



# Federal Register

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**Friday,  
August 10, 2007**

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**Part IV**

## **Securities and Exchange Commission**

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**17 CFR Parts 200, 230, and 239  
Revisions of Limited Offering Exemptions  
in Regulation D; Proposed Rule**

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 200, 230, and 239

[Release No. 33-8828; IC-27922; File No. S7-18-07]

RIN 3235-AJ88

#### Revisions of Limited Offering Exemptions in Regulation D

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rules; request for additional comments.

**SUMMARY:** We propose to revise Regulation D to provide additional flexibility to issuers and to clarify and improve the application of the rules. We propose to create a new exemption from the registration provisions of the Securities Act of 1933 for offers and sales of securities to “large accredited investors.” The exemption would permit limited advertising in an exempt offering where each purchaser meets the definition of “large accredited investor.” We also propose to revise the term “accredited investor” in Regulation D to clarify the definition and reflect developments since its adoption. In addition, we propose to shorten the timing required by the integration safe harbor in Regulation D, and to apply uniform disqualification provisions to all offerings seeking to rely on Regulation D. We are soliciting comments on possible revisions to Rule 504. Finally, we also solicit additional comments on the definition of “accredited natural person” for certain pooled investment vehicles in Securities Act Rules 216 and 509 that we proposed in December 2006.

**DATES:** Comments should be received on or before October 9, 2007.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-18-07 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-18-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments also are available for public inspection and copying in the Commission’s Public Reference Room, 100 F Street, NE., Room 1580, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

#### FOR FURTHER INFORMATION CONTACT:

Gerald J. Laporte, Office Chief, or Anthony G. Barone, Special Counsel, Office of Small Business Policy, at (202) 551-3460, or Steven G. Hearne, Special Counsel, Office of Rulemaking, at (202) 551-3430, Division of Corporation Finance, or, in connection with the proposed definition of accredited natural person, Elizabeth G. Osterman, Assistant Chief Counsel, Division of Investment Management, at (202) 551-6825, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We propose to amend Rule 30-1,<sup>1</sup> Rule 144A,<sup>2</sup> Rule 146,<sup>3</sup> Rule 215,<sup>4</sup> and Form D,<sup>5</sup> and revise Regulation D<sup>6</sup> under the Securities Act of 1933<sup>7</sup> by amending Rules 501,<sup>8</sup> 502,<sup>9</sup> 503,<sup>10</sup> 504,<sup>11</sup> 505,<sup>12</sup> 506<sup>13</sup> and 508,<sup>14</sup> and replacing Rule 507.<sup>15</sup> We also request further comment on proposed new Rules 216 and 509 under the Securities Act.<sup>16</sup>

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<sup>1</sup> 17 CFR 200.30-1.

<sup>2</sup> 17 CFR 230.144A.

<sup>3</sup> 17 CFR 230.146.

<sup>4</sup> 17 CFR 230.215.

<sup>5</sup> 17 CFR 239.500.

<sup>6</sup> 17 CFR 230.501 through 230.508.

<sup>7</sup> 15 U.S.C. 77a et seq.

<sup>8</sup> 17 CFR 230.501.

<sup>9</sup> 17 CFR 230.502.

<sup>10</sup> 17 CFR 230.503.

<sup>11</sup> 17 CFR 230.504.

<sup>12</sup> 17 CFR 230.505.

<sup>13</sup> 17 CFR 230.506.

<sup>14</sup> 17 CFR 230.508.

<sup>15</sup> 17 CFR 230.507.

<sup>16</sup> See Release No. 33-8766 (Dec. 27, 2006) [72 FR 399] (the “Private Pooled Investment Vehicle Release”).

A. Proposed Rule 507—Exemption for Limited Offers and Sales to Large Accredited Investors

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#### I. Background and Overview of Proposals

Regulation D, adopted in 1982, was designed to facilitate capital formation while protecting investors by simplifying and clarifying existing exemptions for private or limited offerings, expanding their availability, and providing more uniformity between federal and state exemptions.<sup>17</sup>

Although Regulation D originated as an effort to assist small business capital formation and continues to play an important role in that arena, all sizes of companies use the registration exemptions in Regulation D.

Regulation D consists of eight rules. Rules 501 through 503 contain definitions, conditions, and other provisions that apply generally throughout Regulation D. Rules 504 through 506 detail specific exemptions from registration under the Securities Act. Rules 504 and 505 provide

<sup>17</sup> See Release No. 33-6389 (Mar. 8, 1982) [47 FR 11251].

exemptions adopted pursuant to the Commission's authority under Section 3(b)<sup>18</sup> of the Securities Act. Rule 504 provides exemptions for companies that are not subject to reporting requirements under the Securities Exchange Act of 1934<sup>19</sup> for the offer and sale of up to \$1,000,000 of securities in a 12-month period. Rule 505 exempts offers by companies of up to \$5,000,000 of securities in a 12-month period, so long as offers are made without general solicitation or advertising. Rule 506 is a safe harbor under Section 4(2)<sup>20</sup> of the Securities Act and provides an exemption without any limit on the offering amount, so long as offers are made without general solicitation or advertising and sales are made only to "accredited investors" and a limited number of non-accredited investors who satisfy an investment sophistication standard. Rules 507 and 508 were added in 1989.<sup>21</sup> Rule 507 disqualifies issuers from relying on Regulation D, under certain circumstances, for failure to file a Form D notice.<sup>22</sup> Rule 508 provides a safe harbor for certain insignificant deviations from a term, condition, or requirement of Regulation D.

Following our adoption in June 2005 of comprehensive amendments to our rules and forms relating to registered public offerings,<sup>23</sup> we believe it is appropriate to propose revisions to our rules applicable to private and limited offerings. Our objective in this effort is to clarify and modernize our rules to bring them into line with the realities of modern market practice and communications technologies without compromising investor protection.<sup>24</sup> Action in this area also is timely because our Advisory Committee on Smaller Public Companies made a number of recommendations relating to private and limited offerings in its final report dated April 23, 2006.<sup>25</sup> Several of

the proposals in this release build on the Advisory Committee's recommendations.

As discussed in detail below, we propose to make changes in the following four principal areas involving Regulation D:

- Creating a new exemption from the registration provisions of the Securities Act for offers and sales to "large accredited investors";
- Revising the definition of the term "accredited investor" to clarify it and reflect developments since its adoption;
- Shortening the length of time required by the integration safe harbor for Regulation D offerings; and
- Providing uniform disqualification provisions throughout Regulation D.

We propose to create a new exemption to the registration requirements of the Securities Act under our general exemptive authority in Section 28 of that Act.<sup>26</sup> This exemption, set forth in proposed new Rule 507, would be limited to sales of securities to "large accredited investors," and would permit an issuer to publish a limited announcement of the offering. The proposed definition of large accredited investor would be based on the "accredited investor" definition, but with higher and somewhat different dollar-amount thresholds. Large accredited investors that participate in these exempt offerings would be considered "qualified purchasers" under Section 18(b)(3) of the Securities Act,<sup>27</sup> thereby providing "covered security" status and the resulting preemption of certain state securities regulation.

We also propose to update the "accredited investor" definition. First, we propose to add an alternative "investments-owned" standard for determining accredited investor and large accredited investor status. This standard would include definitions of "investments" and "joint investments" similar to those we proposed in December 2006 in our initiative to revise Regulation D as it relates to investments by individuals in certain private pooled investment vehicles

2006), at 74–81, 92–93, 94–96, 100–101 (the "Advisory Committee Final Report"), available at <http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf>.

<sup>26</sup> 15 U.S.C. 77z–3. Section 28 states that the Commission, by rule or regulation, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation issued under this title, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

<sup>27</sup> 15 U.S.C. 77r(b)(3).

relying on Rule 506.<sup>28</sup> In addition, we propose a mechanism to adjust the dollar-amount thresholds in the definition of "accredited investor" to reflect future inflation. We propose to add categories of entities to the list of permitted accredited investors. We also propose to shorten the time frame for the integration safe harbor for Regulation D offerings from six months to 90 days to help provide flexibility to issuers. Finally, we propose to establish uniform disqualification provisions for all offerings under Regulation D in order to prevent certain issuers from relying on Regulation D exemptions.

In addition to these proposals, we also are soliciting comment on whether Rule 504 of Regulation D, the "seed capital" exemption, should be amended so that securities sold pursuant to a state law exemption that permits sales only to accredited investors would be deemed "restricted securities" for purposes of Rule 144.<sup>29</sup>

Finally, in last year's Private Pooled Investment Vehicle Release, we solicited comment on two new rules that would establish a new category of accredited investor, "accredited natural person," that individuals would need to satisfy in order to invest in certain private pooled investment vehicles relying on Rule 506.<sup>30</sup> We received approximately 600 comments on that proposal, many of which generally disfavored our proposal, which would raise individual investor thresholds for such investments. We are continuing to consider those comments, and solicit further comment on the proposed definition of accredited natural person made in the Private Pooled Investment Vehicle Release. The Commission may act on the new proposals in this release and the December 2006 proposals at the same time.

## II. Proposed Revisions of Regulation D

### A. Proposed Rule 507—Exemption for Limited Offers and Sales to Large Accredited Investors

We propose to create a new exemption to the registration requirements of the Securities Act for offers and sales of securities to a new category of investors called "large accredited investors."<sup>31</sup> The exemption would permit limited advertising of

<sup>28</sup> See Private Pooled Investment Vehicle Release. We are taking the opportunity to request additional comment on that proposal here. See II.B.5 below.

<sup>29</sup> 17 CFR 230.144.

<sup>30</sup> Proposed Rules 216 and 509 under the Securities Act.

<sup>31</sup> We propose to move the current contents of Rule 507 into proposed Rule 502(e) and then include the new exemption in Rule 507.

<sup>18</sup> 15 U.S.C. 77c(b).

<sup>19</sup> 15 U.S.C. 78a *et seq.*

<sup>20</sup> 15 U.S.C. 77d(2).

<sup>21</sup> See Release No. 33–6825 (Mar. 14, 1989) [54 FR 11369] (adding 17 CFR 230.507 and 230.508).

<sup>22</sup> Rule 503 requires the filing of a Form D notice with the Commission no later than 15 days after the first sale of securities in an offering under Regulation D.

<sup>23</sup> See Release No. 33–8591 (Jul. 19, 2005) [70 FR 44722].

<sup>24</sup> The American Bar Association recently suggested that revisions in this area would be appropriate, in view of the implementation of the securities offering reform rules for registered offerings. See comment letter in Commission Rulemaking File No. S7–11–07 from American Bar Association (Mar. 22, 2007) (the "ABA Private Offering Letter"), available at <http://www.sec.gov/comments/s7-11-07/s71107-4.pdf>.

<sup>25</sup> See *Final Report of the Advisory Committee on Smaller Public Companies to the United States Securities and Exchange Commission* (April 23,

these offerings.<sup>32</sup> Large accredited investors would consist of the same categories of entities and individuals that qualify for accredited investor status under existing Rule 506, but with significantly higher dollar-amount thresholds for investors subject to such thresholds.<sup>33</sup> Legal entities that are considered accredited investors if their assets exceed \$5 million would be required to have \$10 million in investments to qualify as large accredited investors. Individuals generally would be required to own \$2.5 million in investments or have annual income of \$400,000 (or \$600,000 with one's spouse) to qualify as large accredited investors, as compared to the current accredited investor standard of \$1 million in net worth or annual income of \$200,000 (or \$300,000 with one's spouse). Legal entities that are not subject to dollar-amount thresholds to qualify as accredited investors, generally government-regulated entities, would not be subject to dollar-amount thresholds to qualify as large accredited investors.

We believe that we may exempt certain offers and sales that may involve limited advertising from the registration requirements of Section 5 of the Securities Act<sup>34</sup> without compromising investor protection, due to the general increased sophistication and financial literacy of investors in today's markets, coupled with the advantages of modern communication technologies. Our proposal is patterned generally after the Model Accredited Investor Exemption adopted by the North American Securities Administrators Association (NASAA) in 1997.<sup>35</sup> Like the Model Accredited Investor Exemption, our proposal does not eliminate the prohibition on general solicitation and general advertising from the conditions of the exemption. Both the Advisory Committee on Smaller Public Companies and the American Bar Association's Committee on Federal Regulation of Securities recommended relaxing the ban on general solicitation for transactions with purchasers who do

not need the protection of registration.<sup>36</sup> Our proposal attempts to ease restrictions on limited offerings of securities in a manner that is cognizant of the potential harm of offerings by unscrupulous issuers or promoters who might take advantage of more open solicitation and advertising to lure unsophisticated investors to make investments in exempt offerings that do not provide all the benefits of Securities Act registration. We believe easing the restriction on limited offerings of securities as we have proposed is appropriate, given the additional safeguards we have proposed.

The proposed Rule 507 exemption would share the following characteristics with the Rule 506 exemption:

- It would allow an issuer to sell an unlimited amount of its securities to an unlimited number of investors who meet specified criteria-accredited investors in the case of Rule 506 transactions and large accredited investors in the case of Rule 507 transactions;
- Its availability would focus on purchasers, and not depend on the characteristics of offerees;
- It would place no restrictions on the payment of commissions or similar transaction-related compensation;
- It would be non-exclusive, meaning that the issuer could choose to claim any other available exemption without the benefit of the rule;<sup>37</sup>
- Securities acquired in a transaction under the rule would be subject to the limitations on resale under Rule 502(d)<sup>38</sup> and therefore would be treated as "restricted securities" as defined in Securities Act Rule 144(a)(3)(ii);<sup>39</sup>
- The issuer would be required to exercise reasonable care to assure that the purchasers of the securities are not underwriters;<sup>40</sup> and
- The issuer would have an obligation to file a notice of sales in the offering with the Commission on Form D.<sup>41</sup>

<sup>36</sup> See Advisory Committee Final Report at 74–81; ABA Private Offering Letter, n. 24 above, at 26.

<sup>37</sup> An issuer engaging in the limited advertising permitted by Rule 507 may not be able to claim the Section 4(2) exemption if the activity has imparted a public character to the offering. See Release No. 33–7943 (Jan. 26, 2001) [66 FR 8881] (text accompanying n. 31), citing Release No. 33–4552 (Nov. 6, 1962) [27 FR 11316] (public advertising incompatible with claim of private offering).

<sup>38</sup> 17 CFR 502(d).

<sup>39</sup> 17 CFR 230.144(a)(3)(ii). In a companion release, we have proposed changes to Rule 144. Release No. 33–8813 (June 22, 2007) [72 FR 36822].

<sup>40</sup> Rule 502(d). The term "underwriter" is defined in Section 2(a)(11) of the Securities Act. 15 U.S.C. 77b(a)(11).

<sup>41</sup> In a companion release, we are proposing changes to Form D to simplify and update it, as well

In addition, proposed Rule 507 would include the same disqualification provisions as we propose below for other Regulation D exemptions.<sup>42</sup> Currently, Rule 506 has no bad actor disqualification provisions.

Rule 507 would differ from Rule 506 in five ways:

- *Large Accredited Investor Standard.* Rule 507 would be premised on the concept of large accredited investors. Rule 506 would continue to be premised on the concept of accredited investors.

- *Limited Advertising Permitted.* Instead of a total ban on general solicitation and general advertising, as is the case in Rule 506 transactions, issuers in Rule 507 transactions could engage in limited advertising that satisfies the requirements of the rule. All other general solicitation and advertising would be prohibited.

- *No Sales to Persons Who Do Not Qualify as Large Accredited Investors.* Issuers in Rule 507 transactions would not be allowed to sell securities to any investor who does not qualify as a large accredited investor. In Rule 506 transactions, issuers may sell securities to an unlimited number of accredited investors and up to 35 non-accredited investors.<sup>43</sup>

- *Authority for Exemption.* Rule 507 would be adopted as an exemption primarily under the Commission's general exemptive authority under Section 28 of the Securities Act, while Rule 506 was adopted as a safe harbor under Section 4(2) of the Securities Act.

- *Covered Security Status.* Securities sold in accordance with either of these rules would be considered "covered securities," but under different provisions of Section 18 of the Securities Act. Securities sold under Rule 507 would be covered securities because the purchasing large accredited investors would be defined as "qualified purchasers" under Section 18(b)(3) of the Securities Act. Securities sold under Rule 506 would continue to be covered securities under Section 18(b)(4)(D) of the Securities Act<sup>44</sup> because Rule 506

as to require electronic filing. Release No. 33–8814 (June 29, 2007) [72 FR 37376].

<sup>42</sup> See II.C.2 below.

<sup>43</sup> If an issuer sells to non-accredited investors in a Rule 506 transaction, the issuer must furnish them with the information specified in Rule 502(b), 17 CFR 230.502(b). The issuer also must assure that the non-accredited investors meet the investor sophistication requirements of Rule 506(b)(2)(ii), 17 CFR 230.506(b)(2)(ii). We are not proposing these kinds of requirements for Rule 507 transactions because issuers could not sell securities to any non-accredited investors in Rule 507-exempt transactions.

<sup>44</sup> 15 U.S.C. 77r(b)(4)(D).

<sup>32</sup> The exemption would not, however, be available to offers and sales by pooled investment vehicles relying on Section 3(c)(1) (15 U.S.C. 80a–3(c)(1)) or Section 3(c)(7) (15 U.S.C. 80a–3(c)(7)) of the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*). See II.A.4 below.

<sup>33</sup> In II.B below, we propose to make certain changes to other accredited investor qualifications. These changes would apply equally to accredited investors in Rule 505 and 506 transactions and to large accredited investors in Rule 507 transactions.

<sup>34</sup> 15 U.S.C. 77e.

<sup>35</sup> A copy of the Model Accredited Investor Exemption is available on the NASAA Web site at <http://www.nasaa.org/content/Files/Model%5FAccredited%5FInvestor%5FExemption.pdf>.

was issued under Section 4(2) of the Securities Act.<sup>45</sup>

We discuss these five areas of difference in the sections immediately below.

#### 1. "Large Accredited Investor" Standard

We propose to define a new category of investors, called "large accredited investors,"<sup>46</sup> which we would use in Rule 507. The proposed definition of large accredited investor is based on the "accredited investor" definition, but with higher and somewhat different dollar-amount thresholds.<sup>47</sup> We have proposed higher thresholds due to what we perceive are increased investor protection risks relating to the limited advertising that would be allowed under Rule 507.<sup>48</sup> The higher thresholds would provide a cushion over the accredited investor standards for determining eligibility for the new exemption. The greater public access to investors that the new exemption would provide warrants increased assurance of the ability of investors in offerings under that exemption to fend for themselves. Further, the higher thresholds may provide such assurance.

We propose that the entities or institutions that currently must have more than \$5 million in assets to qualify for accredited investor status under Rule 501(a) would be required to have more than \$10 million in investments to qualify as large accredited investors.

<sup>45</sup> State securities regulation of covered securities generally is limited under Section 18(b) of the Securities Act to imposing notice filing requirements on offerings, requiring the filing of a consent to service of process, and assessing a filing fee. Securities sold in offerings that are exempt under Rule 506 are covered securities because Section 18(b)(4)(D) provides that securities sold in transactions exempt under Commission rules issued under Section 4(2), which includes Rule 506, are covered securities. Securities sold in offerings that are exempt under Rule 507 would be covered securities because our proposal provides for an amendment to Rule 146 under the Securities Act that would define the term "qualified purchaser" in Section 18(b)(3) of the Act to include large accredited investors with respect to offers or sales in compliance with Rule 507. Under Section 18(b)(3), qualified purchasers, as defined by the Commission under the Securities Act, purchase covered securities in transactions so designated by the Commission.

<sup>46</sup> See Proposed Rule 501(a).

<sup>47</sup> See the discussion of the accredited investor definition in II.B below.

<sup>48</sup> While the Model Accredited Investor Exemption is limited to accredited investors, we propose to further limit the Rule 507 exemption to large accredited investors. NASAA, the organization of state securities administrators, recently supported a similar higher threshold for any new federal exemption that would relax the prohibitions against general solicitation and general advertising. See comment letter in Commission File No. 265-23 from NASAA to the Advisory Committee (March 28, 2006) (the "NASAA Letter"), at 2, available at <http://www.sec.gov/rules/other/265-23/rastaples1692.pdf>.

Individuals, or "natural persons" as the rule calls them, would be able to qualify as large accredited investors if they own more than \$2.5 million in investments or have had individual annual income of more than \$400,000 (or \$600,000 with one's spouse) in the last two years and expect to maintain the same income level in the current year.<sup>49</sup> We propose to have alternative investments and income tests for individuals because an investments test without an income test tends to favor investors who have had time to build investment portfolios.

Based on estimates from our Office of Economic Analysis, 1.64 percent of U.S. households would qualify as large accredited investors, compared with 8.47 percent that would qualify as accredited investors.<sup>50</sup> Our approach in selecting the dollar-amount thresholds for investors to qualify as large accredited investors reflects an attempt to approximate the standards adopted by the Commission in the 1980s for accredited investors in light of current knowledge and changed circumstances.<sup>51</sup>

We selected the \$10 million amount for institutions for two additional reasons. First, in the interest of uniformity between Federal and State securities regulation, we chose a standard similar to the standard in the Uniform Securities Act of 2002, as amended, that was approved by the National Conference of Commissioners of Uniform State Laws.<sup>52</sup> The model statute, which has been adopted by several states, requires that most non-regulated institutional investors have \$10 million in assets to qualify as "institutional investors." In selecting a standard for large accredited investors, we chose to substitute a \$10 million investments-owned standard for the \$10 million assets-owned standard because, as discussed below, we believe that investments owned may be a more

<sup>49</sup> We discuss our proposed use of the term "aggregate income" instead of the term "joint income," which currently is used in Rule 501(a), 17 CFR 230.501(a), in II.B.2 below.

