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Business Law Section
Securities Regulation Committee

September 23, 2013

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

E-mail address: rule-comments@sec.gov

Attention: Elizabeth M. Murphy, Secretary

RE: File No. S7-06-13
Amendments to Regulation D, Form D and Rule 156
Release No. 33-9416; Release No. 34-69960; Release No. IC-30595

Ladies and Gentlemen:

The Securities Regulation Committee of the Business Law Section of the New York State Bar Association (the "Committee") appreciates the invitation from the Securities and Exchange Commission (the "Commission" or the "SEC") in Securities Act Release No. 9416, Exchange Act Release No. 69960 and Investment Company Act Release No. 30595[1] to comment on the Commission's proposed rules and rule amendments (collectively, the "Proposed Rules") under the Securities Act of 1933, as amended (the "Securities Act"), the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Investment Company Act of 1940, as amended (the "Investment Company Act"), to implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer

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1 Amendments to Regulation D, Form D and Rule 156, Securities Act Release No. 9416, Exchange Act Release No. 69960 and Investment Company Act Release No. 30595 (July 10, 2013) (hereinafter, the "Release"), *available at* http://www.sec.gov/rules/proposed/2013/33-9416.pdf. Capitalized terms used herein without definition have the respective meanings ascribed in the Release.

Protection Act of 2009 (the "Dodd-Frank Act") relating to the amendment of Regulation D and Rule 156 under the Securities Act.

The Committee is composed of members of the New York State Bar Association, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and corporation law departments. A draft of this letter was reviewed by certain members of the Committee. The views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association or its Business Law Section.

Introduction

Lifting the ban on general solicitation and general advertising (collectively, "general solicitation") under Rule 506 was a long-awaited reform for issuers and investors alike, and this Committee joined in applauding the SEC's proposals to create new Rule 506(c).[2] We appreciate the Commission's invitation for public comment on the companion proposals set out in the Proposed Rules.

While we recognize that certain facets of the Proposed Rules raise issues at the heart of the Commission's oversight and investor protection mandates, we respectfully submit that many of the Proposed Rules do not strike the appropriate balance between protecting non-accredited investors and facilitating capital formation. We are deeply concerned that many of the Proposed Rules would significantly constrict private capital formation without providing any material benefit to investors.

The Commission advances its need for increased data collection as its principal rationale for the significant changes to the content and timing requirements underlying Rule 506 and Form D. We believe, however, that the analysis in the Release inappropriately discounts the considerable and important information available to the SEC and the Staff under the current Form D.

We are concerned that the Proposed Rules would render the new Rule 506(c) exemption and Rule 506 generally too burdensome for many issuers, such as small businesses and private funds. We are especially concerned that the proposed penalty for non-compliance with the Form D filing requirements, which would result in the loss of an exemption under Rule 506 for a full year, is significantly disproportionate to any resulting

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[2] N.Y.S.B.A., Bus. L. Section, Sec. Reg. Comm., Comment Letter (Oct. 12, 2012), *available at* http://www.sec.gov/comments/s7-07-12/s70712-161.pdf.

harm for failure to make notice filings. The costs of complying with multiple and inconsistent state blue sky laws as an alternative to Rule 506 would result in a regulatory burden that is unreasonable and not justified by any corresponding regulatory or investor protection benefit.

We are also concerned about the effects of the Proposed Rules on the Rule 506(b) private placement market. We strongly support the preservation of the existing Rule 506(b) safe harbor, and the ability of all issuers, regardless of size, to continue offering and selling privately-placed securities to up to 35 non-accredited investors under Rule 506(b)'s sophistication requirements — without the imposition of any additional costs or regulatory burdens. As proposed, the reforms would significantly complicate, and in some cases jeopardize, use of the existing Rule 506(b) safe harbor, thus increasing the cost of capital without any measurable improvement in the private placement process for sophisticated investors who by definition are deemed capable of "fending for themselves." The Proposed Rules would strongly affect all market participants, especially start-ups and small businesses and the private funds that invest in them.

