



## Department of Commerce

Division of Securities  
John R. Kasich, Governor  
David Goodman, Director

July 3, 2012

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

Re: Comments on the Securities and Exchange Commission's Regulatory Initiatives  
under Title II of the JOBS Act

Dear Ms. Murphy:

The Ohio Division of Securities (the "Division") appreciates the invitation of the Securities and Exchange Commission (the "Commission") for views on the Commission's regulatory initiatives under the Jumpstart Our Business Startups Act ("JOBS Act") prior to the Commission's official comment period. Due to the historic changes brought by Title II of the JOBS Act ("Title II"), the Division wishes to express its view on proposed rulemaking that will be necessary.

In Regulation D, the Commission established safe harbor rules to help issuers ensure that their offerings qualify for the "private offering" exemption from registration under Section 4(2) of the Securities Act of 1933. The most frequently used safe harbor of Regulation D is Rule 506. Pursuant to Rule 506, an issuer may raise an unlimited amount of capital from an unlimited number of accredited investors, but may only raise funds from no more than 35 sophisticated non-accredited investors. Within that private offering framework, the Rule 506 issuer is prohibited from engaging in general advertising and general solicitation. These prohibitions stem from a fundamental concept of investor protection central to Section 4(2) (and Rule 506, as a safe harbor thereunder) — that the issuer of securities in an exempt private offering has a preexisting relationship with its potential investors. Due to this preexisting relationship, private investors are believed to have access to substantially the same information that they would receive in a public offering.<sup>1</sup> In theory, the private investor's access to such information obviates the need for registration of the securities being offered.

In the Division's view, Title II of the JOBS Act does not alter the traditional Rule 506 exempt private offering ("exempt private offering") under Section 4(2). Those offerings will continue to be available to issuers and investors in their present form. Title II, however, does

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<sup>1</sup> *SEC v. Murphy*, 626 F.2d 633, 647 (9<sup>th</sup> Cir. 1980).

make a new and unprecedented exempt form of *public* offering (“exempt public offering”) available to issuers under Rule 506 that, like its private counterpart, will be subject to little or no regulatory oversight or review.

Although Title II’s new exempt public offerings may be sold only to accredited investors, allowing issuers to openly advertise the securities and solicit sales from the public-at-large without adequate regulatory oversight poses significant risks to both investors and issuers participating in the offerings. Accordingly, the views expressed below focus on these risks and other competing interests that the Commission must balance in formulating this new exempt public offering. The Division’s goal is to identify ways the Commission can effectuate Congress’ intent in the JOBS Act of easing capital formation without unduly sacrificing existing issuer and investor protections. In doing so, it will be important to maintain a level playing field between the issuers and broker-dealers participating in exempt public offerings and exempt private offerings under Rule 506, and registered public offerings so as to avoid any unanticipated consequences.

## **I. Disclosure**

The new exempt public offering does not, by its own terms, require the “preexisting relationship” element that is core to traditional exempt private offerings. Accordingly, there is a significant risk that the recipients of general advertising or general solicitation, whether accredited or otherwise, will not have access to the information they would typically receive in a registered public offering. There is a similarly significant risk that issuers may fall short of disclosing all material information required under federal and state securities laws to investors unfamiliar with an issuer’s business. The views in this section are intended to ensure that participants in exempt public offerings both give and receive appropriate disclosure for their own benefit and for the benefit of the market as a whole.

### **A. Anti-Fraud Issues**

Except for the tombstone-type notices<sup>2</sup> of companies registered under Section 12 of the Securities Exchange Act of 1934, the Division’s experience is that fraudulent statements and material omissions are often prevalent in advertising to investors. For example, the Division frequently observes attempts to entice investors through advertising promising “guaranteed returns” and fraudulent projections or forecasts of performance. Typically, these issuers and the content of their communications are ineligible for any safe harbor for forward-looking statements under Section 27A of the Securities Act of 1933. Such presentations may subject issuers to civil or criminal liability for fraud.<sup>3</sup> These risks will be amplified by Title II of the JOBS Act. Accredited investors present prime, well-funded targets to scam artists who will not hesitate to take advantage of the new general solicitation and general advertising freedoms to troll for victims. The damage will not be limited to accredited investors, as Title II opens such advertising to all audiences.

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<sup>2</sup> See Rule 502(c) and Rule 135c.

<sup>3</sup> See Preliminary Notes to Regulation D.

The Division asks the Commission to remind issuers, as an initial matter, that compliance with the new exemption under Rule 506 will not relieve issuers from the antifraud provisions of state and federal securities laws, particularly in connection with advertising materials.

