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Recent SEC Corp/Fin Interpretations of Interest

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Relevance of SEC Staff's Rule 506(c) Minimum Investment Amount Guidance

In new Compliance and Disclosure Interpretations (see CDIs 256.35 and 256.36) and a related no-action letter (Latham & Watkins LLP, March 12, 2025), the staff of the Securities and Exchange Commission's Division of Corporation Finance provided guidance on meeting the requirement under the Rule 506(c) safe harbor exemption from registration under the Securities Act of 1933 that an issuer take reasonable steps to verify the accredited investor status of purchasers. The guidance confirms that what are reasonable verification steps is a facts and circumstances determination and specifically that a high minimum investment amount (generally $200,000 for individuals and $1 million for entities), coupled with certain representations from the purchaser, is a relevant factor and could itself be sufficient.[1] The representations include that the investment was not financed in whole or in part by a third party for the specific purpose of making the particular investment. The issuer also cannot have actual knowledge indicating that a purchaser is not an accredited investor or that the representation regarding the absence of financing is incorrect. Rule 506(c) permits use of general solicitation to find investors if purchasers are limited to accredited investors, but it has had relatively limited use, in part because of the perceived burden on issuers and intrusiveness to investors from the verification requirement. The new guidance may eliminate this concern in cases where a high minimum investment is applicable.

The SEC staff's guidance focuses on the reasonable verification steps requirement of Rule 506(c), but it could have broader application. For example, Rule 506(b) permits an unlimited number of accredited investors to be purchasers without a disclosure requirement for those investors based upon an issuer's reasonable belief that an investor is accredited. If an issuer would satisfy the Rule 506(c) reasonable verification steps test, it likely would meet the reasonable belief standard. Outside of the Rule 506(b) and (c) exemptive safe harbors, a high minimum amount investment or, in the case of debt securities, high minimum denominations has generally been considered a relevant factor in assessing the availability of the statutory 4(a)(2) private offering exemption and the so-called 4(1 ½) private resale exemption as part of an overall assessment of an investor's sophistication and ability to bear the risk of the investment. The use of this factor in being satisfied that these exemptions are available can now find further support by analogy to the SEC staff's Rule 506(c) guidance.

Another place where the SEC staff's guidance may have relevance is in the private offering exemption from the official statement disclosure requirements for underwriters of municipal securities in Rule 15c2-12 under the Securities Exchange Act of 1934. Under 15c2-12(d)(1), primary offerings of municipal securities with $100,000 minimum denominations are exempt from the rule's disclosure requirements if the securities are sold to no more than 35 persons who the underwriter reasonably believes satisfy the sophistication test. Minimum denominations above the $100,000 amount might be a relevant factor in satisfying the reasonable belief of sophistication test.

The new SEC staff guidance is directly helpful for using the Rule 506(c) exemption, but it may also be helpful in other contexts that involve the status of investors.

Lock-Up Agreements in Rule 145 Mergers

Many years ago, a small group involved in the ABA Federal Regulation of Securities Committee met with the SEC staff to discuss issues raised by the traditional practice of an acquiring company obtaining lock-up agreements with voting commitments from key stockholders of a target company to be acquired in a merger transaction requiring registration. The concern prompting the discussion was the staff's position that offers of the securities had begun privately and therefore could not be completed as a registered public offering. An understanding was reached that these agreements were permissible and the securities to be issued in the transaction could be registered so long as there was no actual vote of the shares (which would be considered a "sale" before the registration statement was effective) and that other stockholders would be voting on the transaction. The understanding was first identified at securities law programs and in our outline on the integration of private and public offerings.

The understanding was first addressed by the SEC in the Division of Corporation Finance Outline of Current Issues and Rulemaking Projects at VIII.A.8 (third paragraph) and, after proposed rulemaking that was not adopted, in CDI 239.13. The understanding is now reflected in a recently issued revision of that CDI that allow the key stockholders to deliver written consents in favor of approving the transaction before the registration statement is filed, so long as they don't represent 100% of the voting shares, the offering to them is made pursuant to a valid exemption, which likely would result in their receiving restricted securities, and the registered securities will be given only to stockholders who did not deliver written consents and who were delivered a prospectus.

The new interpretation provides parties to a merger transaction with the flexibility to choose to limit the commitments of key stockholders to an agreement to vote in favor of the transaction and have all the securities to be issued registered or to obtain the actual votes of the key stockholders to enhance the assurance that there will be a completed transaction based upon issuing unregistered securities to those key stockholders whose shares are voted while issuing registered securities to the other stockholders.

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[1] This harkens back to an earlier day when Regulation D was first adopted in 1982 and a minimum $150,000 investment alone, so long as it did not exceed 20% of a purchaser's net worth, was sufficient to qualify a purchaser as an accredited investor. That measure could be subject to abuse and was repealed and is now a factor to consider as part of the reasonable verification steps determination.

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