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US JOBS Act: The SEC delivers proposed amendments to the restrictions on publicity in private placements.

Pursuant to the mandate set out in the Jumpstart Our Business Startups Act (the ***JOBS Act***), the SEC voted on 29 August 2012 to propose for public comment certain amendments (the ***Proposed Amendments***) to Rule 506 of Regulation D and Rule 144A under the U.S. Securities Act of 1933, as amended (the ***Securities Act***).[1] Following on from our previous briefing, *The JOBS Act – a threat to UK listings?*, it is worth examining the Proposed Amendments, particularly in relation to how they might impact non-U.S. issuers.

The comment period is set to end 30 days after the Proposed Amendments are published in the Federal Register. We will keep you apprised of further developments and of the final rules, once they are made public.

Background

Section 5 of the Securities Act prohibits the offer and sale of a security into the United States absent its registration with the SEC, unless both the offer and sale are made in a transaction that is exempt from, or not subject to, registration. Relatively few foreign private issuers (***FPIs***) attempt to register their offerings with the SEC; the preferred alternative being to utilize private placement exemptions, primarily those provided in Rule 144A or Rule 506 under the Securities Act. Each of these exemptions currently imposes a variety of restrictions designed to protect U.S. investors, including with respect to the marketing of the transaction in the United States.

Prior to the JOBS Act revisions, offers of securities to investors in the United States made in reliance on Rule 506 have been subject to a requirement that neither the seller nor anyone acting on its behalf offers or sells the securities by means of any form of "general solicitation" or "general advertising".[2] Furthermore, although Rule 144A does not expressly prohibit "general solicitation" or "general advertising", such marketing activities are effectively prohibited because "offers" to participate in a Rule 144A transaction must only be made to qualified institutional buyers (***QIBs***).

As a result, marketing activities in the United States in relation to private placements pursuant to Rule 144A and Rule 506 have typically been directed at a fairly restricted number of sophisticated investors.

[1] The full text of the Proposed Amendments, along with an SEC discussion, is available at: http://www.sec.gov/rules/proposed/2012/33-9354.pdf

[2] General advertising and general solicitation include any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio and any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.

The Proposals

Rule 506

The Proposed Amendments would create a new subsection under Rule 506, designated as 506(c), which would allow issuers to engage in general solicitation and general advertising in relation to the sale of securities, if the following conditions are met:

- each purchaser in the offering is an accredited investor (either because the purchaser falls into one of the categories set out in Rule 501(a) or, at the time of the sale, the issuer reasonably believes the purchaser qualifies as such);
- the issuer takes reasonable steps to verify that each purchaser is an accredited investor (although the SEC has declined to set out what steps would be reasonable, it has offered some detailed guidance on this requirement, which is further discussed below); and
- all other terms and conditions of Rule 501, 502(a) and 502(d) are satisfied.

The Proposed Amendments leave intact the original safe harbour provided in Rule 506 and designates it as Rule 506(b). This rule has been a frequently-used private placement exemption for UK issuers (and other FPIs). Rule 506(b) still prohibits the use of general solicitation and general advertising.

The Proposed Amendments also contain an addition to Form D, whereby the issuer will be required to notify the SEC whether the offering has been made pursuant to the new Rule 506(c). Note, however, that the Proposed Amendments do not include a requirement that reliance on Rule 506(c) or Rule 506(b) is conditional upon filing Form D.

Rule 144A

Rule 144A currently requires that all offerees are QIBs. The Proposed Amendments would remove this requirement, which would allow general solicitation and general advertising in relation to Rule 144A offerings, so long as the purchasers of the securities offered are reasonably believed by the seller to be QIBs.

New York v. London: A Battle for the IPO Market?

As discussed in our previous briefing, the JOBS Act created a new type of issuer (emerging growth companies) and proposed an "IPO on-ramp" intended to encourage initial public offerings in the United States. Although a Premier League giant may not have been the archetypal issuer contemplated by the legislation, Manchester United availed itself of the new rules and completed its initial public offering in August. The post-float performance has not been stellar; but the company's choice of New York over London appears to have worried law makers in the UK, engendering proposals to amend the UK IPO rules. It remains to be seen whether the Manchester United IPO marks the start of a trend driven by the new "IPO on-ramp" and whether this will encourage changes to the existing regime in the UK. It appears at first glance, perhaps, that greater liquidity and investor demand might be the primary driver for any increase in IPO activity by FPIs in the United States, as opposed to the new opportunities provided by the JOBS Act.

Potential Impact on Market Practice

Rule 506(c): Verification of an Investor's Status

Although Rule 506(c) would require issuers to take reasonable steps to ascertain the status of investors, the SEC did not provide specific procedures or steps which should be taken by issuers to satisfy this requirement. The SEC stated in the proposing release that it is wary of setting out specific requirements in order to maximize flexibility and to reduce potential compliance costs for issuers. The SEC did, however, set out a number of factors that should influence the type of procedures that might be employed in order to confirm an investor's status in a Rule 506(c) offering:

- the information the issuer has in relation to the nature of the purchaser and the amount of money proposed to be invested by the purchaser;
- the nature and terms of the offering, including any minimum investment amount; and
- the manner in which the purchaser became aware of the offering.

The SEC confirmed that the "reasonable belief" criterion provided in the current "accredited investor" definition will apply to Rule 506(c) offers. Therefore, as it is currently set out, an issuer would not necessarily lose the safe harbour protection provided by Rule 506(c) if a non-accredited investor invests in an offering so long as the issuer: (i) has taken reasonable steps to ascertain the investor's status, and (ii) has a reasonable belief that the purchaser is an accredited investor.