<sup>50</sup> These estimates are based on Federal Reserve Board of Governors, Survey of Consumer Finances, 2004. This survey used year-end 2003 values. More information regarding the survey may be obtained at <http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html>.

<sup>51</sup> Our Office of Economic Analysis estimates that in 1982, when Regulation D was adopted, approximately 1.87 percent of U.S. households qualified for accredited investor status. This estimate is based on Federal Reserve Board of Governors, Survey of Consumer Finances, 1983. This survey used year-end 1982 values. More information regarding the survey may be obtained at <http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html>.

<sup>52</sup> See Uniform Securities Act (2002), as amended, available at <http://www.uniformsecuritiesact.org/usa/DesktopDefault.aspx?tabindex=2&tabid=48>.

accurate and more easily administered standard than assets owned to determine whether an investor needs the protection of Securities Act registration. The \$10 million amount also correlates closely with the inflation-indexed value of \$5 million in 1982, when we adopted the \$5 million assets-owned standard.<sup>53</sup>

We selected the \$2.5 million investments-owned standard for individuals and spouses based on the \$2.5 million investments-owned standard we proposed in December 2006 for individuals and spouses to invest in private pooled investment vehicles.<sup>54</sup> We selected the \$400,000 in annual income standard for individuals because it is approximately the inflation-indexed value of \$200,000 in 1982, when the Commission first adopted the \$200,000 in annual income standard for individual accredited investors. Similarly, we selected the \$600,000 in aggregate income for spouses standard because it is approximately the inflation-indexed value of \$300,000 in 1982. Although the \$300,000 combined standard was not adopted until 1988, it was adopted to complement the \$200,000 individual income standard adopted in 1982.<sup>55</sup>

Individuals and entities that currently are not subject to a dollar-amount threshold to qualify as accredited investors also would qualify as large accredited investors. As such, banks, registered investment companies, private business development companies, and other regulated entities identified in Rule 501(a)(1) and (2) that are not subject to an assets test to qualify for accredited investor status also would qualify for large accredited investor status without being subject to an income, assets, or investments requirement.<sup>56</sup> Further, directors and executive officers of the issuer would be considered large accredited investors in addition to being considered accredited investors, without being subject to an income, assets, or investments

<sup>53</sup> Our Office of Economic Analysis estimates that the financial thresholds used in Rule 501(a), adjusted for inflation as of July 1, 2006, would be as follows: the \$5 million asset requirement for certain legal entities would have increased to approximately \$9.5 million; the \$1 million individual net worth test would have increased to approximately \$1.9 million; and the \$200,000 individual income test and \$300,000 joint income test would have increased to approximately \$388,000 and \$582,000, respectively. Our Office of Economic Analysis estimated these levels using the Personal Consumption Expenditures Chain-Type Price Index, as published by the Department of Commerce, available at <http://www.bea.gov>.

<sup>54</sup> See Private Pooled Investment Vehicle Release.  
<sup>55</sup> See Release No. 33-6758 (March 3, 1988) [53 FR 7866].

<sup>56</sup> See 17 CFR 230.501(a)(1) and (2).

requirement.<sup>57</sup> As in the accredited investor standard, these entities and persons are generally deemed not to need the same level of protection under the Securities Act as other entities and non-affiliated persons.

#### Request for Comment

- Do the standards we propose for qualifying as a large accredited investor provide a reasonable basis for determining that, under the circumstances of Rule 507, those investors do not need all of the protections of Securities Act registration? If not, what qualifications should we set? Are other levels more appropriate than \$10 million in investments for legal entities and \$2.5 million in investments for individuals and spouses, or annual income of \$400,000 for individuals and \$600,000 with one's spouse? Should these levels be lower? Should they be higher, especially because of the availability of limited advertising? For example, would \$7.5 million or \$15 million in investments for legal entities and \$1.5 million or \$3.5 million in investments for individuals and spouses, or annual income of \$300,000 or \$600,000 for individuals and \$400,000 or \$800,000 with one's spouse be more appropriate levels? Why? Should we adopt an eligible person threshold of \$1 million in investments for individuals, as suggested by NASAA?<sup>58</sup> If you propose thresholds, please provide the basis for your belief that those thresholds are more appropriate.

- Should we adopt a definition of "large accredited investor" that includes only an investments-owned test for individual investors, as we proposed in the Private Pooled Investment Vehicle Release for certain individual investors in private pooled investment vehicles, or should we adopt alternative investments and income tests as proposed? Please explain the reasons for your views.

- Should we retain the asset-based test instead of using an investment-based test for determining status as a large accredited investor for both individuals and legal entities? In this regard, should the standard for legal entities be \$10 million in assets—the same as the requirement for institutional investors in the Uniform Securities Act?

- Would it be appropriate to modify proposed Rule 507 to include any additional safeguards in the definition of large accredited investor?

#### 2. Limited Advertising Permitted

Rule 507 would permit an issuer in an exempt transaction to publish a limited announcement of an offering.<sup>59</sup> The announcement would be required to state prominently that sales will be made to large accredited investors only, that no money or other consideration is being solicited or will be accepted through the announcement, and that the securities have not been registered with or approved by the Commission and are being offered and sold pursuant to an exemption.<sup>60</sup> At the issuer's option, the announcement also could contain the following additional information:

- The name and address of the issuer;
- A brief description of the business of the issuer in 25 or fewer words;<sup>61</sup>
- The name, type, number, price, and aggregate amount of securities being offered and a brief description of the securities;
- A description of what large accredited investor means;
- Any suitability standards and minimum investment requirements for prospective purchasers in the offering; and
- The name, postal or e-mail address, and telephone number of a person to contact for additional information.<sup>62</sup>

<sup>59</sup> While the proposed statement is similar to the statement permitted under Rule 135c, 17 CFR 230.135c, the proposed exemption is substantially patterned after the Model Accredited Investor Exemption and differs from Rule 135c in that the advertisement is permitted and anticipated to be part of the offering process, whereas Rule 135c is limited to an announcement that is not to be used to condition the market or as part of the solicitation for the offering.

<sup>60</sup> These statements are similar to statements required by the Model Accredited Investor Exemption, except that the proposed announcement is not required to contain a statement that the securities have not been registered with or approved by a state securities agency.

<sup>61</sup> The Model Accredited Investor Exemption limits an issuer's description of the business to 25 or fewer words. We have retained the 25-word limitation in the proposal, but solicit comment below on whether such a limitation is appropriate. We already have one federal exemption from Securities Act registration that permits offerings involving select investors and a limited amount of general solicitation. Our Rule 1001, 17 CFR 230.1001, exempts offerings conducted under Section 25102(n) of the California Corporations Code's "Qualified Purchaser Exemption." Adopted in September 1994, the California provision permits offerings to specified classes of qualified purchasers that are similar to federal classes of accredited investors without state registration. The QPE allows for a general announcement of an offering, including a brief description of the issuer's business, without a word limit. California's QPE served as a prototype for the Model Accredited Investor Exemption.

<sup>62</sup> The additional information permitted in the announcement is patterned after the Model Accredited Investor Exemption, but also permits a description of the meaning of the term "large accredited investor" and a discussion of suitability standards and minimum investment requirements.

Publication of such an announcement would not contravene the prohibition on general solicitation and advertising otherwise applicable to the offer and sale of securities in a Rule 507 transaction. The publication could only be "in written form"<sup>63</sup> but could occur in any written medium, such as in a newspaper or on the Internet. We have proposed to limit the publication to written form in an effort to limit aggressive selling efforts made through the announcement. As part of this limitation, radio or television broadcast spots or "infomercials" would be prohibited.<sup>64</sup>

Rule 507 also provides that an issuer or a person acting on an issuer's behalf may provide information in addition to the limited announcement only if the issuer reasonably believes that the prospective purchaser is a large accredited investor.<sup>65</sup> Additional information may be provided orally or in writing, such as in the form of sales material or an offering circular. Information also may be delivered to prospective purchasers through an electronic database that is restricted to large accredited investors.<sup>66</sup>

#### Request for Comment

- We propose to limit the information included in a Rule 507 announcement and require that the information be in written form. Should we require or permit any other information to be included in the limited announcement proposed in Rule 507 offerings? If so, what additional information would be appropriate? Should any of the optional information be required? Should we eliminate or expand the 25-word limit on the description of the issuer's business? If we did not impose a limit on the business description, would

We propose to permit these latter statements to avoid confusion about the meaning of the term "large accredited investor" and to facilitate management of offerings under the exemption.

<sup>63</sup> Proposed Rule 507 uses the term "in written form" to limit the term and differentiate the concept from "written communication" as defined in Rule 405, 17 CFR 230.405. The term "written communication" is defined in Rule 405 to include a radio or television broadcast. Publication of an announcement under Rule 507 would be substantially more limited.

<sup>64</sup> Limiting the use of certain types of advertisements under Rule 507 would be consistent with our position in Rule 433, 17 CFR 230.433, relating to free writing prospectuses in the context of public offerings by non-reporting and unseasoned issuers.

<sup>65</sup> For a related discussion of what measures an issuer could take to satisfy its obligation under Rule 501(a) to form a reasonable belief that a prospective purchaser satisfies the definition of accredited investor, see n. 99 and accompanying text.

<sup>66</sup> For a discussion of on-line private offerings under Regulation D, see Release No. 33-7856 (Apr. 28, 2000) [65 FR 25843].

<sup>57</sup> See 17 CFR 230.501(a)(4).

<sup>58</sup> See n. 48.

issuers be more or less likely to use inappropriately promotional and non-objective language to describe their businesses in the limited announcement? Should the rule require that any description of the issuer's business be fair and impartial?

- Should we eliminate the requirement that the Rule 507 announcement be in written form? If so, what limitations, if any, should we have on the form of the announcement? Should we define the phrase "in written form"? Should we limit permitted written announcements to publications, as opposed to, for example, flyers handed out on street corners? Should we allow radio or television broadcast announcements? Should we follow the Model Accredited Investor Exemption and allow the announcement to be made by any means? Should we require issuers to retain copies of any advertisements or to submit copies of the script of any radio or television broadcast to the Commission staff? Should they be filed with the Commission, and if so, should the filing be confidential?

- Proposed Rule 507 would require issuers to include in any permitted public announcement a prominent statement that sales will be made only to large accredited investors, that no money is being solicited or will be accepted by way of the announcement, and that the securities have not been registered with or approved by the Commission and are being offered and sold pursuant to an exemption. Are these appropriate requirements for the announcement? Should we require additional statements? Do we need to require that the statement be prominent? If so, should we also specify format or font sizes? How would such a requirement operate for electronic communications? Does the requirement that the announcement prominently state that "no money or other consideration is being solicited or will be accepted through the announcement" make it clear that an investor should not respond to the announcement by sending a check to the issuer? Can you suggest alternative wording?

- Should we allow issuers, at their option, to include in a Rule 507 announcement a coupon, returnable to the issuer, indicating interest in the offering, containing the name, address and telephone number of the prospective purchaser, and stating clearly and separately that the indication of interest is not binding and that no money should be sent?<sup>67</sup>

- The Model Accredited Investor Exemption does not permit telephone solicitation unless, before placing a telephone call, the issuer reasonably believes the prospective purchaser to be solicited is an accredited investor.<sup>68</sup> Should we include a similar limitation in Rule 507 with respect to large accredited investors?

- The rule provides that an issuer or any person acting on an issuer's behalf may provide additional information if the issuer reasonably believes the prospective purchaser is a large accredited investor. Does the proposal adequately acknowledge that the reasonable belief of an agent of the issuer may be attributable to the issuer and thereby permit the issuer to satisfy the standard? What requirements, if any, should apply to the delivery of information to prospective purchasers through an electronic database that is restricted to large accredited investors?<sup>69</sup> Should we provide additional guidance and if so, should the guidance be in the rule?

- Should the rule provide any guidance as to how an issuer may arrive at a reasonable belief that a prospective purchaser is a large accredited investor? Should it be permitted to form the belief entirely on the basis of responses to a questionnaire?

- Rule 508 provides that insignificant deviations from the requirements of Regulation D do not result in the loss of the exemption.<sup>70</sup> Rule 508(a)(2) provides, however, that failures with regard to limitations on the manner of offering are deemed to be significant. What should be the implications for failure to comply with the restrictions on permitted advertising in Rule 507 transactions? Should the issuer no longer be able to rely on the Rule 507 exemption? Are the provisions of Rule 508 sufficient to deal with situations that might arise?

- Should we adopt broader amendments to Rule 508 to address related issues that might arise under the Rule 507 exemption, as well as under other exemptions in Regulation D? For

CFR 254(c). Proposed Rule 135d, although never adopted, had a similar provision in subparagraph (b). See Release No. 33-7188 (June 27, 1995) [60 FR 35648].

<sup>68</sup> Paragraph (G) of the Model Accredited Investor Exemption provides that no telephone solicitation is permitted unless the issuer reasonably believes that the person solicited is an accredited investor before making the telephone solicitation. Proposed Rule 507(b)(2)(iii) provides that any information beyond the announcement may be provided "only if the issuer reasonably believes that the prospective purchaser is a large accredited investor," but does not address telephone solicitation explicitly.

<sup>69</sup> See n. 66.

<sup>70</sup> We propose to amend Rule 508 to add a reference to proposed Rule 507.

example, should we delete the current Rule 508 carve-out of manner of sale limitations in the list of insignificant deviations? This carve-out has been read to provide that an issuer's failure to comply with a ban on general solicitation applicable to a Regulation D offering never can constitute an insignificant deviation. As a result, legal practitioners have expressed concern that an insignificant deviation relating to general solicitation could result in total loss of the Rule 508 defense. If the carve-out were deleted, Rule 508 would treat insignificant failures to comply with an applicable ban on general solicitation like most other deviations from the requirements of Regulation D. One effect of such a rule amendment would be to clearly permit issuers to raise the Rule 508 defense with respect to complaining parties who were not generally solicited in an offering structured to avoid general solicitation, while continuing to preclude the issuer from raising the defense with respect to a party who was generally solicited, depending upon whether it is able to satisfy the other conditions to availability of the defense.

### 3. No Sales to Persons Who Do Not Qualify as Large Accredited Investors

We propose that issuers relying on Rule 507 to exempt a transaction from Securities Act registration be permitted to sell securities only to investors who qualify as large accredited investors. This is a departure from the approach taken in Rule 506, where issuers are permitted to sell securities to up to 35 non-accredited investors, in addition to an unlimited number of accredited investors. Because limited advertising allows issuers to provide information about their offering to anyone, we believe it is appropriate to establish stricter limitations on sales to limit investors to those who do not need all of the protections of Securities Act registration.

A Rule 507 offering could only be conducted simultaneously or "side-by-side" with another Regulation D offering if the two offerings were considered as separate and distinct offerings under the five-factor integration test set forth in Rule 502(a) of Regulation D.<sup>71</sup> Since Rule 506 prohibits the use of general solicitation and advertising and Rule 507 is limited exclusively to sales to large accredited investors, neither of these two exemptions would be available if two offerings were

<sup>71</sup> 17 CFR 230.502(a). We are proposing a note to clarify that Rule 144A does not preclude an issuer or a person acting on the issuer's behalf from publishing a general announcement of an offering pursuant to Rule 507. See I.I.E.2 below.

<sup>67</sup> This provision could be modeled after subparagraph (c) of Rule 254 of Regulation A, 17



considered as integrated where one offering used limited public advertising and the other offering was sold to persons who were not large accredited investors.<sup>72</sup>

#### Request for Comment

- Should we permit investors who do not qualify as large accredited investors to invest in Rule 507 offerings? If so, how should we limit the number of non-qualifying investors? Would permitting investors who do not qualify as large accredited investors to invest in Rule 507 offerings increase the potential for fraud in those offerings?

- To limit sales to large accredited investors, would it be appropriate to limit publication of the announcement to password-protected Web sites that are accessible only by large accredited investors? Should we provide other limitations to ensure that the exemption is not abused?

#### 4. Authority for Exemption

We are proposing Rule 507 as an exemption from the registration provisions of Section 5 of the Securities Act under our general exemptive authority in Section 28 of that Act. Under Section 28, we may exempt any transaction from any provision of the Securities Act “to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.”<sup>73</sup>

We believe proposed Rule 507 meets the standard set forth in Section 28 because it safeguards investor interests by limiting both the advertising permitted and the types of investors that may invest in an exempt offering. The proposal would impose strict controls on advertising and would be limited to offerings that are sold only to investors who meet high financial qualification standards designed to identify investors who have less need for the protections offered by Securities Act registration, as they can “fend for themselves” with regard to the transaction.<sup>74</sup>

<sup>72</sup> We do not propose to provide an integration safe harbor for Rule 507 offerings as was done, for example, in Section 3(c)(7)(E) of the Investment Company Act, 15 U.S.C. 80a-3(c)(7)(E), and under 17 CFR 230.144A(e) and 17 CFR 230.701(f).

<sup>73</sup> 15 U.S.C. 77z-3.

<sup>74</sup> The conclusion that investors do not need all the protections that registration under the Securities Act would offer them and that they can fend for themselves is the determination that must be made under *SEC v. Ralston Purina*, 346 U.S. 119, 125 (1953), to establish that transactions are exempt under Section 4(2) of the Securities Act as transactions “not involving any public offering.” We believe the *Ralston Purina* standard is informative in analyzing whether Rule 507, as proposed, would satisfy the Section 28 standard. As a practical matter, we believe that the use of high financial thresholds to qualify as a large accredited

Proposing Rule 507 under Section 28, rather than Section 4(2),<sup>75</sup> has certain consequences. Among these consequences is that pooled investment vehicles that rely on the exclusion from the definition of “investment company” provided by Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act would not be able to take advantage of the limited advertising proposed to be permitted under Rule 507. This results because those vehicles are required to sell their securities in transactions not involving a public offering.<sup>76</sup> Such vehicles typically rely on Section 4(2) to meet this requirement, frequently through Rule 506, which expressly forbids general solicitation and general advertising.<sup>77</sup> Accordingly, they would be precluded from selling their securities in reliance on Rule 507.

#### Request for Comment

- Are there other implications we should consider as a result of our proposed use of our exemptive authority under Section 28, rather than proposing Rule 507 under Section 4(2)?

#### 5. Covered Security Status

Securities sold under Rule 506 are “covered securities” under Section 18(b)(4)(D) of the Securities Act.<sup>78</sup> To

investor and the imposition of a ban on most general solicitation and advertising would tend to support a determination that Rule 507 is appropriate in the public interest and consistent with the protection of investors.

<sup>75</sup> Because some advertising would be permitted in Rule 507 transactions, we have chosen not to propose the exemption under Section 4(2) of the Securities Act, which the Commission in the past has viewed as incompatible with a non-public offering under Section 4(2). See n. 37.

<sup>76</sup> Section 3(c)(1) of the Investment Company Act excludes from the definition of investment company an issuer the securities (other than short-term paper) of which are beneficially owned by not more than 100 persons and that is not making or proposing to make a public offering of its securities. Section 3(c)(7) of the Investment Company Act excludes from the definition of investment company an issuer the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are “qualified purchasers,” as defined in the Investment Company Act, and that is not making or proposing to make a public offering of its securities. The term “qualified purchaser” is defined for purposes of the Investment Company Act in Section 2(a)(51) of the Investment Company Act, 15 U.S.C. 80a-2(a)(51). This definition applies in the context of the Investment Company Act; the term has a different meaning under the Securities Act, as provided in the proposed amendment to Rule 146(c).

<sup>77</sup> Compliance with Rule 506 provides a safe harbor that a transaction does not involve “any public offering” within the meaning of Section 4(2) of the Securities Act. See 17 CFR 230.506(a).

<sup>78</sup> The National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (Oct. 11, 1996) (“NSMIA”), preempts the state registration and review of transactions involving “covered securities.” It amended Section 18 of the Securities Act to establish classes of covered

enhance the utility of proposed Rule 507, we propose that a large accredited investor that participates in a Rule 507 offering be defined in Rule 146 as a “qualified purchaser” under Section 18(b)(3) of the Securities Act. As such, securities sold in a Rule 507-exempt offering would be “covered securities,” resulting in preemption from state securities regulation as provided under Section 18 of the Securities Act.<sup>79</sup> By providing “covered security” status to the securities, the securities would be primarily regulated on the federal level, with the goal of enhancing efficiency and reducing duplicative regulation without compromising investor protection. Because the dollar-amount thresholds for investors in Rule 507 transactions would be significantly higher than the dollar-amount thresholds in Rule 506 offerings, we believe the policy rationales for making securities in Rule 506 transactions “covered securities” also support making securities in Rule 507 transactions “covered securities.”<sup>80</sup>

#### Request for Comment

- We propose to amend Rule 146 to define the term “large accredited investor” as a “qualified purchaser” for purposes of Section 18 of the Securities Act. Is defining a “large accredited investor” as a “qualified purchaser” under the Securities Act appropriate? Should the definition of “qualified purchaser” be narrower or broader?