## **B. Content Standards for Advertising and Solicitations**

In light of the anti-fraud concerns discussed above, the Commission should consider permitting only limited information in advertising or solicitations, similar to a tombstone as provided in Rules 135c<sup>4</sup> or Rule 504(b)(1)(iii) and the NASAA Model Accredited Investor Exemption.<sup>5</sup> If the Commission finds this approach too narrow, the Commission should consider adopting a uniform set of required disclosures and content restrictions for general advertising and general solicitation used in connection with an exempt public offering. For example, such required disclosures should include a required legend disclosing those jurisdictions where the offering is being made (and disclaiming sales in any others). Financial projections or statements of future performance should be prohibited. Compliance with the content standards should be a mandatory condition of the exemption.

This standards-based approach is consistent with rules and regulations that have been promulgated by the Commission in other contexts,<sup>6</sup> and the Division suggests that such rules and regulations could be informative for the Commission's rulemaking. Moreover, this approach could help increase consistency between the advertising timing and use requirements of registered public offerings and exempt public offerings. Registered public offerings must deliver a prospectus prior to or contemporaneously with the use of advertising materials,<sup>7</sup> while exempt public offerings under section 4(2)<sup>8</sup> may use an advertisement without delivering a prospectus at all. Still, the Commission would likely need to adopt additional content standards, going forward, as the market for exempt public offerings evolves and new abuses emerge.

The Division notes that in the absence of Commission-developed content standards, advertising and solicitation in exempt public offerings will be subject to different requirements depending upon whether the transaction is sold by broker-dealers or by issuers directly. Advertising used in broker-dealer sold offerings is subject to FINRA content standards under NASD Rule 2210, as well as review by FINRA's Advertising Regulation Department. The

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<sup>4</sup> Rule 502(c) permits a publication of a notice in accordance with Rule 135c which is available for issuers that are required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

<sup>5</sup> NASAA Model Accredited Investor Exemption (4/27/97) coordinates with Rule 504(b)(1)(iii) and provides for a "general announcement" similar to tombstone type information.

<sup>6</sup> See, e.g., Securities Act Rule 156, Securities Act Rule 482, Section 35 of the Investment Company Act, and Item 19 to Guide 5 Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships.

<sup>7</sup> See Section 2(10) of the Securities Act of 1933 defining prospectus to include "advertisement"; see also Sections 5(b)(1) and (2) of the Securities Act of 1933 requiring the prospectus to meet the requirements of Section 10 or accompany or be preceded by a prospectus meeting the requirements of Section 10.

<sup>8</sup> Section 4(2), now 4(a)(2), exempts offerings from all components of Section 5.

Division encourages the Commission to consult with FINRA staff to evaluate FINRA content standards that may also be appropriate to apply to issuer-sold offerings.

### **C. Offering Circular Requirement**

The Division asks the Commission to consider revising Rule 502(b) to require an issuer utilizing general advertising or general solicitation in connection with a Rule 506 offering to deliver a disclosure document to *all* investors, regardless of accredited investor status. The Commission already encourages issuers to provide the same information to accredited investors as it would have to provide to non-accredited investors.<sup>9</sup> Requiring issuers to make full and fair disclosure of all material terms and risks of a securities offering through an offering circular not only allows investors to make informed investment decisions, but also helps issuers reduce their exposure to potential civil and criminal liability for fraud. For this reason, many issuers and practitioners already prepare a disclosure document in connection with traditional exempt private offerings even in the absence of any such requirement. Requiring an offering circular in Title II offerings would simply confirm an industry best practice that enhances the integrity of the capital markets.

## **II. Offering Mechanics**

The creation of exempt public offerings by Title II of the JOBS Act introduces significant changes to the way issuers are able to access the capital markets and reach potential investors. Some of these changes are required by the express language of Title II, while others should be considered in light of the practical effects of allowing general solicitation and general advertising in connection with an offering that receives no regulatory review.

### **A. Accredited Investors – Standards and Verification**

Section 201(a)(1) of the JOBS Act states:

(a) Modification of Rules.

(1) Not later than 90 days after the date of the enactment of this Act, the Securities and Exchange Commission shall revise its rules issued in section 230.506 of title 17, Code of Federal Regulations, to provide that the prohibition against general solicitation or general advertising contained in section 230.502(c) of such title shall not apply to offers and sales of securities made pursuant to section 230.506, ***provided that all purchasers of the securities are accredited investors. Such rules shall require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission. . . .***

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<sup>9</sup> See the note to Rule 502(b)(1): “When an issuer provides information to investors pursuant to paragraph (b)(1), it should consider providing such information to accredited investors as well, in view of the anti-fraud provisions of the federal securities laws.”

