



## ANGEL CAPITAL ASSOCIATION

### **ANGEL CAPITAL ASSOCIATION GUIDANCE ON ACCREDITED INVESTOR VERIFICATION: WHAT MEMBERSHIP IN AN ESTABLISHED ANGEL GROUP SAYS ABOUT A PURCHASER**

The Securities and Exchange Commission's (SEC) Rule 506(c), effective on September 23, 2013, requires that a startup company or other issuer seeking to raise capital using general solicitation take reasonable steps to verify that all purchasers of its securities are accredited investors.\* Rule 506(c)<sup>1</sup> employs a principles-based methodology, which relies on factors including the nature of the purchaser, the type of accredited investor the purchaser claims to be, and the amount and type of information that the company has about the purchaser.

Rule 506(c) ends the 80-year ban on general solicitation of private offerings, and represents a significant change in securities law. Much early public attention to the rule focused on four non-mandatory, non-exclusive verification methods (often called "safe harbors") that are deemed to meet the verification requirement. However, the majority of the rule focused on the principles-based verification methodology, which provides for other reasonable steps for verifying investors are accredited. The Angel Capital Association (ACA) underscores the importance of the principles-based methodology that is a fundamental part of Rule 506(c), noting that the principles-based methodology is expected to lead to development of a broad range of cogent and reliable industry practices.

ACA is offering this guidance on Established Angel Groups in order to help issuers and their legal counsel better assess the nature, amount and type of information they have about a purchaser, as the result of an objective determination that the person is a member of an Established Angel Group.

An "Established Angel Group" meets the following criteria:

- The group is a private organization of accredited investors organized for the purpose of investing in early-stage companies and includes one or more members who have previously invested under a Rule 506 exemption.
- Membership is only by invitation or referral from a current member who has a pre-existing relationship with the applicant and is familiar with the professional and financial status of the applicant, and reasonably believes he or she is an accredited investor.
- Each applicant completes a questionnaire that includes professional experience and sector expertise, and certifies at least annually that he or she is an accredited investor.
- Members invest their own funds at their discretion. The group makes no recommendation in regard to any individual member's investment in any offering under consideration.
- Neither the group nor any of its members or employees (if any) receives any transaction-based compensation in connection with offerings considered by the group.

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\*The definition is available at [www.sec.gov/answers/accred.htm](http://www.sec.gov/answers/accred.htm).

<sup>1</sup> SEC Release No. 33-9415 at 21. ([www.sec.gov/rules/final/2013/33-9415.pdf](http://www.sec.gov/rules/final/2013/33-9415.pdf))

- The group has established investment processes, consistent with those recommended by ACA for member groups (see [www.angelcapitalassociation.org/angel-group-operations/](http://www.angelcapitalassociation.org/angel-group-operations/)), and also operates under a strict code of conduct and/or is a member of a professional association such as ACA, and adheres to its code of conduct.

In all cases, an angel group that is a full member of ACA would qualify as an Established Angel Group. While the term “Established Angel Group” is new with this document, the practices identified above have long been in practice by angel investing groups.

Most or all of these factors bulleted above are material to a 506(c) verification inquiry. However, whether or not an objective determination that a purchaser is a member of an Established Angel Group will, by itself, satisfy the “reasonable steps” verification standard of Rule 506(c), depends on the facts and circumstances of the particular transaction. *Issuers should always consult with legal counsel about how to apply the principles-based method of accredited investor verification in any transaction designed to rely upon the exemption under Rule 506(c).*

If a startup or other issuer uses the principles-based method and concludes that the verification requirement is satisfied by objectively determining that a purchaser is a member of an Established Angel Group either on a stand-alone basis or in connection with other relevant information about the purchaser, it should not be necessary to use any of the four non-exclusive, non-mandatory methods of verification listed in Rule 506(c).

Issuers could verify Established Angel Group membership in a number of ways. Ordinarily an issuer will have verified that a natural person is a member of an Established Angel Group if it:

1. obtains a representation and warranty (e.g. in a written purchase or subscription agreement) from the purchaser that he or she is a member of an Established Angel Group;
2. confirms by objective external reference (such as a list of members on an Established Angel Group Web site, a letter from an Established Angel Group, or reference in published media reports) that the person is a member of the Established Angel Group; and
3. does not have knowledge that such person is not an accredited investor.

**About ACA:** ACA is the leading professional and trade association supporting the success of angel investors in high-growth, early-stage ventures. ACA is the largest organization of accredited investors in the world, with more than 200 member angel groups and 10,000 individual accredited investors. ACA provides professional development, industry voice, public policy advocacy and an array of benefits and resources to the angel investing community and the startups in which they invest. [www.angelcapitalassociation.org](http://www.angelcapitalassociation.org); @ACAAngelCapital.

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