

ALLEN & OVERY

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Proposal to Permit General Solicitations and General Advertising in U.S. Private Placements

SPEED READ

On August 29, 2012, in connection with the implementation of Title II (**Title II**) of the Jumpstart Our Business Startups Act¹ (the **JOBS Act**), the Securities and Exchange Commission (the **Commission**) proposed several changes to the Securities Act of 1933, as amended (the **Securities Act**), including the addition of new Rule 506(c) and amendments to current Rule 144A (collectively, the **Proposal**)². The JOBS Act was signed into law on April 5, 2012 and is intended, in part, to open capital markets and encourage economic growth in certain sectors by easing securities regulations. Title II specifically represents a shift in focus from the regulation of offers of privately issued securities to the regulation of sales of such securities in the context of Rule 506 and Rule 144A. Title II does not address transactions under Regulation S. The Proposal closely tracks the language set forth in Title II and may prove beneficial to many issuers who privately place securities in the United States.

The Proposal, if finalized, would make two significant changes to securities regulation: (1) adoption of new Rule 506(c), and (2) modification of Rule 144A. Under proposed Rule 506(c), and in reliance on the definition of accredited investors as defined in Rule 501 (**Accredited Investors**) (which definition was recently amended in connection with implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act³), issuers will be able to use "general solicitation" and "general

advertising" (collectively, **general solicitation**) to offer and sell securities to entities that it has taken reasonable steps to verify, or that it reasonably believes, are Accredited Investors. In establishing a "reasonable steps" method, the Commission adopted a flexible standard resembling current market practice. Issuers who frequently use private placements as a source of financing and as a method for accessing the United States market should benefit from this change in securities regulations, including foreign private issuers and private equity and hedge funds.

The proposed modifications to Rule 144A focus on offering practices. The Proposal eliminates references to "offer" and "offeree" in Rule 144A(d)(1) thereby restricting only sales—and not offers—of securities to qualified institutional buyers as defined in Rule 144A (**QIBs**). The Proposal did not amend Regulation S to clarify whether the use of general solicitation will be considered "directed selling efforts" in a concurrent offering; however, the Commission did state that the historical practice of not integrating securities transactions issued concurrently under Rule 506 or Rule 144A and Regulation S (a **concurrent offer** or **concurrent offering**) will continue. We describe here the terms of the Proposal and we consider its impact on foreign private issuers and private equity and hedge funds.

Proposed Rule 506(c) and Related Changes Allow for Flexibility In Regulation D Offerings

To implement Section 201(a)(1) of the JOBS Act, the Commission proposes creating new Rule 506(c) which will allow issuers to use general solicitation to privately

offer and sell securities provided the issuer has taken reasonable steps to verify, or reasonably believes, that the purchasers of such securities are Accredited Investors.

REASONABLE STEPS

The Commission resisted creating a comprehensive or exclusive list of "reasonable steps" that an issuer must use when verifying that a purchaser is an Accredited Investor. Instead, the Commission emphasized the need for flexibility in this area and noted several characteristics generally in-line with current market practice that an issuer could consider when taking "reasonable steps" to verify that a purchaser is an Accredited Investor, including the nature of the purchaser, the amount and type of information available about the purchaser and the nature and terms of the related offering. Within this framework, issuers can evaluate a range of information and circumstances to determine whether a potential investor is an Accredited Investor, including the category of Accredited Investor (broker-dealer, government

organization, natural person, etc.), filings with the Commission and other regulatory bodies, verification from a credible third-party, an analysis of the manner in which the investor was solicited and the prospective investor's ability to fulfill a large minimum investment amount.

The Commission emphasizes in the release that it is ultimately the issuer's responsibility to prove they are entitled to an exemption from registration and that "reasonable steps" verification, while flexible and generally in-line with market practice, is not simply a duplication of the current reasonable belief standard. To that end, the Commission recommended that issuers retain records of the "reasonable steps" taken to verify a purchaser's status as an Accredited Investor.

REASONABLE BELIEF

The Commission stated in the release that the reasonable belief standard imbedded in the definition of Accredited Investor is applicable to Rule 506(c) offers. Therefore, an issuer's reasonable belief that a purchaser is an Accredited Investor is sufficient to maintain its Rule 506(c)

exemption. This is important because it shields an issuer from loss of their exemption if, despite the issuer's reasonable belief, a purchaser was not an Accredited Investor at the time of sale. The issuer will, of course, need to have taken "reasonable steps" to support its claim

that it had a reasonable belief that the purchaser was an Accredited Investor. This conclusion is in keeping with Rule 144A where the reasonable belief standard is built

into the text of the rule rather than incorporated into the definition of QIBs.