The following discussion of our comments regarding the Proposed Rules includes suggestions that would alleviate the aspects of the proposals most likely to encumber private capital formation while enabling levels of compliance that would facilitate the Commission's vital oversight.

A. Proposed Amendments Relating to Regulation D and Form D

1. Timing of Initial Form D Filing

Although we fully agree that issuers engaging in general solicitations under Rule 506(c) should be given an incentive to provide the SEC with basic information about such offerings, we cannot support the proposals requiring filing of Form D in advance of the offering ("Advance Form D"). The effect of the Advance Form D is to impose a 15-day waiting period before an issuer may commence a private offering with general solicitation. It is unclear why any waiting period should apply to a private offering not subject to merit review. Delaying access to the capital markets should be accompanied by a strong regulatory interest; however, the Release does not provide a compelling rationale for the proposed waiting period or its length. We also note that an Advance Form D may precipitously signal the issuer's competitors and the broader market, which may in turn affect the success of the offering. Imposing advance filings for Rule 506(c) offerings, with no such requirement for Rule 506(b) offerings, will have the effect of discouraging issuers from using general solicitation, thus undermining Congressional intent to generally facilitate Rule 506 offerings.

We believe that notice within 15 calendar days after the first sale of securities, as required by current Rule 503, is reasonable and sufficient. This filing period provides early notice to the SEC and other regulators of a new offering under Regulation D, while permitting the issuer a reasonable period to complete and submit the Form. Issuers and their promoters continually revise and negotiate their private offering terms right up to the first sale. They are accordingly unable to provide some of the required notice information any sooner, *e.g.*, size of offering, related persons, use of proceeds, affiliate compensation or even the final name of the issuer. Under these circumstances, it would also be unreasonable and burdensome to require regular updates as these terms solidify in advance of a first sale.

The Advance Form D is also problematic in the event of inadvertent general solicitation, which we discuss in greater detail in Part D of this letter. In many cases, an issuer will have no intention of engaging in a general solicitation. However, someone at the issuer may agree to an interview or present at a conference, which in retrospect may give rise to questions as to whether the conduct could be construed as a general solicitation. This puts additional pressure on compliance personnel who may find out months after the fact about an inadvertent "public" comment that may constitute a general solicitation. There is no clarity around which public statements constitute general solicitation, further contributing to issuers' difficulty in determining whether to make a filing under Rule 506(c) at all, but issuers will be particularly uncertain whether to make such a filing in anticipation of a potential inadvertent public statement. Forcing an early filing to address a potential inadvertent general solicitation will not provide the Commission more meaningful information.

In other cases, an issuer may not have determined 15 days in advance of an offering whether or not it will use general solicitation methods. The issuer may prefer to see how the offering proceeds before making a decision. Because offerings may not result in a sale for a multitude of reasons, the information on an Advance Form D as it relates to a subsequently discontinued offering would be of scant regulatory interest. Even with respect to ultimately successful offerings, the Commission (and state securities regulators) will have no way of distinguishing between an advance filing for an actual general solicitation and a precautionary filing in case there is an inadvertent general solicitation or in case the issuer later decides to use general solicitation. Furthermore, under the Proposed Rules, an issuer that chooses to make a precautionary filing loses the option to admit a single non-accredited investor, flexibility which we believe should continue to be available if the issuer has not actually engaged in general solicitation. Such an issuer would also be subject to penalty if it unintentionally admits a single non-accredited investor. Given the high stakes and the limited informational value of an early filing, an issuer should be permitted to see how the offering proceeds up until at least 15 days after the first sale to determine whether to rely on Rule 506(b) or Rule 506(c). We accordingly believe that until an issuer actually engages in general solicitation, the safe harbors should be non-exclusive, and an issuer should not be precluded from claiming any other available exemption.

