

SEC Issues Proposed Revisions of Limited Offering Exemptions in Regulation D

August 10, 2007

On August 3, 2007, the SEC issued a series of proposed revisions¹ to Regulation D. These proposals include changes to the definition of “accredited investor,” a new exemption from the registration requirements of the Securities Act of 1933 for offers and sales to “large accredited investors,” a new rule to restrict certain “bad actors” from relying on Regulation D, and other general changes.

The SEC has requested comments on each of the proposed rules discussed below and, in particular, has requested comment with regard to the dollar-value thresholds for each of the proposals.

Update to the Definition of “Accredited Investor”

Under its Private Pooled Investment Vehicle Release on December 27, 2006,² the SEC proposed the creation of a new “accredited natural person” standard that would apply only to the offer and sale of securities issued by private investment vehicles relying on the exclusion from the definition of “investment company” under Section 3(c)(1) of the Investment Company Act of 1940. In this Release, the SEC proposes updating the definition of “accredited investor” used in Regulation D.

Investments-Owned Standard

As an alternative to the criteria already in place to qualify as an accredited investor, the SEC is proposing an “investments-owned” standard that it believes will provide a clearer and more objective standard for assessing an investor’s need for the protections provided by registration under the Securities Act. For entities that currently must meet a \$5 million *assets* test, an alternative \$5 million in *investments* standard will be available under the proposed rules. For individuals and their spouses, a new \$750,000 in *investments* standard may be used instead of the current \$1 million in net worth or \$200,000/\$300,000 income limits currently in place. Real estate used for personal purposes (e.g., personal residences) and the value of places of business would be excluded when calculating investments.

For purposes of the investments-owned standard, only half of the investments held jointly with a spouse would count as joint investments if only one spouse signs and is to be bound by the investment documentation. All investments held jointly with a spouse would be counted toward joint investments if both spouses sign and are to be bound by the investment documentation.

Inflation Adjustments to Thresholds

Out of concern that the failure over time to adjust Regulation D income, asset, and investment thresholds has effectively lowered those thresholds from a real purchasing power perspective, the SEC proposes to adjust for inflation all dollar-amount thresholds set forth in Rule 501 of Regulation D (e.g., those in the definitions of “accredited investor” and “large accredited investor”). The proposed adjustments would be made on a going-

¹ Release No. 33-8828; IC-27922; File No. S7-18-07.

² Release No. 33-8766, IA-2576; File No. S7-25-06.

forward basis only, starting on July 1, 2012, and continuing every five years thereafter, based on 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.

New Proposed Rule 507—Limited Offers and Sales to Large Accredited Investors

Proposed Rule 507 would exempt offers and sales of securities to a new category of investors called “large accredited investors” from registration under the Securities Act. The two principal differences between Proposed Rule 507 offerings and Rule 506 offerings are that (i) limited advertising would be permitted for Proposed Rule 507 offerings, whereas no advertising is permitted for Rule 506 offerings, and (ii) Proposed Rule 507 offerings may be made only to large accredited investors, whereas Rule 506 offerings may be made to accredited investors and to a limited number of nonaccredited investors.

Hedge funds, private equity funds, and other pooled investment vehicles relying on the exclusion from the definition of “investment company” under Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940 would not be able to take advantage of the new limited advertising allowed under Proposed Rule 507. This is because the SEC is proposing Rule 507 pursuant to its general exemptive authority under Section 28 of the Securities Act, and not as an additional safe harbor under Section 4(2) of the Securities Act, which exempts private offerings from the registration requirements of the Securities Act. The exclusion from the definition of “investment company” under Sections 3(c)(1) and 3(c)(7) of the Investment Company Act does not permit a fund to sell its securities in a public offering, and the limited advertising permitted under Rule 507 would not be consistent with this restriction. Accordingly, hedge funds and private equity funds will need to continue to rely on Rule 506, which provides a safe harbor for transactions that do not constitute a public offering within the meaning of Section 4(2).

Large Accredited Investor

The proposed definition of “large accredited investor” incorporates all of the provisions of the accredited investor definition, with the following changes:

- Entities that currently must have more than \$5 million in *assets* to qualify as an accredited investor will be required to have more than \$10 million in *investments* to qualify as a large accredited investor.
- Individuals must have either \$2.5 million in investments or joint investments with a spouse, or must have had in excess of \$400,000 of individual income (or aggregate income with a spouse in excess of \$600,000) in each of the two most recent years, and a reasonable expectation of reaching that same level in the current year.
- An entity in which all of the equity owners are large accredited investors is itself a large accredited investor.

Limited Advertising

Under Proposed Rule 507, issuers may publish a written (e.g., newspaper or Internet) limited announcement of an offering. The announcement *must* state prominently that sales are to be made to large accredited investors only, that no money or other consideration is being solicited or will be accepted solely through the announcement, and that the securities are not registered and will be sold pursuant to an exemption under the Securities Act. The announcement *may* state, among other things, the name of the issuer, a brief description of the business of the issuer (limited to 25 or fewer words) and the securities, and a contact person for additional information.

In addition to the permitted announcement, the issuer (or a person acting on the issuer’s behalf) may provide additional information regarding the investment if the issuer reasonably believes the prospective purchaser is a large accredited investor. There is no similar requirement that such additional information be in written form, and thus issuers could conceivably deliver additional information to prospective purchasers by means of conference presentations or telephone communications.

Other Changes

Proposed Rule 502(e) would preclude certain “bad actors” from being able to rely on Regulation D for a period of 5 to 10 years, depending on the level of egregiousness of the conduct leading to disqualification, based on a determination by a government official, government agency, or self-regulatory organization that the “bad actor” has violated the law or engaged in other wrongdoing. The disqualification of an issuer is also imputed to 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% or more of any class of the issuer’s equity securities; and any promoter connected with the issuer. Proposed Rule 502(e) sets forth six bases for disqualification, which include, for example, (i) conviction of criminal offenses related to the offer, purchase, or sales of securities; (ii) adjudication of violation of securities, commodities, or other finance-related laws or regulations; and (iii) certain suspensions or expulsions from a national securities exchange or association.

Other items in the proposed changes to Regulation D include:

- The reduction of the six-month nonintegration safe harbor in Rule 502(a) to 90 days
- Expansion of the list of entities that may qualify as accredited investors to include limited liability companies, Indian tribes, labor unions, governmental bodies, and similar legal entities

These proposals are not integrated with the SEC’s proposed rules in the Private Pooled Investment Vehicles Release regarding investor requirements for pooled investment vehicles (e.g., hedge funds and private equity funds that rely on the Section 3(c)(1) exclusion from the definition of “investment company” under the Investment Company Act). Those proposed rules remain outstanding, though the SEC requested further comment on the definition of “accredited natural person” set forth in the Private Pooled Investment Vehicles Release and stated that it may act upon these proposed rules and the proposed rules in the Private Pooled Investment Vehicle Release at the same time.

[Read the SEC’s Proposed Rules and Request for Comment in its entirety.](#)

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