- Proposed Rule 146(c) includes a provision that indicates clearly that states may continue to impose substantially similar notice filing requirements as those imposed by the Commission on transactions with qualified purchasers. Is this provision necessary? Should we define “substantially similar” more precisely? If so, please provide specific language. Would the proposed language preclude states from requiring that certain supplemental items be attached to notice filings?

#### B. Proposed Revisions Related to Definition of “Accredited Investor”

We propose revisions to the definition of the term “accredited investor” in

securities, including securities offered or sold to “qualified purchasers,” as defined by Commission rule.

<sup>79</sup> In 2001, we proposed to define the term “qualified purchaser” in the Securities Act to equate that term with our definition of the term “accredited investor” in Rule 501(a). See Release No. 33-8041 (Dec. 19, 2001) [66 FR 66839]. That proposal is no longer under consideration by the Commission.

<sup>80</sup> These policy rationales are contained in the legislative history of NSMIA, especially H.R. Rep. No. 104-622, at 159-165 (1996).



Rule 501(a) of Regulation D, which sets forth the standards to qualify as an accredited investor. The current definition provides that a person who comes within, or who the issuer reasonably believes comes within, one of eight enumerated categories at the time of sale is an accredited investor. Currently, the Rule 501(a) categories include:

- Institutional investors;<sup>81</sup>
- Private business development companies;
- Corporations, partnerships and tax exempt organizations with total assets in excess of \$5 million;
- Directors, executive officers and general partners of the issuer;
- Individuals with a net worth exceeding \$1 million, either alone or with their spouses;
- Individuals with income in excess of \$200,000 in each of the two most recent years or joint income with the individual's spouse in excess of \$300,000 in each of those years;
- Trusts with total assets in excess of \$5 million; and
- Entities in which all of the equity owners are accredited investors.

The revisions we propose to the Rule 501(a) "accredited investor" qualification standards would affect Rules 504 through 506 and, to the extent that the standards to qualify as a "large accredited investor" are based on the standards to qualify as an "accredited investor," Rule 507.<sup>82</sup> We believe our proposed revisions of the qualification standards for accredited investors will result in those standards, together with the substantive provisions of the exemptions in Regulation D, better determining who meets the requirements for reliance on the exemptions. Our proposed revisions would:

- Add an alternative "investments-owned" standard to Rule 501(a);
- Define the term "joint investments";

<sup>81</sup> This category includes banks, savings and loan associations, registered brokers and dealers, insurance companies, registered investment companies, business development companies, and small business investment companies. The category also includes certain employee benefit plans within the meaning of the Employee Retirement Income Security Act (codified primarily at 29 U.S.C. ch. 18), with total assets in excess of \$5 million. See Rule 501(a)(1).

<sup>82</sup> The revisions may affect offerings made by pooled investment vehicles under Sections 3(c)(1) and 3(c)(7) of the Investment Company Act, as those offerings must qualify as non-public offerings under Section 4(2) of the Securities Act and many such offerings are structured to take advantage of the Rule 506 safe harbor for the Section 4(2) exemption. We recently proposed revisions to our accredited investor qualification standards for individuals investing in certain pooled investment vehicles. See II.B.5 below.

- Establish a mechanism to adjust the dollar-amount thresholds in the definitions in the future to reflect inflation; and

- Add several categories of permitted entities to the list of accredited and large accredited investors.

In addition, in the Private Pooled Investment Vehicle Release, we proposed to revise Regulation D to establish a new category of accredited investor, "accredited natural person," that individuals would need to satisfy in order to invest in certain private pooled investment vehicles relying on Rule 506.<sup>83</sup> We are continuing to consider the comments received on that proposal. We also are taking the opportunity to solicit further comment on the questions we asked in December 2006 when we issued that proposal, especially in light of the new proposals in this release, and to solicit comment on additional questions on the proposal, as discussed below.

#### 1. Adding Alternative Investments-Owned Standards to Accredited Investor Standards

Rule 501(a) currently provides generally that certain legal entities must have total assets in excess of \$5 million to qualify as accredited investors, that individuals and spouses may qualify if they have a net worth above \$1 million, that individuals also may qualify if they have annual income above \$200,000, and that spouses also may qualify if they have annual income above \$300,000. We propose to add alternative standards for these entities and for individuals and spouses in Rule 501(a) that reflect investments owned by the prospective investor as an additional and alternative method of establishing accredited investor status.<sup>84</sup> We believe an investments-owned standard will add another, potentially more accurate method to assess an investor's need for the protections of registration under the Securities Act. We also believe an investments-owned standard may reduce and simplify compliance burdens for companies by providing an alternative standard that may be assessed more easily than the current assets or net worth or annual income standards.

<sup>83</sup> Proposed Rules 216 and 509 under the Securities Act.

<sup>84</sup> As explained above with respect to large accredited investors, an investments-owned standard would be an alternative to the income standards for establishing large accredited investor status for individuals and spouses and the sole method for establishing large accredited investor status for entities that must satisfy a dollar-amount threshold.

#### a. Proposed Definition of "Investments"

We propose a definition of "investments" for purposes of qualifying for accredited investor and large accredited investor status that is substantively the same as the definition we proposed in December 2006 in the Private Pooled Investment Vehicle Release.<sup>85</sup> However, in order to establish a uniform definition that applies throughout Regulation D, the newly proposed definition contains slight differences. The Private Pooled Investment Vehicle Release proposed separate definitions for the terms "prospective accredited natural person," "related person," "investment purposes," "valuation," and "deductions."<sup>86</sup> Our current proposal replaces the term "prospective accredited natural person" with the term "purchaser." In addition, the concepts underlying the terms "related person," "investment purposes," "valuation," and "deductions" are discussed in the notes to the definition of "investments" in our current proposal rather than as separate definitions, as was done in the Private Pooled Investment Vehicle Release.<sup>87</sup> We believe including these concepts as notes to the definition of "investments" in proposed Rule 501(h) will provide greater clarity and ease use of the definition.

#### b. Amount of Investments Required

For legal entities required to satisfy a \$5 million assets test, the proposed amendment would add an alternative investments standard of \$5 million. For individuals and spouses, the proposed amendment would provide a new alternative standard of \$750,000 in investments that could be used instead of the current net worth standard of \$1 million or annual income standards of \$200,000 (or \$300,000 with one's

<sup>85</sup> The standard proposed in December 2006 would require investors to satisfy a two-part test—they would be required to be an accredited investor, as defined in Rule 501(a)(5) or (6) for transactions offered under Rule 506 or Rule 215(e) or (f) for transactions under Section 4(6) of the Securities Act (15 U.S.C. 77d(6)), and to own at least \$2.5 million in "investments," as that term would be defined in Rule 509 as proposed in the Private Pooled Investment Vehicle Release.

<sup>86</sup> Unlike in the Private Pooled Investment Vehicle Release, we have not here proposed a definition of "certain retirement plans and trusts" for use in our proposed definition of "investments." We assume that investments held in retirement plans and trusts would be included in our proposed definition of investments.

<sup>87</sup> In order to simplify the definition of "investments," we included the concepts of "related person" and "deduction" in the notes as they relate to "investment purposes" and "valuation," respectively. See proposed notes 1 through 3 to paragraph (h) of Rule 501.

spouse).<sup>88</sup> We proposed an investments-owned standard as part of our December 2006 proposal for a new category of accredited investor, the “accredited natural person,” which was developed to address eligibility for individuals to invest in private pooled investment vehicles that rely on the exclusion from the definition of the term “investment company” provided by Section 3(c)(1) of the Investment Company Act.<sup>89</sup>

Unlike the December 2006 proposed definition, the proposed alternative standards would not result in a reduction in the number of investors eligible for accredited investor status; rather, the standard is intended to ease issuers’ threshold determinations and provide a possibly more logical basis for them.<sup>90</sup> In determining whether an investor meets the threshold under the investments-owned standard, the value of personal residences and places of business would not be included. Although we recognize that we have historically included (and may continue to include) personal residences and places of business as assets in calculating total assets for legal entities and net worth for individuals, we believe, consistent with our December 2006 proposed definition, that an accurate method of assessing an investor’s need for the protections of registration under the Securities Act when based on an investments test is to exclude these real estate assets from the definition of investments, since they are not held for investment purposes.<sup>91</sup>

<sup>88</sup> We are proposing the \$750,000 investments-owned standard because the dollar-amount threshold is the same as the dollar-amount threshold initially proposed in Regulation D for the assets test, which, as initially proposed, excluded certain assets, including personal residences. The assets threshold was increased to \$1 million and adopted for the sake of simplicity and reflected a \$250,000 increase in large part to account for the value of the primary residence. See Release No. 33-6389, at 11255.

<sup>89</sup> See n. 76.

<sup>90</sup> As proposed, there would be no changes to the current standards for accredited investors in Regulation D that would decrease the existing pool of potential investors. We do not believe these amendments would substantially change the number of investors now eligible for accredited investor status. Based on the 2004 Federal Reserve survey cited in n. 50, our Office of Economic Analysis estimates that adding an alternative \$750,000 investments standard to the current accredited investor standard for natural persons (net worth in excess of \$1 million or individual income in excess of \$200,000 (or \$300,000 with the person’s spouse)) would result in 8.69 percent of households qualifying for accredited investor status in 2003, as opposed to 8.47 percent of households qualifying for accredited investor status without the proposed alternative.

<sup>91</sup> This approach follows the proposed approach in the Private Pooled Investment Vehicle Release. Commenters generally preferred including the primary residence in the valuation of investments. We continue to consider those comments, but are

Accordingly, real estate would not be considered to be held for “investment purposes” if the real estate is used by the person or certain related persons for personal purposes (e.g., as a personal residence).<sup>92</sup> The term “personal purposes” is derived from the Internal Revenue Code provision that addresses circumstances under which a taxpayer is allowed deductions with respect to certain “dwelling units.”<sup>93</sup> The proposed definition refers to the Internal Revenue Code because it would allow determinations of whether residential real estate is an investment based on the same provisions that would apply in determining whether certain expenses related to the property are deductible for purposes of completing tax returns. Similarly, property that has been used as a place of business or in connection with the conduct of a trade or business also would not be considered to be held for investment purposes.<sup>94</sup>

#### Request for Comment <sup>95</sup>

- Are the dollar-amount thresholds for the proposed investments-owned standard appropriate? Are other levels more appropriate than the \$5 million in investments for legal entities and \$750,000 in investments for individuals and spouses? Should these levels be higher or lower? For example, would \$4 million in investments for legal entities and \$500,000 in investments for individuals and spouses be more appropriate levels? Why?

- Is there a better way to define “investments” to meet the goals of the standard in Regulation D? Is our proposed definition of investments too complicated? Should we specifically include additional types of investment asset classes in the definition of investments? Should we exclude or

again proposing to exclude the primary residence when determining the value of investments, as the value of an individual’s primary residence may have little relevance with regard to the individual’s need for the protections of Securities Act registration.

<sup>92</sup> See proposed Note 1 to Rule 501(h).

<sup>93</sup> The proposed rule would treat residential real estate as an investment if it is not treated as a dwelling unit used as a residence in determining whether deductions for depreciation and other items are allowable under the IRC. Section 280A of the IRC provides, among other things, that a taxpayer uses a dwelling unit during the taxable year as a residence if he or she uses such unit for personal purposes for a number of days that exceeds the greater of 14 days or 10 percent of the number of days during which the unit is rented at a fair rental. 26 U.S.C. 280A.

<sup>94</sup> See proposed Note 1 to Rule 501(h).

<sup>95</sup> We intend to consider comments we receive in response to this request for comment along with the comments on the Private Pooled Investment Vehicle Release.

limit any of the investment asset classes we have proposed for inclusion?

- We are proposing a definition of “investments” in proposed paragraph (h) of Rule 501 that is substantially similar to the definition in proposed Securities Act Rule 509(b)(3)<sup>96</sup> and existing Investment Company Act Rule 2a51-1(b).<sup>97</sup> Should we adopt a less technical, more principles-based definition of “investments”? Would a more principles-based definition be more appropriate for the many smaller companies and small businesses with limited resources that commonly use Regulation D, sometimes operating without sophisticated legal counsel? If a more principles-based definition would be more appropriate, should the rule define “investments” as meaning cash and cash equivalents, securities, real estate, commodities, and commodity interests held for investment purposes, provide that the value of investments be calculated “net of investment indebtedness,” and provide that investment purposes would not include use of real estate by a prospective purchaser as a primary or secondary residence or primary place of business?

- Should we specifically exclude from the definition of investments real estate used as a primary residence or primary place of business? Should we exclude secondary residences? Is it appropriate to include secondary residences that are not held for investment purposes? Would it be appropriate to specify in the rule that residential real estate that currently qualifies for the home mortgage interest deduction under the Internal Revenue Code is the type of residential real estate that would be excluded for purposes of determining investments owned? Commenters are asked to discuss why they believe that real estate of the kind excluded should or should not be counted as an investment under the rules and why.

- Our proposed definition of “investments” excludes securities that constitute a “control interest” in an issuer. Limiting the definition in this manner is designed to exclude, among other things, controlling ownership interests in family-owned and other closely-held businesses.<sup>98</sup> Such holdings may not demonstrate the lack of need for protection of the Securities Act registration provisions. Proposed

<sup>96</sup> See the Private Pooled Investment Vehicle Release.

<sup>97</sup> 17 CFR 270.2a51-1(b).

<sup>98</sup> For a more in-depth discussion of the concept of investments as used in proposed Rule 501(h), proposed Rule 509(b)(3) and Rule 2a51-1(b)(1), see the adopting release for Rule 2a51-1, Release No. IC-22597 (Apr. 3, 1997) [62 FR 17511].

Rule 501(h) and proposed Rule 509(b)(3) and the underlying existing rule upon which these two proposals are based, Rule 2a51-1(b)(1), all contain the same exceptions from the control interest exclusion—interests in “investment vehicles,” “public companies” and “large private companies”—all of which are defined in Rule 2a51-1. Should these three exceptions be omitted from the definition of investments or referred to in Rule 501(h) in a shorter, more principles-based definition so as to be easier to comprehend?

- Note 3 to proposed Rule 501(h) indicates that the value of investments is the fair market value on the most recent practicable date or their cost and that the determination is made net of any outstanding indebtedness incurred to acquire or for the purpose of acquiring the investments. Would it be appropriate to provide that the test be the higher or lower of fair market value or cost, or solely fair market value? Should we simply use the concept of net of investment indebtedness or is it more helpful to have a more detailed explanation of the deductions?

- Does an investments-owned standard serve as a better proxy than a net worth or total assets standard for determining whether an investor is among those investors who do not need the protections of Securities Act registration? Would an investments-owned standard be a more appropriate determinant of accredited investor status than the current net worth standard?

- Our experience indicates that some issuers may not have taken appropriate measures to satisfy their obligation under Rule 501(a) to form a reasonable belief that a prospective purchaser satisfied the definition of accredited investor. What additional measures could and should we take to improve issuers' understanding and practices in this area? Should we create a safe harbor in Regulation D that sets forth the type of investigation required for an issuer to reach a reasonable belief? Would it be appropriate to set forth in the safe harbor that an issuer must conduct a reasonable investigation in order to come to a reasonable belief? Are there other modifications to the existing requirements under Regulation D that would improve issuers' practices in forming a reasonable belief that prospective purchasers satisfy the definition of accredited investor? Should we provide specific details as to what kind of investigation an issuer can rely upon to form a reasonable belief, as

we did in Rule 144A(d)(1)?<sup>99</sup> What other criteria or methods could be used by issuers to form a reasonable belief that an investor is accredited? Or would any of the foregoing render the rule less usable for capital formation?

## 2. Proposed Definition of “Joint Investments”

Our rules currently allow issuers to count all of the assets that an individual owns jointly with a spouse or that are part of a shared community interest in the calculation of whether the individual is an accredited investor under Rule 501(a)(5) because the individual has a “joint net worth” with the spouse of more than \$1 million. In the Private Pooled Investment Vehicle Release, we proposed to take a different approach to determining eligibility for accredited investor status by reason of assets owned by a spouse or as part of a shared community interest in calculating “joint investments.”<sup>100</sup> We propose to take that same approach in calculating “joint investments” to apply throughout Regulation D. We propose a simplified definition of the term “joint investments” to apply throughout Regulation D that retains the substantive meaning of the definition proposed in the Private Pooled Investment Vehicle Release.

The definition of “joint investments” that we propose provides that investments of an individual seeking to make an investment in a Regulation D-exempt offering without obtaining the signature and binding commitment of his or her spouse may include only 50 percent of:

- Any investments held jointly with the individual's spouse; and
- Any investments in which the individual shares a community property or similar shared ownership interest with the individual's spouse.

<sup>99</sup> 17 CFR 230.144A(d)(1). In determining whether a prospective purchaser is a qualified institutional buyer, Rule 144A(d) provides that a seller and any person acting on its behalf are entitled to rely upon the following non-exclusive methods of establishing the prospective purchaser's ownership and discretionary investment of securities: (i) The prospective purchaser's most recent publicly available financial statements; (ii) the most recent publicly available information appearing in documents filed by the prospective purchaser with the Commission or another U.S. federal, state, or local government agency or self-regulatory organization, or with a foreign governmental agency or self-regulatory organization; (iii) the most recent publicly available information appearing in a recognized securities manual; or (iv) a certification by the chief financial officer, a person fulfilling an equivalent function, or other executive officer of the purchaser, specifying the amount of securities owned and invested on a discretionary basis by the purchaser as of a specific date on or since the close of the purchaser's most recent fiscal year.

<sup>100</sup> Private Pooled Investment Vehicle Release at 407.

Where spouses both sign and are bound by the investment documentation, the full amount of their investments (whether made jointly or separately) may be included for purposes of determining whether the investors are either accredited or large accredited investors.<sup>101</sup>

To avoid confusion and clarify language in other parts of Rule 501 in connection with the “joint investments” proposal, we propose to change the words used to describe the threshold for spouses to qualify for accredited investor status on the basis of net worth under Rule 501(a)(5) from “joint net worth” to “aggregate net worth” and to change the words used to describe the income threshold for spouses to qualify as accredited investors under Rule 501(a)(6) from “joint income” to “aggregate income.” We also would use the “aggregate income” terminology in the definition of large accredited investor. We believe these changes are advisable to avoid confusion between the interpretation of the word “joint” in the context of the term “joint investments” and in the context of the terms “joint net worth” and “joint income.” Our previous releases and staff interpretations in this area have used the terms “joint net worth” and “joint income” to mean aggregate net worth and aggregate income, and we do not intend for these changes to alter the meaning of the rules.<sup>102</sup>

## Request for Comment

- Does the proposed joint investments approach properly address the application of the accredited investor standard to marital assets? Should we base the determination as to whether marital assets may be considered in determining the accredited investor status of individual spouses on something other than whether both spouses sign and are bound by the investment documentation?

- Under Rule 501(a)(5) as we propose to amend it, an issuer could count 100

<sup>101</sup> We received substantial comment on this issue in response to the Private Pooled Investment Vehicle Release, urging that we permit a spouse's assets to be included in any calculation for determining an investor's accreditation. See, e.g., comment letters in Commission Rulemaking File No. S7-25-06 from American Bar Association (Mar. 12, 2007) (the “ABA Private Pooled Investment Vehicle Letter”), available at <http://www.sec.gov/comments/s7-25-06/s72506-584.pdf>, and New York State Bar Association (Mar. 14, 2007), available at <http://www.sec.gov/comments/s7-25-06/s72506-597.pdf>. We continue to consider this issue.

<sup>102</sup> For a discussion of “joint net worth,” see Release No. 33-6389, at n. 14 (Mar. 8, 1982) [47 FR 11251]. For a discussion of “joint income,” see Release No. 33-6683 (Jan. 16, 1987) [52 FR 3015] and Release No. 33-6758 (Mar. 3, 1988) [53 FR 7866].

percent of the assets held jointly with an individual's spouse or as part of a shared community interest in determining, on the basis of net worth, the eligibility for accredited investor status of an individual investing without his or her spouse but only 50 percent of those same assets (if they are investments) in determining eligibility on the basis of investments owned. Is this approach workable? Should we treat assets of a spouse the same regardless of whether an individual investor is qualifying on the basis of net worth or investments owned? For instance, should we permit an issuer to include only 50 percent of an individual investor's marital assets in calculating both net worth and investments owned? Or should we permit the issuer to include 100 percent or some other part of the marital assets?

- We believe that the definition of joint investments proposed today does not reflect any material change in substance from the definition of joint investments proposed in the Private Pooled Investment Vehicle Release. Would adopting both definitions, with their immaterial differences, create confusion, and why? Would it create less confusion and be more appropriate to modify the definition of joint investments in proposed Rule 216 and proposed Rule 509 to mirror the definition we propose today?

### 3. Future Inflation Adjustments

Our staff recently indicated that "inflation, along with the sustained growth in wealth and income of the 1990s, has boosted a substantial number of investors past the 'accredited investor standard.'" <sup>103</sup> By not adjusting these dollar-amount thresholds upward for inflation, we have effectively lowered the thresholds in terms of real purchasing power. <sup>104</sup> We recognize, however, that raising the accredited investor standards of Regulation D too high may result in some issuers returning to pre-1982 practices of effecting private placements under the statutory exemption in Section 4(2) and forgoing the Regulation D safe harbor. This result may not be desirable for issuers or for the health of our private capital markets because issuers would be required to incur the expenses and complications of multi-state securities law compliance and the uncertainty of case law interpretations of the Section 4(2) exemption, as was the case before

<sup>103</sup> See *Implication of the Growth of Hedge Funds*, Staff Report to the U.S. Securities and Exchange Commission (Sept. 2003) available at <http://www.sec.gov/news/studies/hedgefunds0903.pdf>.