The Advance Form D requirement also presents specific challenges for certain classes of issuers. It would unduly burden start-ups and small businesses to require a filing prior to raising any capital, and before there are any investors warranting the SEC's protection. Many issuers determine to initiate an offering based on market conditions on very short notice. An issuer in this situation will need to either not avail itself of general solicitation or wait 15 days after filing the Advance Form D, at which point market conditions may have deteriorated such that an offering is no longer possible. The advance notice requirement along with the proposed penalties for non-compliance could potentially disqualify issuers (and their predecessors and affiliates) from relying on Regulation D for later transactions when the prior offering resulted in no investors and accordingly no harm. This result is all the more disproportionate when considering the purpose of Form D, which should be to provide the SEC and other regulators with information regarding completed sales.

Certain state regulators have said that they are in favor of the Advance Form D filing requirement so that they are in a position to answer investor questions about an offering. We believe investors will be able to conduct their due diligence without the assistance of state regulators. If an investor does seek the assistance of a state regulator, any relevant information to be checked with state regulators will be included in the offering materials or can be obtained from the issuer upon request. The heavy burden of an advance filing requirement outweighs any interest the states may have in being able to review Form D and answer investor questions.

Although we submit that issuers should not be required to pre-file Form D, for either Rule 506(c) or 506(b) offerings, we believe that the SEC should continue to permit advance filings. An early filing of this type may somewhat diminish the usefulness of the initial Form D notice from a regulatory perspective, but it should be no less informative than an early filing of Form D under Rule 506(b), and it would be subject to the amendment provisions. Given the breadth of what constitutes "general solicitation," issuers relying on Rule 506(c) may choose to file early but, for the reasons described in Part A.4 below, they should not be required to do so as a condition to Rule 506(c). We also believe that if the Commission requires the Advance Form D, issuers should be permitted the option to provide information only to the extent that it is available at such time.

2. Form D Closing Amendment for Rule 506(b) and 506(c) Offerings

For similar reasons, we cannot support the Commission's proposal to require a closing amendment to Form D not later than 30 calendar days after the termination of a Rule 506 offering. As noted in the Release, Rule 503(a)(3)(ii) currently requires an issuer to amend a previously filed Form D to reflect changes in the information provided, subject to certain enumerated exceptions. The initial filing and the required amendments should provide enough information for the SEC and other regulators to perform their oversight role. Further, the information in any closing amendment (as opposed to the sales information already collected through prior filings) would be largely duplicative of prior amendment filings, except as to formal termination of the offering and the precise amount of securities sold.

We also highlight that it will be difficult for many issuers to determine when exactly an offering has terminated. Companies in their start-up phase, as well as many private fund managers, are in essentially continuous fund-raising mode, which may simply peter out, without a precise endpoint. This presents a practical compliance problem, since an issuer may be unable to determine the filing deadline with certainty.

Aside from the practical problems, requiring a closing amendment is an obligation that would impose additional costs and burdens that issuers currently do not have. This extra requirement would also subject issuers to penalties for non-compliance that are disproportionate to the value of any incremental information. The SEC retains full authority to request the information from the issuer in those cases where it considers the same to have regulatory import. As noted in the Release, the Commission eliminated the closing amendment requirements in 1986. At the time, the Commission anticipated that doing so would have negligible consequences for investors and would result in some cost savings for both issuers and the SEC. We believe the same analysis continues to militate against requiring closing amendments today.

In the event the Commission adopts the closing amendment requirement, it should be accompanied by a significant reduction in the types of circumstances in which amendment filings are required. In particular, no amendment should be required if no securities are sold. The disclosure would be burdensome for a private issuer, which should not be forced to publicize the discontinuation or failure of its non-public offering. We do not think the Commission will be able to determine anything significant from the lack of a sale as there could be a multitude of issuer specific issues or market factors leading to an aborted offering.

As an alternative to a closing amendment, an additional requirement to file an amended Form D for sales in excess of 10% of the amount last reported should adequately address the only significant information the Commission should be interested in obtaining. We do not believe that any other additional amendment filings should be required either to provide more information or to file more frequently and are only suggesting the additional requirement relating to sales in lieu of a closing amendment. In the event that the Commission retains the disqualification for failure to file, we believe that the Commission should provide additional guidance as to the circumstances in which amendment filings are and are not required.

