally, investment managers should take care when hiring new employees (including employees who are added through corporate transactions) to ensure any

[19] The adopting release states that generally, "issuers should make factual inquiry of the covered persons." In some circumstances, however, it "may be sufficient to make inquiry of an entity concerning the relevant set of covered officers and controlling persons, and to consult publicly available databases concerning the past disciplinary history of the relevant persons;" for example, in the case of a registered broker-dealer acting as placement agent.

[20] The adopting release states that "for continuous, delayed or long-lived offerings, reasonable care includes updating the factual inquiry on a reasonable basis." The "frequency and degree of updating will depend on the circumstances of the issuer, the offering and the participants involved." Certain circumstances would indicate closer monitoring is required, for example, "notice that a covered person is the subject of a judicial or regulatory proceeding." Absent such facts, the adopting release states that periodic updating could be sufficient.

[21] For example, financial institutions which settle enforcement matters often simultaneously seek exemptive relief from the disqualification provisions of Section 9 of the Investment Company Act. We would expect that sponsors of private funds will similarly need to negotiate a waiver from the "bad actor" disqualifications at the same time they negotiate the settlement of any enforcement actions.

such employees constituting covered persons are not subject to any "bad actor" disqualifications under Rule 506(d).

Expansiveness of Covered Persons

A fund intending to rely on Regulation D could be prohibited from doing so based on the actions of a large number of actors not under the direct control of the fund or its investment manager. For example, depending on the circumstances, bad actors might include placement agents and their personnel, entities affiliated with the investment manager (but with no involvement in the business of the investment manager or the fund), or large investors holding voting securities in a fund. As a result, fund sponsors relying on Regulation D should determine the full range of persons that could subject them to the Bad Actor Amendment and should consider adopting procedures to monitor for bad actors.

Open Questions

Several questions critical for interpreting these requirements are not addressed in the rule or adopting release.

- It is not yet clear how broadly "affiliate issuer" will be interpreted (e.g., would it include advisers under common control with a fund's adviser that are separately operated, or the portfolio companies of private equity funds).[22]
- It is unclear under what conditions an officer of the issuer is "participating in an offer."
- The effect on an offering is unclear in circumstances where a placement agent or one of its officers becomes a "bad actor" in the middle of an offering. For example, a fund would need to consider whether the offering would need to be terminated, or whether it could be cured if the placement agent fires the bad actor or the fund fires the placement agent.

For an issuer that is disqualified from using Rule 506, a separate question is whether the nature of the offering permits reliance on Section 4(a)(2) to conduct the offering, notwithstanding the non-availability of the safe harbor that would otherwise be provided by Rule 506.

SEC Proposals

The SEC also proposed new rules that seek to better monitor the market, provide additional investor protection safeguards and provide more information to regulators, especially in light of new Rule 506(c). These proposals include:

- Requiring issuers to file an abbreviated Form D at least 15 calendar days in advance of the first use of general solicitation material in a Rule 506(c) offering and file a closing Form D amendment within 30 calendar days after the termination of a Rule 506 offering;
- Requiring issuers to provide additional information about the issuer and the offering on Form D, including, if the offering relies on Rule 506(c), the methods used to verify accredited investor status of investors;

[22] See endnote 14.

- Disqualifying issuers from relying on Rule 506 for one year if the issuer, its predecessor or affiliate failed to comply with the Form D filing requirements of Rule 503 in connection with a Rule 506 offering within the last five years (the proposing release states that the look-back period would not extend past the effective date of the rule). The SEC proposed a 30-day cure period for an issuer's first late filing, if good cause is shown;
- Requiring issuers to include legends and disclosures in written general solicitation materials. The SEC proposed additional legends and disclosures that are specific to private funds' written general solicitation materials (including that the securities offered are not subject to the protections of the Investment Company Act and certain other disclosures on written general solicitation materials that include performance data). Further, the SEC proposed to require that performance data in general written solicitation materials used by private funds be subject to requirements related to the time period the data covers and disclosure regarding whether fees and expenses have been deducted;
- Requiring issuers to submit written general solicitation materials to the SEC through an intake page on the SEC's website (the SEC has proposed this as a temporary rule, to expire automatically two years after its effective date). Such materials would be provided to the SEC on a confidential basis and would not be made available to the public; and
- Extending to private offerings the anti-fraud guidance required by Rule 156 for general solicitation materials for public offerings.

If adopted, these requirements would impose significant additional changes on the private fund offering process. Among other things, the proposed rules would place critical importance on timely Form D filings, and could result in a flood of written offering materials for private funds (potentially including PPMs, marketing decks, websites and other marketing materials) being provided directly to the SEC. The resulting increases in administrative burdens and regulatory profile could materially influence a fund sponsor's decision-making over whether to rely on Rule 506(c).

The SEC also requested comment on whether to impose manner and content restrictions for private funds (i.e., rules that would restrict the content that could be included in private fund offering documents, and/or the manner in which information in such documents is prepared and conveyed), especially for performance data. The SEC did not propose standardized calculation methodologies for performance of private funds based on the conclusion that different types of funds may have legitimate reasons to calculate performance differently and because the SEC believes that the federal securities laws' antifraud provisions and the Rule 506(c) accredited investor requirement provide sufficient investor protections.

Lastly, the SEC has begun to review the definition of accredited investor as it relates to natural persons, and is considering changing (i.e., tightening) the definition, especially in light of the general solicitation and general advertising permitted by Rule 506(c). The SEC requested comment on the definition of accredited investor.

The proposing release is available here. Comments should be submitted to the SEC no later than 60 days after the proposed rules are published in the Federal Register, which is expected shortly.

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For more information on the adopted rules or the proposed rule, please contact your regular Ropes & Gray attorney.