Private Placements

In 2012 , Congress passed the JOBS Act, which directs the Securities and Exchange Commission (SEC) to implement rules that, among other things, allow general solicitation and advertising of private placement offerings that are made in reliance on Regulation D, Rule 506. Once implemented, those rules will allow companies and promoters to offer securities through means such as direct mail, cold calls, free lunch seminars and media advertisements. As a result, unscrupulous companies and promoters may take advantage of the new rules to offer potentially fraudulent investments.

What is a Private Placement Offering?

Private placement offerings allow companies to raise money by selling stocks, bonds and other instruments. Such offerings may be exempt from federal securities registration requirements. This exemption allows a company to raise business capital without having to comply with the registration requirements of a public securities offering.

Federal law allows companies to make a private placement offering to people who have sufficient wealth or access to information that would presumably allow them to make completely informed investment decisions. Those investors are known as "accredited" or "sophisticated" investors.

Currently, Rule 506 of Regulation D of the Securities Act of 1933 does not permit general solicitation or advertising of private placement offerings.

The JOBS Act directs the SEC to lift this ban on general solicitation or advertising as long as the sales are limited to "accredited" investors.

Who is an Accredited Investor?

To qualify as an accredited investor, you must:

- Have a net worth, not including your primary residence, of a least $1 million; or
- Have an income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year.

Private Placements and the Risk of Fraud

Entities raising capital through private placements often have a limited operating history and typically have more modest revenue streams than larger companies.

Because private placement offerings made in reliance on Rule 506 of Regulation D are not reviewed by regulators, they have become a haven for fraud. According to the most recent enforcement statistics from the North American Securities Administrators Association, private placement offerings are the most frequent source of enforcement cases conducted by state securities regulators.

To learn more or for help with these or other products, contact:
Indiana Office of the Secretary of State, Securities Division, 302 W. Washington St., Room E-111, Indianapolis, IN 46204 | (317) 232-6681 | (317) 233-3675 (fax) | www.sos.in.gov

The Office of the Indiana Secretary of State
Securities Division

Risks Associated with Private Placement Offerings

- Because private placement offerings are exempt from registration requirements at both the state and federal level, no regulator has reviewed the offerings to make sure the risks associated with the investment and all material facts about the entity raising money are adequately disclosed.
- There may not be regulatory background checks of the sellers or managers and officers of the company issuing the investment.
- Private placement offerings often project higher rates of return, but this is only because the risk of the underlying investment is also significantly higher.
- Securities offered through private placements are generally illiquid, meaning there are limited opportunities to resell the security. Therefore, investors may be forced to hold the investment indefinitely.
- Investors in a private placement offering are usually provided with less disclosure information than they would receive in a public securities offering. Consequently, investors know much less about the investment and the people behind it.
- Historically, private placement offerings have been sold through familiar sources such as the recommendation of a friend, a broker-dealer, or members of a church or other social organizations. These sales rely upon directed communication and trusted relationships. Once the general solicitation provision of the JOBS Act is implemented, private placement offerings may be sold through unknown sources by such means as cold calls or free lunch seminars that may use high pressure sales tactics and impose artificial time limits in an effort to hurry the investment decision.

How to Protect Yourself When Considering a Private Placement Offering

- Do not complete a Subscription Agreement or Accredited Investor Questionnaire unless you understand it and agree with the entire document.
- If you are asked to falsify your financial information to qualify as an accredited investor, walk away.
- If the seller cannot satisfactorily answer your questions about the company, its business model, or its executives' backgrounds, walk away.
- Ask for information. Even though federal and state securities laws do not mandate companies to disclose information in a private placement offering, an investor should still ask questions and request information. Take control and withhold your investment dollars if you do not get the information you request.

The Bottom Line

If you have any questions about private placement offerings, contact the Indiana Office of the Secretary of State, Securities Division at (317) 232-6681.

This **Informed Investor Advisory** is brought to you by the Indiana Office of the Secretary of State, securities Division, a member of the North American Securities Administrators Association. For more investor alerts and advisories, visit the NASAA website at www.nasaa.org.