

SEC Proposes Amendments to Rule 506 to Allow General Solicitation

Under Federal law, companies seeking to raise capital by issuing securities must either register the offer and sale of their securities under the Securities Act of 1933 or comply with an exemption from registration. The most widely used exemption, Rule 506, allows a company to sell an unlimited amount of securities to accredited investors (essentially certain high net worth persons and institutional investors) provided that the company does not engage in general solicitation or advertising of its securities offering.

New Rule 506

The recently enacted Jumpstart Our Business Startups Act directed the SEC to remove the general solicitation and advertising prohibition for securities offerings that rely on Rule 506. The SEC's proposed rules would split Rule 506 into two separate exemptions:

- New Rule 506 would permit a company to use general solicitation and advertising to offer its securities, provided that the company takes reasonable steps to *verify* that all purchasers of the securities are accredited investors. Whether the company took reasonable steps to verify purchasers' accredited investor status would be an objective determination based on the particular facts and circumstances of each offering and investor, however, the SEC does not propose any specific verification procedures.
- Current Rule 506 would still continue so companies that do not use "general solicitation or advertising" may rely on the *reasonable belief* standard that purchasers are accredited investors. Note that under limited circumstances, current Rule 506 allows the sale of securities to up to 35 non-accredited investors.

Hedge and Other Private Offered Funds

Hedge funds and other privately offered funds historically have been prohibited from engaging in general solicitation or advertising for two reasons. First, private funds typically rely on Rule 506 when offering their fund interests in the United States. Second, private funds relying on the exclusion from the definition of investment company under the Investment Company Act of 1940 by virtue of Section 3(c)(1) or 3(c)(7) of such Act were not allowed to engage in general solicitation or advertising of their fund interests. The new Rule 506 will permit private funds to engage in general solicitation and advertising without losing the ability to rely on Section 3(c)(1) or 3(c)(7).

The SEC is soliciting comments from the public on the proposed rule changes. The comment period ends on October 5, 2012.

James Smith
jsmith@tarterkrinsky.com
212-216-8060

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TARTER
KRINSKY &
DROGIN^{LLP}
ATTORNEYS AT LAW

New York Office: 1350 Broadway, New York, NY 10018 • Tel: 212. 216. 8000 • Fax: 212. 216. 8001
New Jersey Office: 475 Wall Street, Princeton, NJ 08540 • Tel: 609. 683. 9494 • Fax: 609. 683. 7490
www.tarterkrinsky.com