<sup>104</sup> See n. 53 and the discussion in II.A.1.

the adoption of Regulation D. <sup>105</sup> In addition, regulators and investors would no longer be provided with Form D filings, which help in monitoring private placement activity. <sup>106</sup> Accordingly, we are reluctant at this time to immediately adjust upward for inflation the current income requirements and investment thresholds in Rule 501(a).

Instead, at this time we propose to adjust for inflation all dollar-amount thresholds set forth in Rule 501 of Regulation D on a going forward basis, starting on July 1, 2012, and every five years thereafter, to reflect any changes in the value of the Personal Consumption Expenditures Chain-Type Price Index (or any successor index thereto), as published by the Department of Commerce, from December 31, 2006. <sup>107</sup> We propose to round the adjusted dollar amounts to the nearest multiple of \$10,000. By adjusting the thresholds for inflation in the future, we intend to retain the income, assets, and investments requirements in real terms so that the accredited investor standards will not erode over time. <sup>108</sup>

### Request for Comment

- We have noted the effects of inflation on the total assets, net worth, and income thresholds currently used in the accredited investor qualification standards. Should we make a one-time adjustment now to the thresholds to increase them to take into account the effects of inflation?

- Is our proposal to adjust the dollar-amount thresholds in Regulation D every five years in the future and the methodology that we have proposed for this purpose appropriate? Should the time period between adjustments be longer or shorter than five years? Should the adjusted dollar amounts be rounded to the nearest multiple of \$10,000, as

<sup>105</sup> For transactions that are exempt under Rule 506, the federal preemption of most state securities regulation under Section 18(b)(4)(D) of the Securities Act would apply.

<sup>106</sup> The current version of Form D was developed by the Commission and NASAA as a uniform form to be filed with both the Commission and the States. See Release No. 33-6663 (Oct. 2, 1986) [51 FR 36385]. Form D continues to be accepted and used by many states to monitor private placement activity.

<sup>107</sup> This index was selected based on discussions with the Federal Reserve Bank and wide use of the index as an indicator of inflation in the U.S. economy. Adjusting thresholds every five years ensures that the thresholds stay current while limiting the disruption caused by changing the threshold.

<sup>108</sup> This is the same method we have proposed to apply to the accredited natural person standards we proposed for private pooled investment vehicles. See the Private Pooled Investment Vehicle Release, at 406.

proposed, or to a different nearest multiple, such as \$50,000 or \$100,000? What would the impact of this inflation adjustment be on the ability of companies to raise capital, particularly small businesses?

- Is there more appropriate data to use that would support different conclusions as to our proposal to adjust Regulation D dollar-amount thresholds for inflation? Is there a more appropriate way to interpret the data that we have provided?

- Is another index more appropriate for our purposes than the Personal Consumption Expenditures Chain-Type Price Index (or any successor index thereto), as published by the Department of Commerce?

### 4. Adding Categories of Entities to List of Accredited and Large Accredited Investors

The definition of accredited investor in Rule 501(a)(3) currently includes a list of legal entities that may qualify as accredited investors, assuming they satisfy other conditions. The list includes organizations described in Section 501(c)(3) of the Internal Revenue Code, <sup>109</sup> corporations, Massachusetts or similar business trusts, and partnerships. It does not include limited liability companies, Indian tribes, labor unions, governmental bodies, and similar legal entities, leading to some degree of uncertainty as to whether these types of entities may qualify as accredited investors.

Accordingly, we propose to amend the Rule 501(a)(3) list of legal entities so that it includes any corporation (including any non-profit corporation), Massachusetts or similar business trust, partnership, limited liability company, Indian tribe, labor union, governmental body or other legal entity with substantially similar legal attributes. We also would add a definition of the term "governmental body" to Rule 501(a), similar to the definition of that term that appears commonly in transactional financing documents. <sup>110</sup> Our staff is regularly asked questions about which entities may qualify as accredited investors, and has provided guidance that limited liability companies and certain governmental units may so qualify. <sup>111</sup> We hope these changes will

<sup>109</sup> 26 U.S.C. 501(c)(3).

<sup>110</sup> See, e.g., Section of Business Law, American Bar Association, Model Stock Purchase Agreement with Commentary, at 15-16 (1995). Our proposed definition of "governmental body" would apply only to the definition of "accredited investor" in Rule 215 and Rule 501(a), which apply only in the context of exempt offerings under Section 4(6) and Regulation D.

<sup>111</sup> In this regard, see Division of Corporation Finance no-action letter to *Wolf, Block, Schorr and*

reduce uncertainty and legal costs and promote more efficient private capital formation.

#### Requests for Comment

- Should we add or delete types of legal entities from the list in paragraph (a)(3) of Rule 501? For example, should we specifically include “joint venture” or “college or university endowment” in the list, or is it clear that they would be covered by the proposed language of the rule?<sup>112</sup> Should we delete the list entirely and simply say that any legal entity that can sue or be sued in the United States, assuming it meets the other standards for becoming an accredited investor, can qualify as an accredited investor?

- Should we define the terms “Indian tribe” and “labor union” and, if so, how? For example, should we define “Indian tribe” in terms of a tribe, band, nation, pueblo, village, or community that the Secretary of the Interior acknowledges to exist as an Indian tribe under the Federally Recognized Indian Tribe List Act of 1994?<sup>113</sup> Should we include state-recognized Indian tribes? Should we make any special provision for labor union pension funds?

- When we first proposed Rule 144A, we noted that the type of “qualified institutional buyers” contemplated under that rule would generally include “very large institutions, long involved in the resale market for restricted securities, as to which there has been little concern with respect to Section 5 implications.”<sup>114</sup> As a result, we looked to the list of institutional accredited investors contained in Rule 501(a)(3) to develop the Rule 144A(a)(1)(i)(H) list of qualified institutional buyers. Because we are now proposing to amend Rule 501(a)(3) by expanding the list of institutional accredited investors, we

*Solis-Cohen* (Dec. 11, 1996) (limited liability companies), and Release No. 33–6455 (Mar. 4, 1983) [48 FR 10045] at Q & A 19, citing Division of Corporation Finance no-action letter to *Voluntary Hospitals of America, Inc.* (Dec. 30, 1982) (governmental unit that falls within the substantive description of 26 U.S.C. 501(c)(3)).

<sup>112</sup> As originally proposed, the definition of “accredited investor” in Regulation D specifically included college or university endowment funds. See Release No. 33–6339 (Aug. 7, 1981) [46 FR 41791]. Upon adoption, college or university endowment funds were intended to be included within the category “organization[s] described in Section 501(c)(3) of the Internal Revenue Code.” See Release No. 33–6389 (Mar. 8, 1982) [47 FR 11251]. Since we now propose to replace the phrase “organization described in Section 501(c)(3) of the Internal Revenue Code” with a reference to non-profit corporations, we seek to assure that college and university endowment funds will still be considered accredited investors if they satisfy the applicable financial standard.

<sup>113</sup> 25 U.S.C. 479a.

<sup>114</sup> See Release No. 33–6806 (Oct. 25, 1988) [53 FR 33147].

are seeking comment on whether the Rule 144A(a)(1)(i)(H) list of qualified institutional buyers should be expanded in a similar manner. Is it appropriate to consider all institutions that would come under Rule 501(a)(3) and that meet the \$100 million investment size threshold under Rule 144A as having sufficient experience with the resale market for restricted securities? Should any or all of the categories of institutional accredited investors contained in Rule 501(a)(3) be included in the Rule 144A(a)(1)(H) list of qualified institutional buyers? Are there any categories of institutions included in proposed Rule 501(a)(3) that should not be included in the definition of qualified institutional buyer under Rule 144A?

- Rule 144A contains few procedural restrictions relating to the transferability of restricted securities sold under Rule 144A. Do we need to make any modifications in light of the possibility that, if we were to expand the definition of qualified institutional buyer under Rule 144A, these restrictions would lead to a greater likelihood of restricted securities flowing into the public market?

#### 5. Proposed Definition of Accredited Natural Person

In the Private Pooled Investment Vehicle Release, we expressed our concerns about the increased number of individual investors who may today be eligible as accredited investors to make investments in pooled investment vehicles relying on Section 3(c)(1) of the Investment Company Act. We noted that the existing \$1 million net worth and \$200,000 (\$300,000 with one’s spouse) income tests provide some investor protection for individuals seeking to invest in pooled investment vehicles relying on Section 3(c)(1) of the Investment Company Act, but expressed our concern that some further level of protection may be necessary to safeguard investors seeking to make an investment in such vehicles in light of their unique risks, including risks with respect to undisclosed conflicts of interest, complex fee structures, and the higher risk that may accompany such vehicles’ anticipated returns. Accordingly, we proposed for comment a standard that would require individual investors to satisfy a two-part test to qualify as accredited investors for purposes of investing in certain private pooled investment vehicles—they would be required to satisfy the current standard to qualify as accredited investors, as defined in (i) Rule 501(a)(5) or (6) for transactions under Rule 506 or (ii) Rule 215(e) or (f) for transactions

under Section 4(6) of the Securities Act, and also to own at least \$2.5 million in “investments,” as that term would be defined in proposed Rule 509 or proposed Rule 216, as applicable.

We recognize that if we adopt the alternative investments-owned standard for individuals in the definition of accredited investor in proposed Rule 215(e) and Rule 501(a)(5) (\$750,000) and the investments-owned standard for the definition of accredited natural person in proposed Rule 216 and Rule 509 (\$2.5 million), an individual who meets the investment test as an accredited natural person would also meet the investments test as an accredited investor. We believe that the different amounts applicable under the definitions are targeted to address concerns about the nature of different types of offerings. As noted, the alternative investments-owned standards proposed under the definition of accredited investor are designed to add another method to assess an investor’s need for the protections of registration under the Securities Act. The additional and higher investments-owned standard proposed in the definition of accredited natural person is intended to provide a more objective and clearer standard to use in ascertaining whether an individual is likely to have sufficient knowledge and experience in financial and business matters to enable that investor to evaluate the merits and risks of a prospective investment in certain private pooled investment vehicles, or to be able to hire someone with such knowledge and experience who may help the individual to make such an evaluation.

We received numerous comments disagreeing with the proposed definition of accredited natural person. Most of those submitting comments argued that the proposal limits investor access to private pooled investment vehicles and questioned the dollar amount of the investments standard. In light of those comments, we are soliciting additional comments on the following points.

#### Requests for Comment

- We request comment on whether we should revise the proposed definition of accredited natural person to include alternative income and investment standards similar to those used in the definition of “large accredited investor” in proposed Rule 507 (income of \$400,000 (or \$600,000 with one’s spouse) or investments of \$2.5 million). Would such a revision address some of the concerns noted by those who submitted comments on the

Private Pooled Investment Vehicle Release? Would a higher (e.g., \$500,000 (or \$700,000 with one's spouse)) or lower (e.g., \$300,000 (or \$400,000 with one's spouse)) income standard be more appropriate, and why? Would a higher (e.g. \$3 million) or lower (e.g. \$2 million) investments standard be more appropriate, and why? In responding to this request for comment, please also comment on any concerns you might have if any final definition that we may adopt includes an inflation adjustment provision. For example, some comment letters on the December 2006 proposal raised a concern that the proposed inflation adjustment could result in the proposed standard for accredited natural persons ultimately being higher than the existing \$5 million investments-owned requirement for private investment pools that rely on Section 3(c)(7) of the Investment Company Act.<sup>115</sup> How would you propose to address this concern? Should we set a dollar limit above which the dollar amount of investments included in proposed Rule 216 and proposed Rule 509 may not rise (for example, should we cap the investments amount at \$4.9 million), and why?

- We believe that the changes we propose to make in the definition of "investments" proposed today do not reflect any material change from the definition of "investments" proposed in the Private Pooled Investment Vehicle Release. Would adopting both definitions, with their immaterial differences, create confusion, and why? Would it create less confusion and be more appropriate to modify the definition of "investments" in proposed Rule 216 and proposed Rule 509 to mirror the definition we propose today?

- Would a more principles-based definition of the term "investments," like the one we have suggested as an alternative to the definition we are proposing for Rule 501(h), also be appropriate in the context of proposed Rule 509 and Rule 216? Is there any reason to have a definition of "investments" in Rule 501(h) that is different from the definition used in

proposed Rule 509 and Rule 216, and why?

- Earlier in this release, we request specific comment on the treatment of real estate as an investment, the treatment of securities that constitute a "control interest" in an issuer as an investment, and how investments are proposed to be valued under the definition of "investments" proposed in this release. We solicit comment with respect to those points in connection with the definition of the term "investments" as proposed for use with the term "accredited natural person." Is there any reason to have a definition of the term "investments" under proposed Rules 216 and 509 that is different from the one proposed in this release? Please explain why or why not.

- As we have explained, we modeled the definition of "investments" in proposed Rule 216 and proposed Rule 509 on the definition included in Rule 2a51-1(b) under the Investment Company Act. Would a more principles-based definition of the term "investments," like the one we have suggested as an alternative to the definition we are proposing for Rule 501(h), also be appropriate in the context of Rule 2a51-1, and why? Should we adopt coordinated definitions of "investments" for purposes of proposed Rule 501(h), proposed Rule 216, proposed Rule 509 and Rule 2a51-1, or should there be different definitions applicable to these rules, and why?

### C. Proposed Revisions to General Conditions of Regulation D

Rule 502 of Regulation D sets forth conditions that are applicable to offers and sales made under Regulation D. We propose to make changes to those conditions, including shortening the amount of time issuers are required to wait to make offers and sales in order to rely on the integration safe harbor provided in Rule 502(a) and adding disqualification provisions for certain issuers seeking to rely on the exemptions in Regulation D. We also are providing guidance regarding the integration of concurrent public and private offerings.

Our Advisory Committee on Smaller Public Companies advised that the six-month safe harbor period from integration provided in Rule 502(a) "represents an unnecessary restriction on companies that may very well be subject to changing financial circumstances, and weighs too heavily in favor of investor protection, at the expense of capital formation."<sup>116</sup> The

Committee supported "clearer guidance concerning the circumstances under which two or more apparently separate offerings will or will not be integrated."<sup>117</sup> The Advisory Committee acknowledged the difficulty, however, of modifying the five-factor test contained in Rule 502(a) and concluded that the issue could be more readily addressed through a shortening of the six-month period. Based on their analysis of the issue, the Advisory Committee recommended that we shorten the integration safe harbor from six months to 30 days.<sup>118</sup>

In making recommendations with respect to the integration doctrine, the Advisory Committee recommended, in addition to decreasing the time period of the integration safe harbor in Regulation D, that the Commission clarify the interpretation of or amend Securities Act Rule 152<sup>119</sup> in order to permit companies to conduct a valid private placement immediately before the filing of a registration statement without concern that the two offerings would be integrated.<sup>120</sup> The Advisory Committee also noted in making this recommendation that, in addition to the concerns that companies may not be able to raise capital privately in the time shortly before the filing of a registration statement, there also are continuing integration considerations when conducting concurrent private placements while a registration statement is pending with the Commission.<sup>121</sup> This recommendation and commentary demonstrate that questions continue to arise in the capital raising process concerning the ability of issuers to conduct a private placement before a Securities Act registration statement is filed with the Commission, or in the period between the filing and effectiveness of the registration statement.

We understand that capital raising around the time of a public offering, in particular an initial public offering, often is critical if companies are to have sufficient funds to continue to operate while the public offering process is ongoing. For this reason, we are providing guidance so that companies and their counsel may have a better

<sup>117</sup> *Id.* at 95.

<sup>118</sup> *Id.* at 94.

<sup>119</sup> 17 CFR 230.152. Rule 152 specifies that "[t]he phrase 'transactions by an issuer not involving any public offering' in Section 4(2) shall be deemed to apply to transactions not involving any public offering at the time of said transaction although subsequently thereto the issuer decides to make a public offering and/or files a registration statement."

<sup>120</sup> Advisory Committee Final Report at 100-101.

<sup>121</sup> Advisory Committee Final Report at n. 207.

<sup>115</sup> See, e.g., comment letters in Commission Rulemaking File No. S7-25-06 from Schulte, Roth & Zabel LLP (Mar. 9, 2007), available at <http://www.sec.gov/comments/s7-25-06/s72506-549.pdf>, and ABA Private Pooled Investment Vehicle Letter, n. 101 above.

An individual that invests in 3(c)(7) pools must be a qualified person, defined in Section 2(a)(51)(A)(1) of the Investment Company Act as an individual who owns not less than \$5 million in investments. Rule 2a51-1(b) under the Investment Company Act defines investments, and is the basis for the definition we proposed in December 2006 and today.

<sup>116</sup> Advisory Committee Final Report at 96.

framework for evaluating their particular circumstances.<sup>122</sup>

Consistent with Securities Act Rule 152, the staff of the Division of Corporation Finance, in its review of Securities Act registration statements, will not take the view that a completed private placement that was exempt from registration under Securities Act Section 4(2) should be integrated with a public offering of securities that is registered on a subsequently filed registration statement.<sup>123</sup> Consistent with the staff's approach to this issue, we are of the view that, pursuant to Securities Act Rule 152, a company's contemplation of filing a Securities Act registration statement for a public offering at the same time that it is conducting a Section 4(2)-exempt private placement would not cause the Section 4(2) exemption to be unavailable for that private placement.<sup>124</sup>

We recognize that a company's financing needs do not end with the filing of a registration statement. As a general matter, however, the filing of a registration statement has been viewed as a general solicitation of investors.<sup>125</sup> Today, upon the filing of a registration statement, information about a company and its prospects is available immediately through our EDGAR filing system. The staff of the Division of Corporation Finance has issued interpretive letters to the effect that, notwithstanding the availability of the information in the registration statement, companies may continue to conduct concurrent private placements without those offerings necessarily being integrated with the ongoing public offering.<sup>126</sup> Concerns remain, however,

with the ability to complete such concurrent private placements in factual situations that were not considered previously by the Division staff in interpretive letters. The Division staff has not applied any *per se* approach in addressing these circumstances in its review of filings, but rather has requested a discussion of the relevant facts and in some cases an opinion of counsel when concerns arose as to the potential integration of the concurrent private offering and public offering and the availability of the Section 4(2) exemption after the filing of the registration statement.<sup>127</sup>

Our view is that, while there are many situations in which the filing of a registration statement could serve as a general solicitation or general advertising for a concurrent private offering, the filing of a registration statement does not, *per se*, eliminate a company's ability to conduct a concurrent private offering, whether it is commenced before or after the filing of the registration statement. Further, it is our view that the determination as to whether the filing of the registration statement should be considered to be a general solicitation or general advertising that would affect the availability of the Section 4(2) exemption for such a concurrent unregistered offering should be based on a consideration of whether the investors in the private placement were solicited by the registration statement or through some other means that would otherwise not foreclose the availability of the Section 4(2) exemption. This analysis should not focus exclusively on the nature of the investors, such as whether they are "qualified institutional buyers" as defined in Securities Act Rule 144A or institutional accredited investors, or the number of such investors participating in the offering; instead, companies and their counsel should analyze whether the offering is exempt under Section 4(2) on its own, including whether securities were offered and sold to the private placement investors through the means of a general solicitation in the form of the registration statement. For example, if a company files a registration statement and then seeks to offer and sell securities without registration to an

investor that became interested in the purportedly private offering by means of the registration statement, then the Section 4(2) exemption would not be available for that offering. On the other hand, if the prospective private placement investor became interested in the concurrent private placement through some means other than the registration statement that did not involve a general solicitation and otherwise was consistent with Section 4(2), such as through a substantive, pre-existing relationship with the company or direct contact by the company or its agents outside of the public offering effort, then the prior filing of the registration statement generally would not impact the potential availability of the Section 4(2) exemption for that private placement and the private placement could be conducted while the registration statement for the public offering was on file with the Commission. Similarly, if the company is able to solicit interest in a concurrent private placement by contacting prospective investors who (1) Were not identified or contacted through the marketing of the public offering and (2) did not independently contact the issuer as a result of the general solicitation by means of the registration statement, then the private placement could be conducted in accordance with Section 4(2) while the registration statement for a separate public offering was pending. While these are only examples, we believe they demonstrate the framework for analyzing these issues that companies and their counsel should apply and that the staff will consider when reviewing registration statements.

#### 1. Proposed Revisions to Regulation D Integration Safe Harbor

The integration doctrine seeks to prevent an issuer from improperly avoiding registration by artificially dividing a single offering into multiple offerings such that Securities Act exemptions would apply to the multiple offerings that would not be available for the combined offering. The integration concept was first articulated in 1933<sup>128</sup> and was further developed in two interpretive releases issued in the 1960s.<sup>129</sup> The interpretive releases clarified that determining whether a particular securities offering should be integrated with another offering requires an analysis of the specific facts and circumstances of the offerings. In our guidance, we identified five factors to

<sup>122</sup> This guidance does not affect the risk that the Commission or a court could find a violation of Section 5 where a company begins an offering as a private placement and seeks to complete that offering pursuant to a registration statement, or where a company commences a registered offering and seeks to complete that offering through a private placement, except in those circumstances specified in Securities Act Rule 155. See *Integration of Abandoned Offerings*, Release No. 33-7943 (Jan. 26, 2001) [66 FR 8887].

