

Investor Alerts and Bulletins

Private Placements under Regulation D – Investor Bulletin

Aug. 17, 2022

The SEC's Office of Investor Education and Advocacy is issuing this Investor Bulletin to educate investors about investing in unregistered securities offerings, sometimes called private placements, under [Regulation D](#) of the Securities Act.

What is a private placement?

Under the federal securities laws, a company may not offer or sell securities unless the offering has been registered with the SEC or an exemption from registration is available. Offerings exempt from the SEC's registration requirements pursuant to Securities Act Section 4(a)(2) or its safe harbor under *Regulation D* of the Securities Act are often referred to as *private placements*.

Red flags. Fraudsters may use unregistered offerings to conduct investment scams. See our [Investor Alert](#) about red flags to watch out for in an unregistered offering. ***It may be difficult or impossible to [recover](#) the money you invest in an offering that turns out to be fraudulent.***

Private and public companies, including everything from small start-ups to large, well-established companies, engage in private placements to raise funds from investors. [Hedge funds](#) and other private funds also engage in private placements. Private placements are an important way in which companies raise capital to grow, fund and expand their business. Accordingly, these offerings play an important role in capital formation.

Important risk considerations. As further detailed below, these are some important considerations to take into account when considering an investment in a private placement:

- **Ability to weather a total loss.** Companies engaging in private placements may be early stage and high risk. You should be able to afford the increased risk of loss with such investments, including the potential of a total loss.
- **Illiquid investment.** Unlike an investment purchased on a stock exchange, an investment in a private placement is highly illiquid. You will mostly likely be investing in [restricted securities](#), may have difficulty finding a buyer for the securities when you can resell and, as a result, may need to hold the securities indefinitely.
- **Limited disclosure.** Companies engaging in private placements are not required to provide the disclosure that would be required in a registered offering. You may have less information to make an informed investment decision than, for example, stock purchased on a stock exchange, including information that may help you determine whether the price asked for the investment is a fair price.

What is Regulation D?

Regulation D includes two SEC rules—*Rules 504* and *506*—that issuers often rely on to sell securities in unregistered offerings. Most private placements are conducted pursuant to Rule 506.

Rule 506

Issuers may raise an unlimited amount of money in offerings relying on one of two possible *Rule 506* exemptions—Rules 506(b) and 506(c). An issuer relying on Rule 506(b) may sell to an unlimited number of *accredited investors*, but to no more than 35 non-accredited investors.

Accredited investor. One reason these offerings are limited to accredited investors is to ensure that all participating investors are financially sophisticated and able to fend for themselves or sustain the risk of loss, thus rendering less necessary the protections that come from a registered offering.

An individual is an *accredited investor* if they:

- earned income that exceeded \$200,000 (or \$300,000 together with a spouse or *spousal equivalent*) in each of the prior two years, and reasonably expects the same for the current year, **OR**
- has a net worth over \$1 million, either alone or together with a spouse or *spousal equivalent* (excluding the value of the person's primary residence and any loans secured by the residence (up to the value of the residence)), **OR**
- are a broker or other financial professional holding certain certifications, designations or credentials in good standing, including a Series 7, 65 or 82 license.

A *spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

Any non-accredited investors in the offering must be financially sophisticated or, in other words, have sufficient knowledge and experience in financial and business matters to evaluate the investment. This financial sophistication requirement may be satisfied by having a *purchaser representative* for the investor who satisfies the criteria. An investor engaging a purchaser representative should pay particular attention to any conflicts of interest the representative may have, such as having a financial interest in the offering or separately being compensated by the issuer.

If the issuer offers securities to non-accredited investors, the issuer must disclose certain information about itself, including its financial statements. If selling only to accredited investors, the issuer has discretion as to what to disclose to investors. Any information provided to accredited investors also must be provided to non-accredited investors.

