Hot Investment Trend:

Private Placements in Self-Directed IRAs

An Exclusive Report from The Entrust Group

Introduction

Private Placements have been permitted as an IRA investment for many years, attracting investors who seek the potential for higher returns, despite the high degree of risk involved. This introductory report explains this form of investment, how it works in an IRA, and the rules that govern who can pursue them.

The Potential of Private Placements in IRAs

"Private Placements" is a term that refers to investing in privately-held entities, such as companies or small businesses. Banks have recently tightened their purse strings lending to these entities, creating a higher demand for development capital from investors.

For those seeking funds, obtaining capital from a self-directed IRA owner can be simpler and faster than the loan process with institutional lenders. For self-directed IRA owners, this type of lending has the potential to bring higher returns than the stock market or CDs.

Self-directed IRAs and private placements are a match made in investment heaven. Consider these indications from the 2013 *Global Survey of Individual Investors*, written by Natixis Global Asset Management, of investors' interest in moving away from traditional investment vehicles[1]:

- **76** percent of investors surveyed are interested in products unrelated to the performance of the broader markets.
- **61** percent no longer trust that the traditional equities/bond approach to portfolio management will deliver the best returns.
- **72** percent would consider alternative investments if their advisor recommended them.
- **20** percent plan to increase their exposure to emerging market stocks and private equity.

[1] 2013 *Global Survey of Individual Investors* done by Natixis Global Asset Management

The Basics of Private Placements

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You should not underestimate the power of self-directed IRAs in this arena. After all, by 2012, Americans had approximately $5 trillion invested in IRAs[2] and nearly $100 billion (2 percent) of that was in self-directed accounts[3]. Account owners and financial advisors owe it to themselves to learn more about the new opportunities in private placements.

The Basics of Private Placements

A Private Placement is an offering of a company that is not offered to the public. Because this is offered to a limited group of investors and is not public, the placement does not have to be registered with the U.S. Securities and Exchange Commission (SEC).

However, some private placements are offered in accordance to Regulation D. This specifies the amount of money that can be raised and the type of investor who can be solicited to participate in the offering.

There are limits on who can invest in private placements with personal funds. To protect investors, general solicitation and advertisement rules exist regarding how to offer this investment to the public. These offerings were typically only offered to accredited investors until the JOBS Act of 2012.

To qualify as an accredited investor[4], 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
- Have a joint income with a spouse exceeding $300,000 for those years, and a reasonable expectation of the same income level in the current year.

When investing in a private placement through an IRA, the SEC looks to the IRA owner. The IRA is considered accredited when its owner is accredited.

However, the limitations on how these types of investments are offered or marketed to the general public are changing. The JOBS Act and crowdfunding are also changing the landscape for private placements, making it easier for investors to diversify their investments.

JOBS Act of 2012

The Jumpstart Our Business Startups (JOBS) Act was signed into law on April 5, 2012, with the intention of easing the process of raising funds for startups. Now, not only is the SEC directed to rewrite the regulations concerning

[2] Investment Company Institute, The Role of IRAs in U.S. Households' Saving for Retirement, 2012, http://www.ici.org/pdf/per18-08.pdf
[3] U.S. Securities and Exchange Commission
[4] ICI Research Perspective, www.ici.org, December 2012 | Vol. 18, No. 8

general solicitation rules or public advertising rules (Rule 506), but it also has increased the thresholds before a security must be registered with the SEC. The law:

- Increases the number of shareholders a business is allowed to have before it must register with the SEC to 2000 (unless it is offered under an employee benefit plan or an exempt crowdfunding offerings). This allows more small businesses to accept private placements from more investors.

- Allows for offering private placements through the Internet (known as crowdfunding). This makes investing as easy as logging onto a website.

- Relaxes Sarbanes-Oxley Act of 2002 compliance for emerging growth companies. The lighter the compliance burden, the more likely businesses are to take advantage.

