

August 12, 2015

SEC Issues Guidance on “General Solicitation or General Advertising”

On August 6, 2015, the Securities and Exchange Commission (“SEC”) issued (i) new compliance and disclosure interpretations regarding general solicitation or general advertising, and (ii) a no-action letter confirming Citizen VC, Inc.’s conclusions regarding pre-existing, substantive relationships in the context of a private offering made in reliance on Rules 502(c) and 506(b) of Regulation D under the Securities Act of 1933, as amended.¹ For the most part, the SEC did not provide new guidance, but reaffirmed and expanded upon existing guidance. The SEC raises a few points that are worth noting:

- an issuer’s publicly available website reflecting “factual business information”² (which does not, for a continuously offered fund, include a track record) does not constitute a general solicitation or general advertising;
- an issuer may rely on a pre-existing, substantive relationship formed by a registered investment adviser to the prospective investor (*e.g.*, a pension consultant), and not only by a registered broker-dealer; and
- capital introduction programs should not be considered a general solicitation if the program organizer has a pre-existing, substantive relationship with each of the invitees.

The SEC guidance elaborates on the meaning of a “pre-existing, substantive relationship” with a prospective investor in order to demonstrate the absence of a general solicitation.

- **Pre-existing relationship.** A “pre-existing” relationship is one that the issuer has formed with a prospective investor prior to the commencement of the offering or, alternatively, that was established through an intermediary (typically, a registered broker-dealer or a registered investment adviser) prior to the registered broker-dealer or registered investment adviser participating in the offering. As a general matter, the SEC clarified that there is no minimum waiting period required to establish a pre-existing, substantive relationship with a prospective investor. However, the SEC also confirmed prior no-action letter guidance that allows a prospective investor who qualifies as an accredited or financially sophisticated investor to purchase securities in private fund offerings posted on a website platform prior to the investor’s subscription to the platform, so long as the purchase was made after the end of a waiting period (generally considered to be 30 days) in view of the fact that subscriptions for interests in private funds are offered and accepted on an ongoing basis (*i.e.*, offered monthly for hedge funds, or routinely during the offering period for private equity funds).³

¹ See, <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#256.23>, <http://www.sec.gov/divisions/corpfin/guidance/safinterp.htm#130.15>, and Citizen VC, Inc., SEC No Action Letter, (August 6, 2015) available at <http://www.sec.gov/divisions/corpfin/cf-noaction/2015/citizen-vc-inc-080615-502.htm> (“Citizen VC No Act”).

² “Factual business information” includes information about the issuer, its business, financial condition, products or services, but does not include predictions, projections or opinions about the value of a security. For a continuously offered fund, “factual business information” does not include a track record.

³ Lamp Technologies, Inc., SEC No-Action Letter, (May 29, 1997) available at <https://www.sec.gov/divisions/investment/noaction/1997/lamptechnologies052997.pdf>. In this situation, a prospective investor: (i) was required to complete a questionnaire designed to allow Lamp to form a reasonable basis for determining that the prospective investor was an “accredited investor” and a “qualified eligible participant;” (ii) after being pre-qualified, received a password permitting the prospective investor access to information on specific hedge funds posted on Lamp’s website; and (iii) was not permitted to invest in any posted hedge fund for a period of 30 days following the prospective investor’s qualification.

- **Substantive relationship.** A “substantive” relationship is one in which the issuer (or its agent) has sufficient information to evaluate, and does, in fact, evaluate, a prospective investor’s financial circumstances and sophistication, in determining its status as an accredited or sophisticated investor. Self-certification alone (*i.e.*, by checking a box) is not sufficient. The quality of the relationship between an issuer (or its agent) and a prospective investor is the most important factor. There is no specific duration of time or particular short form accreditation questionnaire that can be relied upon solely to create a “substantive” relationship.

A private fund and other issuer should develop policies and procedures to establish a pre-existing, substantive relationship with a prospective investor prior to offering its interests and to make an appropriate determination of the prospective investor’s accreditation, financial sophistication, financial circumstances and ability to understand the nature and risk of the interests being offered.⁴

The SEC guidance makes it clear that a pre-existing, substantive relationship can be established indirectly and not only through registered broker-dealers or registered investment advisers. Where groups of experienced, sophisticated investors share information about private offerings through their networks, members who have a relationship with a particular issuer may introduce that issuer to other members of the network without having the shared information deemed a general solicitation. Issuers that utilize this type of referral may be able to rely on those members’ network to establish a reasonable belief that other offerees in the network have the necessary financial experience and sophistication. This guidance may provide comfort to private funds that participate in capital introduction programs, conferences organized by family office associations or similar network meetings that such events will not constitute a general solicitation.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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⁴ In the Citizen VC No Act, prospective investors initially contacted the issuer via a publicly available website. After satisfactory completion of an “accredited investor” questionnaire and a determination that a prospective investor was accredited, Citizen VC established a substantive relationship with each prospective investor pursuant to procedures designed to evaluate its sophistication, financial circumstances and ability to understand the nature and risks of the securities, including: contacting a prospective investor via email and telephone to discuss the investor’s investing experience, investment goals, financial suitability, risk awareness; utilizing credit reporting services to confirm a prospective investor’s identity and to gather additional financial and credit history information; and answering questions regarding the website and potential investments. Thereafter, a prospective investor was given access to the password protected portions of the website where it could explore investment opportunities and related offering materials. Based upon these facts and circumstances, the SEC confirmed that the issuer had developed pre-existing, substantive relationships with prospective investors prior to any securities actually being offered, and, therefore, was not engaging in a general solicitation.