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Regulatory Update

SEC Provides Updated Guidance Reducing Burden for Rule 506(c) Verification Requirement

By Chris Centrich, Yousuf Dhamee, Colin Diamond, David Elder, Patrick Hurley, Ryan Swan, Scott Gluck, Andrey Babenkov and Mary Day Royston

On March 12, 2025, the Staff of the SEC Division of Corporation Finance (the Staff) provided guidance in response to a letter requesting interpretive guidance (the No-Action Letter) to clarify the verification requirement of Rule 506(c) of Regulation D. In addition, on the same day, the Staff published two new Compliance and Disclosure Interpretations (C&DIs) related to questions surrounding the verification requirement of Rule 506(c). The Staff's guidance from the No-Action Letter and updated C&DIs will likely encourage issuers (including private investment funds) to raise capital through offerings that use general solicitation and advertising.

Background to Rule 506(c)

As part of the Jumpstart Our Business Startups Act (JOBS Act) passed in 2012, Congress directed the SEC in Section 201(a) of the act to eliminate the prohibition on general solicitation and advertising for exempt offerings under Rule 506 of Regulation D. The SEC subsequently adopted Rule 506(c) to create this safe harbor.

Rule 506(c) provides an exemption from registration for securities that are offered and sold by companies to accredited investors in a private placement. Under this rule, an issuer may broadly solicit and generally advertise such an offering that otherwise meets the relevant conditions of Regulation D so long as (1) all purchasers in the offering are accredited investors, and (2) the issuer takes reasonable steps to verify that all purchasers are indeed accredited investors.

Rule 506(c) includes a list of "non-exclusive and non-mandatory" steps an issuer might take to satisfy the verification requirement, including reviewing tax documents or bank statements, or obtaining written confirmations or representations from certain third parties (e.g., an attorney, accountant, broker or investment adviser). However, these methods are examples of "safe harbor" procedures, and the issuer is not actually required to use any of those specific steps to verify accredited investor status. In the Rule 506(c) Adopting Release published in July 2013, the Staff also stated that details about the nature of an offering, such as minimum investment amount, might also be reasonable factors to consider when verifying accredited investor status under a principles-based method of verification (a position that was subsequently reiterated in a 2020 release).

Notwithstanding these provisions, issuers have generally been reluctant to use Rule 506(c) due to the rule's additional verification requirement and the more burdensome and potentially intrusive inquiry associated with complying with certain of the enumerated means of verification. By providing a roadmap to conduct a Rule 506(c) offering without the added intrusive diligence, the No-Action Letter has the potential to expand the use of Rule 506(c) for issuers such as private fund sponsors and other serial and substantial private placement offerors.

Guidance

The No-Action Letter indicates that the Staff views reliance on certain minimum investment amounts (generally, $200,000 for natural persons or $1 million for legal entities[1]), including pursuant to a binding commitment to invest in installments, and written representations from a purchaser as sufficient to fulfill the verification requirement. As a result, an issuer following these procedures could reasonably conclude that it has taken reasonable steps to verify the accredited investor status of such purchasers in a Rule 506(c) offering (and thus comply with the Rule 506(c) verification requirement).

The written representations from the purchaser must confirm that (1) the purchaser is an accredited investor and (2) the purchaser's funding with respect to its minimum investment amount is not being financed in whole or in part by a third party.[2] The No-Action Letter provides that a purchaser would be able to make this financing representation if the purchaser obtains capital through one or more (i) credit facilities established for other purposes, (ii) preexisting financings or commitments to the purchaser that pre-date the Rule 506(c) offering and (iii) purchaser-conducted financings where the purchaser, as issuer, has satisfied the conditions of the No-Action Letter.

In conjunction with the No-Action Letter, the Staff also published two new C&DIs. C&DI Question 256.35 addresses what other methods an issuer can use that will satisfy the requirement to take reasonable steps to verify accredited investor status if the issuer does not undertake the safe-harbor steps described under Rule 506(c)(2). The Staff responds by, among other things, reiterating factors from the Adopting Release that issuers should consider when determining if their steps to verify the prospective accredited investor's status were "reasonable," stating that "[a]mong the factors that issuers should consider under this facts and circumstances analysis are:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount."

C&DI Question 256.36 addresses whether the terms of a Rule 506(c) offering, in particular a high minimum investment requirement, would be enough to satisfy the verification requirement where the issuer (i) has no actual knowledge that any purchaser is not an accredited investor and (ii) has confirmed with each purchaser that its investment is not being financed, in whole or in part, by a third party. The Staff responds by citing among other things the No-Action Letter as well as language from the Adopting Release, which states that if a purchaser is able to meet a high investment amount requirement, "the likelihood of that purchaser satisfying the definition of an accredited investor may be sufficiently high such that, absent any facts that indicate that the purchaser is not an accredited investor, it may be reasonable for the issuer to take fewer steps to verify or, in certain cases, no additional steps to verify accredited investor status other than to confirm that the purchaser's cash investment is not being financed by a third party."

Conclusion

The No-Action Letter offers a method for issuers to conduct private placements under Rule 506(c) in a manner that is more efficient for investors and less invasive for purchasers, and the new guidance will likely encourage more issuers to take advantage of the safe harbor provided by Rule 506(c). For example, the streamlined verification process may appeal to private fund sponsors who believe more widespread marketing and publicity efforts will be beneficial to their fundraising process for one reason or another. Despite the welcome guidance, reliance on Rule 506(c) should still be carefully considered by potential issuers in a holistic manner that takes into account competing interests (e.g., other business considerations, ongoing offerings and other jurisdictional requirements and the effect of any minimum commitment amounts on targeted distribution channels).

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Chicago

Ryan Swan
+1-312-499-6080
ryanswan@paulhastings.com

Houston

Chris Centrich
+1-713-860-7309
chriscentrich@paulhastings.com

Patrick J. Hurley
+1-713-860-7328
patrickhurley@paulhastings.com

Los Angeles

Yousuf I. Dhamee
+1-213-683-6179
yousufdhamee@paulhastings.com

Arthur L. Zwickel
+1-213-683-6161
artzwickel@paulhastings.com

New York

Colin J. Diamond
+1-212-318-6007
colindiamond@paulhastings.com

Anna Rips
+1-212-318-6037
annarips@paulhastings.com

Max J. Rosenberg
+1-212-318-6229
maxrosenberg@paulhastings.com

Joshua H. Sternoff
+1-212-318-6011
joshsternoff@paulhastings.com

Scott Gluck
+1-212-318-6610
scottgluck@paulhastings.com

San Francisco

David A. Hearth
+1-415-856-7007
davidhearth@paulhastings.com

Kenneth P. Herzinger
+1-415-856-7040
kennethherzinger@paulhastings.com

Washington, D.C.

Brad Bondi
+1-202-551-1701 / +1-212-318-6601
bradbondi@paulhastings.com

[1] For legal entities that are accredited by virtue of having only accredited investors as equity owners, the minimum investment amount is $1 million or $200,000 for each equity owner if all of the purchaser's equity owners are fewer than five natural persons.

[2] For legal entities that are accredited by virtue of having only accredited investors as equity owners, the representations must also include a representation that each of the purchaser's equity owners has a minimum obligation to the purchaser, including pursuant to a binding commitment to invest in installments, of at least $200,000 for natural persons and $1 million for legal entities. Furthermore, the no financing representation in this circumstance must also include a representation to the effect that the equity owners' minimum amounts are not so financed.