

# **July 3, 2014 Updates to Securities Act Rules Compliance and Disclosure Interpretations ("C&DIs")**

## **Natural Person Accredited Investor Definition**

**and**

## **Rule 506(c) Accredited Investor Verification**

### **Securities Act Rules (UPDATED 07/03/2014)**

#### **Section 255. Rule 501 - Definitions and Terms Used in Regulation D**

##### **Question 255.48**

Question: If a purchaser's annual income is not reported in U.S. dollars, what exchange rate should an issuer use to determine whether the purchaser's income meets the income test for qualifying as an accredited investor?

Answer: The issuer may use either the exchange rate that is in effect on the last day of the year for which income is being determined or the average exchange rate for that year. [July 3, 2014]

##### **Question 255.49**

Question: Can assets in an account or property held jointly with another person who is not the purchaser's spouse be included in determining whether the purchaser satisfies the net worth test in Rule 501(a)(5)?

Answer: Yes, assets in an account or property held jointly with a person who is not the purchaser's spouse may be included in the calculation for the net worth test, but only to the extent of his or her percentage ownership of the account or property. [July 3, 2014]

#### **Section 260. Rule 506 - Exemption for Limited Offers and Sales Without Regard to Dollar Amount of Offering**

##### **Question 260.35**

Question: Rule 506(c)(2)(ii)(A) sets forth a non-exclusive method of verifying that a purchaser is an accredited investor by, among other things, reviewing any Internal Revenue Service form that reports the purchaser's income for the "two most recent years." If such an Internal Revenue Service form is not

yet available for the recently completed year (e.g., 2013), can the issuer still rely on this verification method by reviewing the Internal Revenue Service forms for the two prior years that are available (e.g., 2012 and 2011)?

Answer: No, the verification safe harbor provided in Rule 506(c)(2)(ii)(A) would not be available under these circumstances. We believe, however, that an issuer could reasonably conclude that a purchaser is an accredited investor and satisfy the verification requirement of Rule 506(c) under the principles-based verification method by:

- reviewing the Internal Revenue Service forms that report income for the two years preceding the recently completed year; and
- obtaining written representations from the purchaser that (i) an Internal Revenue Service form that reports the purchaser's income for the recently completed year is not available, (ii) specify the amount of income the purchaser received for the recently completed year and that such amount reached the level needed to qualify as an accredited investor, and (iii) the purchaser has a reasonable expectation of reaching the requisite income level for the current year.

Where the issuer has reason to question the 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 the purchaser is an accredited investor. For example, if, based on this review, the 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. [July 3, 2014]

### **Question 260.36**

Question: A purchaser is not a U.S. taxpayer and therefore cannot provide an Internal Revenue Service form that reports income. Can an issuer review comparable tax forms from a foreign jurisdiction in order to rely on the verification method provided in Rule 506(c)(2)(ii)(A)?

Answer: No, the verification safe harbor provided in Rule 506(c)(2)(ii)(A) would not be available under these circumstances. In adopting this safe harbor, the Commission noted that there are "numerous penalties for falsely reporting information" in Internal Revenue Service forms. See Securities Act Release No. 33-9415 (July 10, 2013). Although the safe harbor is not available for tax forms from foreign jurisdictions, we believe that an issuer could reasonably conclude that a purchaser is an accredited investor and satisfy the verification requirement of Rule 506(c) under the principles-based verification method by reviewing filed tax forms that report income where the foreign jurisdiction imposes comparable penalties for falsely reported information.

Where the issuer has reason to question the reliability of the information about the purchaser's income after reviewing these documents, it must take additional verification measures in order to establish that it has taken reasonable steps to verify that the purchaser is an accredited investor. [July 3, 2014]

#### **Question 260.37**

Question: Under the non-exclusive verification method set forth in Rule 506(c)(2)(ii)(B), an issuer can verify that a 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." Tax assessments, which are one of the types of documentation listed in this provision of the rule, are often prepared annually. Would an issuer be able to rely on this non-exclusive verification method if it reviewed the most recent tax assessment that is available, even if it is dated more than three months?

Answer: No, the verification safe harbor provided in Rule 506(c)(2)(ii)(B) would not be available under these circumstances. Although the safe harbor is not available, we believe that an issuer could reasonably conclude that a purchaser is an accredited investor and satisfy the verification requirement of Rule 506(c) under the principles-based verification method if it uses the most recently available tax assessment when determining whether the purchaser has the requisite net worth. For example, if the most recent tax assessment shows a value that, after deducting the purchaser's liabilities results in a net worth substantially in excess of \$1 million, it may be sufficient verification that the purchaser has met the net worth test.

Where the issuer has reason to question whether the assessment reasonably reflects the value of the purchaser's assets, it must take additional verification measures in order to establish that it has taken reasonable steps to verify that the purchaser is an accredited investor. [July 3, 2014]

#### **Question 260.38**

Question: Under the non-exclusive verification method set forth in Rule 506(c)(2)(ii)(B), an issuer must review a consumer report from one of the "nationwide consumer reporting agencies" to determine the purchaser's liabilities. Would a consumer report from a non-U.S. consumer reporting agency that performs similar functions as a U.S. nationwide consumer reporting agency be sufficient for purposes of this verification method?

Answer: No, such a consumer report would not satisfy the requirements of the verification safe harbor in Rule 506(c)(2)(ii)(B). Although the safe harbor is not available, we believe that an issuer could reasonably conclude that a purchaser is an accredited investor and satisfy the verification requirement of Rule 506(c) under the principles-based verification method by reviewing this report and taking any other steps necessary to determine the purchaser's liabilities (such as a written representation from the

purchaser that all liabilities have been disclosed) in determining whether the purchaser has the requisite net worth.

Where the issuer has reason to question the extent of the 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 the purchaser is an accredited investor. [July 3, 2014]