Issuers relying on the Rule 506(b) exemption may not *generally solicit* their offerings. However, the Rule 506(c) exemption *permits* the issuer to generally solicit or advertise for potential investors. As a result, you may see an investment opportunity advertised through the Internet, social media, seminars, print, or radio or television broadcast. ***Only accredited investors, however, are allowed to purchase in generally solicited offerings under Rule 506(c), and the issuer will have to take reasonable steps to verify your accredited investor status.***

Rule 504

Rule 504 permits certain issuers to offer and sell up to \$10 million of securities in any 12-month period. ***These securities may be sold to any number and type of investor, and the issuer is not subject to specific disclosure requirements.*** Generally, securities issued under Rule 504 will be *restricted securities* (as further explained below), unless the offering meets certain additional requirements. As a prospective investor, you should confirm with the issuer whether the securities being offered under this rule will be restricted, which will affect your ability to resell the securities.

How can you tell whether you are being offered a private placement?

As an individual investor, you may be offered an opportunity to invest in a private placement. You may be told that you are being given an exclusive opportunity. The opportunity may come from a broker, acquaintance, friend, or relative. You may have seen an advertisement regarding the opportunity. The securities involved may be, among other things, common or preferred stock, limited partnerships interests, a membership interest in a limited liability company, or an investment product such as a note or bond. **As mentioned, private placements can be very risky and any investment may be difficult to resell in the future.**

You can identify private placements relying on Regulation D by the prominent legends that are required to be placed on any offering documents and on the certificates or other instruments that represent the securities. The legends should state that the offering has not been registered with the SEC and the securities have restrictions on their transfer. Consider it a **red flag** if documents relating to a private placement are missing these required legends.

Other Exempt Offerings. You may also come across offerings that rely on exemptions from registration other than Regulation D. These may include [crowdfunding](#) and [Regulation A offerings](#). Each exemption is governed by one or more rules setting forth specific requirements that the company offering the securities—called the *issuer*—must meet in order to qualify for the exemption. Most exempt offering materials will indicate that the issuer is relying on an exemption. **If you have reason to believe that an unregistered offering claiming to rely on an exemption does not satisfy the applicable requirements, consider this to be a red flag about the investment.**

What should you do before investing?

Private placements may be pitched as a unique opportunity being offered to only a handful of investors, including you. Be careful. Don't be fooled by this high-pressure sales tactic. Even if the deal is "unique," it may not be a good investment. **It is important for you to obtain all the information that you need to make an informed investment decision.** In fact, issuers relying on the Rule 506(b) exemption must provide non-accredited investors an opportunity to ask questions and receive answers regarding the investment. If an issuer fails to adequately answer your questions, consider this a warning against making the investment.

Private placements, however, are not subject to some of the laws and rules designed to protect investors, such as the comprehensive disclosure requirements that apply to registered offerings. Issuers offering securities in private placements are required to provide only limited disclosure to non-accredited investors, or may face no disclosure requirements at all. Therefore, investors in private placements are generally on their own in obtaining the information they need to make an informed investment decision. Investors need to fully understand what they are investing in and fully appreciate what risks are involved.

Some things to consider.

- Did the issuer provide financial statements and, if so, what do they tell you about the business?
- Are the financial statements independently audited?
- Are the claims and expectations reasonable?
- How reasonable is the issuer's reliance on a particular technology, customer, product or natural resources claim?
- Who are the issuer's competitors?
- What is the experience and background of management?
- How long has the issuer been in business and has the issuer conducted prior offerings?
- How does the issuer plan to use the money raised?

- If the securities you are considering purchasing have transfer restrictions, when will and how may the restrictions be lifted?
- Because you may not be able to resell your investment easily, are you comfortable holding it indefinitely?
- If the company were to fail, could you afford to lose most or all of your investment?

Issuers may provide a document called a *private placement memorandum* or *offering memorandum* that introduces the investment and discloses information about the securities offering and the issuer. This document is not required. However, if the issuer does not provide information about itself and the securities offering, either through this type of document or otherwise, it may be a red flag to consider before investing. **Moreover, private placement memoranda and other offering documents typically are not reviewed by any regulator and may not present the investment and related risks in a balanced light.**

All issuers relying on a Regulation D exemption are required to file a document called a Form D no later than 15 days after they first sell the securities in the offering. The Form D will include brief information about the issuer, its management and promoters, and the offering itself. If the offering you are considering has prior sales, you can search for the Form D filing on the SEC's [EDGAR](#) system. Some issuers may not comply with this requirement to file a Form D, which may be a [red flag](#).

