

FACT SHEET

Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings

SEC Open Meeting

July 10, 2013

Background

Current Offering Process

Companies seeking to raise capital through the sale of securities must either register the securities offering with the SEC or rely on an exemption from registration. Rule 506 of Regulation D is the most widely-used exemption from registration.

Issuers relying on the Rule 506 exemption are prohibited from engaging in a general solicitation or general advertising - that is, advertising in newspapers or on the Internet among other things - in connection with securities offerings.

Dodd-Frank Act and JOBS Act

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 926 of the Dodd-Frank Act requires the SEC to adopt rules that would prohibit the use of the Rule 506 exemption for any securities offering in which certain felons and other bad actors are involved. This section also requires the new rules to be "substantially similar" to the bad actor disqualification provisions of Regulation A, another exemption from registration for certain small offerings.

After the passage of the Dodd-Frank Act, Congress passed the Jumpstart Our Business Startups Act (JOBS Act) in April 2012. Section 201(a)(1) of the JOBS Act directs the SEC to remove the prohibition on general solicitation or general advertising for securities offerings relying on Rule 506 provided that sales are limited to accredited investors and an issuer takes reasonable steps to verify that all purchasers of the securities are accredited. The Commission also will consider rules to implement this provision today.

Final Rule

Under the final disqualification rule approved today, an issuer cannot rely on the Rule 506 exemption if the issuer or any other person covered by the rule had a ";disqualifying event."

Covered Persons

The final disqualification rule covers the issuer, including its predecessors and affiliated issuers, as well as:

- Directors and certain officers, general partners, and managing members of the issuer.
- 20 percent beneficial owners of the issuer.
- Promoters.
- Investment managers and principals of pooled investment funds.

Persons compensated for soliciting investors as well as the general partners, directors, officers, and managing members of any compensated solicitor.

Disqualifying Events

Under the final rule, a "disqualifying event" includes:

Criminal convictions in connection with the purchase or sale of a security, making of a false filing with the SEC or arising out of the conduct of certain types of financial intermediaries. The criminal conviction must have occurred within 10 years of the proposed sale of securities (or five years in the case of the issuer and its predecessors and affiliated issuers).

Court injunctions and restraining orders in connection with the purchase or sale of a security, making of a false filing with the SEC, or arising out of the conduct of certain types of financial intermediaries. The injunction or restraining order must have occurred within five years of the proposed sale of securities.

Final orders from the Commodity Futures Trading Commission, federal banking agencies, the National Credit Union Administration, or state regulators of securities, insurance, banking, savings associations, or credit unions that ...

Bar the issuer from associating with a regulated entity, engaging in the business of securities, insurance or banking, or engaging in savings association or credit union activities, or...

Are based on fraudulent, manipulative, or deceptive conduct and are issued within 10 years of the proposed sale of securities.

Certain SEC disciplinary orders relating to brokers, dealers, municipal securities dealers, investment companies, and investment advisers and their associated persons.

SEC cease-and-desist orders related to violations of certain anti-fraud provisions and registration requirements of the federal securities laws.

SEC stop orders and orders suspending the Regulation A exemption issued within five years of the proposed sale of securities.

Suspension or expulsion from membership in a self-regulatory organization (SRO) or from association with an SRO member.

U.S. Postal Service false representation orders issued within five years before the proposed sale of securities.

Reasonable Care Exception

The final rule provides an exception from disqualification when the issuer can show it did not know and, in the exercise of reasonable care, could not have known that a covered person with a disqualifying event participated in the offering.

Disclosure of Pre-Existing Disqualifying Events

Disqualification applies only for disqualifying events that occur after the effective date of this rule. But matters that existed before the effective date of the rule and would otherwise be disqualifying are subject to a mandatory disclosure requirement to investors.

What's Next

The rule amendments will become effective in 60 days after publication in the Federal Register.