3. Proposed Amendments to the Content Requirements of Form D

We also cannot support most of the proposed amendments expanding the content disclosures of Form D. We believe the legitimate purpose of Form D is to collect aggregate market data — not to serve as a disclosure document for investors. However, the benefit, whether from an information collection or investor protection standpoint, of requiring issuers to make most of these new disclosures is not clear. The Commission may obtain much of this information through other means. In the case of reporting companies, as well as registered advisers and broker-dealers, most of the information is already provided by the issuer or its affiliates through other required filings, and by ordinary course examinations of any private fund issuer or its SEC-registered affiliates. In terms of investor protection, non-accredited investors are not permitted to participate in Rule 506(c) offerings. Any sophisticated investors who opt to participate have no need for heightened protections or disclosures, as they are capable of eliciting from issuers the information they deem relevant.

In contrast, the increased burdens on issuers are tangible and extensive. The proposed disclosures would increase the time and cost of preparing and amending Form D, and in some cases impose more extensive disclosure obligations than are currently required for public offerings under the strictures of Regulation S-K. Specifically:

- Item 3 (*Related Persons*) amplifies the categories of individuals subject to disclosure by including any person who directly or indirectly controls the issuer. This may result in more extensive disclosure than would be required in a public offering. In many cases, this may be sensitive and private information that the issuer (and its related persons) may not wish to be publicly disseminated. It may also be a nuanced determination that requires consultation with counsel, which would impose an additional cost. In contrast, it is relatively simple for the SEC or a potential investor to separately request the information.

    - Although we do not support this disclosure, if the SEC were to require it, a clear test of control for this purpose should be adopted. As applied to private funds, this disclosure requirement should be limited to persons who may direct the investment strategies of the fund, *i.e.*, the general partner or managing member, or the fund's directors, as well as its investment advisers, but should not include limited partners in their capacity as such. The required public disclosure of large investors may discourage seed or foundation investors from providing initial capital to private funds, thus adding new complications to an already-challenging fundraising environment.

- Item 5 (*Issuer Size*) would require an issuer to disclose, if it engages in a general solicitation, including an inadvertent one, information about its revenues or net asset value if the information has already been made public. The information about net asset value is often volatile and could become subject to the amendment requirements of Form D, thus imposing a heavy burden.

- Item 14 (*Investors*) would require new breakdowns (both by number and amount raised) as between accredited and non-accredited investors, and also as between natural and legal persons. The new breakdowns are likely to be of little practical use to the SEC, as the composition of investors may be dictated by any number of regulatory, tax or other issues. On the other hand, it is an additional burden that imposes extra costs. We note also that this Item appears to overlap with Item 17 (*Accredited Investors*).

- Item 16 (*Use of Proceeds*) would require more disclosure than is required in certain public offerings.

- Item 19 (*Filing of General Solicitation Materials with FINRA*). The information requested under this item should be easily obtainable by the SEC Staff via other means.

- Item 21 (*Types of General Solicitation*). Issuers engaging in general solicitation should be permitted the flexibility to take advantage of all new and traditional advertising methods, without the burden of determining whether the particular method fits into one of the listed categories and whether it was appropriately disclosed. The simple notice to the SEC that the issuer intends to engage in a Rule 506(c) offering should suffice.

- Item 22 (*Methods Used to Verify Accredited Investor Status*). Issuers are liable for errors resulting from their verification methods irrespective of whether they report those methods to the SEC on Form D. Given the variety of acceptable verification methods, any one or more of which may be in use with respect to a particular investor, the utility of the information to be disclosed is unlikely to be meaningful. Further, imposing a "check the box" requirement may undermine the principles-based approach advanced by the Commission, which contemplates consideration of the specific facts and circumstances of each case. Eliminating this requirement would not undermine the Commission's ability to monitor the issuer's verification methods.

