Are you an informed investor?

Private Placement Offerings

In 2012, Congress passed the JOBS Act, which directed the 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 Regulation D, Rule 506. Those rules allow companies and promoters to offer securities through means such as direct mail and e-mail, Internet ads, cold calls, free lunch seminars and newspaper and television advertisements. As a result, unscrupulous companies and promoters may take advantage of the new rules to offer potentially fraudulent investments.

What is a Private Placement Offering?

Private placement offerings allow companies to raise money 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 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.

Rule 506 of Regulation D. of the Securities Act of 1933 permits general solicitation or advertising of private placement offerings.

The JOBS Act of 2012 directed the SEC to lift an 80-year-old ban on general solicitation or advertising as long as the sales are limited to "accredited" investors.

Who is an Accredited Investor?

To qualify as an accredited investor, you must:

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

Private Placements and the Risk of Fraud

Entities raising capital through private placements often have a limited operating history and typically have more modest revenue streams than larger companies.

Because private placement offerings made in reliance on Rule 506 of Regulation D are nor reviewed by regulators, they have become a haven for fraud. 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 conducted by state securities regulators.

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 only 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.
- Historically, private placement offerings have been sold through familiar sources such as the recommendation of a friend, a broker-dealer, or members of a church or other social organizations. These sales rely upon directed communication and trusted relationships. Now, 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.

The Bottom Line

If you have any questions about private placement offerings, contact **The Office of the Commissioner of Financial Institutions of Puerto Rico**

By mail: Commissioner of Financial Institutions of PR
Securities Area Section
PO Box 11855, San Juan, PR 00910-3855

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Email: valores@ocif@gobierno.pr
Call toll free: 1-800-981-7711
Internet: www.ocif.gobierno.pr

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.
- Carefully review the use of proceeds. Make sure that you understand how much of the proceeds from the offering will be used for the stated purpose and how much will paid out as commissions and other fees.
- Review the backgrounds of the managers. Conduct an internet search of all management principals and owners, check websites and social media. Determine if this is the first offering by the management team.
- Research the business model. Conduct an internet search to determine if the business model has been successful in the past.
- Determine how the funds will be handled. If there is a minimum amount to be raised, will the funds be held in an escrow account until the minimum is reached.
- If the company will provide audited financials, make sure it is from a reputable firm. Check the Public Company Accounting Oversight Board website to check whether the firm is registered.
- 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.
- Scrutinize sale materials. Namely be wary of phrases like, "guaranteed, can't miss, low risk, and limited time opportunity."
- Look for red flags such as offers that pay excessively high returns or promise daily interest. Remember if it sounds too good to be true it probably is.

This Informed Investor Advisory is brought to you by the Commissioner of Financial Institutions of Puerto Rico, a member of the North American Securities Administrators Association. For more investor alerts and advisories, visit the NASAA website at www.nasaa.org.

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