PRESERVATION OF RULE 506(b)

The Proposal preserves Rule 506(b) allowing issuers to continue offering securities to persons they reasonably believe are Accredited Investors (and up to 35 non-Accredited Investors who meet certain other "sophistication" criteria) provided they avoid general solicitation in connection with such offering. The

Commission notes that Rule 506(b) would continue to be available to issuers that "do not wish to engage in general solicitation in their Rule 506 offerings (and become subject to the new requirement to take reasonable steps to verify the accredited investor status of purchasers)"⁴.

CHANGES TO FORM D

In connection with proposed Rule 506(c), the Commission proposes to amend Form D, as well. That amendment will be minor and will consist of a new "check-the-box" category for Rule 506(c) offerings to distinguish them

from Rule 506(b) offerings. No additional disclosure requirements under Form D for Rule 506(c) issuers were proposed.

Amendments to Rule 144A Open Offers Up to Non-QIBs

The proposed amendments to Rule 144A focus on offers but do not impact sales. Although Rule 144A does not contain an explicit prohibition against general solicitation, it currently limits both offers and sales of securities to QIBs which has the same effect as Rule 502(c)'s direct prohibition against these activities. Removing references to "offer" and "offeree" in Rule 144A(d)(1) allows issuers to offer securities broadly through general solicitation

provided they only sell such securities to QIBs or persons they reasonably believe to be QIBs. All other conditions applicable to Rule 144A transactions still apply, including that reasonable steps are taken to assure purchasers that the transaction has been conducted pursuant to Rule 144A, the issuer has undertaken to provide certain on-going information to purchasers, and the securities, when issued, were not listed on a United States securities exchange.

Current Practice on Regulation S Integration Maintained

Offers and sales of securities outside the United States to non-U.S. persons benefit from the safe harbor from registration provided by Regulation S, provided, that, "directed selling efforts" are not used by the issuer in the United States to market the securities. Directed selling efforts continue to be prohibited in connection with securities offerings pursuant to Regulation S, however, in connection with the relaxation of private placement

marketing restrictions in the United States by the JOBS Act, the Commission has confirmed they will maintain their current position that offerings conducted in compliance with Regulation S will not be integrated with concurrent domestic registered or unregistered offerings. The real world implications of this position and their impact on market practice are not clear.

Impact

If the Proposal is passed in substantially its current form, issuers of privately placed securities, including foreign private issuers and private equity and hedge funds, should be able to utilize general solicitation in connection with the private placement of securities under Regulation D and Rule 144A through a variety of methods including, for example, print, mailings, advertisements in newspapers and magazines, e-mail communications, websites, and social media such as Twitter or blogs. Smaller funds and

funds of funds in particular may enjoy significant benefits from enhanced marketing activities—reaching a broader audience of potential investors and thereby competing more effectively against larger, better-branded funds.

Perhaps more importantly, implementation of the Proposal would constitute a significant loosening of the current restriction on communications under Regulation D with potential investors as to which there was not a preexisting relationship.

Special Considerations for Funds

We expect to see increased transparency in the fund industry following the relaxation of these marketing

limitations. Such transparency will be achieved by investors being provided with greater access to fund

performance information through, for example, enhanced databases containing valuable analytics and metrics across various funds.

We note that some funds may determine not to take advantage of these newly permitted forms of marketing due to a desire to maintain a level of privacy and a less public profile. In addition, funds with a global investor base could be reluctant to engage in such marketing efforts

which may jeopardize, or at least be inconsistent with, their compliance with private placement requirements of other jurisdictions. Furthermore, fund managers may abstain from engaging in general advertising in order to remain in compliance with the "no holding out" requirement for exemption from registration under Section 203 of the Investment Advisers Act of 1940.

INVESTMENT COMPANY ACT CONSIDERATION

The JOBS Act provides that offerings conducted pursuant to Regulation D will remain "private placements" and will not be deemed "public offerings" under the federal securities laws as a result of the newly permitted general

solicitation. Section 3(c)(1) and Section 3(c)(7) of the Investment Company Act of 1940 (the ICA), which many funds rely upon for exemption from registration, prohibit funds from making a "public offering" of their securities.

Comment Period

The Commission will consider comments on the Proposal for 30 days following publication in the Federal Register.

It remains to be seen how these items will be addressed in the final rulemaking and guidance provided by the

Commission or when such final rules will be promulgated; however, we are available to discuss any issues that you might have, and in assisting in drafting a response to the Commission's request for comment.

Key Contacts

If you require advice on any of the matters raised in this document, please call any of our the individuals listed below or your usual contact at Allen & Overy.

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Endnotes

¹ P.L. 112-106, H.R. 3606.

² Release No. 33-9354; File No. S7-07-12.

³ P.L. 111-203, H.R. 4173.

⁴ Release No. 33-9354; File No. S7-07-12, page 12.