In the event the Commission determines to require some version of these additional disclosures, we suggest that the Commission expand the list of items in Rule 503(a)(3)(ii) for which changes do not trigger an amendment requirement to include all of the proposed new disclosure items.

4. Proposed Amendment to Rule 507 Disqualifying from Use of Rule 506 Persons Who Fail to Comply with Notice Filing Requirements

a. Conditioning Rule 506 Exemption on Compliance with Rule 503

We strongly support the Commission's long-held position that failure to comply with Rule 503 and the notice filing requirements of Regulation D should not be a condition of Rule 506. Moreover, because Rule 506(c) offerings are limited to accredited investors and subject to heightened verification standards, we believe this position applies with greater force to those offerings.

The failure to file Form D does not, under currently applicable regulations, constitute a basis for the loss of the Securities Act registration exemption and the preemption of state blue sky laws provided by Section 18 of the Securities Act. As noted by the Commission, if the notice filings and related amendments were a condition of Rule 506 and an issuer failed to make them, the issuer would lose the exemption for the entire offering at issue. This includes sales that were made while the issuer was in compliance with Rule 503, a result that is unreasonable and disproportionately punitive.

In offerings by large institutional or seasoned issuers planning to use general solicitation, we would expect the level of compliance with the filing requirements to be high, because the incentive to file, and to clearly make a record of reliance on Rule 506(c), is higher than in the past under Regulation D. Accordingly, the penalty may have greater effect on the generally unwary or those who are accessing the private markets without the benefit of comprehensive legal advice. Since there will be no fallback under Section 4(a)(2) of the Securities Act where general solicitation has been used (as has often been the case in Rule 506 offerings to this point), conditioning the exemption in this manner may disproportionately penalize those whose access to the markets Congress was most keen to facilitate.

Further, it would be inappropriate to penalize an issuer with the loss of the offering exemption for failure to make a Form D filing or amendment in a Rule 506 transaction (most evidently in the case of technical errors), as the harm extends not only to the issuer and its principals, but also to prior investors who may lose their investments if the issuer lacks the funds to make rescission payments or is forced to dissolve. Such a result is wholly contrary to the purposes of Rule 506, namely, to encourage American enterprise by facilitating investments by sophisticated investors who do not require the SEC's protection.

For the reasons described above, Rule 508 should apply with respect to compliance with all Form D filing deadlines, so that an issuer that unintentionally delays a filing beyond the deadline would not be precluded from relying on Regulation D.

b. Disqualification as a Penalty for Non-Compliance with Rule 503

We believe similar reasoning applies when assessing the Commission's proposed alternate penalty for non-compliance, which is a one-year disqualification from future use of Regulation D.[3] As proposed, issuers would be disqualified from using Rule 506 based on non-compliance with Rule 503 within the past five years in connection with any Rule 506 offering by them or their predecessors and affiliates, including fund portfolio companies. We believe the proposed disqualification penalty would create an insurmountable hurdle for many issuers' capital raising efforts (and those of their predecessors and affiliates), and we accordingly cannot support the Commission's proposal. For the same reasons, we do not support its extension to smaller issuers relying on Rules 504 or 505.

While we concur that issuers should have an incentive to provide the SEC with basic Form D information, the penalty for any failure to do so should be commensurate with the harm caused by non-compliance or delayed compliance. As we understand it, the chief purpose of the Form D filing requirement is to enable the Commission to better understand and evaluate the Regulation D marketplace. A mandatory filing requirement that omits reasonable opportunity to cure and penalizes even minor, technical errors by precluding the issuer, its predecessors and affiliates from relying on Regulation D would expose issuers and investors alike to significant legal risk, in turn damaging investor confidence and depressing capital formation. This is particularly true as the SEC proposes increasingly more onerous and complex Form D filing requirements.