<sup>123</sup> See, e.g., Division of Corporation Finance no-action letter to *Verticom, Inc.* (Feb. 12, 1986).

<sup>124</sup> In these circumstances, companies should be careful to avoid any pre-filing communications regarding the contemplated public offering that could render the Section 4(2) exemption unavailable for what would be an otherwise exempt private placement.

<sup>125</sup> See, e.g., Division of Corporation Finance no-action letter to *Michael Bradfield, General Counsel, Board of Governors of the Federal Reserve System* (Mar. 16, 1984).

<sup>126</sup> See, e.g., Division of Corporation Finance no-action letters to *Black Box Incorporated* (June 26, 1990) and *Squadron Ellenoff, Pleasant & Lehrer* (Feb. 28, 1992). The guidance in this release does not affect the ability of issuers to continue to rely on the views expressed by the Division staff in these letters.

<sup>127</sup> The guidance that follows applies in the context of private placements conducted under existing exemptions from registration. If we adopt proposed Rule 507 of Regulation D, we may provide additional interpretive guidance on any potential integration issues unique to that exemption. In this regard, we note that, as proposed, offers and sales exempt under Rule 507 would be subject to a ban on general solicitation except as permitted under the rule and would be considered "limited," rather than "private," offerings.

<sup>128</sup> Release No. 33-97 (Dec. 28, 1933).

<sup>129</sup> Release No. 33-4434 (Dec. 6, 1961) [26 FR 11896] and Release No. 33-4552 (Nov. 6, 1962) [27 FR 11316].



consider in making the determination of whether the offerings should be integrated.<sup>130</sup> In 1982, we included the five factors and established an integration safe harbor in Rule 502(a). We stated that the five factors relevant to the question of integration are:

“Whether (1) The different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, and (5) the offerings are made for the same general purpose.”<sup>131</sup>

Under the safe harbor, offers and sales more than six months before a Regulation D offering or more than six months after the completion of a Regulation D offering will not be considered part of the same offering. This provides issuers with a bright-line test upon which they can rely to avoid integration of multiple offerings.

In making its recommendation that the integration safe harbor be shortened, the Advisory Committee noted that smaller companies' financing needs often are unpredictable, making the six-month waiting period for use of the safe harbor problematic for issuers in need of capital. Other commenters have made similar recommendations to decrease the waiting period in the safe harbor.<sup>132</sup> While we recognize the burdens that the integration doctrine places on capital formation, improper reliance on exemptions from registration harms investors by depriving them of the benefits of full and fair disclosure and the civil remedies that flow from registration. Any changes that we make to the integration doctrine must continue to provide that issuers are aware of their obligation to analyze the exemptions upon which they rely and whether any offers and sales are, in reality, part of a single plan of financing.

The current six-month time frame of the safe harbor in Rule 502(a) provides a substantial time period that has worked well to clearly differentiate two similar offerings and provide time for the market to assimilate the effects of the prior offering. The Advisory Committee has expressed concern, however, that such a long delay could inhibit companies, particularly smaller companies, from meeting their capital needs.<sup>133</sup> We recognize that increased

volatility in the capital markets and advances in information technology have changed the landscape of private offerings. We remain concerned, however, that an inappropriately short time frame could allow issuers to undertake serial Rule 506-exempt offerings each month to up to 35 non-accredited investors in reliance on the safe harbor, resulting in unregistered sales to hundreds of non-accredited investors in a year. Such sales could result in large numbers of non-accredited investors failing to receive the protections of Securities Act registration. Our proposal seeks to strike an appropriate balance between the number of non-accredited investors allowed in an offering relying on the integration safe harbor and the non-public nature of that offering. It would be an anomalous result that an issuer could make an offering to hundreds of non-accredited investors in reliance on the integration safe harbor, triggering reporting requirements under the Exchange Act, without a public offering. We propose, therefore, to lower the safe harbor time frame to 90 days rather than the 30 days recommended by the Advisory Committee.<sup>134</sup> We believe 90 days is appropriate, as it would permit an issuer to rely on the safe harbor once every fiscal quarter.<sup>135</sup> This reduction in time should provide additional flexibility to issuers, while still requiring them to wait a sufficient period of time before initiating a substantially similar offer in reliance on the safe harbor.<sup>136</sup>

The same integration analysis as applies to other Regulation D offerings would apply to offerings made under proposed Rule 507. Accordingly, an issuer would not be able to take advantage of the safe harbor in Rule 502(a) for any sales to investors that are not large accredited investors within the safe harbor period after the publication of a general announcement as permitted by Rule 507. The new 90-day safe harbor would apply to Rule 507 offerings, allowing issuers to make offerings without integration concerns

after waiting the requisite period of time.

#### Request for Comment

• As proposed, we would reduce the time frame for the integration safe harbor from six months to 90 days. Is 90 days an appropriate time frame for the safe harbor? Is 90 days still too long a delay for issuers seeking capital in reliance on the integration safe harbor? Would this reduction increase the possibility that issuers will use the safe harbor and undertake serial offerings?

• Some commentators have suggested that a 30-day integration safe harbor would be appropriate. We are concerned that such a short time period could encourage serial private offerings that would otherwise be integrated and effectively allow unregistered public offerings. If we were to reduce the time period of the safe harbor, should we limit the total number of non-accredited investors to whom an issuer may sell over the course of the year? If so, how many non-accredited investors would be an appropriate limitation per year—100, 140, 210 or some other number?

• The five-factor test provides issuers with an analytical framework to differentiate offers so that they need not be integrated. Does the five-factor test provide sufficient guidance for issuers to make their analysis? If not, how could we improve the factors to provide clearer guidance? Should we provide additional factors? Would the proposed 90-day time frame obviate the need to revise the test?

• Would the interaction between the general announcement permitted by proposed Rule 507 and the proposed 90-day integration safe harbor present opportunities for abuse? Could issuers use the general announcement permitted by proposed Rule 507 to test the waters before deciding whether to undertake either a registered public offering or unregistered exempt offering under Regulation D? Should we permit this use of a Rule 507 general announcement? Should we modify proposed Rule 507 to prohibit such a practice?

#### 2. Disqualification Provisions

In conjunction with the proposed revisions to Regulation D, we have considered the need for general “bad actor” disqualification provisions for all offerings under Regulation D. Our concern arises from the number of recidivists we see in problematic Regulation D offerings. Before the National Securities Markets Improvement Act of 1996,<sup>137</sup> recidivists

<sup>130</sup> Release No. 33-4552 (Nov. 6, 1962) [27 FR 11316].

<sup>131</sup> *Id.*

<sup>132</sup> See ABA Private Offering Letter, n. 24 above, at 33. The ABA letter also suggested expanding the factors to consider when making the determination of whether an offering should be integrated.

<sup>133</sup> See Advisory Committee Final Report at 96.

<sup>134</sup> Both the Advisory Committee and the ABA recommended reducing the time frame for the integration safe harbor to 30 days. Their proposals do not address our concerns that such a short time frame could result in public offerings conducted under the guise of private offerings. See ABA Private Offering Letter, n. 24 above, at 33 and Advisory Committee Final Report at 94.

<sup>135</sup> For issuers that provide quarterly reports, the 90-day requirement would provide time and transparency for investors and the market to take into account the offering and its results.

<sup>136</sup> The five-factor test would continue to apply, providing issuers with flexibility where they are making separate offerings within the 90-day time frame.

<sup>137</sup> Pub. L. 104-290.

were excluded from most Rule 506 offerings by state disqualification provisions. The National Securities Markets Improvement Act preempts the states from enforcing those provisions in favor of federal regulation, raising the question whether federal disqualification provisions should be adopted to replace them.

We propose that availability of all Regulation D exemptions be conditioned on the application of bad actor disqualification provisions. By deterring recidivists from participating in our primary private and limited offering marketplaces, we intend to improve the effectiveness of Regulation D offerings for a significant majority of companies, especially smaller companies, that do not have bad actors associated with their securities offerings and will not be disqualified under the proposed provisions.

Currently, in Regulation D, only Rule 505 provides disqualification provisions.<sup>138</sup> Rule 505 refers issuers to the substantive disqualification provisions of Rule 262<sup>139</sup> under Regulation A,<sup>140</sup> essentially incorporating those provisions by reference. Under those provisions, issuers are barred from relying on the exemption where the issuer, any of its predecessors, any affiliated issuers, any director, officer or general partner of the issuer, any beneficial owner of 10 percent or more of any class of its equity securities, any promoter of the issuer presently connected with the issuer, any underwriter of the securities to be offered, or any partner, director or officer of the underwriter have committed relevant violations of laws and regulations. The Model Accredited Investor Exemption<sup>141</sup> and the Uniform Securities Act of 2002<sup>142</sup> also provide for similar disqualification provisions for these types of issuers and associated persons.

<sup>138</sup> 17 CFR 230.505(b)(2)(iii).

<sup>139</sup> 17 CFR 230.262.

<sup>140</sup> 17 CFR 230.251 through 230.263. Regulation A is an exemption from Securities Act registration, promulgated under Section 3(b) of the Securities Act, 15 U.S.C. 77c(b), for public offerings not exceeding \$5 million in any 12-month period.

<sup>141</sup> According to NASAA, as of 1999, 33 states plus the District of Columbia and Puerto Rico had adopted a form of this exemption and seven more states had bills pending in their legislatures. See North American Securities Administrators Association, Written Statement before the House Small Business Committee, Government Programs and Oversight Subcommittee (Oct. 14, 1999).

<sup>142</sup> See <http://www.uniformsecuritiesact.org>. According to the drafting committee, as of April 27, 2007, the Act had been enacted in 11 states and the U.S. Virgin Islands and is endorsed by NASAA, the Securities Industry and Financial Markets Association (formerly known as the Securities Industry Association) and the American Bar Association.

The exemption in proposed Rule 507 and the proposal to reduce the time that issuers must wait to rely on the integration safe harbor would provide issuers with greater flexibility in preparing and conducting private offerings. Given this proposed increase in flexibility, as well as enforcement issues we have confronted with recidivists involved in purported Regulation D offerings,<sup>143</sup> we believe it is appropriate to propose that certain issuers be precluded from relying on any of the Regulation D exemptions if they or the persons designated in proposed Rule 502(e) have violated the law. We are proposing a rule that is based generally on the provisions in Regulation A, the Model Accredited Investor Exemption and the Uniform Securities Act of 2002.<sup>144</sup> In the interests of coordination and uniformity, we drew extensively from the Model Accredited Investor Exemption, but have modified some of the provisions, taking into account provisions of the Uniform Securities Act. The proposed disqualification provisions all relate to determinations by regulators and courts of problematic behavior or wrongdoing. It is our intent that the Commission's adoption of disqualification provisions based on provisions in use in many states will lead to increased uniformity in federal and state securities regulation.<sup>145</sup>

Exempt private and limited offerings under Regulation D do not provide the protections that registration would afford. We believe that registration, with its incumbent rights for investors and duties of the issuer, is more appropriate for offerings by issuers and persons that have been subject to determinations of violations of law or wrongdoing than offerings relying on Regulation D exemptions. Thus, we believe it would be prudent to preclude certain persons who have been shown to have acted improperly from relying on Regulation D to make or be involved with unregistered offers and sales of securities.

As proposed, the disqualification provisions in new Rule 502(e) would

<sup>143</sup> See, e.g., *SEC v. Calvo*, 378 F.2d 1211, 1216 (11th Cir. 2004).

<sup>144</sup> In response to the Advisory Committee's proposed recommendations, NASAA commented that any new exemption in Regulation D should "contain at least disqualification provisions like those contained in Rule 505(b)(2)(iii), Rule 1.B of the NASAA Uniform Limited Offering Exemption (1983), and Section D of the Model Accredited Investor Exemption." See NASAA Letter, n. 48 above.

<sup>145</sup> Several provisions of the federal securities laws call for greater uniformity in federal and state securities regulation. See, e.g., Securities Act § 19(d), 15 U.S.C. 77s(d).

apply to all offerings made in reliance on Regulation D, precluding reliance by the issuer on Regulation D if the issuer itself is disqualified or the presence of any of the enumerated persons disqualifies the issuer.<sup>146</sup> The disqualification provisions under proposed Rule 502(e) would apply to:

- The issuer, any predecessor of the issuer, and any affiliated issuer;
- Any director, executive officer, general partner, or managing member of the issuer;
- Any beneficial owner of 20 percent or more of any class of the issuer's equity securities; and
- Any promoter connected with the issuer.

The persons and entities we propose to subject to the disqualification provisions are substantially similar to those in Regulation A and the Model Accredited Investor Exemption, except that we do not propose to include underwriters.<sup>147</sup> Both Regulation A and the Model Accredited Investor Exemption include underwriters among the classes of persons to whom disqualification provisions apply.<sup>148</sup> Underwriters generally do not directly control the issuer or determine for an issuer whether to conduct an offering. In weighing the balance of adding the disqualification provisions, we determined that adding provisions throughout Regulation D would have positive effects on the private and limited offering equity markets. In order to limit the burden of expanding these provisions, we propose to limit the application, and therefore the due diligence burden, to the issuer and those persons whom we regard as having substantial influence over the issuer.<sup>149</sup>

<sup>146</sup> In conjunction with this proposal, we also propose to delete the current disqualification provisions in Rule 505(b)(2)(iii).

<sup>147</sup> We propose to add managing members to the traditional list of directors, officers, and general partners to indicate clearly that managing members of limited liability companies are intended to be included in the provision. We also propose to limit the provisions to "executive officers" rather than "officers" and to 20 percent beneficial owners rather than 10 percent beneficial owners as provided in Rule 262 of Regulation A. We believe that limiting the scope of these provisions to executive officers and 20 percent beneficial owners would be appropriate, given their greater influence on the policies of the issuer as compared to officers and 10 percent beneficial owners.

<sup>148</sup> The term "underwriters" is used in both Regulation A and the Model Accredited Investor Exemption. The term underwriters includes selling broker-dealers, who are commonly called underwriters in Regulation A offerings and placement agents in private offerings.

<sup>149</sup> We have chosen not to use in this context the concept of "affiliate," which we use in other rules under the Securities Act to designate certain persons with control relationships with issuers. Rule 505 of Regulation D currently refers issuers to

Proposed Rule 502(e) provides six disqualification provisions that would preclude an issuer from relying on Regulation D. Each of the disqualification provisions requires a determination by a government official or agency or self-regulatory organization that the relevant person has violated the law or engaged in other wrongdoing. These provisions apply where the issuer or the covered persons:

- Filed a registration statement within the last five years that is the subject of a currently effective permanent or temporary injunction or an administrative stop order;<sup>150</sup>
- Was convicted of a criminal offense in the last 10 years that was in connection with the offer, purchase or sale of a security or involved the making of a false filing with the Commission;<sup>151</sup>
- Has been subject to an adjudication or determination within the last five years by a federal or state regulator that the person violated federal or state securities or commodities law or a law under which a business involving investments, insurance, banking or finance is regulated;<sup>152</sup>

the disqualification provisions of Rule 262 of Regulation A. Under the proposed disqualification provisions, Rule 505 would refer to Rule 502(e) and not to the disqualification provisions in Regulation A.

<sup>150</sup> Rule 262(a)(1) provides that the issuer, any of its predecessors or any affiliated issuer "has filed a registration statement which is the subject of any pending proceeding or examination under Section 8 of the Act, or has been the subject of any refusal order or stop order thereunder within five years prior to the filing of the offering statement required by Rule 252." As proposed, the provision would not be limited to the issuer and the language of the provision would apply more generally to court injunctions and stop orders or similar orders by the Commission or state securities agencies. The proposed language tracks Section 306(a)(3) of the Uniform Securities Act.

<sup>151</sup> Rule 262 provides disqualification provisions for "any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the Commission." Under Rule 262, the disqualification of issuers, predecessors and affiliated issuers is for five years, while for any director, officer or general partner of the issuer, beneficial owner of 10 percent or more of any class of its equity securities, any promoter of the issuer presently connected with it in any capacity, any underwriter of the securities to be offered, or any partner, director or officer of any such underwriter the disqualification is for 10 years. The proposed provision tracks Rule 262 instead of the Model Accredited Investor Exemption or Uniform Securities Act, because the language focuses on securities-related offenses while the other models use broader language. The proposal uses the term "criminal offense" instead of specifying "felony or misdemeanor" as used in Rule 262 and uniformly applies a 10-year disqualification for these more egregious acts. This provision would substantially cover situations addressed in Rule 262(a)(3) and Rule 262(b)(3).

<sup>152</sup> This provision is based on Section 412(d)(6) of the Uniform Securities Act, but more generally includes "federal or state regulator" and "federal or state securities or commodities laws or a law under which a business involving investments, insurance,

• Is subject to an order, judgment or decree by a court entered within the last five years that restrains or enjoins the issuer or a person from engaging in any conduct or practice involving securities and other similar businesses, including an order for failure to comply with Rule 503 (the filing of Form D);<sup>153</sup>

• Is subject to a cease and desist order entered within the last five years issued under federal or state securities or similar laws;<sup>154</sup> or

• Is subject to a suspension or expulsion from membership in or association with a member of a national securities exchange or national securities association for an act or omission constituting conduct inconsistent with just and equitable principles of trade.<sup>155</sup>

The length of disqualification from reliance on Regulation D in the proposal is generally five years. For more egregious conduct resulting in a criminal conviction, we propose disqualification for 10 years.<sup>156</sup> We believe that these disqualification provisions would provide a deterrent effect, as well as offer protection to investors from recidivists who have violated securities and related laws and rules in the past.

Proposed subparagraphs (i), (iii), (iv), and (v) of Rule 502(e)(1) enumerate the various administrative and civil orders, judgments, and determinations that would trigger disqualification for an issuer. Proposed subparagraph (ii)

banking, or finance is regulated" instead of providing a specific list of relevant statutes. The Model Accredited Investor Exemption contains a similar, but more limited provision that disqualifies a person if they are "currently subject to any state or federal administrative enforcement order or judgment \* \* \* finding fraud or deceit in connection with the purchase or sale of any security."

<sup>153</sup> We sought to simplify the provisions in Rule 262(a)(2) and (b)(2) of Regulation A by following the Model Accredited Investor Exemption provision (D)(1)(d). Rather than refer to "involving fraud or deceit in connection with the purchase or sale of any security," we broadened the application to a business "involving securities, commodities, investments, insurance, banking, or finance" as suggested by the Uniform Securities Act. We did not, however, include a business involving franchises as in the Uniform Securities Act list. We also added a specific reference to Rule 503, which is being moved from current Rule 507, as discussed below.

<sup>154</sup> This provision, while similar to the provisions in Rule 502(e)(1)(iii) and (iv), is based on Section 412(12) of the Uniform Securities Act.

<sup>155</sup> This provision is substantially similar to Rule 262(b)(4) and seeks to bar similar persons to those covered by Uniform Securities Act Section 412(13).

<sup>156</sup> The period of disqualification generally follows the periods provided in Regulation A. The disqualification period for issuers convicted of a criminal offense would be increased from five to 10 years to conform with the disqualification for other criminal offenders and to better conform with the Uniform Securities Act.

provides a similar disqualification provision for criminal convictions, and proposed subparagraph (vi) provides a disqualification provision that relates to decisions of self-regulatory organizations. Each disqualification provision relates to a failure to comply with laws or regulations, raising concerns that the person may continue to disregard laws and regulations relating to the offering of securities. For this reason, we believe an issuer should not be allowed to rely on Regulation D if the issuer or one of the covered persons meets the disqualification provisions in proposed Rule 502(e).

In order to combine all of the disqualification provisions in the same rule, we propose to remove the disqualification provision relating to failure to comply with Rule 503 (the filing of Form D) that is found in current Rule 507 and replace the substance of that provision with a clause in proposed Rule 502(e)(1)(iv). Proposed Rule 502(e)(1)(iv) would specifically indicate that an order for failure to comply with Rule 503 of Regulation D would trigger the disqualification provision. Proposed Rule 502(e)(2) would expand upon the concept in current Rule 507 and allow the Commission, upon a showing of good cause, to waive any of the enumerated disqualification provisions in proposed Rule 502(e)(1).<sup>157</sup> Proposed Rule 502(e)(2) also would provide a safe harbor for an offering by an issuer, if that issuer establishes that it did not know and reasonably could not have known that the disqualification existed.<sup>158</sup>

#### Request for Comment

- Should we limit the disqualification provisions to Rule 505 exemptions only, as is currently the case, rather than applying these provisions to all Regulation D exemptions? Are there any

<sup>157</sup> The waiver provision tracks the preliminary language in Rule 262 and provides flexibility for the Commission. The Commission staff has, and would continue to have, delegated authority to act on waiver requests under Rule 262 of Regulation A and Rule 505, and we are proposing a similar delegation for all other Regulation D disqualification waiver requests. See I.I.E.3 below.

