

INSIDE THE DEAL

Don't Rev Up Your Advertising Engines Just Yet

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The Securities and Exchange Commission proposed rule amendments this past August to implement one of the most widely anticipated provisions of the JOBS Act: elimination of the ban on general solicitation and advertising in certain private securities offerings.

Under the rule amendments, private funds and other issuers of securities will be able to use general solicitation and advertising in pri-

ivate offerings made in reliance on a new subsection (c) of Regulation D, Rule 506, provided they take “reasonable steps to verify” that all purchasers are accredited investors.

As proposed, offerings made in reliance on new Rule 506(c) will be regarded as non-public for purposes of Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. This will allow private funds to engage in general solicitation and advertising without falling into the definition of an “investment company.”

In an effort to provide flexibility to accommodate all types of issuers, investors, and methods of verification, the commission declined to define what might constitute taking reasonable steps to verify an investor’s status as an accredited investor and instead has stated that reasonableness should be an objective determination based on the facts and circumstances of a particular transaction.

This flexibility has proven controversial and, probably more than anything else, has led to a delay in the adoption of a final rule. In the meantime, the commission has held a dozen meetings with market participants and received hundreds of public comments on the proposed rule amendments.

Many of the comments concur with the commission’s flexible approach to the investor verification process, some advocate for the issuance of further interpretive guidance, and others encourage the adoption of a definitive safe harbor provision.

Another line of comments, of particular importance to private funds, has also emerged. The Investment Company Institute, Consumer Federation of America, and certain senators, led by **Senator Carl Levin** (D-Mich.), have maintained that Congress never intended to remove the ban on general solicitation and advertising for private funds.

Senator Levin et al. argue that Congress’s focus in removing the ban on general solicitation and advertising “was solely on small businesses seeking to raise capital for their operations...” and not on private funds. They contend “no argument was made during the debate of the bill that the objective was to ease the capital aggregation process for private investment vehicles... [and that] [t]he words ‘hedge fund,’ ‘private fund,’ or

‘investment vehicle’ were not used either during the committee or floor debate in the House of Representatives...”

They have urged the commission to propose a new regulatory framework that distinguishes between “issuers that engage in operational businesses and those that are merely investment vehicles.” The Investment Company Institute and Consumer Federation of America have also argued that, among other things, the final rule amendments should impose content restrictions on private fund advertising that are at least as extensive as those applicable to mutual funds and require that private fund advertisements be filed with and reviewed by FINRA.

Since the close of the comment period, there has been a fair amount of change at the commission. Chairman **Mary Schapiro** resigned in December, Internal emails released in the wake of Schapiro’s resignation suggest that she delayed implementation of final rule amendments eliminating the ban partly out of a fear of tarnishing her own legacy at the commission.

Commissioner **Elisse B. Walter** was elevated to the role of chairman and, at a Jan. 18, meeting of the Investor Advisory Committee established by the Dodd-Frank Act, she noted that while the proposed rule amendments “proved to be highly controversial...[the Commission is] looking very hard at how [to] move forward.” Less than a week later, on Jan. 24, President Obama nominated **Mary Jo White**, a Democrat and former federal prosecutor, to take over the role of chairman.

Given the current 2-2 split along party lines among the commissioners, it’s questionable whether any rulemaking, particularly one as divisive as elimination of the ban, will be completed prior to White’s confirmation, assuming she is confirmed, which, as some have suggested, may drag out through the summer.

Whatever your view, you may want to write your Congressman today because these changes will impact the business of fundraising. ❖

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