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## **Informed Investor Advisory: Private Placement Offerings** *New Federal Rules Allow Advertising and General Solicitation~But Beware of Fraud!*

*In 2012, Congress passed the JOBS Act, which directed the U.S. 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 federal Regulation D, Rule 506. Those rules 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.*

“The new federal rules permitting advertising and general solicitation will make it easier for legitimate small businesses and other securities promoters to reach a larger pool of accredited investors” Idaho Department of Finance Director Gavin Gee said. “Unfortunately, based on state securities regulators’ long-term experience with abusive private placement offerings, the new rules potentially open the door to even more wide-spread fraudulent offerings, requiring potential investors to be especially vigilant BEFORE they invest.”

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### **What is a Private Placement Offering?**

Private placement offerings allow companies to raise capital 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 now 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.

### **Who is an Accredited Investor?**

To qualify as an accredited investor, you must:

- Have a net worth, not including your primary residence, of at 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.

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 brought by state securities regulators around the country, including Idaho.

## **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 usually 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.
- 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.
- Seek advice from a trusted advisor. Private placement and other securities offerings can be complex financial transactions, especially for inexperienced investors. It is always a good idea to seek expert advice from a trusted independent advisor BEFORE investing.

If you have any questions about private placement offerings, contact the Idaho Department of Finance at 208-332-8004 or toll free in Idaho at 888-346-3378.

*Department of Finance Press Releases can be found on the Internet at <http://finance.idaho.gov> and may be obtained by contacting the Department at (208) 332-8004 or Idaho toll-free at (888) 346-3378.*