(2) Not later than 90 days after the date of enactment of this Act, the Securities and Exchange Commission shall revise subsection (d)(1) of section 230.144A of title 17, Code of Federal Regulations, to provide that securities sold under such revised exemption may be *offered* to persons other than qualified institutional buyers, including by means of general solicitation or general advertising, provided that securities are sold only to persons that the seller and any person acting on behalf of the seller *reasonably believe* is a qualified institutional buyer

(emphasis added).

As set forth above, Section 201(a) clearly contemplates a different standard for the new exempt public offerings that employ general advertising and solicitation than the prevailing standard for traditional exempt private offerings under Rule 506. Specifically, Section 201(a)(1) establishes two requirements for an issuer using general advertising or solicitation.

First, Congress chose the words “all” and “are” in the requirement “that *all* purchasers of the securities *are* accredited investors” (emphasis added). This wording clearly evidences Congressional intent that the exemption be available to an issuer only if every purchaser is accredited. Section 201(a)(1) is quite clear – the sale of a security to even one non-accredited investor in an exempt public offering disqualifies an issuer from the exemption. The Commission’s rules should also be clear that a strict liability standard applies to sales in an exempt public offering. This is consistent with the existing Rule 508, which has never offered a good faith defense for violations of Rule 502(c).

Second, Title II requires that the issuer “take **reasonable steps to verify** that the purchasers are accredited investors” (emphasis added). This language is meant to ensure that there are no accidental sales to non-accredited investors. The Division notes that the words “reasonable steps” and “verify” are different than the language used in Section 201(a)(2) in connection with sales to qualified institutional buyers (“securities are only sold to persons...the seller reasonably believe[s] is a qualified institutional buyer”). This language stands in contrast to the existing language in Regulation D, where the “reasonably believes” standard is used repeatedly in the definition of accredited investor,<sup>10</sup> in the computation of purchasers,<sup>11</sup> and in the sophistication of purchasers.<sup>12</sup> Congress’ use of different language, both within Title II itself and between Title II and Regulation D, strongly indicates that a new and higher standard must be applied to exempt public offerings. Congress’ bifurcation of standards applicable to offerings claiming the same exemption is not a new concept to Regulation D. Rule 504 applies three different standards depending upon the approach taken by the issuer. The creation of different standards for exempt private offerings and exempt public offerings is clearly the reasoned and equitable result intended by Congress.

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<sup>10</sup> See Rule 501(a) of Regulation D.

<sup>11</sup> See Rule 506(b)(2)(i).

<sup>12</sup> See Rule 506(b)(2)(ii).

In granting issuers greater access to capital, Congress also gave issuers greater responsibilities, including a key and active role in “taking reasonable steps to verify” that each investor is accredited. A “check-the-box” approach to investor self-verification of accredited status will not suffice because the Title II issuer must have more than a belief that a prospective purchaser is accredited.<sup>13</sup> Indeed, Title II expressly requires the issuer take multiple, active steps to actually verify accredited status, whereas completing a “check-the-box” questionnaire entails only a single, passive step taken by the purchaser. As for what multiple, active steps the Commission should require Title II issuers to take, the Division would recommend the following:

- The issuers should review and confirm (and maintain appropriate records of) the accredited investor’s level of sophistication in a similar fashion to the requirements for sophisticated, non-accredited investors in Rule 506(b)(2)(ii);
- The issuer should review financial statements and/or tax returns evidencing actual satisfaction of accredited investor thresholds; and
- In the case of accredited investor *entities*, the issuer should review the accredited investor status of equity owners per the above bullet points, and/or review regulatory letters or certificates approving or confirming the entity’s status as a bank, insurance company, registered investment company, business development company, or small business investment company.

To enjoy the benefits of general advertising and general solicitation in an exempt public offering, thereby exposing more of the public to risk, issuers must take a greater and more active role in ensuring that risk is limited to accredited investors who are better able to bear such risk.

