

# How do I Create a Substantive Relationship?

**Question:** If I am doing a 506(b) offering, do I still need a pre-existing substantive relationship before I can solicit from an Accredited Investor (AI)? If “yes,” is there still any waiting period after I get that Accredited Investor to sign a document attesting to being an AI?

**Answer:** Rule 506(b) still has a requirement that no offers or sales may be made through any means of general solicitation or advertising. The way to prove that is to demonstrate that you have a pre-existing relationship with the investor, regardless of whether that person is accredited or unaccredited.



There was NO change to Rule 506 (the original rule) resulting from the JOBS Act, other than to rename it Rule 506(b), so all of the previous requirements are still in effect. Additionally, the issuer claiming a Rule 506(b) exemption must have a record-keeping system (or written policy and procedure) to document the relationship, including meetings held, who was present and what was discussed; and to show that a “passage of time” had occurred between the initial meeting and the offer. There is no actual rule that establishes how much time, but meeting someone at an event and later on during the event asking them to invest probably doesn’t qualify. The SEC has further opined that it is the “quality of the relationship” versus the length of time that is of the utmost importance — all of which is very subjective.

The U.S. Securities and Exchange Commission (“SEC”) issues interpretive letters in response to questions from issuers in the form of “No Action Letters.” These No Action Letters provide guidance to the Securities legal community and issuers of securities (“issuers”) as to whether a specific proposed program would be in compliance with applicable securities laws. Issuers model their own policies.

In response to a No Action Letter by Citizen VC, Inc. in August 2015, the SEC confirmed its position regarding pre-existing relationships, post-JOBS Act, for a Rule 506(b) exempt offering as follows:

There must be a pre-existing relationship between the issuer and investor that is not built solely through a specific duration of time or a short form accreditation questionnaire.

*Rather, it can be established by adhering to specific policies and procedures both online and offline (where appropriate), which enable the issuer to evaluate the prospective investor’s financial sophistication, circumstances, suitability, and his or her ability to understand the nature and risks of the Interests to be offered; and that the issuer actually followed this process to make such an evaluation.* Please click [here](#) for some example questions you can ask prospective investors to comply with this requirement.

The relationship must pre-date the offer.

You must have a record-keeping system to record compliance with Nos. 1-3 above.

**Note that the SEC makes no distinction between whether the investors are accredited or unaccredited in its response; as long as the issuer is relying on Rule 506(b), the rules are the same for either.**

Anyone who says “there is no longer a pre-existing substantive relationship requirement and no waiting period” has confused Rule 506(b) with Rule 506(c), which *does* allow advertising to anyone, provided the issuer takes reasonable steps to ensure that it only accepts funds from investors who are accredited and their financial qualifications have been verified within 90 days of making the investment.

**Bottom Line:** Pre-existing relationships are still required for *ALL* investors in a Rule 506(b) offering, regardless of their financial qualifications, and a pre-qualification questionnaire is not sufficient to *establish* a pre-existing relationship, but it’s a good start. The issuer must have a conversation with the investor about his or her financial sophistication, circumstances, and suitability, and all of that must be done before making an offer.

*NOTE: The discussion herein is of a general nature only and is not to be construed as specific legal advice, which requires the establishment of an attorney-client relationship and fee agreement.*

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