- Raises fundraising limits for some companies from $5 million to $50 million, opening up a new fundraising arena for firms with larger monetary needs.

Private Placements in a Self-Directed IRA

While the accredited investor rule applies to anyone investing in private placement with personal funds, this rule does not apply to investments made through a crowdfunding portal. A non-accredited investor's IRA can invest in a private placement in this instance. However, a private placement issuer or company might still request that the investor be an accredited investor.

Investing in private placements with self-directed IRAs is very popular. And when you do it correctly, it can potentially significantly increase the size of your IRA. In the past two years we have seen an increase in clients taking advantage of these types of investments to diversify their retirement portfolio.

The investment options include:

- Private placements
- Pooled investment funds
- Land trusts
- Secured and unsecured notes
- Limited Liability Corporations (LLCs)
- C corporations
- Private stock
- Partnerships

How to Participate in Private Placements in a Self-Directed IRA

To invest in private placements with The Entrust Group, simply:

- Open an account.
- Fund the account with a contribution, funds transfer, or rollover.
- Provide investment documentation to your self-directed IRA administrator, directing it to purchase the investment on your behalf.

Due Diligence for Private Placements

Conducting Due Diligence on Private Placements

It is very important that you understand what it is you are investing in. Find out as much as possible about the company and the investment. Here are some tips to keep in mind:

- Beware promises of high returns. If it's too good to be true, it probably is.
- Investigate the background of the broker or company principals. Meet the representative in person. Visit their office, if possible. Keep detailed notes on all conversations that you have with officials seeking your investment.
- Ask for copies of written materials before making an investment.
- Research risks and how you might liquidate your private placement securities.
- Review the private placement memorandum PPM and consult with a financial advisor.
- Research whether the private placement is being sold on a conditional basis. Sometimes, certain conditions need to be met, or a specific dollar amount invested. An offering without a minimum level of investment amount and other conditions such as deadlines could be a red flag. The issuer can use the proceeds immediately.
- Research the return policy should the private placement not fund.
- If you are close to retirement, make sure that you will be able to make your required minimum distributions. Some entities do not allow investors to sell or withdraw funds for a fixed amount of time.
- Pass on the investment if you are asked to falsify any financial information to qualify as an accredited investor.
- Do not complete a Subscription Agreement or Accredited Investor Questionnaire unless you understand it and agree with the entire document.
- Do not invest if the seller can't satisfactorily answer your questions about the company, its business model, and its executives' experience.

Beware of promises of guaranteed high returns. Remember, if it sounds too good to be true, it probably is.

4 Keys to Smooth Private Placement Transactions

- **Review the entity's required documents.** It may require a passport, driver's license, or a utility bill. If these requirements exist, easy-to-read copies of each must also be submitted to The Entrust Group.
- **Know the roles of the administrator.** Be aware that Entrust is a third-party administrator of self-directed retirement accounts, and IRAs are not protected by the Employee Retirement Income Security Act (ERISA). Read and understand how ERISA pertains to qualified plans, such as 401(k)s. Select and mark the appropriate item on your investor documents appropriately in regards to ERISA.

- **Obtain copies of statements, reports, notices.** The entity needs to send one copy of each document related to the transaction to you, and one copy to Entrust . Sometimes that does not happen, and you will need to email us a legible copy at Statements@TheEntrustGroup.com.

- **Additional funding.** If additional funds are needed for the investment, supporting documentation is needed. This can be the letter to you from the entity, requesting additional funds. Please send us copies of the documentation you receive.

About The Entrust Group

Entrust strives to provide personal, professional services and education that empowers clients to control their investment choices. You can rely on The Entrust Group for up-to-date training and continuing education about self-directed alternative investments. Our reports, webinars, and live events can help you keep up with the increasing demand to diversify portfolios.

To learn more about private placements in self-directed IRAs, please visit The Entrust Group Learning Center[5].

[5]The Entrust Group, [learningcenter.theentrustgroup.com/pages/catalog/CourseCatalog.aspx]