Given that loss of the exemption is wholly disproportionate to any resulting harm, disqualification from future use is too harsh a penalty. Raising capital through the public markets or in accordance with the multiple, inconsistent and cumbersome state securities laws are not viable alternatives to raising capital under Regulation D. Further, a

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[3] If the Commission adopts the Rule 507(b) substantially as proposed, we suggest that it clarify that the disqualification would end at the earlier of one year after correcting all missed filings and five years after a missed filing. In the absence of this technical clarification, someone who corrects after the fourth anniversary would have a longer disqualification than if they obviated the corrective filing altogether, a result which could provide a disincentive to make corrective filings in the final year of disqualification.

penalty that precluded an issuer from future reliance on Regulation D would be particularly unworkable for start-ups and private funds. Many start-ups, which by definition are continuously fundraising, would see their efforts to access private angel capital severely limited. Hedge funds, which typically conduct continuous offerings that permit investors to periodically subscribe and redeem their interests, would also be excessively burdened. These issuers that need continued access to the private capital markets may fail as a result of the proposed length of the disqualification period.

The Commission's proposal to extend disqualification to an issuer's predecessors and affiliates is also problematic. It would improperly penalize innocent parties, including investors in affiliated investment vehicles, for someone else's failure to comply with a notice filing. We find the application to portfolio companies of a fund manager who failed to file particularly unfair and unnecessarily harmful to capital formation. It is not an exaggeration to suggest that the Proposed Rule could trigger a "domino" disqualification for private funds and the myriad portfolio companies in which they may be deemed to hold direct or indirect control positions. In view of the inequities, to the extent the Commission determines to impose some measure of disqualification or other penalty for non-compliance, it should be expressly limited to the offending issuer.

Further, the penalty for non-compliance should only affect issuers who do not make the initial Form D filing. There is no equity in exposing an issuer to so heavy a penalty for failure to amend a notice filing. It is easy for issuers, especially those who make frequent offerings, to inadvertently lose track of the various situations in which an amendment may or may not be required and the additional information provided is not sufficient to justify so severe a sanction.

The foregoing discussion reinforces our conclusion that issuers who engage in general solicitation under Rule 506(c) already have considerable incentives to file Form D and perfect the safe harbor without the imposition of any additional penalties by the Commission. Issuers who engage in general solicitation will have an interest in confirming their entitlement to rely on Rule 506(c), particularly for purposes of clearly establishing preemption of state blue sky laws that would not permit general solicitation. Given the issuer's potential legal exposure if a state securities regulator were to challenge its entitlement to effect a general solicitation, we believe it is unnecessary for the SEC to impose any additional penalties.

c. Opportunities to Cure Non-Compliance; Alternatives to Proposed Rule 507(b)

In view of the substantial pressures for issuers to perfect the Regulation D safe harbor, we believe the Commission should expand the opportunities to cure non-compliance. We agree with the Commission's proposal to provide a cure period for failure to file or amend Form D; however, we submit that the ability to cure should be available regardless of whether the issuer has previously failed to comply with a Form D filing deadline in connection with the same or any other offering. A liberal cure provision would positively encourage compliance and promote the use of Rule 506(c), which we believe will greatly facilitate private capital formation.

Balancing the regulatory interests and the effect of any penalties for non-compliance, we believe that the Commission should permit issuers to cure at any time within a reasonable period following the initial sale (such as six months post-sale) by payment of a modest late filing fee.

In general, the Commission always retains the right to initiate administrative proceedings against an issuer. Under our suggested approach, an issuer that filed Form D or the applicable amendment within a reasonable period after the filing deadline would be permitted to continue its reliance on Regulation D without subjecting the issuer's business or its investors to the uncertainties and legal risks that would arise if it was precluded or disqualified from using Regulation D. The failure to make notice filings that provide limited information of limited use to the Commission and to state securities regulators should not impose significant impediments on U.S. businesses.

If the Commission determines that it is necessary to impose a disqualification period, which we believe is unjustifiably harsh, the period should be significantly reduced to not more than 15 days. A disqualification of this length would still cause extreme hardship to issuers in need of capital and issuers whose business depends on continuous capital raising.

