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The JOBS Act: Potential Pitfalls for Pooled Investment Vehicles and their General Partners, Managers and/or Regional Center Sponsors

Article By:

Steven M. Felsenstein

The hallways are abuzz with **EB-5 Program** conference attendees excited about the prospect of finally being able to conduct **public campaigns** for their projects by advertising, discussing projects in media interviews, undertaking internet marketing campaigns and website postings, and by sponsoring seminars and other broad-based capital raising meetings once the **U.S. Securities and Exchange Commission (the "SEC")** adopts rules to implement an expansive new law.[1] Securities lawyers and conference speakers are explaining that the **Jumpstart Our Business Startups Act** (the **"JOBS Act**") removes the longstanding prohibitions against general solicitation and advertising in private offerings made pursuant to Rule 506 of Regulation D under the **Securities Act**, but only if all purchasers in these offerings are accredited investors, and the issuer takes reasonable steps to verify using methods to be determined by the SEC that all investors are accredited.[2] Careful lawyers and lecturers remind conference attendees that these securities law changes authorized by the JOBS Act are not yet in effect. They also note that the new provisions do not obviate the need for a well-written, adequate disclosure document commonly referred to as a private placement memorandum or PPM.[3] The changes in the law, however, will not reduce the risks of poorly implemented offerings.

The Potential Trap –

Implications for Private Investment Companies

Absent an exemption, pooled investment vehicles that raise capital from investors for the purpose of lending that capital to a project company are considered investment companies by the SEC. Accordingly, such a pooled investment vehicle must register with the SEC as an investment company under the Investment Company Act of 1940 (the "1940 Act") unless there is an available exemption or exclusion from registration. Two exemptions commonly relied upon are found in Sections 3(c)(1) and 3(c)(7) of the 1940 Act. Each of these requires that the securities being offered must not be part of a "public offering."

Historically, the SEC Division of Investment Management has taken the position that the concept of a public offering as applied under the 1940 Act has the same meaning as "general solicitation" and "general advertising" (i.e., "public offering") under the Securities Act of 1933 (the "Securities Act"),

and has rejected any notion that the term “public offering” could have a different meaning under the 1940 Act. However, with the redefining of the term “public offering” under the Securities Act by the JOBS Act,[4] and the SEC’s reported concerns about risks of abuse due to changes made under the JOBS Act, the staff of the Division of Investment Management may take the position that the term “public offering” in the 1940 Act has a different meaning than the term “public offering” in the Securities Act. If this is the case, many pooled investment vehicles desiring to avoid registration as an investment company using either of these exemptions under the 1940 Act may find that they cannot engage in the general solicitation or general advertising activities soon to be permitted by the JOBS Act in connection with a securities offerings relying on the Rule 506 exemption.

Implications for the Advisers to Private Investment Companies

It is well settled that the general partner (or manager) of an investment company formed as a limited partnership (or limited liability company) that retains investment control over assets is likely to be deemed to be a “private fund adviser” required to register under the **Investment Advisers Act of 1940 (the “Advisers Act”)** or under comparable state securities laws. Under the Advisers Act, the adviser (whether or not registered with the SEC) should be mindful that advertisements and solicitations remain subject to both the regulatory standards and anti-fraud provisions of the Advisers Act and rules thereunder, and that despite the JOBS Act’s removal of the prohibition against general advertising/solicitation under Rule 506, the SEC still retains broad oversight and anti-fraud authority under Section 206 of the Advisers Act. Accordingly, the SEC could exercise this authority by issuing new rules that, in effect, make certain types of general solicitation and advertising fraudulent or misleading under the Advisers Act, thereby diminishing the scope of permitted marketing by pooled investment vehicles and their general partners or managers.

In addition, many state laws governing the registration of investment advisers provide an exemption from registration if the investment adviser satisfies certain conditions, including the condition that the investment adviser not hold itself out generally to the public as an investment adviser. By undertaking general solicitation and advertising activities on behalf of a pooled investment vehicle, the applicable general partner or manager of a pooled investment vehicle may be treated as holding itself out to the public as an investment adviser, thereby making the investment adviser ineligible for an exemption that might otherwise be available..

Implications for Offerings pursuant to Regulation S under the Securities Act

Changes to the Securities Act effected by the JOBS Act do not apply to securities offerings exempt from registration pursuant to Regulation S promulgated by the SEC under the Securities Act. Accordingly, pooled investment vehicles relying on the Regulation S exemption will be prohibited from conducting directed selling efforts in connection with such offerings, despite their ability to advertise the offering under Rule 506 of Regulation D.

Implications for broker-dealers under the Securities Exchange Act of 1934

Changes to the Securities Act also do not impact regulation of broker-dealers involved in the distribution of securities. This is a separate topic that we note here so that a reader is alert to other concerns.

Conclusions

The JOBS Act does not address some issues of concern to issuers and advisers. The JOBS Act

does not amend either Section 3(c)(1) or 3(c)(7) under the 1940 Act, so the SEC could prohibit pooled investment vehicles that want to rely on 3(c)(1) or 3(c)(7) registration exemptions from using general solicitation and general advertising to offer securities to potential investors. Without further guidance from the SEC, an issuer undertaking a general solicitation or advertising pursuant to the JOBS Act amendment to the Rule 506 could run afoul of the prohibition on public offerings contained in the 1940 Act and lose its exemption from registration. This will depend on whether the SEC continues to treat the term "public offering" consistently in both the 1940 Act and the Securities Act. If the SEC applies the new standards to pooled investment vehicles relying on the 3(c)(1) or 3(c)(7) exemption, then these pools may be able to approach a wider audience when seeking investors using a variety of media, including print and electronic communications, than previously had been permitted.

The foregoing notwithstanding, we anticipate that the SEC will impose, as part of the rulemaking implementing the JOBS Act, certain content-based standards and restrictions on advertisements and other forms of solicitation by pooled investment vehicles undertaking the loan approach.

The JOBS Act also does not alter the authority of the SEC to regulate and oversee advisers to pooled investment entities, or any advertising that they use under changes that will be made to Rule 506.

The views expressed in this publication are those of the author and not necessarily those of Greenberg Traurig LLP. The comments contained herein do not constitute legal opinion and should not be regarded as a substitute for legal advice.

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[1] Pooled investment vehicles generally have been prohibited from advertising or contacting potential investors other than those with whom either the general partner of the pooled investment vehicle or applicable third-party placement agent has a preexisting relationship.

[2] Rule 506 is a safe harbor exemption from Securities Act registration for non-public offerings of securities primarily to persons who are "accredited investors" under the Securities Act.

[3] The JOBS Act directs the SEC to revise Rule 506 by July 4, 2012 to provide (i) that the prohibition against general solicitation and general advertising no longer apply to offers and sales of securities made under Rule 506, provided that all purchasers of the securities are accredited investors;

(ii) that the SEC devise methods to be used by issuers to verify whether such purchasers are accredited investors; and (iii) that issuers undertake

reasonable steps to verify that the purchasers are accredited investors.

[4] The JOBS Act amends Section 4 of the Securities Act to provide that offers and sales of securities that are exempt under Rule 506 will not be deemed public offerings for purposes of the federal securities laws as a result of general solicitation or general advertising.

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