Lastly, the Division encourages the Commission to revisit the monetary thresholds set forth in the “accredited investor” definition in Rule 501 to account for inflation that has occurred since the rule’s adoption. According to the U.S. Bureau of Labor Statistics, \$1,000,000, the net worth threshold for accredited status, had the same buying power in 1982 as \$2,384,300.52 in 2012.<sup>14</sup> Similarly, \$200,000 (\$300,000 with spouse), the annual income thresholds for accredited status, had the same buying power in 1982 as \$476,860.10, and \$715,290.16, respectively, in 2012.<sup>15</sup> The Division urges the Commission to revisit and revise the thresholds for accredited investor status to account for inflation, consistent with the treatment of other dollar thresholds under Titles III and IV of the JOBS Act.<sup>16</sup>

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<sup>13</sup> The Commission previously scrutinized “check the box” suitability as conducted in Internet based offerings. SEC Release No. 33-7856 (May 4, 2000).

<sup>14</sup> See [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm).

<sup>15</sup> *Id.*

<sup>16</sup> The Division notes that Title IV of the JOBS Act mandates periodic Commission review of the aggregate offering amount of Regulation A offerings, and Title III of the JOBS Act requires the Commission to inflation adjust the dollar amounts of the crowdfunding exemption not less than once every five years.

## **B. Revisions to Form D**

The Division encourages the Commission to adopt several revisions to the Form D to reflect the introduction of exempt public offerings.

First, it will be imperative for both the Commission and states to have a quick and easy way to determine whether an issuer is conducting an exempt private offering or an exempt public offering. The simple addition of a line item indicating an issuer's use of general advertising and general solicitation would allow regulators to quickly ascertain which Rule 506 exemption is being claimed by the issuer.

Second, the Commission should consider reintroducing the appendix that was included on the Form D prior to March 16, 2009 for issuers making exempt public offerings under Rule 506. Because advertising, and in particular internet advertising, has the ability to easily cross state lines, it is critical that the issuer identify where the securities will be offered for sale. The Division notes that the appendix, in conjunction with an appropriate legend on advertising as suggested above, may help issuers utilize internet advertising exemptions available in the many jurisdictions and ease concerns that advertising may constitute a "sale."<sup>17</sup>

Third, in connection with future rule-making regarding bad actor disqualifiers in Rule 506 offerings (as further discussed below), Form D should be revised to provide more appropriate background information to allow broker-dealers, regulators and the investing public assess whether an issuer has been disqualified from using Rule 506. The information currently required on the Form D is insufficient to evaluate potential disqualifiers. For example, with existing information, it is impossible for regulators, investors or broker-dealers to conduct requisite background checks if the principal officer's name is "John Smith." The inclusion of "addresses" for related parties provides nominal additional value given that issuers commonly provide only their business addresses for related parties. The Division is mindful that Form D's are publicly available through EDGAR and that sensitive personal information (e.g., home addresses, social security numbers, etc.) would need to be filtered to appropriate parties in a secure fashion. At a minimum, the issuer could provide basic useful information, such as a related party's past affiliations or past participation in securities offerings, which would help narrow the scope of review necessary to check for bad actor disqualifiers.

Lastly, the Commission should require issuers to file all proposed general advertising and general solicitation material as an exhibit to the Form D. The Commission should consider any material that is intended to reach offerees with no pre-existing substantive relationship to the issuer (including, for example, internet websites, television and radio broadcasts, scripts for telephone calls, broker-dealer use only materials, and presentation slideshows) as material to be filed with the Commission. The advertising and solicitation material should be made available on EDGAR in connection with the Form D, and notice filings of the Form D to states should include all such exhibits. The Division notes that such a filing requirement is consistent with the requirements of the Commission, FINRA, and the states that issuers in registered public

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<sup>17</sup> For example, the Division maintains an exemption for certain internet advertising under Ohio Administrative Code Section 1301:6-3-03(E)(8).

offerings file all related advertising and solicitation materials prior to use, and will further level the playing field between registered public offerings and exempt public offerings.

### **C. Form D Timing**

Issuers making an exempt public offering should be required to file the Form D, including the suggested appendix and advertising exhibits, prior to the issuer's first use of any general advertising or solicitation. Correspondingly, issuers in an exempt private offering should be required to file the Form D prior to the issuer's first sale. The pre-advertising filing requirement for an exempt public offering would allow the Commission and/or states to review the Form D to confirm that the Commission's content standards for advertising are met. The pre-sale/pre-advertising filing requirement in all Rule 506 exempt offerings will allow the Commission and/or the states to ensure that no bad actor disqualifiers prevent the issuer's use of Rule 506. The pre-advertising filing and the review of the advertising and solicitation material enhance the fairness and consistency between registered public offerings and exempt public offerings. Moreover, many jurisdictions consider general advertising and solicitation to constitute the sale of a security. In those jurisdictions, an issuer who is caught advertising an otherwise unregistered, non-exempt offering could simply file a Form D and claim the intent to accept only accredited investors. By requiring issuers to declare that they will be making an exempt public offering prior to any sales or use of any advertising, issuers will not be able to engage in gamesmanship that will diminish the vitality and integrity of the private offering market.

