

July 8, 2014

Securities Alert

SEC Division of Corporation Finance Issues Compliance and Disclosure Interpretations

On July 3, 2014, the SEC's Division of Corporation Finance issued six new **Compliance and Disclosure Interpretations** (CDIs) regarding the accredited investor verification process under Regulation D. The new CDIs are summarized below.

- If a prospective purchaser's annual income is not reported in US dollars, an issuer may use either the exchange rate in effect on the last day of the year for which income is being determined or the average exchange rate for that year to determine whether the income of such purchaser meets the accredited investor income test.
- Assets in an account or property held jointly with another person who is not the prospective purchaser's spouse may be included in determining whether such purchaser satisfies the net-worth test in Rule 501(a)(5), but only to the extent of his or her percentage ownership of the account or property.
- Under the non-exclusive verification safe harbor set forth in Rule 506(c)(2)(ii)(A), an issuer can verify that a prospective purchaser is an accredited investor by, among other things, reviewing any IRS form that reports such purchaser's income for the two most recent years. If such an IRS form is not yet available for the recently completed year, an issuer may not rely on this verification method by reviewing the IRS forms for the two prior years that are available. Nonetheless, such issuer could still reasonably conclude that such purchaser is an accredited investor and satisfy the verification requirement of Rule 506(c) under the principles-based verification method by: (a) reviewing the IRS forms that report income for the two years preceding the recently completed year; and (b) obtaining written representations from such purchaser that: (i) the relevant form for the recently completed year is not available; (ii) specify such purchaser's income for the recently completed year, and

that such amount reaches the requisite income; and (iii) such purchaser has a reasonable expectation of reaching the requisite income level for the current year. The relevant CDI notes that if the issuer has reason to question the prospective purchaser's claim to be an accredited investor after reviewing these documents, it must take additional verification measures in order to establish that it has taken reasonable steps to verify that such purchaser is an accredited investor (for example, if based on this review, such purchaser's income for the most recently completed year barely exceeded the threshold required, the foregoing procedures might not constitute sufficient verification, and more diligence might be necessary).

- An issuer may not rely on the non-exclusive verification safe harbor provided in Rule 506(c)(2)(ii)(A) for a prospective purchaser that is not a US taxpayer and cannot provide an IRS form that reports income. However, an issuer could reasonably conclude that such a purchaser is an accredited investor and satisfy the verification requirement of Rule 506(c) under the principles-based verification method by reviewing such purchaser's filed tax forms that report income if the relevant foreign jurisdiction imposes penalties for falsely reporting information on such forms comparable to those applicable to falsely reporting information on IRS forms. As above, the relevant CDI notes that where the issuer has reason to question the reliability of the information after reviewing these documents, it must take additional verification measures in order to establish that it has taken reasonable steps to verify that such purchaser is an accredited investor.
- The non-exclusive verification safe harbor set forth in Rule 506(c)(2)(ii)(B) permits an issuer to verify that a prospective purchaser is an accredited investor on the basis of net worth by reviewing certain documentation of the purchaser's assets and liabilities dated within the prior three months, including tax assessments. Recognizing that tax assessments are often prepared annually, the relevant CDI states that although an issuer cannot rely on this safe harbor using a tax assessment that is more than three months old, it could reasonably rely on such a tax assessment to conclude that a prospective purchaser is an accredited investor under the principles-based verification method. As an example, if the most recent tax assessment is more than three months old and shows property with a value that, after deducting the prospective purchaser's liabilities, results in a net worth substantially in excess of \$1 million, it may be sufficient to support a principles-based verification that such purchaser has met the net-worth test. If, however, the issuer has reason to question whether the assessment reasonably reflects the value of such purchaser's assets, it must take additional verification measures in order to establish that it has taken reasonable steps to verify that such purchaser is an accredited investor. Notably, the CDI does not address whether it would be reasonable to make a principles-based determination based on other documentation of a type set forth in the "safe harbor" list that is more than three months old, such as bank and brokerage statements, which are typically issued monthly.
- In determining a prospective purchaser's liabilities for purposes of the non-exclusive verification safe harbor set forth in Rule 506(c)(2)(ii)(B), an issuer must review a consumer

report from at least one of the “nationwide consumer reporting agencies.” Under the relevant CDI, although a consumer report from a non-US consumer reporting agency is not sufficient for purposes of that safe harbor, an issuer could reasonably conclude that such purchaser is an accredited investor and satisfy the verification requirement of Rule 506(c) under the principles-based verification method by reviewing such a report and taking any other steps necessary to determine such purchaser’s liabilities (including a written representation from such purchaser that all liabilities have been disclosed) in determining whether such purchaser has the requisite net worth. If the issuer has reason to question the extent of the prospective purchaser’s liabilities after reviewing these documents, it must take additional verification measures in order to establish that it has taken reasonable steps to verify that such purchaser is an accredited investor.

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