The Office of Secretary of State
Securities and Charities Division

**INVESTOR ALERT:** **Private Placement Investments**
*Issued: August 23, 2023*

The Secretary of State's Division of Securities and Charities is issuing this Investor Alert as a resource to raise awareness about how Private Placement offerings may affect Georgia investors' financial goals and opportunities.

Investors have numerous alternatives to conventional stock and bond investments; one alternative is a category of investments called "Private Placements." Before investing in these private securities offerings, it's crucial for investors to understand each investment's distinct features, risks, and rewards.

## What are Private Placements?

A Private Placement is an offering of unregistered securities to a limited pool of investors. In a Private Placement, a company, called the "Issuer" in this type of offering, sells shares of stock in the company or other interest in the company, such as warrants or bonds, in exchange for cash.

Private Placements are regulated by a series of Securities and Exchange Commission (SEC) rules known as Regulation D ("Reg D"). Among other things, the Reg D rules mandate that Private Placements may only be sold to accredited investors possessing sufficient net worth and a limited number of sophisticated non-accredited investors. Issuers selling securities in a Private Placement generally have fewer disclosure requirements than issuers that sell securities in a public offering.

Investors in Private Placements should always do their own due diligence on the offering, which may include consulting with their own legal counsel or accountant.

## Rule 506: Private Placement Exemptions from Registration

Under the SEC's Rule 506, securities issues may raise an unlimited amount of money through their Private Placement offerings.

There are two possible ways for an issuer to offer securities under Rule 506: (1) Rule 506(b); and (2) Rule 506(c).

Rule 506(b): Safe Harbor Provision

- Rule 506(b) allows an issuer to sell Private Placements to an unlimited number of **accredited investors**, but to no more than 35 **non-accredited investors**.

  An **accredited investor** is an investor who: (1) earned more than $200,000 in income in each of the prior two years, and reasonably expects the same for the current year; OR (2) has a net worth over $1,000,000, either alone or together with a spouse or spousal equivalent (a cohabitant occupying a relationship generally equivalent to that of a spouse); OR (3) are a broker or other financial professional holding certain certifications, designations, or credentials in good standing, including a Series 7, 65, or 82 license.

- Any **non-accredited investor** considering investing in an offering under Rule 506(b) must have sufficient knowledge and experience in financial and business matters to evaluate the investment. If the issuer offers Private Placements to non-accredited investors, the issuer must disclose certain information about itself, including its financial statements.

Issuers using the Rule 506(b) exemption cannot advertise their Private Placement offering to the general public.

Rule 506(c): General Solicitation

Rule 506(c) is similar to Rule 506(b) except for one important difference: issuers under Rule 506(c) may advertise the Private Placement offering to the general public.

Such advertising may be on social media, TV, the radio, or in a newspaper. An issuer may only take advantage of Rule 506(c) if they meet two conditions. First, all investors offered the advertised Private Placements are accredited investors. Second, the issuer must take steps to make sure that the investors are accredited investors, such as reviewing investor documents, bank statements, and credit reports.

## Risks of Private Placement Investments

- Issuers engaging in Private Placements may be “start-ups” with higher risk. Investors should be sure they can afford the increased risk of loss with such investments, including the risk of losing your entire investment.

- Unlike an investment on a stock exchange, an investment in a Private Placement is not easy to exchange for cash. Investors will most likely be purchasing restricted securities, may have difficulty finding a buyer for the securities when the investors can resell, and may need to hold the securities indefinitely.

    - ❖ Restricted Securities are securities that are not freely tradeable, which can limit your ability to convert your investments into cash.

- Issuers engaging in Private Placements are not required to provide the same information that they would have to in a offering. Issuers offering registered securities should provide investors with description of the issuer's properties and business, a description of the security to be offered for sale, information about the management of the issuer, and financial statements certified by independent accountants.
    - ❖ Investors may have more limited information when investing in a Private Placement. It may be difficult for investors to determine if they are offered a fair price for the investment.

## Important Considerations For Investing in Private Placements

- ✓ Did the issuer provide financial statements, and, if so, what do they tell you about the business?
- ✓ Have the financial statements been reviewed by someone outside of the issuer?
- ✓ Are the issuer’s 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 offered securities before?
- ✓ How does the issuer plan to use the money it raises?
- ✓ If the securities you are considering purchasing have transfer restrictions, when will and how the restrictions be lifted?
- ✓ Are you comfortable holding the securities indefinitely?
- ✓ If the issuer were to fail, could you afford to lose most, <u>or even all</u>, of your investment?