The Commission will also need to make clarifying rule changes for amendments to Form D. If advertising is to be filed as an exhibit to the Form D and/or a jurisdictional appendix is reintroduced, the Commission would need to adopt rules requiring issuers to file an amended Form D any time (i) new advertising or solicitation material is added to an ongoing exempt public offering, (ii) an issuer wants to convert an exempt private offering into an exempt public offering in order to use general advertising or solicitation,<sup>18</sup> or (iii) any time the securities are going to be offered in a new jurisdiction. Consistent with the first filing of the Form D, amendments should be filed pre-sale and pre-use to ensure that the Commission and/or states have sufficient time to review the material. Like exempt private offerings, exempt public offerings should also be required to file an amended Form D on an annual basis to update information concerning sales and commissions; however, the Division also encourages the Commission to require the filing of a closing amendment relating final sales and commissions information for all Rule 506 offerings. Although closing amendments are currently permitted, in practice, issuers do not routinely make closing amendments (particularly in connection with offerings closing within one year). The information provided in a closing amendment will be invaluable to the Commission and states in determining the extent to which issuers are making exempt public offerings.

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<sup>18</sup> Provided that no sales had previously been made to non-accredited investors.

#### **D. Bad Actor Disqualifiers**

The Dodd-Frank Act of 2010 required that, within one year of its enactment, the Commission adopt standards disallowing issuers from conducting an exempt private offering under Rule 506 if an issuer's related parties had previously engaged in or been convicted of certain bad acts. In the view of the Division, these "bad actor disqualifiers" apply to all offerings under Rule 506, including the new exempt public offerings. As of the date of this letter, the Commission has proposed "bad actor disqualifiers" but has not adopted final rules implementing them. The final "bad actor disqualifiers" must be implemented before (or in connection with) the rulemaking required under Title II. The alternative is to allow bad actors to have freer access to investor capital, a result clearly not anticipated or intended by the Dodd-Frank Act or the JOBS Act.

#### **III. Integration**

The Commission should require a longer integration period for issuers making exempt public offerings before they are permitted to conduct a second Regulation D offering (whether under Rule 506 or otherwise). Currently, Rule 502(a) presumes that offerings are not integrated if a six month window separates the end of one Regulation D offering from the beginning of a subsequent Regulation D offering. The Division is highly concerned that issuers will retain lists of non-accredited offerees contacted during an exempt public offering and six months later make sales to such non-accredited offerees in a subsequent exempt private offering. The filing of a closing or annual amendment to the Form D suggested above would also help identify integration issues.

The Commission should enact strict rules to prohibit the use of the crowdfunding exemption introduced by Title III of the JOBS Act simultaneously with and for a sufficient time after an offering under Rule 506. Section 302(a)(6)(A) of the JOBS Act clearly intends for crowdfunding offerings to be integrated with all other securities offerings for a period of twelve months preceding the crowdfunding offering.<sup>19</sup> Crowdfunding offerings are designed to offer securities to non-accredited investors which are advertised *only* through an intermediary and in a very limited fashion. Crowdfunding issuers will be subject to offering amount restrictions and investor concentration limits, which could be subverted through Rule 506 offerings made concurrently with or in close proximity to a crowdfunding offering. Additionally, in the case of a concurrent crowdfunding and exempt private offering, crowdfunding advertising would generally be available to non-accredited investors; this should result in an integration of the offerings and the loss of both the private offering exemption and the crowdfunding exemption.

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<sup>19</sup> "(A) the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, is not more than \$1,000,000."

Finally, other integration provisions and exemptions such as Section 3(a)(11), Rule 147, Rule 155, and Regulation A should be considered in reviewing the proposed rules dealing with general advertising and general solicitation.

The Division appreciates the opportunity to present its views to the Commission. The reforms in the JOBS Act are substantial and we welcome further dialogue. If you have any questions or concerns, please contact Mark Heurman, Registration Chief Counsel, at (614) 644-9529 or me at (614) 644-7435.

Very truly yours,

A handwritten signature in black ink that reads "Andrea L. Seidt". The signature is written in a cursive, flowing style.

Andrea L. Seidt  
Commissioner  
Ohio Division of Securities