Issuers that plan to conduct in Rule 506(c) offerings (as well as investment banks or other third parties that assist or participate in such offerings) should review and, where necessary, revise the procedures by which they screen potential investors. Significantly, the Proposed Amendments do not impose the verification requirement on Rule 506(b) offers.

Although it is unclear exactly how the new Rule 506(c) will impact market practice among FPIs and investment banks, they may decide to maintain their current verification procedures and rely on Rule 506(b), particularly in relation to transactions which can be completed without general solicitation and general advertising through the banks' existing network of investor clients.

Rule 144A: Blue Sky Laws

U.S. state securities laws (***Blue Sky Laws***) apply to the offer of sale of securities to investors in the relevant state, unless the securities are "covered securities" and therefore exempted by federal securities laws. Although securities offered pursuant to Rule 506 are considered to be covered securities, this is not always the case with Rule 144A transactions. In those instances, engaging in general solicitation and general advertising may be prohibited under certain Blue Sky Laws, which could negatively impact the timing and the outcome of the offering.

Will the new rules on research change current market practice on the distribution of market research on FPIs?

The JOBS Act sets out numerous changes to the rules and regulations governing the distribution and drafting of research. We had previously questioned whether the SEC would seek to reconcile these new rules with the restrictions set out in the 2003 Global Research Settlement between the SEC and a number of global investment banks. The SEC provided its response to this question, as well as to a number of other questions raised by interested parties during the comment period, in its 22 August 2012 responses to "Frequently Asked Questions". The SEC staff has said that the JOBS Act does not amend or modify the Global Settlement. The restrictions under the Global Settlement will remain in place until such time as at least one of the banks pursues the amendment process set out in the Global Settlement, which includes seeking an amendment from the relevant court.

Implication for Global Offerings

It is often the case that FPIs will conduct "global offerings", whereby they undertake an offering outside of the United States pursuant to Regulation S, alongside a private placement of securities to investors in the United States pursuant to Rule 144A or Rule 506.

Regulation S prohibits any "directed selling efforts" in the United States by or on behalf of an issuer in relation to an offering of securities to investors outside of the United States. Directed selling efforts include any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for the securities that are being offered outside of the United States.

Although there are no statutory examples provided in relation to the term "directed selling efforts", there is significant overlap between this concept and the activities deemed to be general solicitation and general advertising. Directed selling efforts would include general and targeted marketing activities in the United States intended to raise awareness of the Regulation S offering but would not include appropriate marketing activities done in relation to the U.S. tranche of the offering.

Therefore, there have been questions as to how the Proposed Amendments might impact the marketing efforts in relation to global offerings, as the Proposed Amendments do not amend the prohibition on "directed selling efforts" set out in Regulation S. The SEC has stated that an issuer's use of general solicitation and general advertising in compliance with the rules as amended by the Proposed Amendments will not prejudice the issuer's ability to pursue a simultaneous Regulation S offering.[3]

However, marketing activities that utilize general solicitation and general advertising in the context of a global offering will almost inevitably generate broader market interest, in both the onshore Rule 506(b) or Rule 144A tranche and the offshore Regulation S tranche, from U.S. persons that are neither accredited investors nor QIBs (i.e., activity that could be

[3] The SEC's release provided the following: "In the adopting release for Regulation S, the Commission stated that '[o]ffshore transactions made in compliance with Regulation S will not be integrated with registered domestic offerings or domestic offerings that satisfy the requirements for an exemption from registration under the Securities Act.' We believe that this approach continues to apply. Consistent with the historical treatment of concurrent Regulation S and Rule 144A/Rule 506 offerings, concurrent offshore offerings that are conducted in compliance with Regulation S would not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A, as proposed to be amended."

reasonably expected to have the effect of conditioning the market in the United States for the securities offered in reliance upon Regulation S). It could reasonably be argued that the Proposed Amendments, in part, appear to be in conflict with the legislative intent of Regulation S as it pertains to the prohibition on directed selling efforts.

Impact on Section 4(a)(2) Offerings

Rule 506 has historically functioned as a non-exclusive safe harbour so that, in the event that an offering or sale does not meet the specific requirements of Rule 506, Section 4(a)(2) (previously Section 4(2)) might still be available as an exemption from registration. As the SEC expressly declined to change Section 4(a)(2)'s prohibition on general solicitation and general advertising, offerings that include general solicitation and general advertising will likely not benefit from Section 4(a)(2).

Private fund offerings

Hedge funds, venture capital funds, private equity funds and other private funds usually rely on Section 4(a)(2) and Rule 506 for their fundraisings. In addition, such funds usually rely on either Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (the ***ICA***) in order to avoid having to register as an "investment company". Sections 3(c)(1) and 3(c)(7) of the ICA are not available, however, to a private fund making a "public offer" of its securities.

The prohibition on "public offers" set out in the ICA resulted in questions regarding whether private funds would be able to use general solicitation and general advertising for fundraising, while maintaining their exemptions under the ICA. The SEC has confirmed that the use of general solicitation in compliance with the Proposed Amendments will be compatible with reliance on the Section 3(c)(1) and Section 3(c)(7) exemptions.

Conclusion

Irrespective of the content of the final rules, the U.S. antifraud provisions under Section 10b and Rule 10b-5 of the Securities Exchange Act of 1934, as amended, will still apply to any offering of securities in the United States (including any related marketing).

Furthermore, the verification requirements set out in the proposed Rule 506(c) and the potential uncertainty around how marketing activities for "global offerings" will work in practice may give issuers, particularly FPIs, and their advisers pause.

Although the Proposed Amendments create clear benefits for U.S. domestic issuers, only time will tell whether or in what manner market practice will change for foreign private issuers in cross-border fundraisings.