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VIA E-MAIL

To Our Investment Adviser Clients and Other Friends

Re: SEC Proposes Amendments to Regulation D to Permit General Solicitation in Rule 506 Offerings

Summary. On August 29, 2012, the Securities and Exchange Commission (the "SEC") proposed amendments to Rule 506 of Regulation D under the Securities Act of 1933 (the "Securities Act"), as required by the Jumpstart Our Business Startups Act enacted earlier this year (the "JOBS Act"). The proposed amendments would permit an issuer to engage in general solicitation and advertising in connection with an offering of securities under Rule 506 of Regulation D, if all of the purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify their accreditation.[1] If the amendments are adopted as proposed, they may affect the manner in which issuers, including hedge funds and other private investment funds, solicit investors.

Current Rule 506 Safe Harbor. When hedge funds, venture capital funds, private equity funds and other private investment funds (collectively, "Funds") issue interests to investors, they are offering securities that are subject to the registration requirements of the Securities Act. Most Funds rely on an exemption from registering their securities provided by section 4(a)(2) of the Securities Act and Rule 506 of Regulation D thereunder. Section 4(a)(2) exempts securities issued in a transaction by an issuer that does not involve a public offering, and Rule 506 provides a safe harbor for issuers seeking to rely on this exemption.

Under Rule 506(b), an issuer, such as a Fund, may offer its securities to an unlimited number of accredited investors and up to thirty-five non-accredited investors who meet certain sophistication requirements. The issuer may not, however, offer or sell such securities by any general solicitation or general advertising. Among other things, this limitation generally precludes issuers from soliciting investors through advertisements in

[1] The SEC has also proposed similar amendments to Rule 144A under the Securities Act, which provides a safe harbor for re-sales of certain securities to qualified institutional buyers. We do not address the amendments to Rule 144A because few Funds rely on Rule 144A to offer their securities.

newspapers or magazines, on television or radio or in other media or through websites that are accessible by the public.

The proposed Rule 506 amendments do not alter the existing Rule 506(b) safe harbor. Funds that choose not to engage in general solicitation or advertising may continue to rely on Rule 506(b).

Proposed New Rule 506 Safe Harbor. The SEC proposes to amend Rule 506 to add a new sub-section (c), permitting an issuer to use general solicitation and general advertising to offer and sell its securities, if:

- all of the purchasers are accredited investors; and
- the issuer takes reasonable steps to verify that the purchasers are accredited investors.

Accredited Investors. Unlike the existing Rule 506(b) safe harbor, the proposed new safe harbor would limit sales by an issuer using general solicitation or advertising to accredited investors only. Accordingly, each investor in a Fund relying on the new exemption must belong to one of the categories enumerated in the definition of "accredited investor" in Rule 501(a) of Regulation D, or the Fund must reasonably believe that the investor belongs in one of those categories.

Some Fund managers have allowed non-accredited investors (such as employees and family members) to invest in their Funds. Under the proposed amendments, a Fund manager may not permit any non-accredited investors to invest in a Fund if it engages in general solicitation or advertising for that Fund. The SEC did not address the extent to which a Fund may rely on the new safe harbor if it has already admitted non-accredited investors and continues to offer its securities, but it might do so before adopting the proposed amendments.

Verification Requirement. To rely on the new exemption, a Fund must take reasonable steps to verify that its investors are accredited investors. The SEC has so far declined to specify what procedures would be deemed reasonable. Instead, the SEC has stated that whether an issuer has taken reasonable steps would depend on the particular facts and circumstances of each transaction, including:

1. The nature of the investor and the type of accredited investor that it claims to be: For example, a Fund could verify that an investor is accredited because it is a registered broker by checking the BrokerCheck website maintained by Financial Industry Regulatory Authority, Inc. To verify that an individual is accredited, the Fund may need to obtain information concerning his or her net worth or income.

2. The amount and type of information that the Fund has about the investor: The more information that a Fund has about an investor, the fewer steps it may need to take to verify the investor's accredited status. A Fund could review publicly available information about an investor (such as filings with government agencies), information from third parties that provides reasonably reliable evidence of the investor's status (such as an

individual's Form W-2) or verification of an investor's accredited status by a third party (such as a brokerage firm, accountant or attorney), so long as the Fund has a reasonable basis for relying on the third party.

