

DuaneMorris

Securities Act of 1933 Fund Private Placements

David A. Sussman
Steven J. Gray
March 2016

©2014 Duane Morris LLP. All Rights Reserved. Duane Morris is a registered service mark of Duane Morris LLP.

Duane Morris – Firm and Affiliate Offices | New York | London | Singapore | Philadelphia | Chicago | Washington, D.C. | San Francisco | Silicon Valley | San Diego | Boston | Houston | Los Angeles | Hanoi | Ho Chi Minh City | Atlanta | Baltimore | Wilmington | Miami | Boca Raton | Pittsburgh | Newark | Las Vegas | Cherry Hill | Lake Tahoe | Myanmar | Oman | Mexico City | Duane Morris LLP – A Delaware limited liability partnership

www.duanemorris.com

Sales of Fund Securities

- Interests in a fund are “securities” under the Securities Act of 1933 (the “1933 Act”), and must be registered with the SEC for sale unless exempt
- Section 4(a)(2) of the 1933 Act is the statutory exemption from registration for “private placements”
- Regulation D under the 1933 Act provides a safe harbor for private placements under Section 4(a)(2)
 - Sets forth the rules for conducting a private securities offering
 - Specifies objective criteria for eligible investors and the manner of offering
- Rule 506 under Regulation sets forth two exemptions for offerings that qualify as private placements
- Fund offerings in the US are almost always conducted under Rule 506
- Offshore offerings must comply with Regulation S

Rule 506 Offerings

- Rule 506(b)
 - Private offering without general solicitation or advertising
 - No limitation on the amount of securities sold
 - Unlimited number of purchasers who qualify as “accredited investors” and up to thirty-five sophisticated non-accredited investors
 - Exclusions for counting non-accredited investors apply to certain family members, family businesses or estate planning vehicles and trustee non-contributory employee benefit plans
 - No general solicitation or advertising is permitted
 - No articles, interviews, ads or notices in any print media
 - No broadcasts over television, radio or the internet
 - No seminars or conferences open to the public
 - No mass mailings or internet blasts
 - Substantive pre-existing relationship with investors required
 - Prior business relationship or knowledge of investor’s financial condition and circumstance
 - Funds need only a reasonable belief as to whether purchasers are “accredited investors”
 - Usually established through investor questionnaires and subscription agreements

Rule 506 Offerings

- Rule 506(c)
 - Private offering with general solicitation or advertising
 - No limitation on the amount of securities sold
 - Unlimited number of purchasers who qualify as “accredited investors”
 - General solicitation and advertising is permitted
 - Any form of communication with the public is permitted
 - May maintain publicly available website for the offering
 - Funds need to verify that all purchasers are accredited investors
 - Investor representations alone are not sufficient
 - Must obtain and review documentation from prospective investors, which could include tax returns, bank statements, brokerage statements, independent asset appraisals and credit reports
 - Most fund sponsors do not conduct Rule 506(c) offerings
 - Confidentiality of offering is preferred
 - Difficulty and uncertainty surrounding accredited investor verification process

Accredited Investors

- Accredited investors include the following persons:
 - Natural persons with \$200,000 in income (or \$300,000 with a spouse) in each of the past 2 years and expected in the current year
 - Natural persons with a net worth of at least \$1,000,000
 - Cannot include the value of one's residence as an asset
 - Mortgage debt up to the fair market value of residence excluded from liabilities, except that increases in mortgage debt within 60 days of investment is included unless incurred in home purchase
 - Mortgage debt exceeding fair market value of residence must be included as a liability
 - Any director, executive officer of the issuer
 - Corporations, partnerships, 501(c)(3) organizations or business trusts with assets over \$5,000,000
 - Trusts with assets over \$5,000,000 (not formed to purchase the securities offered) if managed by a person sophisticated in investments
 - Any bank, savings institution, broker-dealer, insurance company, registered investment companies, business development company, small business investment company, or state and local government employee benefit plan with assets over \$5,000,000
 - Any employee benefit plan under ERISA where investments are (1) managed by a bank, savings institution, insurance company or registered investment adviser, (2) the plan has total assets over \$5,000,00, or (3) if a self-directed plan, investments are made by a person that is accredited
 - Any entity in which all owners are accredited

Standard Provisions

- Investors must purchase securities for their own account for investment purposes and not with a view to redistribution
- Securities purchased are “restricted securities”
 - Cannot be resold without registration or unless an exemption is available
 - Issuers must notify investors and place legends on certificates that transfers or sales are subject to restriction and limitation
- “Bad actors” are disqualified from conducting private placements under Rule 506
 - Covers persons who have committed securities law violations or securities fraud
 - Extends to the issuer and any of its directors, officers or 10% owners, and any promoter, solicitor or investment manager or any of their principals or representatives involved in the offering
 - Effective September 23, 2013; any prior bad acts must be disclosed to investors
- Form D must be filed with the SEC within 15 days of first sale in the offering
- Sales under Rule 506 pre-empts state law regulation of private placements
 - States cannot separately require registration
 - States may require a notice filing and payment of fee for sales in the state
 - Placement agents or solicitors may need to be licensed in where securities are offered

Offshore Offerings

- Regulation S is a safe harbor from registration under the Securities Act for securities offered and sold to foreign investors outside the United States
- Foreign investors need not be accredited and there are no prohibitions on general solicitation or general advertising for purposes of U.S. law
 - Laws of non-U.S. jurisdictions remain applicable
- Regulation S conditions:
 - Offer and sale must be made in an “offshore transaction”
 - Offer is not made to a person in the U.S. and at the time of the buy order the buyer is outside the U.S.
 - No “directed selling efforts” are allowed in the United States
 - No conditioning of U.S. markets for securities being offered
 - Steps must be taken to prevent U.S. persons from participating in the offshore offering
 - No advertisements in publications of general circulation in the U.S.
 - No TV, radio or internet broadcasts
 - Limited tombstone ads, limited offshore press activities and Internet postings of offering documents or roadshows with appropriate disclaimers and safeguards are permitted
 - Securities cannot be offered or sold to “U.S. persons” during a compliance period of one year following the closing of the Regulation S offering
 - U.S. persons include, among others, any natural person resident in the U.S., any company organized in the U.S., estates or trusts administered by a U.S. person, any agency or branch of a U.S. person located outside the U.S., non-discretionary accounts of a U.S. person, discretionary accounts held by U.S. companies or natural persons resident in the U.S.
- Funds can conduct simultaneous offerings under Regulation D and Regulation S

Further Information

David Sussman, Partner, Newark
dasussman@duanemorris.com
+1 (973) 424-2011

Steven J. Gray, Partner, Chicago
sjgray@duanemorris.com
+1 (312) 499-0112

DuaneMorris

Securities Act of 1933 Fund Private Placements

David A. Sussman
Steven J. Gray
March 2016

©2014 Duane Morris LLP. All Rights Reserved. Duane Morris is a registered service mark of Duane Morris LLP.

Duane Morris – Firm and Affiliate Offices | New York | London | Singapore | Philadelphia | Chicago | Washington, D.C. | San Francisco | Silicon Valley | San Diego | Boston | Houston | Los Angeles | Hanoi | Ho Chi Minh City | Atlanta | Baltimore | Wilmington | Miami | Boca Raton | Pittsburgh | Newark | Las Vegas | Cherry Hill | Lake Tahoe | Myanmar | Oman | Mexico City | Duane Morris LLP – A Delaware limited liability partnership

www.duanemorris.com