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SEC Proposes Amendments to Modernize the Regulation D Safe Harbor for Private Offerings

The U.S. Securities and Exchange Commission (SEC) recently proposed revisions to modernize Regulation D under the Securities Act of 1933.¹ Regulation D, adopted by the SEC in 1982, was implemented to assist in capital formation by clarifying existing exemptions and providing greater uniformity between federal and state securities registration exemptions. Both private and public entities rely on Regulation D to raise capital without having to spend the considerable time and money in registering securities under federal and state securities laws. The SEC believes that the proposed revisions, if implemented, would increase the number of investors qualified as accredited investors and increase the pool of capital available to companies that engage in exempt offerings relying on Regulation D. However, several of the proposals are designed to avoid perceived abuses in order to balance investor protection against the liberalizing changes.

The SEC's proposed revisions to Regulation D are summarized as follows:

1. Establish a new Rule 507, which would allow most issuers to sell their securities under Regulation D and engage in limited, tombstone-like advertising so long as they sell only to a new category of investors called "large accredited investors." This new category of investors, estimated by the SEC to cover 1.64 percent of U.S. households, would include individuals who own at least \$2.5 million in investments or have annual individual income of at least \$400,000 (or aggregate income of \$600,000 with one's spouse). The \$2.5 million in investments threshold is identical to the SEC's December 2006 proposal to enhance the qualification requirements for accredited investors who invest in private pooled investment vehicles. Under the large accredited investor definition, institutional investors would meet the criteria if they have at least \$10 million in investments. In addition, securities sold under this exemption would be "covered securities" under the Securities Act of 1933, which would preempt state securities registration requirements for these securities.

¹ For a complete copy of the proposed revisions, see SEC Release No. 33-8828 "Revisions of Limited Offering Exemptions in Regulation D." (<http://www.sec.gov/rules/proposed.shtml>)

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2. Provide an alternative way to qualify for accredited investor status in addition to the current total assets, net worth, and income standards with a new "investments-owned" threshold of \$750,000 for individuals and \$5 million for institutions.
3. Impose an adjustment for inflation on the standards to meet the accredited investor and Rule 507 large accredited investor definition, but not until July 1, 2012, and only every five years thereafter.
4. Add categories of entities to the list of accredited and large accredited investors to include limited liability companies, joint ventures, and college or university endowments.
5. Decrease the amount of time from six months to 90 days that issuers are required to wait in order to make offers and sales that will be deemed part of a separate offering under Regulation D.²
6. Provide uniform, updated "bad actor" disqualifications for all offerings under Regulation D. Currently, disqualification provisions are found only under one of three Regulation D exemptions and do not apply to Rule 506 offerings, which preempt the application of similar "bad boy" provisions in state exemptions.
7. Require securities sold under Rule 504 of Regulation D, pursuant to state law exemptions that permit general solicitation and advertising if sales are made exclusively to accredited investors, to be deemed "restricted securities." This change, which stems from a concern with "pump and dump" schemes, would require a 12-month holding period before these securities could be resold.

The SEC's proposed revisions to Regulation D as summarized above are open for public comment until October 9, 2007.

In a separate rule proposal,³ the SEC proposed to require that Form D be filed electronically with the SEC as opposed to the current paper filing. The interactive online filing system for electronic Form D filings would be acceptable from any computer with Internet access. Filers could input data, which would be tagged automatically and easily searchable by regulators and members of the public.

² Regulation D provides that successive or concurrent offerings by the same or related issuers that have certain common characteristics may be "integrated" for purposes of determining if the Regulation D exemption is available. Currently, if the offerings in question are more than six months apart, the offerings will not be deemed to be integrated.

³ SEC Release No. 33-8814, "Electronic Filing and Simplification of Form D."