Form D does not represent SEC approval or registration. Beware of any claims of SEC approval. The SEC does not [approve](#) any offering. Further, fraudsters may try to [lure](#) you into investing with them by falsely claiming to be registered, or that the offering is registered, with the SEC. In one [case](#), the defendants allegedly recruited investors by falsely claiming that their firm was “registered” or “duly registered” with the SEC and pointing to the firm’s Form D filings to support this misrepresentation.

What if my investment professional recommends the investment?

The opportunity to invest in a private placement may come from your investment professional. **Your investment professional can assist and enable you to better understand the opportunity and risks, as well as investigate and gather additional information, but it is your money, your risk and your decision whether to invest.** You should also ask about the compensation your investment professional is receiving for the transaction and any relationships, business ties or other conflicts of interest that could create an incentive for your investment professional to recommend the investment, regardless of whether it is in your [best interest](#).

Background check. It is always a good idea to [check](#) on the background of an investment professional. It is easy and free. If you have any questions on checking the background of an investment professional, call the SEC’s toll-free investor assistance line at (800) 732-0330. You can also check with your state securities regulator regarding the person soliciting your investment.

Broker misconduct. In *In the Matter of Advanced Equities, Inc.*, the SEC charged a broker with allegedly making exaggerated misstatements to investors when pitching an unregistered offering of securities in a non-public alternative energy company. The SEC alleged, for example, that the broker said the company had more than \$2 billion in order backlogs when the backlog never exceeded \$42 million.

What should I know about restricted securities?

Generally, most securities acquired in a private placement will be [restricted securities](#). **You should not expect to be able to easily and quickly resell your restricted securities. In fact, you should be prepared to hold the securities indefinitely.**

There are two principal things to think about before buying restricted securities. The first is that unless you have made arrangements with the issuer to resell your restricted securities as part of a registered offering, you will need to comply with an exemption from registration to resell. One [rule](#) investors commonly rely on to resell restricted securities requires you to hold the restricted securities for at least a year if the company does not file periodic reports (such as annual and quarterly reports) with the SEC and six months if the company does file periodic reports with the SEC. Most private companies that issue private placements do not file these periodic reports. You may wish to hire an attorney to help you comply with the legal requirements to resell restricted securities. Issuers may require a legal opinion that you satisfy an exemption to resell your restricted securities.

The second thing to think about is whether the securities are easy to sell when you wish to do so. When attempting to resell securities in private companies, keep in mind that these securities will not be as liquid as securities that trade on a stock exchange. Unlike with a publicly traded company, information about a private company is not typically available to the public, and a private company may not provide information to you or your buyer. Any restricted status of your securities may also transfer to your buyer. For these reasons, it will generally be more difficult to find buyers compared to selling stock of a public company on a stock exchange.

In addition to these considerations, you may be required to enter into one or more contracts or agreements when investing that may contain provisions that restrict or prevent you from freely transferring the securities.

What else should I know?

Despite not being subject to the same disclosure obligations as registered offerings, private placements are subject to the antifraud provisions of the federal securities laws. Any information provided must not have any material misstatements and must not omit any material facts necessary to prevent the statements made from being misleading. ***You should be aware that it may be difficult or impossible to [recover the money you invest in an offering that turns out to be fraudulent](#).*** In addition, even though the offering may be exempt from SEC registration, the offering may have to comply separately with state securities laws, including state registration requirements or a state exemption from registration.

Private placements may offer investment returns. However, the attractive potential rewards often come with high risks of loss.

Additional Information

To learn more about private placements, see this [website](#).

For additional investor educational information, see the SEC's website for individual investors, [Investor.gov](#).

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Modified: Jan. 11, 2023