<sup>158</sup> The Model Accredited Investor Exemption provides exemptions from disqualification where a waiver is provided or where the issuer establishes that it did not know and in the exercise of reasonable care, based on a factual inquiry, could not have known of the disqualification. Regulation A does not include the exemption where an issuer reasonably could not have known. Due to the broad application of the proposed Rule, we have proposed similar exemptions to those in the Model Accredited Investor Exemption providing for waiver and for an issuer that reasonably could not have known. We have not included the requirement for a factual inquiry to establish the reasonable basis as in the Model Accredited Investor Exemption.

current disqualifications not included in the proposed rule that we should include? Are any persons not covered who should be?

- What would be the effects on disqualified issuers? How many issuers would be affected?

- Unlike the Regulation A, Regulation E<sup>159</sup> and current Rule 505

disqualification provisions, proposed Rule 502(e) excludes selling broker-dealers, underwriters, and placement agents from the disqualification provisions. Should selling broker-dealers, underwriters, and placement agents be covered in the disqualification provisions? Would including selling broker-dealers, underwriters, and placement agents give issuers an incentive to check their backgrounds before engaging them for an offering? If they were included, should there be an exemption for persons who continue to be licensed or registered to conduct securities related business in the jurisdiction where the order, judgment, or decree creating the disqualification was entered, as is the case in the Model Accredited Investor Exemption?

- Does the proposed rule adequately cover the disqualification provisions of Regulation A, which currently apply to Rule 505? For example, proposed Rule 502(e)(1)(iii) would disqualify persons subject to an adjudication or determination by a federal or state regulator that the person violated securities or commodities laws or a law under which a business involving investments, insurance, banking, or finance is regulated. Under Rule 262(a)(5), a United States Postal Service false representation order and certain other orders and injunctions are specifically enumerated. Does the proposed rule adequately cover these and other related orders and injunctions? If not, should we revise the proposed rule to specifically cover United States Postal Service orders and injunctions or other specific circumstances?

- Should the disqualification provisions for being currently subject to an order, judgment, decree, or cease and desist order apply as long as the person is subject to the order, no matter when the order was entered into, or should the provisions apply only to orders entered into within the last five years, as proposed?

- The length of disqualification in the proposed rules generally is consistent with our current Rule 262 provisions in

Regulation A. The proposal increases the length of disqualification for criminally convicted issuers from 5 years to 10 years. Under the Uniform Securities Act of 2002, a person convicted of a felony involving the business of securities is permanently barred from relying on the exemption. Should such felony convictions permanently disqualify a person? Is 10 years an appropriate disqualification period? Is 5 years an appropriate length of time to protect investors adequately from persons who have been determined to have violated or have been sanctioned for violations of securities-related and similar laws and regulations?

- How should the Commission phase in the new disqualification provisions, if adopted? Should we “grandfather” individuals and entities from the consequences of the new disqualification provisions if an issuer commences an offering before the effectiveness of proposed Rule 502(e)? With respect to offerings commenced before the effectiveness of proposed Rule 502(e), should we subject individuals and entities that become newly associated with the issuer after effectiveness to all the consequences of the new disqualification provisions? In these cases, should we provide any special waiver provisions and/or condition any waiver on providing disclosure in the offering document regarding any past disqualifying events?

- Would mandatory disclosure of the adverse orders, judgments, and determinations be an adequate substitute for disqualification?<sup>160</sup> If so, how should disclosure be mandated and enforced?

- The proposed rule provides an exemption from the disqualification provisions if, in the exercise of reasonable care, the issuer could not have known that a disqualification existed. Is this appropriate? If so, should an issuer be required to establish that reasonable care was based on a factual inquiry, as required in the Model Accredited Investor Exemption? Are there circumstances where no factual inquiry would be necessary? Would the requirement for a factual inquiry be burdensome?

- Should we revise the disqualification provisions in Regulation A and Regulation E to conform with proposed Rule 502(e)?

<sup>160</sup> We recently proposed changes to Form D, the form required of issuers relying on Regulation D, that would include requiring each issuer submitting the form to certify that it is not disqualified from relying on Regulation D for one of the reasons stated in proposed Rule 502(e). See Release No. 33-8814 (June 29, 2007) [72 FR 37376].

What changes specific to Regulation A or Regulation E should we make to the proposed disqualification provisions?

#### D. Possible Revisions to Rule 504

Rule 504 of Regulation D is known as the “seed capital” exemption. It is limited to offerings by non-reporting companies that do not exceed an aggregate annual amount of \$1 million. Rule 504 places substantial reliance upon state securities laws, because the size and local nature of these offerings has not appeared to warrant imposing significant federal regulation.

Rule 504 sets forth the requirements for four separate exemptions from the registration requirements of the Securities Act. Among these is Rule 504(b)(1)(iii),<sup>161</sup> which provides an exemption from registration for offers and sales of securities that are conducted “according to state law exemptions from registration that permit general solicitation and general advertising so long as sales are made only to ‘accredited investors’ as defined in [Rule 501(a)].”<sup>162</sup> Securities sold without registration in reliance on this provision are not subject to the limitations on resale established in Rule 502(d) and, as such, are not “restricted securities” for purposes of Rule 144(a)(3)(ii).

We added Rule 504(b)(1)(iii) as a new exemption to Rule 504 in 1999.<sup>163</sup> It was an attempt to apply the appropriate federal securities law treatment to offerings made under state registration exemptions that satisfied its conditions. As an example of these exemptions, we cited the Model Accredited Investor

<sup>161</sup> 17 CFR 230.504(b)(1)(iii).

<sup>162</sup> Rule 501(a) has been discussed at length at various places above. The other three Rule 504 exemptions, which would not be affected by the possible revisions we are discussing here, are contained in:

(a) The introductory clause of Rule 504(b)(1), 17 CFR 230.504(b)(1) (exemption for offers and sales of restricted securities that do not involve general solicitation and advertising); and

(b) Rules 504(b)(1)(i) and 504(b)(1)(ii), 17 CFR 230.504(b)(1)(i) and 230.504(b)(1)(ii) (exemptions for offers and sales of unrestricted securities that may involve general solicitation and advertising if the offering is registered under appropriate state securities laws that require the public filing and delivery of a disclosure document to investors before sale).

In a companion release, we have proposed to amend Form D, the notice that must be filed with us when an issuer sells securities in a Regulation D offering, to require issuers relying on Rule 504 to specify the precise Rule 504 exemption on which they are relying. See Release No. 33-8814 (June 29, 2007) [72 FR 37376]. One of the purposes of this change is to provide us with better information on the extent of use of the different types of Rule 504 offerings.

<sup>163</sup> See Release No. 33-7644 (Feb. 25, 1999) [64 FR 11090]. Previously, securities sold under Rule 504 were not deemed restricted securities.

<sup>159</sup> 17 CFR 230.601 through 230.610a. Regulation E is an exemption from Securities Act registration, promulgated under Section 3(c) of the Securities Act, 15 U.S.C. 77c(c), for securities of small business investment companies.

Exemption, which was a model exemption developed in 1997 by the North American Securities Administrators Association.<sup>164</sup> It was our understanding at the time that securities issued under Rule 504(b)(1)(iii) generally could not be transferred under state law, and that immediate resale generally would not be possible.<sup>165</sup>

The addition of Rule 504(b)(1)(iii) in 1999 was part of a series of changes designed to deter abusive practices in Rule 504 offerings while not impeding legitimate “seed capital” offerings. The Commission had been concerned for some time with abusive practices in Rule 504 offerings, many of which involved “pump and dump” schemes for securities of non-reporting companies that traded over the counter. At the time, we stated that we would monitor the use of Rule 504 as revised and contact state securities regulators regarding their experience with these offerings. We further stated that if abusive practices involving Rule 504 continued, we would consider stronger measures in the future.<sup>166</sup>

In recent years, the Commission has taken enforcement action against numerous “pump and dump” schemes, most of which involve the securities of small companies without large market capitalization or significant market following.<sup>167</sup> Several of these cases have involved claims of purported compliance with Rule 504(b)(1)(iii) and state securities laws that are submitted to transfer agents as the basis for the issuance of securities without restrictive legends to permit immediate resale. In informal discussions, state securities regulators also have raised concerns about abusive practices involving Rule 504(b)(1)(iii) offerings. These factors lead us to question whether we should amend Rule 504(b)(1) to provide that the limitations on resale set forth in Rule 502(d) would apply to securities sold in a Rule 504(b)(1)(iii) transaction. Such an amendment would result in those

securities being “restricted securities” for purposes of Rule 144.

In a companion release, we have proposed to amend Rule 144 to provide that non-affiliates receiving restricted securities of non-reporting companies would be eligible to resell those securities after 12 months without any restrictions.<sup>168</sup> A 12-month holding period would be consistent with the Model Accredited Investor Exemption. If we adopt the Rule 144 proposal and revise Rule 504(b)(1) to provide that securities sold in a Rule 504(b)(1)(iii) transaction are “restricted securities,” the resale restrictions will be less stringent than under current Rule 144.<sup>169</sup>

#### Request for Comment

- The Commission seeks comment as to whether Regulation D should be amended so that securities sold in reliance on Rule 504(b)(1)(iii) pursuant to a state law exemption that permits sales only to accredited investors would be subject to the limitations on resale in Rule 502(d) and, as such, be deemed “restricted securities” for purposes of Rule 144.<sup>170</sup>

- If Regulation D were amended to make securities issued under Rule 504(b)(1)(iii) “restricted securities,” would the amendment impose a significant burden on start-up and other smaller companies? If you believe so, please explain your reasons, given the resale restrictions typically required under state securities law exemptions. Do any states have resale restrictions that are narrower than would apply to “restricted securities”?

#### E. Other Proposed Conforming Revisions

##### 1. Proposed Amendments to Rule 215

We propose to amend Rule 215 to conform the definition of “accredited investor” in Rule 215 with the definition in Rule 501(a) of Regulation D. Rule 215 defines accredited investor

<sup>168</sup> See Release No. 33-8813 (June 22, 2007) [72 FR 36822].

<sup>169</sup> For resales of securities by non-affiliates of the issuer, current Rule 144 requires a one-year holding period followed by an additional year when resales are subject to manner of sale restrictions, volume limitations, current public information requirements, and notice requirements. Unlimited resales may occur after the second year.

<sup>170</sup> We envision that any such amendment would not affect the resale status of securities sold under the exemptions in Rules 504(b)(1)(i) and 504(b)(1)(ii), which exempt certain offerings of securities that are registered under a state securities law that requires the public filing and delivery of a disclosure document to investors before sale. As such, the resale limitations of Rule 502(d) would continue not to apply to securities sold in transactions that are exempted by those rules and those securities would not be “restricted securities” for purposes of Rule 144.

under Section 2(a)(15) of the Securities Act<sup>171</sup> for purposes of Section 4(6) of the Securities Act and would track the proposed definition in Rule 501(a) of Regulation D.

##### 2. Proposed Amendment to Rule 144A

Rule 144A currently provides a safe harbor under Section 5 of the Securities Act for offers and resales of securities to a qualified institutional buyer or to an offeree or purchaser that the seller and any person acting on the seller’s behalf reasonably believe is a qualified institutional buyer. A general announcement of an offering published by an issuer in accordance with Rule 507 may be deemed inconsistent with the requirement under Rule 144A that offers be made solely to such persons. As a result, we propose to add a Preliminary Note 8 to Rule 144A to clarify that publication of a general announcement of an offering in accordance with Rule 507 would not preclude resales pursuant to Rule 144A.

#### Request for Comment

- As proposed, Preliminary Note 8 to Rule 144A would not make any distinctions based on the type of security that is being offered pursuant to Rule 507. Should the Preliminary Note only apply to debt securities, as opposed to equity, because debt securities are more likely to be sold to institutional investors?

##### 3. Delegated Authority

Under Rule 30-1,<sup>172</sup> the Commission has delegated to the Director of the Division of Corporation Finance the authority to grant applications for exemptions to the disqualification provisions under Regulation A and Rule 505. As we are proposing to include disqualification provisions for all Regulation D offerings, we propose to revise Rule 30-1(c) to delegate authority to the Director of the Division of Corporation Finance to grant applications for exemptions to the disqualification provisions of Regulation D.

#### III. General Request for Comment

The Commission is proposing these revisions. We welcome your comments. We solicit comment, both specific and general, on each component of the proposals. We request and encourage any interested person to submit comments regarding:

- The proposals that are the subject of this release;

<sup>171</sup> 15 U.S.C. 77b(a)(15).

<sup>172</sup> 17 CFR 200.30-1(b)(1), 200.30-1(c).

<sup>164</sup> *Id.* A copy of the Model Accredited Investor Exemption is available on the NASAA Web site at <http://www.nasaa.org/content/Files/Model%5FAccredited%5FInvestor%5FExemption.pdf>.

<sup>165</sup> See Release No. 33-7644, n. 38.

<sup>166</sup> *Id.* Other suggested measures included the expansion of disqualification provisions similar to those in Rule 505(b)(2)(iii) and Rule 262. We propose to expand such disqualification provisions to all Regulation D offerings in this release. See I.L.C.2 above.

<sup>167</sup> See, e.g., *SEC v. Integrated Services Group Inc.*, Lit. Release No. 19476 (Nov. 29, 2005) (reporting complaint filed in S.D. Tex.); *SEC v. Custom Designed Compressor Systems, Inc.*, Lit. Release No. 19101 (Feb. 28, 2005) (reporting complaint filed in D. N.M.).

- Additional or different revisions to Regulation D; and
- Other matters that may have an effect on the proposals contained in this release.

In December 2006, the Commission proposed to add a new category of accredited investor, defined as accredited natural person, under the Securities Act.<sup>173</sup> We are taking the opportunity to solicit further comment on the questions we asked in connection with that proposal, especially in light of the new proposals in this release. Are there any differences in the regulation of operating and private pooled investment vehicles that we should consider in crafting harmonious rules for limited offerings? Finally, we solicit comment on whether any additional conforming amendments are necessary.

Comment is solicited from the point of view of both issuers and investors, as well as of capital formation facilitators, such as broker-dealers, and other regulatory bodies, such as state securities regulators. Any interested person wishing to submit written comments on any aspect of the proposal is requested to do so.

#### IV. Paperwork Reduction Act

The proposals contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995.<sup>174</sup> The title of these requirements is:

- “Form D” (OMB Control No. 3235–0076).<sup>175</sup>

We adopted Regulation D and Form D as part of the establishment of a series of exemptions for offerings and sales of securities under the Securities Act.<sup>176</sup> We are submitting these requirements to the Office of Management and Budget (“OMB”) for review and approval in accordance with the Paperwork Reduction Act and its implementing regulations.<sup>177</sup>

We propose to make changes in four principal areas involving Regulation D, as well as to make other conforming changes, relating to:

<sup>173</sup> See Private Pooled Investment Vehicle Release.

<sup>174</sup> 44 U.S.C. 3501 *et seq.*

<sup>175</sup> Form D was adopted pursuant to Sections 2(a)(15), 3(b), 4(2), 19(a) and 19(c)(3) of the Securities Act (15 U.S.C. 77b(15), 77c(b), 77d(2), 77s(a) and 77s(c)(3)).

<sup>176</sup> In a companion release, Release No. 33–8814, we are proposing changes to Form D that would require that Form D be filed electronically. If Form D is required to be filed electronically, filers will be required to file Form ID in order to be able to file electronically. If the proposal to require electronic Form D is adopted, any increase in the number of companies filing Form D will result in an increase in the number of Form ID filings.

<sup>177</sup> 44 U.S.C. 3507(d); 5 CFR 1320.11.

- Creating a new exemption from the registration provisions of the Securities Act for offers and sales of covered securities to “large accredited investors”;

- Revising the definition of the term “accredited investor” to clarify it and reflect developments since its adoption;

- Shortening the timing required by the integration safe harbor for Regulation D offerings; and

- Providing uniform disqualification provisions to apply throughout Regulation D.<sup>178</sup>

We also are soliciting comment on whether to amend Rule 504 of Regulation D so that securities sold pursuant to a state law exemption that permits sales only to accredited investors would be deemed “restricted securities” for purposes of Rule 144.

The information collection requirements related to the filing with the Commission of Form D are mandatory to the extent that an issuer elects to make an offering of securities in reliance on the relevant exemption. Responses are not confidential. The hours and costs associated with preparing and filing forms and retaining records constitute reporting and cost burdens imposed by the collection of information requirements. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number.

##### A. Summary of Information Collections

Form D contains collection of information requirements, requiring an issuer to file a notice of sale of securities pursuant to Regulation D or Section 4(6) of the Securities Act. The Form D is required to include basic information about the type of filing, the issuer, certain related persons, and the offering. Form D is filed by issuers as a notice of sales without registration under the Securities Act based on a claim of exemption under Regulation D or Section 4(6) of the Securities Act. The information is needed for implementing the exemptions and monitoring their use.

We propose to amend Form D to add a check box to indicate an offering relying on the proposed Rule 507 exemption. We do not believe the proposed change will have any effect on the paperwork burden of the form. However, we believe the overall effect of

<sup>178</sup> Currently under Regulation D, only Rule 505 offerings are subject to disqualification provisions. The proposal would subject issuers making any offering in reliance on Regulation D to similar disqualification provisions.

the proposals will be to increase the number of forms that are filed with the Commission. While we anticipate an increase in the number of filings, we believe that most issuers that are seeking capital in the private equity markets would do so even without the proposed amendments. We believe the following proposals are likely to increase the number of exempt offerings and therefore the number of forms filed:

- The proposal to create a new exemption from the registration provisions of the Securities Act for offers and sales to large accredited investors permitting limited advertising, providing issuers a new option for offering securities;

- The proposals to clarify the definition of accredited investor will slightly increase the pool of accredited investors and, due to the increased pool of investors, is likely to marginally increase the number of offerings to those investors;<sup>179</sup> and

- The proposal to shorten the timing of the integration safe harbor will allow issuers to conduct more frequent offerings using the safe harbor.<sup>180</sup>

On the other hand, some of our proposals are likely to decrease the number of exempt offerings and therefore the number of forms filed:

- The proposal to revise the disqualification provisions applicable to Rule 505 and apply those provisions to all offerings relying on Regulation D may have the effect of reducing the number of forms filed.<sup>181</sup>

- The proposal to require for the determination of accredited investors status that an individual may count only 50 percent of any joint investments with their spouse unless both persons sign the investment documentation may reduce the pool of accredited investors where spouses decide not to invest together.

<sup>179</sup> We propose to add an “investments-owned” standard to the current standards under accredited investor. We anticipate that will increase the pool of accredited investors from 8.47 percent of U.S. households to 8.69 percent of U.S. households. See n. 90. Most of the additional clarification supports current staff positions on who may qualify as an accredited investor and should not significantly affect the size of the investor pool, though it may increase awareness among those groups of their ability to qualify.

<sup>180</sup> We anticipate the reduction in the safe harbor waiting period will increase the number of Forms D filed, but do not believe it will increase the number of Forms ID filed, as any increase in Forms D will be from repeat filers.

<sup>181</sup> We believe that very few issuers will be subject to the disqualification provisions and expect the number of Forms D filed will be minimally affected. We believe the revisions are necessary in order to exclude a small number of recidivists who have been found by regulators and courts to have violated applicable laws and regulations.

- To the extent that an amendment to revise Rule 504 to treat securities sold pursuant to a state law exemption that permits sales only to accredited investors as “restricted securities” for purposes of Rule 144 may result in potentially greater limitation on resale than may exist under state securities laws, this could have the effect of slightly reducing the number of forms filed.

### *B. Paperwork Reduction Act Burden Estimates*

According to our Office of Filings and Information Services, in 2006, 16,829 companies made 25,329 Form D filings. The annual number of Form D filings rose from 17,390 in 2002 to 25,239 in 2006 for an average increase of approximately 2,000 Form D filings per year. Assuming the number of Form D filings continues to increase by 2,000 filings per year for each of the next three years, the average number of Form D filings in each of the next three years would be about 29,300.<sup>182</sup>

As described above, we estimate that our proposals, if adopted, would have mixed effects on the number of Forms D filed with the Commission. Use of the new exemption, the shortened delay for the Regulation D safe harbor, and the slight increase in the pool of accredited investors due to the revised accredited investor definition likely would raise the number of Forms D filed. The utility of the established exemptions, particularly Rule 506, makes large numbers of Regulation D-exempt offerings that otherwise would not have been filed unlikely. In addition, the new disqualification provisions, some aspects of the revised definition of accredited investor, and the possible revisions to Rule 504 may slightly lower the number of filings.

We estimate that if the proposed rules are adopted, the burden for responding to the collection of information in Form D would not increase for most companies because the information required in the form would not change. Balancing the increasing and decreasing effects of the proposals, for purposes of the Paperwork Reduction Act, we estimate an annual increase in the number of Form D filings of five

<sup>182</sup> Our current OMB information collection estimate indicates that we expect 17,480 Form D filings per year. In conjunction with the Private Pooled Investment Vehicle Release, OMB revised the Form D information collection estimates to reflect an expected decrease in responses from 17,500 Form D filings to 17,480. However, based on the new data, we are increasing our estimated number of Form D filings.

percent, or approximately 1,500 filings.<sup>183</sup>

For purposes of the Paperwork Reduction Act, we estimate that, over a three-year period, the average burden estimate will be four hours per Form D. This burden is reflected as a one-hour burden of preparation on the company and a cost of \$1,200 per filing. Our burden estimates represent the average burden for all issuers. We expect that the burden and costs could be greater for larger issuers and lower for smaller issuers. For Form D notices, we estimate that 25 percent of the burden of preparation is carried by the company internally and that 75 percent of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of \$400 per hour.<sup>184</sup> The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours. We estimate the proposals will incrementally increase the number of Form D filings and therefore the filing burden by 1,500 hours of company personnel time and \$1,800,000. Based on this increase, we estimate that the annual compliance burden in the proposed collection of information requirements in hours for issuers making Form D filings will be an aggregate 30,800 hours of company personnel time and \$36,960,000 for the services of outside professionals per year.