3. The nature of the offering, such as the manner in which the investor was solicited to participate in the offering, and the terms of the offering, such as the minimum investment amount: For example, a Fund that offers its securities on a publicly accessible website likely would need to take greater steps to verify that investors are accredited than a Fund that solicits persons on a list of accredited investors that have been pre-screened by a brokerage firm. The SEC noted that it does not believe that an issuer soliciting investments through a public website would have taken reasonable steps if it only requires an investor to check a box in a questionnaire or sign a form, absent other information indicating that the investor is accredited. Similarly, the terms of the offering may be relevant to determining what steps a Fund must take to verify an investor's status. If a high minimum investment is required, the Fund may not need to take any steps to verify the investor's accredited status other than to confirm that the investment is not being financed by a third party.

Coordination with Other Laws. The proposed amendments also would affect several other exemptions and exclusions from federal laws on which Funds typically rely.

Investment Company Act Exclusions. Funds generally rely on the exclusions from the definition of investment company provided by sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 to avoid registering as investment companies. Those exclusions require, among other things, that the Fund not make or propose to make a public offering of securities. A Fund that complies with Rule 506 generally is deemed not to be making a public offering of securities for purposes of these exclusions. The SEC has stated that a Fund may make a general solicitation in compliance with amended Rule 506 without losing these exclusions.

Regulation S for Offshore Offerings. Offshore Funds offer their securities to non-U.S. investors without registering them under the Securities Act, in reliance on Regulation S. Regulation S provides a safe harbor for offers and sales of securities outside the U.S. and, among other things, prohibits directed selling efforts in the United States. Offerings made in compliance with Regulation S generally are not integrated with U.S. offerings that are exempt from registration under the Securities Act, and therefore Funds are able to make offshore offerings outside the U.S. in compliance with Regulation S concurrently with non-public offerings within the U.S. in compliance with Rule 506. The SEC has stated that an offshore offering that complies with Regulation S would not be integrated with a concurrent U.S. offering that complies with amended Rule 506.

Commodity Exchange Act Exemptions. An investment adviser to a Fund that trades in commodities, futures, swaps and similar instruments may be required to register as a commodity pool operator or commodity trading adviser under the Commodity Exchange Act (the "CEA"). Pursuant to Rules 4.13(a)(3) and 4.14(a)(5) under the CEA, a Fund manager may be exempt from registration as a commodity pool operator or commodity trading adviser with respect to a Fund that offers and sells interests without marketing to the public in the U.S. and complies with other requirements. An offering that qualifies under Rule 506 generally is not considered a public offering for purposes of this requirement The

Commodity Futures Trading Commission has not provided any guidance whether a Fund that engages in general solicitation or advertising in compliance with the amendment will be deemed to be marketing its interests to the public.

In addition, Fund managers that register as commodity pool operators often rely on an exemption from CEA reporting and disclosure requirements provided by Rule 4.7 under the CEA. The exemption is only available with respect to Funds that offer and sell interests only to qualified eligible persons in an offering that is exempt from the registration requirements of the Securities Act pursuant to section 4(a)(2) of that Act. The requirement that a Fund offer interests only to qualified eligible persons may preclude general solicitation by a Fund, because a general solicitation may include offers to persons who are not qualified eligible persons. As with Rules 4.13(a)(3) and 4.14(a)(5), the Commodity Futures Trading Commission has not issued any guidance whether a Fund may rely on Rule 4.7 if it engages in general solicitation or advertising in compliance with the amendment.

Investment Advisers Act and Similar State Laws. Investment advisers to Funds with over $150 million in assets generally are required to register as investment advisers with the SEC. A foreign investment adviser to a Fund that has fewer than fifteen U.S. investors and less than $25,000,000 in assets from U.S. investors is not, however, required to register as an investment adviser, so long as it does not hold itself out generally to the public in the U.S. as an investment adviser. The SEC has not indicated whether a foreign investment adviser to a Fund that engages in general solicitation or advertising after the SEC adopts the amendment to Rule 506 would be deemed to be holding itself out to the public.

A Fund manager that is exempt from registering as an investment adviser with the SEC may be subject to registration requirements in one or more states. Many state investment adviser laws exempt from registration investment advisers that do not hold themselves out to the public and have a limited number of clients. It is unclear how state securities administrators will apply those requirements to Fund managers that engage in general solicitation or advertising after the SEC adopts the amendment to Rule 506.

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This letter only generally summarizes the proposed amendments to Rule 506. The amendments may not be adopted as proposed, and we do not know when they will be adopted. This letter is not intended as specific or complete advice and is subject to change if the SEC modifies the proposed amendments. If you need assistance in determining the effects of these developments on your business, or preparing to comply with them, please contact Doug Hammer, John Broadhurst, Geoff Haynes, Chris Rupright, Carolyn Reiser, Neil Koren, Jim Frolik, Joan Grant, Ellyn Roberts, Anthony Caldwell, Christina Hamilton or Charles Clinger.

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