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Recent SEC Corp/Fin Interpretations of Interest: Troutman Pepper Locke

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.

Continue reading.

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