

## SEC Issues New CD+Is Regarding Rule 506 “Bad Actor” Disqualifications

Earlier this week, the SEC’s Division of Corporation Finance updated its Compliance and Disclosure Interpretations to add 14 new interpretations regarding the application of the “bad actor” disqualifications from Rule 506 private placements. These CD+Is clarify the final rules approved by the SEC disqualifying securities offerings from relying on the safe harbor from registration provided by Rule 506 of Regulation D if felons or other specified “bad actors” are involved in the offering.

The rules set forth disqualifying events for issuers and specified covered persons, subject to exception if an issuer establishes that it did not know, and could not have known, that a disqualification existed after conducting a reasonable factual inquiry. [Access the new interpretations](#) (Questions 260.14 – 27).

The new CD+Is are summarized below:

- Issuers must determine if they are subject to bad actor disqualification any time they are offering or selling securities in reliance on Rule 506. An issuer may reasonably rely on a covered person’s agreement to provide notice of a potential or actual bad actor triggering event, however, if an offering is continuous, delayed or long-lived, the issuer must update its factual inquiry periodically.
- If a placement agent or one of its covered control persons becomes subject to a disqualifying event while an offering is still ongoing, the issuer may rely on Rule 506 for future sales in that offering if the engagement with the placement agent was terminated and the placement agent did not receive compensation for the future sales. If the triggering disqualifying event affected only the covered control persons of the placement agent, however, the issuer could continue to rely on Rule 506 for that offering if such persons were terminated or no longer performed roles with respect to the placement agent that would cause them to be covered persons for purposes of Rule 506(d).
- Under Rule 506(d), an “affiliated issuer” of the issuer is an affiliate (as defined in Rule 501(b) of Regulation D) of the issuer that is issuing securities in the same offering, including offerings subject to integration pursuant to Rule 502(a) of Regulation D.
- All persons who have been or will be paid, directly or indirectly, remuneration for solicitation of purchasers are covered by Rule 506(d), regardless of whether they are, or are required to be, registered under Exchange Act Section 15(a)(1) or are associated persons of registered broker-dealers. The disclosure required in Item 12 of Form D expressly contemplates that compensated solicitors may not appear in FINRA’s Central Registration Depository (CRD) of brokers and brokerage firms.
- The term “participating” does not include persons whose sole involvement with a Rule 506 offering is as members of a compensated solicitor’s deal or transaction committee responsible for approving such compensated solicitor’s participation in the offering.
- Participation in a Rule 506 offering is not limited to solicitation of investors, but also includes involvement in due diligence activities or the preparation of offering materials (including analyst reports used to solicit investors), providing structuring or other advice to the issuer in connection with

the offering and communicating with the issuer, prospective investors or other offering participants about the offering (such activities must be more than transitory or incidental activities, such as opening brokerage accounts, wiring funds and bookkeeping activities).

- Disqualification under Rule 506(d) is not triggered by actions taken in jurisdictions other than the United States.
- Disqualification under Rule 506(d)(1)(v) is triggered only by orders to cease and desist from violations of scienter-based provisions of the federal securities laws, including scienter-based rules. An order to cease and desist from violations of a non-scienter based rule would not trigger disqualification, even if the rule is promulgated under a scienter-based provision of law.
- If an order issued by a court or regulator provides that disqualification from Rule 506 should not arise as a result of the order, it is not necessary to seek a waiver from the SEC or to take any other action to confirm that bad actor disqualification will not apply as a result of the order.
- The reasonable care exception applies whenever the issuer can establish that it did not know and, despite the exercise of reasonable care, could not have known that a disqualification existed under Rule 506(d)(1). This may occur when, despite the exercise of reasonable care, the issuer was unable to determine the existence of a disqualifying event, that a particular person was a covered person, or initially reasonably determined that the person was not a covered person but subsequently learned that determination was incorrect. Upon discovery of Rule 506(d) disqualifying events and covered persons during an ongoing Rule 506 offering, an issuer may need to seek waivers of disqualification, terminate the relationship with covered persons, provide Rule 506(e) disclosure, or take other remedial steps to address the Rule 506(d) disqualification.
- There is no procedure for issuers to seek a waiver of the obligation to disclose past events that would have been disqualifying, except that they occurred before September 23, 2013 (the effective date of Rule 506(d)).
- Rule 506(e) requires only disclosure of events that would have triggered disqualification at the time of the offering had Rule 506(d) been applicable.
- Issuers are required to provide all investors with the Rule 506(e) disclosure for all compensated solicitors who are involved with the offering at the time of sale and their covered control persons.
- A reasonable time prior to the sale of securities in reliance on Rule 506, the issuer must provide the required disclosure with respect to all compensated solicitors that are involved at the time of sale. Disclosure with respect to compensated solicitors who are no longer involved with the offering need not be provided under Rule 506(e).

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