We request comment on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission’s estimate of burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

<sup>183</sup> To arrive at this estimate, we multiplied the number of Form D filings estimated per year (29,300) by 5 percent and rounded up to the nearest 100.

<sup>184</sup> The hourly cost estimate is based on our consultations with several registrants and law firms and other persons who regularly assist registrants in preparing and filing with the Commission.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090, with reference to File No. [S7-18-07]. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. [S7-18-07], and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, Washington, DC 20549. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

### *C. Paperwork Reduction Act—Accredited Natural Person*

In December 2006, the Commission proposed to add a new category of accredited investor, defined as accredited natural person, under the Securities Act.<sup>185</sup> We do not believe that the additional questions regarding that proposal on which we solicit comment in this release change our analysis under the Paperwork Reduction Act provided in the Private Pooled Investment Vehicle Release. We solicit comment on that conclusion and on whether our estimates continue to be accurate.

## **V. Cost-Benefit Analysis**

### *A. Background and Summary of Proposals*

Adopted in 1982, Regulation D was designed as a comprehensive scheme for exemptions from the registration provisions of the Securities Act for smaller companies attempting to sell securities in private or limited offerings. We are proposing revisions to Regulation D in order to clarify certain rules and definitions and to add a new exemption. The proposed changes include:

- Providing issuers a more flexible exemption in proposed Rule 507 that would allow limited advertising in offerings of covered securities made exclusively to large accredited investors,

<sup>185</sup> See Private Pooled Investment Vehicle Release.



a new category of investor proposed in Rule 501(a);

- Revising the definition of the term “accredited investor” to clarify it and reflect developments since its adoption, including adding alternative investments-owned standards to the definition, accounting for future inflation, clarifying the list of legal entities that may qualify as accredited investors and clarifying the meaning of “joint investments”;

- Shortening the timing required by the integration safe harbor for Regulation D offerings from six months to 90 days; and

- Providing uniform disqualification provisions to apply throughout Regulation D.

We also are soliciting comment on whether to amend Rule 504 of Regulation D so that securities sold pursuant to a State law exemption that permits sales only to accredited investors would be deemed “restricted securities” for purposes of Rule 144.

We have identified certain costs and benefits that may result from the proposals. We encourage commenters to identify, discuss, analyze and supply relevant data regarding these or any additional costs and benefits.

#### B. Benefits

We believe the proposals will benefit investors by providing a new offering exemption to issuers, clarifying our existing rules and barring certain recidivists from offering securities in Regulation D exempt offerings. The benefits discussed are difficult to quantify and value. Generally, we believe the proposals will reduce the cost of Regulation D exempt offerings and thereby encourage issuers to substitute this form of offering for more costly alternatives, thereby lowering the cost of capital generally. The benefits of the proposals may include the following:

- Proposed Rule 507 would allow for limited advertising in offerings made exclusively to large accredited investors. Permitting limited advertising in an exempt offering would provide issuers more efficient access to the pool of potential investors and capital. This may reduce the cost of capital formation by allowing issuers to contact investors directly, and avoid the need for financial intermediaries to provide unnecessary costly assistance in the effort to raise capital. Finally, offerings of covered securities are preempted from state registration requirements permitting issuers to more readily offer their securities nationally.

- The proposal to revise the definition of accredited investor would

add alternative investments-owned standards to the current accredited investor standards. We believe an investments-owned standard is both easier to establish and a more accurate indicator of whether an investor needs the protections afforded by registration, providing issuers a potentially better way of identifying accredited investors.<sup>186</sup> We believe the proposed standards would decrease the cost of establishing accredited investor qualification and slightly expand the number of accredited investors, thereby increasing the pool of potential investors and thus potentially benefiting investors by decreasing the cost of capital.

- The proposal would revise the accredited investor thresholds to account for future inflation, to clarify the meaning of “joint investments” and to clarify the list of legal entities that may qualify as accredited investors. Greater clarity in the rule would generally benefit investors by making the rule easier to apply and easing regulatory burdens on issuers.

- The proposal to shorten the Regulation D integration safe harbor from six months to 90 days would provide issuers greater flexibility to conduct more frequent offerings to meet unpredictable financing needs. Greater flexibility would allow issuers to better time their offerings, benefiting investors by potentially lowering the cost of capital.

- The proposal to establish uniform bad actor disqualification provisions to apply throughout Regulation D would preclude certain issuers from relying on Regulation D exemptions. We believe these disqualification provisions will help to keep recidivists out of the limited and private offering market. By deterring bad actors from conducting exempt offerings under Regulation D, we believe we may reduce fraud in the market, thereby ultimately lowering the cost of capital.

- An amendment to revise Rule 504 to treat securities sold pursuant to a state law exemption that permits sales only to accredited investors as “restricted securities” for purposes of Rule 144 would likely have a deterrent effect on abusive practices, such as “pump and dump” schemes for securities of non-reporting companies that trade over the counter.

<sup>186</sup> If the criteria to determine accredited investor status are easier to apply, the cost of determining accredited investor status and the risk of sales to non-accredited investors would decrease. This would also lower the risk that the issuer may need to make a rescission offer or that an investor may inappropriately invest in an offering.

#### C. Costs

Our proposals may impose some costs on investors by placing additional regulatory burdens on issuers. We have estimated for our Paperwork Reduction Act analysis that the proposals will increase the number of Form D filings by 1,500, resulting in \$2,062,500 in additional costs relating to the filing of additional Forms D.<sup>187</sup> Many of the costs are dependent on a number of factors, but may include:

- Proposed Rule 507 would allow limited advertising in an exempt offering to large accredited investors. If the proposed rule is successful, issuers may substitute Rule 507 offerings for registered offerings, resulting in investors losing some of the informational and enforcement benefits of federal securities registration. Investors in the covered securities to be offered under Rule 507 in lieu of registered offerings also may incur costs due to the lost benefits of state registration and oversight.

- We expect that the majority of Rule 507 offerings would be undertaken by issuers in lieu of Rule 506 offerings, since all large accredited investors eligible to participate in Rule 507 offerings also would be eligible to participate in Rule 506 offerings. We believe the informational, enforcement and state registration and oversight benefits of Rule 507 would be the same as those of Rule 506, with no difference in costs to investors.

- Proposed Rule 507 may also cause certain issuers to undertake an offering of securities that they otherwise may not have undertaken in the absence of the new rule. The costs to conduct a Rule 507 offering, including attorney and accountant fees, as well as the costs related to limited advertising permissible in Rule 507 offerings, would be in lieu of the costs of other traditional financing methods, such as bank loans or the costs of not raising additional capital.

- If there is an increase in fraudulent activity through the limited advertising and solicitation allowed under proposed Rule 507, such activity could discourage the use of the exemption and other Regulation D exemptions generally, and thereby have the unintended consequences of increasing the cost of capital formation above what would occur in the absence of the rule amendment.

<sup>187</sup> We estimate that the burden of preparation for the 1,500 additional Form D filings carried by outside professionals will cost \$1,800,000 and an additional 1,500 hours of company personnel time which we estimate to be valued at \$175 per hour.

- The proposal to account for future inflation in the definition of accredited investor would limit the growth and could shrink the pool of accredited investors, imposing costs on investors by increasing issuers' cost of capital relative to what would occur in the absence of the rule amendment.
- The proposal to establish uniform disqualification provisions to apply throughout Regulation D may disqualify certain issuers from undertaking Regulation D exempt offerings relative to what would occur without the rule amendment. The application of the proposed disqualification provisions would add an additional cost to offerings for investigations in order to determine whether any of the participants in the offering will cause the issuer to be disqualified.<sup>188</sup> In addition, a disqualified issuer would not have access to Regulation D, which would likely impose costs on investors by increasing the cost of raising capital for the issuer.
- An amendment to revise Rule 504 to treat securities sold pursuant to a state law exemption that permits sales only to accredited investors as "restricted securities" for purposes of Rule 144 could result in potentially greater limitations on resale than may exist under state securities laws.

#### D. Request for Comment

We solicit comments on the costs and benefits of the proposed revisions. We request your views on the costs and benefits described above, as well as on any other costs and benefits that could result from the adoption of these proposals. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or any additional costs and benefits. Specifically, we ask the following:

- What are the costs and benefits of limited advertising and greater flexibility in the proposed Rule 507 exemption?
- What are the nature and extent of the costs and benefits to investors that would result from amending the accredited investor standards as proposed? Are there costs to accredited investors relating to the application of the investments-owned standard?

<sup>188</sup> Under the current rules, disqualification provisions are included in Rule 505, but do not apply to Rule 504 or Rule 506. As proposed, the new disqualification provisions would apply to all Regulation D exemptions. Therefore, new costs would apply to offerings under Rules 504, 506 and 507. Costs would likely decrease for Rule 505 offerings, since the proposed disqualification provisions would not include "underwriters," which are currently included in the Rule 505 disqualification provisions.

• What are the costs and benefits of the shortened 90-day integration safe harbor?

• What are the costs and benefits of the disqualification provisions we propose for Regulation D?

• What would be the costs and benefits if we revised Rule 504 to treat securities sold pursuant to a state law exemption that permits sales only to accredited investors as "restricted securities" for purposes of Rule 144?

In general, we request comment on all aspects of this cost-benefit analysis, including identification of any additional costs or benefits of the proposals not already defined, that may result from the adoption of these proposed amendments and rules. We generally request comment on the competitive benefits or anticompetitive effects that may impact any market participants if the proposals are adopted as proposed. We also request comment on what impact the proposals, if adopted, would have on efficiency and capital formation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

#### E. Accredited Natural Person

In December 2006, the Commission proposed to add a new category of accredited investor, defined as accredited natural person, under the Securities Act.<sup>189</sup> We do not believe that the additional questions regarding that proposal on which we solicit comment in this release change the cost-benefit analysis we provided in connection with that proposal. We solicit comment on that conclusion. For example, would changing the thresholds on who can invest materially affect investors in or issuers of pooled investment vehicles? We also welcome further comments on all aspects of that analysis.

### VI. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

#### A. General

Section 2(b) of the Securities Act<sup>190</sup> requires us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. The proposals are intended to modernize

and streamline Regulation D without compromising investor protection.

We do not believe most of the proposals will place a significant burden on or otherwise affect competition. The proposed Rule 507 exemption, the revisions to the definition of accredited investor and the Regulation D safe harbor would apply equally to all issuers and should encourage additional Regulation D offerings. The limited advertising permitted in the proposed Rule 507 exemption may provide issuers with a competitive alternative to using finders and private placement agents to locate prospective investors in exempt offerings. This may help to reduce an issuer's costs of raising capital. The proposed disqualification provisions may provide a competitive disadvantage for issuers subject to them, as such issuers would be required to take appropriate actions to no longer be subject to the disqualification, seek a waiver or raise capital through a registered offering rather than use Regulation D. We believe any disadvantage would be tempered by an issuer's ability to avoid disqualification by dissociating from the disqualified person or seeking a waiver.

We believe our proposals may positively affect efficiency and capital formation. The proposals to provide a new exemption that allows limited advertising in offerings made exclusively to large accredited investors and to shorten the time frame of the Regulation D integration safe harbor should both promote more efficient allocation of resources and increase capital formation, by allowing issuers greater flexibility in their choice of the method and timing of their offerings. We believe the proposals to add alternative investments-owned standards and to clarify the definition of accredited investors would promote efficiency by providing clearer guidance on the application of the accredited investor standard. The proposal to account for future inflation may reduce the number of accredited investors and add complications when calculating new accredited investor thresholds in the future, but also would limit the erosion of the accredited investor threshold over time. Finally, the application of bad actor disqualification provisions to all offerings under Regulation D would require issuers to determine whether executive officers and other related parties would subject the issuer to the disqualification provisions. Issuers subject to the disqualification provisions would be able to seek capital through registered offerings, with their heightened

<sup>189</sup> See Private Pooled Investment Vehicle Release.

<sup>190</sup> 15 U.S.C. 77b(b).

protections for investors. Although this would add costs to an issuer's capital formation, we believe this provision would serve more generally to promote capital formation by providing additional investor protection and inspiring greater confidence in the private equity markets.

We are soliciting comment on whether to amend Rule 504 so that securities sold pursuant to a state law exemption that permits sales only to accredited investors would be deemed "restricted securities" for purposes of Rule 144. Given the resale restrictions typically required under state securities law exemptions, if this amendment were adopted, we do not believe it would have a material affect on issuers' ability to raise capital.

We request comment on whether the proposed amendments, if adopted, would promote or burden efficiency, competition and capital formation. Finally, we request commenters to provide empirical data and other factual support for their views if possible. We believe adoption of the proposed revisions to Regulation D would have a minor impact on competition, and would have a positive impact on the efficiency of raising capital and on capital formation.

#### B. Accredited Natural Person

In December 2006, the Commission proposed to add a new category of accredited investor, defined as accredited natural person, under the Securities Act.<sup>191</sup> We do not believe that the additional questions regarding that proposal on which we solicit comment in this release change our analysis under Section 2(b) of the Securities Act with respect to that proposal. We solicit comment on that conclusion. For example, would harmonized definitions increase the efficiency of limited offerings? Would different investment thresholds affect capital formation? We also welcome further comments on all aspects of that analysis.

### VII. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed revisions to Regulation D under the Securities Act.

#### A. Reasons for the Proposed Action

Our objective in this effort is to clarify and modernize our rules to bring them into line with the realities of modern market practice and communications

technologies without compromising investor protection. Action in this area also is timely because our Advisory Committee on Smaller Public Companies made a number of recommendations relating to private and limited offerings in its final report dated April 23, 2006. We propose to revise Regulation D to provide additional flexibility to issuers and to clarify and improve the application of the rules through:

- Creating a new exemption from the registration provisions of the Securities Act for offers and sales of covered securities to "large accredited investors";
- Revising the definition of the term "accredited investor" to clarify it and reflect developments since its adoption;
- Shortening the timing required by the integration safe harbor for Regulation D offerings; and
- Providing uniform disqualification provisions to apply throughout Regulation D.

#### B. Objectives

The goal of Regulation D was to facilitate capital formation consistent with the protection of investors through simplification and clarification of existing exemptions, expansion of their availability and greater uniformity between federal and state exemptions. Our proposals offer revisions that would continue to simplify and clarify the exemptions and facilitate capital formation for smaller issuers, while protecting investors.

We propose to provide issuers with a more flexible safe harbor exemption in Rule 507 that would allow limited advertising in offerings made exclusively to large accredited investors. Proposed Rule 507 would permit issuers to publish a limited announcement of their offering, thereby providing issuers with greater access to potential investors and reducing their costs of raising capital. We also propose to adjust the definition of accredited investor:

- To add alternative investments-owned standards along with the current total asset and net worth standards, because an investments-owned standard may be easier to use and may provide a more accurate method to assess an investor's need for the protections of registration under the Securities Act;
- To adjust the dollar-amount thresholds in Rule 501 to account for inflation so that the thresholds will not erode over time;
- To clarify the list of legal entities that may qualify as accredited investors to eliminate existing uncertainty regarding the list;

- To clarify under the definition of "joint investments" that only 50 percent of the assets held jointly by spouses should be used in determining an individual's accredited investor status.

In addition, we propose to shorten the Regulation D integration safe harbor from six months to 90 days to provide flexibility to issuers to meet financing needs, which often are unpredictable. Finally, we propose that certain issuers be precluded from relying on Regulation D if they are subject to the disqualification provisions in proposed Rule 502(e). We believe these disqualification provisions will serve to guard against fraud in exempt offerings and improve the market's perceptions of these offerings, thereby reducing the cost of capital.

We are soliciting comment on whether to amend Rule 504 so that securities sold pursuant to a state law exemption that permits sales only to accredited investors would be deemed "restricted securities" for purposes of Rule 144. Given that Rule 504 issuers tend to be small entities, this amendment would affect small entities, to the extent that Rule 144 restrictions would be greater than current state law restrictions.

#### C. Legal Basis

The amendments are being proposed under the authority set forth in Sections 2(a)(15), 3(b), 4(2), 4(6), 18, 19, and 28 of the Securities Act.

#### D. Small Entities Subject to the Proposed Rules

The proposals would affect issuers that are small entities. For purposes of the Regulatory Flexibility Act under our rules, an issuer is a "small business" or "small organization" if it has total assets of \$5 million or less as of the end of its most recent fiscal year.<sup>192</sup> For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year. The proposed amendments would apply to all issuers that rely on Regulation D for an exemption to Securities Act registration.

All issuers that offer securities in reliance on Regulation D must file a Form D with the Commission. However, the vast majority of companies filing Form D are not required to provide financial reports to the Commission. As previously noted, in 2006, 16,829 issuers filed Form D. We believe that many of these issuers are small entities,

<sup>191</sup> See Private Pooled Investment Vehicle Release.

<sup>192</sup> 17 CFR 230.157.

but we currently do not collect information on total assets to determine if they are small entities for purposes of this analysis.

#### *E. Reporting, Recordkeeping and Other Compliance Requirements*

None of our proposed revisions to Regulation D would increase in any material way the information or time required to complete the Form D that must be filed with the Commission in connection with a Regulation D transaction. Our proposed revisions would also not require any further disclosure than is currently required in offerings made in reliance on Regulation D, other than requiring each issuer submitting a Form D to certify that it is not disqualified from relying on Regulation D for one of the reasons stated in proposed Rule 502(e).<sup>193</sup>

Proposed Rule 507 would permit an issuer to publish a limited advertisement and to solicit large accredited investors. The limitations of the advertisement are detailed in Rule 507(b)(2)(ii). The exemption builds on the accredited investor definition in Regulation D, requiring that an issuer evaluate whether investors meet the large accredited investor eligibility requirements. The same systems and procedures an issuer would use to determine accredited investor eligibility would be required to determine large accredited investor eligibility. Issuers may need to establish new procedures if they intend to make an offering on their own and relied on financial intermediaries to establish the procedures in the past.

Proposed Rule 502(e), establishing uniform disqualification provisions throughout Regulation D, would require issuers to determine whether the issuer, any predecessor of the issuer, any affiliated issuer, any director, executive officer, general partner or managing member of the issuer, any beneficial owner of 20 percent or more of any class of its equity securities, or any promoter currently connected with the issuer is subject to any of the disqualification provisions.

#### *F. Duplicative, Overlapping or Conflicting Federal Rules*

We believe that there are no rules that conflict with or duplicate the proposed rules.

#### *G. Significant Alternatives*

The Regulatory Flexibility Act directs us to consider significant alternatives

that would accomplish the stated objective of our proposals, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments and rules, we considered the following alternatives:

- The establishment of different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- The clarification, consolidation, or simplification of the rule's compliance and reporting requirements for small entities;
- The use of performance rather than design standards; and
- An exemption from coverage of the proposed rules, or any part thereof, for small entities.

Regulation D provides exemptions to the registration requirements under the Securities Act. The proposed amendments to Regulation D would apply equally to all issuers that rely upon these exemptions. The regulation is designed to facilitate access to capital by providing exemptions to registration under the Securities Act. These exemptions allow issuers to raise capital without having to expend the time and resources necessary to undertake a registered public offering. Our proposals are intended to further the goals of Regulation D through simplification and clarification of the exemptions, expansion of their availability and by providing greater uniformity between federal and state exemptions.

With respect to the establishment of special compliance requirements or timetables under the proposals for small entities, we do not think this is feasible or appropriate. Our proposals are designed to further facilitate issuers' access to capital for both large and small issuers. Excepting small entities from our proposals would increase, rather than decrease, their regulatory burden. Nevertheless, we request comment on whether it is feasible or appropriate for small entities to have special requirements or timetables for compliance with our proposals.

With respect to clarification, consolidation and simplification of Regulation D's compliance and reporting requirements for small entities, we believe our proposals are designed to streamline and modernize Regulation D for all issuers, both large and small. Nevertheless, we request comment on ways to clarify, consolidate, or simplify any part of the proposed amendments and rules.

With respect to the use of performance or design standards, we do not consider using performance rather than design standards to be consistent

with our statutory mandate of investor protection in the present context. Because the proposed rules seek compliance with specific standards without seeking to achieve pre-determined levels of capital formation or offering activity, design standards are necessary to achieve the objective of the proposals. Nevertheless, we request comment on these matters.

With respect to exempting small entities from coverage of these proposed rules, we believe such changes would be impracticable. These proposed rules are designed to facilitate an issuer's access to capital, regardless of the size of the issuer. We have endeavored throughout these proposed amendments and rules to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives. Nevertheless, we request comment on ways in which we could exempt small entities from coverage of any unduly onerous aspects of our proposed amendments and rules.

