



# The JOBS Act, Regulation D, and Rule 506(c)

September 2013

The Jumpstart Our Business Startups (JOBS) Act was signed into law by President Obama on April 5, 2012. The law mandated certain changes to Rule 506 of SEC Regulation D designed to spur capital formation for growing innovators. The required Regulation D reforms took effect on September 23, 2013, after being finalized by the SEC this summer. A summary of these changes is outlined below. ***This policy overview is not intended to, and does not, constitute legal counsel – issuers should consult their own legal teams before considering an offering and should not rely on this overview when considering such an offering.***

## What is Rule 506?

Prior to the passage of the JOBS Act, Rule 506 of SEC Regulation D allowed issuers to raise an unlimited amount of capital through a private offering to an unlimited number of accredited investors and up to 35 non-accredited investors. The SEC defines an accredited investor as one with a net worth over \$1 million (excluding the investor's primary residence) or more than \$200,000 in annual income (\$300,000 for couples). Companies were prohibited from using general solicitation or general advertising to market their securities.

The pre-JOBS version of Rule 506 has been maintained in its entirety as Rule 506(b). Issuers wishing to conduct a private offering to a mix of accredited investors and up to 35 non-accredited investors may still do so, provided that they do not use general solicitation to advertise the offering.

## What is Rule 506(c)?

The JOBS Act directed the SEC to lift the ban on general solicitation for offerings conducted under Rule 506, provided that issuers A.) sell securities only to accredited investors and B.) take reasonable steps to verify that all purchasers in an offering are accredited. The SEC finalized these reforms at its open meeting in July by creating a new Rule 506(c) that allows general solicitation in offerings to accredited investors. The finalized rules took effect on September 23.

As specified in the statute, issuers conducting Rule 506(c) offerings can now advertise to the general public, subject to certain conditions. This is a significant change from Rule 506(b), which prohibits general solicitation entirely. Though there are no specified limits on the reach of general solicitation under Rule 506(c), only accredited investors are permitted to purchase in an offering. The issuer must also take reasonable steps to verify that each investor in the offering is accredited. Other relevant SEC requirements or legal provisions may also apply.

The SEC amended Form D, which is filed in conjunction with Rule 506 offerings, to add a checkbox for issuers to indicate whether they are relying on the new Rule 506(c) exemption and conducting general solicitation.

## How can issuers verify that their investors are accredited?

The SEC has indicated that it will adopt a principles-based approach when determining whether an issuer took reasonable steps to verify its investors' accreditation status. The SEC encourages issuers to take into account the particular facts and circumstances of each offering when evaluating their investor verification process. The SEC has provided a list of factors that issuers should consider:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be
- the amount and type of information that the issuer has about the purchaser
- 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

The SEC's stated goal of this case-by-case approach is to provide sufficient flexibility to cover various types of issuers and investors.

## Has the SEC provided any concrete guidance on which verification methods would be considered reasonable?

To supplement the principles-based framework, the SEC has adopted a non-exclusive safe harbor to give further guidance on acceptable methods to verify that investors in a Rule 506(c) offering are accredited. Rule 506(c) includes four specific non-exclusive methods of verifying accredited investor status that, if used, are deemed to satisfy the verification requirement. The SEC has noted that issuers are not required to use any of these methods and can still rely on the particular facts and circumstances of their offering when addressing investor verification. Any one of the following methods will satisfy the verification requirement, according to the SEC:

- To verify an investor's income (required to be \$200,000 or greater), an issuer may review copies of any IRS form that reports income for the two most recent years, along with obtaining a written statement from the purchaser that he or she has a reasonable expectation of maintaining that income level.
- To verify an investor's net worth (required to be \$1 million or greater, excluding the value of the investor's primary residence), an issuer may review documentation, dated within three months of the offering, that describes net worth. For assets, these documents could include, for example, bank statements, brokerage statements, certificates of deposit, tax assessments, and appraisal reports. Purchasers are also required to provide a credit report to disclose liabilities.
- An issuer may obtain written confirmation from a certified public accountant, a licensed attorney, an SEC-registered investment adviser, or a registered broker-dealer that the purchaser meets the accredited investor requirements.
- If an issuer conducted a Rule 506(b) offering prior to September 23, 2013, any accredited investors participating in that offering that remain investors in the issuer may participate in a Rule 506(c) offering.

## **Are there any other new requirements for conducting a Rule 506(c) offering?**

The SEC has issued a proposed rule that would enhance disclosures related to offerings conducted under Rule 506(b) and Rule 506(c). This proposal would make certain changes to Form D requiring more information from issuers. It would also update the disclosure requirements to reflect the ability of issuers to conduct general solicitation under Rule 506(c) and the requirement that they take reasonable steps to verify that their purchasers are accredited investors.

BIO provided feedback to the SEC on this proposed rule, expressing concern that costly disclosure requirements could serve as a roadblock to growing biotech companies considering a Rule 506 offering. It is unclear at this point when or if the SEC will finalize this proposed rule and what the final version might look like. BIO will continue to work with the SEC to effectively implement the changes to Regulation D so that it will stimulate important capital formation to support the groundbreaking research being conducted by BIO members.

The SEC also finalized a rule, mandated by the Dodd-Frank Act, disqualifying felons and other bad actors from participating in Rule 506 offerings.

## **Where can issuers learn more about Rule 506(c) offerings?**

- The SEC's information page on Rule 506 can be accessed [here](#).
- The legislative text of the JOBS Act is available [here](#). The changes to Regulation D are authorized by Title II, Section 201.
- The SEC's initial rule proposal, discussing the principles-based approach to investor verification, can be accessed [here](#).
  - BIO's comment letter responding to this proposal is available [here](#).
- The finalized SEC rule creating Rule 506(c), which took effect September 23, can be accessed [here](#).
- The SEC's proposal that would add certain disclosure requirements to Rule 506 offerings, which has yet to be finalized, can be accessed [here](#).
  - BIO's comment letter responding to this proposal is available [here](#).
- The finalized "bad actors" rule can be accessed [here](#).