

# The Securities Exchange Commission (SEC) New General Solicitation Rules Are Here

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Since the inception of the federal securities laws in the 1930s, a basic rule has been, absent registering with the **Securities Exchange Commission (SEC)** (and/or the state equivalent of the SEC), companies may not conduct general solicitations of the offerings of securities. This includes not making private placement memoranda or other offering documents on a company's website. In 2012, Congress passed and the President signed the JOBS Act which instructed the SEC to create rules to allow general solicitation to accredited investors.

On July 10, the SEC issued these rules, as Rule 506(c) of Regulation D of the Securities Act of 1933. These new rules are scheduled to become effective 60 days after their publication.

The first thing to note is that while Rule 506(c) provides a new way to raise risk capital without running afoul of the SEC, it does not eliminate or change any of the ways that have previously existed and used for years. Issuers now will have a new option, one that includes general solicitation, to go with all of the other previous options.

Rule 506(c) states that issuers can generally solicit investors provided (i) only "accredited" investors are actually permitted to invest; and (ii) the entrepreneur takes "appropriate steps" to insure that anyone who invests is so accredited.

The accredited investor description is the same definition that has been used under Regulation D. However, unlike a private placement under Regulation D in which up to 35 non-accredited investors could be included so long as disclosure thresholds are met, under Rule 506(c), absolutely no non-accredited investors may be allowed to invest in the offering.

As to the new "appropriate steps" requirement, the SEC specifically set forth as examples of appropriate steps an issuer's review of a potential investor's tax returns and bank and brokerage statements. This is absolutely new to the private placement world, where previously an issuer could simply rely (so long as it was reasonable) on an investor's certifying in subscription documents as to

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the investor's accredited investor status.

The practical implications of Rule 506(c) are not all that clear. While the availability of the general solicitation option for raising private risk capital will no doubt look appealing to entrepreneurs and other issuers, how many of such entrepreneurs (and what kind of entrepreneurs) will actually be interested in taking these steps and collecting this information? More to the point, will potential investors be interested in sharing personal financial and tax records with the managers of their potential investments?

It is doubtful, for the reasons listed below, that the availability of this new method of offering securities will change the landscape.

1. The "best" entrepreneurs and issuers, the ones most likely to get funded in any event, generally know the best investors (institutional venture capital funds and sophisticated, active angels) and how to approach them. It does not appear to us that these issuers would find much advantage in generally soliciting the public for capital, noting that the vast majority of the public (who are not accredited investors) cannot invest in any event.
2. As noted above, the requirement under Rule 506(c) stating that entrepreneurs engaging in general solicitation take "appropriate" steps to ensure all investors are accredited will likely be a deterrent both to entrepreneurs and investors. The rule itself does not specifically say what will be considered appropriate in a particular circumstance, but it does make clear entrepreneurs will have to do more to establish their investors are accredited. One example the new rule gives, reviewing each investor's tax returns and/or personal financial records, will likely be problematic for many investors.
3. Venture capitalists and more sophisticated/experienced angels and other investors will be skeptical of entrepreneurs and deals involving general solicitations. These investors have historically frowned on deals that arrive on their desks "over the transom" (that is cold calls/submissions from entrepreneurs).

We can easily envision the rise of websites and placement agents who will specialize in the issuance of general solicitations; and such an architecture to support offerings under this new rule may provide an active alternative to the existing private placement processes. This would probably be the domain of the smaller, less sophisticated issuers and investors, a private analogue to the market in publicly traded penny stocks.

One last thing to note is the SEC's rules on integration of offerings remain in place. While the new rule did not go into detail, it can be assumed an issuer that begins a Rule 506(c) offering and makes a general solicitation, would then not be able to convert an unsuccessful offering into an effective standard private placement, and then may be out of the capital raising market for some time.

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