#### *H. Request for Comment*

We encourage comments with respect to any aspect of this initial regulatory flexibility analysis. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposals;
- The existence or nature of the potential impact of the proposals on small entities discussed in the analysis; and
- How to quantify the impact of the proposed rules.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the final regulatory flexibility analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

#### *I. Accredited Natural Person*

In December 2006, the Commission proposed to add a new category of accredited investor, defined as accredited natural person, under the Securities Act.<sup>194</sup> We do not believe that the additional questions regarding that proposal on which we solicit comment in this release change our Initial Regulatory Flexibility Analysis provided on that proposal. We solicit comment on that conclusion and welcome further comments on all aspects of that analysis.

<sup>193</sup> In a companion release, we are proposing this change to Form D. See Release No. 33-8814 (June 29, 2007) [72 FR 37376].

<sup>194</sup> See Private Pooled Investment Vehicle Release.

### VIII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,<sup>195</sup> a rule is “major” if it has resulted, or is likely to result in:

- An annual effect on the economy of \$100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a “major rule” for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment or innovation.

### IX. Statutory Basis and Text of Proposed Amendments

The amendments are being proposed under the authority set forth in Sections 2(a)(15), 3(b), 4(2), 4(6), 18, 19 and 28 of the Securities Act, as amended.

#### Text of Proposed Amendments

##### List of Subjects

17 CFR Part 200

Authority delegations (Government agencies).

17 CFR Part 230 and 239

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

#### PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The authority citation for part 200, Subpart A, continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

\* \* \* \* \*

2. Amend § 200.30-1 by revising paragraph (c) to read as follows:

##### § 200.30-1 Delegation of authority to Director of Division of Corporation Finance.

\* \* \* \* \*

(c) With respect to the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) and Regulation D thereunder (§ 230.501 *et*

*seq.* of this chapter), to authorize the granting of applications under Rule 502(e)(2)(ii) (§ 230.502(e)(2)(ii) of this chapter) upon the showing of good cause that it is not necessary under the circumstances that the exemption under Regulation D be denied.

\* \* \* \* \*

#### PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

3. The authority citation for part 230 continues to read in part as follows:

**Authority:** 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

4. Amend § 230.144A by adding Preliminary Note 8 to read as follows:

##### § 230.144A Private resales of securities to institutions.

\* \* \* \* \*

8. The publication of a general announcement of an offering in accordance with Rule 507 (17 CFR 230.507) would not preclude resales pursuant to Rule 144A.

\* \* \* \* \*

5. Amend § 230.146 by adding paragraph (c) to read as follows:

##### § 230.146 Rules under section 18 of the Act.

\* \* \* \* \*

(c) *Definition of Qualified Purchaser.* For purposes of Section 18(b)(3) of the Act (15 U.S.C. 77r(b)(3)), the term “qualified purchaser” shall mean any large accredited investor as defined in § 230.501(k) with respect to an offer or sale in compliance with § 230.507, but this paragraph does not prohibit a state from imposing notice filing requirements that are substantially similar to those imposed by the Commission for transactions with such investors.

6. Revise § 230.215 to read as follows:

##### § 230.215 Accredited investor.

The term *accredited investor* as used in section 2(a)(15)(ii) of the Securities Act of 1933 (15 U.S.C. 77b(a)(15)(ii)) shall include the following persons:

(a) Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act, whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under

the Investment Company Act of 1940 or business development company as defined in section 2(a)(48) of that Act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to this § 230.215); or any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such statute, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to this § 230.215) or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;

(b) Any private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

(c) Any corporation (including any non-profit corporation), Massachusetts or similar business trust, partnership, limited liability company, Indian tribe, labor union, governmental body, or other legal entity with substantially similar legal attributes, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to this § 230.215);

(d) Any director, executive officer, general partner, or managing member of the issuer of the securities being offered or sold, or any director, executive officer, general partner, or managing member of a general partner or managing member of that issuer;

(e) Any natural person whose individual net worth, or aggregate net worth with that person's spouse, at the time of purchase exceeds \$1,000,000 or whose individual investments, or joint investments with that person's spouse, at the time of purchase exceeds \$750,000 (each as adjusted for inflation in accordance with the Note to this § 230.215);

(f) Any natural person who had an individual income in excess of \$200,000

<sup>195</sup> Pub. L. 104-121, Title II, 110 Stat. 857 (1996).

in each of the two most recent years or aggregate income with that person's spouse in excess of \$300,000 in each of those years (each as adjusted for inflation in accordance with the Note to this § 230.215) and has a reasonable expectation of reaching the same income level in the current year;

(g) Any trust, with total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to this § 230.215), not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii); and

(h) Any entity in which all of the equity owners are accredited investors.

**Note to § 230.215:** The dollar amounts of the accredited investor thresholds as set forth in paragraphs (a), (c), (e), (f) and (g) of this section shall be adjusted for inflation every five years, with the first adjustments effective July 1, 2012, by appropriate publication by the Commission in the **Federal Register**. The inflation adjustments shall be computed by: Dividing the annual value of the Personal Consumption Expenditures Chain-Type Price Index (or any successor index thereto), as published by the Department of Commerce, for the calendar year preceding the calendar year in which the adjustment is being made by the annual value of such index (or successor) for the calendar year ending December 31, 2006; and multiplying the dollar amounts by the quotient obtained. The adjusted dollar amounts shall be rounded to the nearest multiple of \$10,000.

**Instruction to § 230.215:** All terms used in the definition of "accredited investor" shall have the meaning indicated in § 230.501.

7. The general authority citation for Part 230, Regulation D—Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933 is revised to read as follows:

**Regulation D—Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933**

**Authority:** Section 230.501 to 230.508 issued under 15 U.S.C. 77c, 77d, 77r, 77s, and 77z-3.

\* \* \* \* \*

**§§ 230.501 through 230.508 [Amended]**

8. Amend Preliminary Note 2 to Regulation D, consisting of §§ 230.501 through 230.508, by revising the reference to "19(c)" to read "19(d)".

9. Amend § 230.501 by:

- a. Revising paragraph (a).
- b. Redesignating paragraphs (g) and (h) as paragraphs (i) and (l).
- c. Revising the reference in newly redesignated paragraph (l)(1)(ii) that

reads "(h)(1)(i) or (h)(1)(iii)" to read "(l)(1)(i) or (l)(1)(iii)".

d. Revising the reference in newly redesignated paragraph (l)(1)(iii) that reads "(h)(1)(i) or (h)(1)(ii)" to read "(l)(1)(i) or (l)(1)(ii)".

e. Revising the reference in Note 2 to newly redesignated paragraph (l) that reads "paragraph (h)(3) and the disclosure required by paragraph (h)(4)" to read "paragraph (l)(3) and the disclosure required by paragraph (l)(4)".

f. Adding new paragraphs (g), (h), (j) and (k).

The revisions and additions read as follows:

**§ 230.501 Definitions and terms used in Regulation D.**

\* \* \* \* \*

(a) *Accredited investor*. "Accredited investor" shall mean any person who comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories, at the time of the sale of the securities to that person:

(1) Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act, whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or business development company as defined in section 2(a)(48) of that Act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to paragraph (a)); or any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such statute, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to paragraph (a)) or, if a self-directed plan,

with investment decisions made solely by persons that are accredited investors;

(2) Any private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;

(3) Any corporation (including any non-profit corporation), Massachusetts or similar business trust, partnership, limited liability company, Indian tribe, labor union, governmental body, or other legal entity with substantially similar legal attributes, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to paragraph (a));

(4) Any director, executive officer, general partner, or managing member of the issuer of the securities being offered or sold, or any director, executive officer, general partner, or managing member of a general partner or managing member of that issuer;

(5) Any natural person whose individual net worth, or aggregate net worth with that person's spouse, at the time of purchase exceeds \$1,000,000 or whose individual investments, or joint investments with that person's spouse, at the time of purchase exceeds \$750,000 (each as adjusted for inflation in accordance with the Note to paragraph (a));

(6) Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or aggregate income with that person's spouse in excess of \$300,000 in each of those years (each as adjusted for inflation in accordance with the Note to paragraph (a)) and has a reasonable expectation of reaching the same income level in the current year;

(7) Any trust, with total assets in excess of \$5,000,000 or investments in excess of \$5,000,000 (each as adjusted for inflation in accordance with the Note to paragraph (a)), not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii); and

(8) Any entity in which all of the equity owners are accredited investors.

**Note to paragraph (a):** The dollar amounts of the accredited investor thresholds as set forth in paragraphs (a)(1), (a)(3), (a)(5), (a)(6) and (a)(7) of this section and the large accredited investor thresholds as set forth in paragraphs (k)(1) through (k)(3) of this section shall be adjusted for inflation every five years, with the first adjustments effective July 1, 2012, by appropriate publication by the Commission in the **Federal Register**. The inflation adjustments shall be computed by: Dividing the annual value of the Personal

Consumption Expenditures Chain-Type Price Index (or any successor index thereto), as published by the Department of Commerce, for the calendar year preceding the calendar year in which the adjustment is being made by the annual value of such index (or successor) for the calendar year ending December 31, 2006; and multiplying the dollar amounts by the quotient obtained. The adjusted dollar amounts shall be rounded to the nearest multiple of \$10,000.

\* \* \* \* \*

(g) *Governmental body*. “Governmental body” shall mean any:

(1) Nation, state, county, town, village, district or other jurisdiction of any nature;

(2) Federal, State, local, municipal, foreign or other government;

(3) Governmental or quasi-governmental authority of any nature (including any governmental agency, branch, department, official or entity and any court or other tribunal);

(4) Multi-national organization or body; or

(5) Body exercising, or entitled to exercise, any administrative, executive, judicial, legislative, police, regulatory or taxing authority or power of any nature.

(h) *Investments*. “Investments” shall mean:

(1) Securities (as defined by section 2(a)(1) of the Act), other than securities issued by an issuer that is controlled by the prospective purchaser that owns such securities, unless such issuer is:

(i) An investment company, as defined in section 3(a) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(a)), or a company that would be an investment company under section 3(a) but for the exclusions from that definition provided by sections 3(c)(1) through 3(c)(9) of the Investment Company Act (15 U.S.C. 80a–3(c)(1) through 3(c)(9)), or the exclusions provided by § 270.3a–6 or § 270.3a–7 of this chapter, or a commodity pool;

(ii) A company that:

(A) Files reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); or

(B) Has a class of securities that are listed on a “designated offshore securities market” as such term is defined by Regulation S under the Act (§§ 230.901 through 230.904); or

(iii) A company with shareholders’ equity of not less than \$50 million (determined in accordance with generally accepted accounting principles) as reflected on the company’s most recent financial statements, provided that such financial statements present the information as of a date within 16 months preceding the date on which the prospective

purchaser acquires the offered securities;

(2) Real estate held for investment purposes;

(3) Commodity interests held for investment purposes. For purposes of this section, commodity interests means commodity futures contracts, options on commodity futures contracts, and options on physical commodities traded on or subject to the rules of:

(i) Any contract market designated for trading such transactions under the Commodity Exchange Act (7 U.S.C. 1 *et seq.*) and the rules thereunder (17 CFR 1.1 through 190.10); or

(ii) Any board of trade or exchange outside the United States, as contemplated in Part 30 of the rules under the Commodity Exchange Act (17 CFR 30.1 through 30.12);

(4) Physical commodities held for investment purposes. For purposes of this paragraph, physical commodities means any physical commodity with respect to which a commodity interest is traded on a market specified in paragraph (h)(3)(iii) of this section;

(5) To the extent not securities, financial contracts (as such term is defined in section 3(c)(2)(B)(ii) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(c)(2)(B)(ii))) entered into for investment purposes; and

(6) Cash and cash equivalents (including foreign currencies) held for investment purposes. For purposes of this section, cash and cash equivalents include:

(i) Bank deposits, certificates of deposit, bankers acceptances and similar bank instruments held for investment purposes; and

(ii) The net cash surrender value of an insurance policy.

**Note 1 to paragraph (h):** Solely for the purpose of determining “investment purposes” in this paragraph (h), real estate shall not be considered to be held for investment purposes by a prospective purchaser if it is used by the prospective purchaser, a sibling, spouse or former spouse, a direct lineal descendant by birth or adoption, or spouse of such lineal descendant or ancestor for personal purposes or as a place of business, or in connection with the conduct of the trade or business of the prospective purchaser or such related person, provided that real estate owned by a prospective purchaser who is engaged primarily in the business of investing, trading or developing real estate in connection with such business may be deemed to be held for investment purposes. Residential real estate shall not be deemed to be used for personal purposes if deductions with respect to such real estate are not disallowed by section 280A of the Internal Revenue Code (26 U.S.C. 280A).

**Note 2 to paragraph (h):** Solely for the purpose of determining “investment

purposes” in this paragraph (h), a commodity interest or physical commodity owned, or a financial contract entered into, by the prospective purchaser who is engaged primarily in the business of investing, reinvesting, or trading in commodity interests, physical commodities or financial contracts in connection with such business may be deemed to be held for investment purposes.

**Note 3 to paragraph (h):** Solely for the purpose of determining whether a prospective purchaser meets the dollar-amount investor thresholds in Regulation D, the aggregate amount of investments owned and invested on a discretionary basis shall be the investments’ fair market value on the most recent practicable date or their cost provided that in the case of commodity interests, the amount of investments shall be the value of the initial margin or option premium deposited in connection with such commodity interests. There shall be deducted from the amount of such investor’s investments the amount of any outstanding indebtedness incurred to acquire or for the purpose of acquiring the investments owned by such person.

\* \* \* \* \*

(j) *Joint investments*. “Joint investments” shall mean:

(1) In the case of a purchase binding on both spouses and where both spouses sign the investment documentation, the aggregate of their investments held individually and their investments held jointly or as community property or similar shared ownership interest; or

(2) In the case of a purchase made by an individual spouse or where only an individual spouse signs the investment documentation, the aggregate of the investments held individually by the purchaser and 50 percent of any investments held jointly with the individual’s spouse or as community property or similar shared ownership interest.

(k) *Large accredited investor*. “Large accredited investor” shall mean an accredited investor as defined in paragraph (a) of this section, except that:

(1) Any person described in paragraph (a)(1), (a)(3), or (a)(7) of this section required to have a dollar amount of assets shall instead be required to have investments in excess of \$10,000,000 (as adjusted for inflation in accordance with the Note to paragraph (a) of this section);

(2) Any person described in paragraph (a)(5) of this section shall be required to have investments, or joint investments with that person’s spouse, in excess of \$2,500,000 (as adjusted for inflation in accordance with the Note to paragraph (a) of this section);

(3) Any person described in paragraph (a)(6) of this section shall be required to



have had an individual income in excess of \$400,000 in each of the two most recent years or aggregate income with that person's spouse in excess of \$600,000 in each of those years (each as adjusted for inflation in accordance with the Note to paragraph (a) of this section) and have a reasonable expectation of reaching the same income level in the current year; and

(4) All of the equity owners of entities described in paragraph (a)(8) of this section shall be required to be large accredited investors.

\* \* \* \* \*

10. Amend § 230.502 by:

a. Revising the references that read "six months" in paragraph (a) to read "90 days" and revising the reference that reads "six month periods" in paragraph (a) to read "90-day periods".

b. Adding to the first sentence of paragraph (c) the phrase "or § 230.507(b)(2)(ii)" after the phrase "Except as provided in § 230.504(b)(1)".

c. Adding paragraph (e).

The addition reads as follows:

**§ 230.502 General conditions to be met.**

\* \* \* \* \*

(e) *Disqualification provisions.* (1) An issuer may not rely on Regulation D if the issuer, any predecessor of the issuer, any affiliated issuer, any director, executive officer, general partner, or managing member of the issuer, any beneficial owner of 20 percent or more of any class of its equity securities, or any promoter currently connected with the issuer:

(i) Within the last 5 years, has filed a registration statement that is the subject of a currently effective permanent or temporary injunction of a court or an administrative stop order or similar order entered by the Commission or the securities commission (or any agency or office performing like functions) of any state;

(ii) Within the last 10 years, has been convicted of a criminal offense in connection with the offer, purchase or sale of any security or involving the making of a false filing with the Commission;

(iii) Within the last 5 years, has been the subject of an adjudication or determination, after notice and opportunity for hearing, by a Federal or State regulator that the person violated Federal or State securities or commodities law or a law under which a business involving investments, insurance, banking, or finance is regulated; or

(iv) Is currently subject to any order, judgment or decree of any court of competent jurisdiction, entered within the last 5 years, temporarily,

preliminarily or permanently restraining or enjoining such party from engaging in or continuing to engage in any conduct or practice involving securities, commodities, investments, insurance, banking, or finance, including an order for failure to comply with § 230.503;

(v) Is currently subject to a cease and desist order, entered within the last 5 years, issued under Federal or State securities, commodities, investment, insurance, banking or finance laws; or

(vi) Is suspended or expelled from membership in, or suspended or barred from association with a member of, a national securities exchange registered under section 6 of the Exchange Act or a national securities association registered under section 15A of the Exchange Act for any act or omission to act constituting conduct inconsistent with just and equitable principles or trade.

(2) Paragraph (e)(1) of this section shall not apply if:

(i) Upon a showing of good cause and without prejudice to any other action by the Commission, the Commission determines that it is not necessary under the circumstances that the exemption be denied; or

(ii) The issuer establishes that it did not know, and in the exercise of reasonable care could not have known, that a disqualification existed under paragraph (e)(1).

**§ 230.503 [Amended]**

11. Amend § 230.503 paragraph (a) by revising the reference that reads "§ 230.504, § 230.505, or § 230.506" to read "§ 230.504, § 230.505, § 230.506, or § 230.507".

**§ 230.504 [Amended]**

12. Amend § 230.504 paragraph (b)(1) by revising the reference that reads "230.502(a), (c) and (d)" to read "230.502(a), (c), (d) and (e)".

**§ 230.505 [Amended]**

13. Amend § 230.505 by removing paragraph (b)(2)(iii).

14. Amend § 230.506 by adding a Note at the end to read as follows:

**§ 230.506 Exemption for limited offers and sales without regard to dollar amount of offering.**

\* \* \* \* \*

**Note to § 230.506:** Securities sold in compliance with § 230.506 are "covered securities" within the meaning of section 18 of the Act by reason of section 18(b)(4)(D) of the Act, which limits state regulation as provided in section 18 of the Act.

15. Revise § 230.507 to read as follows:

**§ 230.507 Exemption for limited offers and sales to large accredited investors.**

(a) *Exemption.* Offers and sales of securities that satisfy the conditions in paragraph (b) of this section by an issuer shall be exempt from the provisions of section 5 of the Act under section 28 of the Act.

(b) *Conditions to be met.*—(1) *General conditions.* To qualify for an exemption under this section, offers and sales must satisfy all the terms and conditions of §§ 230.501 and 230.502(a), (c), (d) and (e) to the extent not superseded by paragraph (b)(2)(ii) of this section.

(2) *Specific Conditions.*—(i) *Limitation on purchasers.* All purchasers are or the issuer reasonably believes that all purchasers are large accredited investors.

(ii) *Limited announcement.* Notwithstanding § 230.502(c), offers and sales of securities may qualify for exemption under this section if the issuer or a person acting on the issuer's behalf publishes in written form an announcement of a proposed offering that prominently states that sales will be made to large accredited investors only, no money or other consideration is being solicited or will be accepted through the announcement, and the securities have not been registered with or approved by the U.S. Securities and Exchange Commission and are being offered and sold pursuant to an exemption from registration, and the announcement contains no more than the following optional information:

(A) The name and address of the issuer;

(B) The name, type, number, price and aggregate amount of securities being offered and a brief description of the securities;

(C) A description of what "large accredited investor" means;

(D) Any suitability standards and minimum investment requirements for prospective purchasers in the offering;

(E) A brief description of the business of the issuer in 25 or fewer words; and

(F) The name, address and telephone number of a person to contact for additional information.

(iii) *Additional Information.* The issuer or a person acting on the issuer's behalf may provide information in addition to the announcement permitted under subparagraph (b)(2)(ii) of this section to a prospective purchaser only if the issuer reasonably believes that the prospective purchaser is a large accredited investor. Information may be delivered to prospective purchasers through an electronic database that is restricted to large accredited investors.

**Note 1 to § 230.507:** Securities sold to large accredited investors in compliance with

§ 230.507 are “covered securities” within the meaning of section 18 of the Act by reason of section 18(b)(3) of the Act and § 230.146(c), which limits state regulation as provided in section 18 of the Act.

**Note 2 to § 230.507:** A private pooled investment vehicle that would be an investment company but for the exclusion provided by § 3(c)(1) or § 3(c)(7) of the Investment Company Act may not rely on § 230.507.

**§ 230.508 [Amended]**

16. Amend § 230.508 by:  
a. Revising the references that read “§ 230.504, § 230.505 or § 230.506” in paragraph (a), (a)(3) and (b) to read “§ 230.504, § 230.505, § 230.506 or § 230.507”.

b. Revising the reference that reads “and paragraph (b)(2)(i) of § 230.506” in paragraph (a)(2) to read “, paragraph (b)(2)(i) of § 230.506 and paragraph (b)(2)(i) of § 230.507”.

**PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

17. The general authority citation for part 239 continues to read as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(d), 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

18. Amend Form D (referenced in § 239.500), by adding a check box that reads “Rule 507” between the “Rule 506” and “Section 4(6)” check boxes in the “Filing Under” information requested in the forepart of the Form.

**Note:** The text of Form D does not, and the amendments will not, appear in the Code of Federal Regulations.

Dated: August 3, 2007.

By the Commission.

**Nancy M. Morris,**  
*Secretary.*

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