In addition, we believe the Commission should consider amending Proposed Rule 507(b) to specify that failure "to comply with the requirements of §230.503" means failure to file an initial Form D. Rule 503 currently requires the filing of Form D and all of its items. When Proposed Rule 507(b) is read in conjunction with existing Rule 503, it is unclear whether an issuer who makes a good faith error or omission, irrespective of materiality, would be deemed to have failed to comply with Rule 503 for purposes of Rule 507(b). Such an outcome could subject the issuer to the disqualification, which we believe would be excessively punitive. If the Commission determines to retain the formulation of 507(b) as proposed, we recommend the Commission consider specifying a materiality qualifier for any errors or omissions.

Finally, we do not think the waiver mechanism proposed by the Commission provides any meaningful relief to disqualification because there will be no assurances as to whether relief will be provided and the process will likely be expensive and time-consuming. However, if the Commission imposes some measure of disqualification, streamlined waiver procedures that would result in an expedited determination should also be implemented.

B. Proposed Rule and Rule Amendments Relating to General Solicitation Materials

1. Mandated Legends and Other Disclosure for Written General Solicitation Materials: New Rule 509

The Proposed Rules include a new Rule 509 of Regulation D, which would establish (i) a legend requirement for all general solicitation and general advertising materials and (ii) additional disclosure requirements for advertising materials used by private funds. The proposal also disqualifies an issuer from relying on Rule 506(b) or (c) if it or any predecessor or affiliate has been subject to any order, judgment or court decree enjoining that person for failure to comply with Rule 509. For the reasons described below, we believe these additional requirements would impose significant new burdens on issuers without any corresponding material increase in investor protections.

a. *Proposed Legend Requirement*

In offerings limited to accredited investors, Rule 506 does not currently impose specific content requirements. Instead, "[c]ompanies must decide what information to give to accredited investors, so long as it does not violate the antifraud prohibitions of the federal securities laws."[4] However, a legend requirement could pressure issuers to incur the costs of preparing more extensive written disclosures to match the formality of the legend. Moreover, because the proposed legend requirements would not relieve an issuer from the requirement to verify that all purchasers in Rule 506(c) offerings are accredited investors, requiring them to include the legends would burden issuers with providing specially-tailored information to persons who are not the intended audience and who cannot invest.

From a practical standpoint, we note that the Release does not address the inclusion of legends in communications where they will not be readily practicable, *e.g.*, communications involving certain live and social media. For example, the legend could not be easily added to the text of a Tweet (which is typically limited to a maximum of 140 characters). It would also be difficult to include the legends in TV and radio advertisements.

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[4] SEC Staff Interpretation, Rule 506 of Regulation D (Jan. 16, 2013), *available at* http://www.sec.gov/answers/rule506.htm.

In the event the Commission requires a legend in Rule 506(c) offerings, the Commission should consider significantly abbreviating the required legends to serve only as a notice that non-accredited investors may not participate. As an alternative, the Commission could consider exceptions for non-written materials and informal communications such as e-mail and social media. Additional exceptions could be available for written solicitation materials in concurrent offerings that are not subject to integration, whether registered or otherwise exempt, *e.g.*, under Regulation S. Further, if Proposed Rule 509 is adopted in some form, Rule 502(b) (which provides that no specific disclosure requirements apply to offerings limited to accredited investors, other than the antifraud rules) should cross-reference new requirements, if any.

b. *Disclosure of Most Recent Performance Information by Private Funds in Rule 506(c) General Solicitations*

We cannot support the measures included in Proposed Rule 509 regarding private fund performance data. If a private fund's written general solicitation materials include performance data, the Commission's Proposed Rule would require such data to be as of the most recent practicable date considering the type of private fund and the media through which the data will be conveyed. As proposed, the private fund would also be required to disclose the period for which performance is presented. Although the Commission considered some of the practicalities involved with the proposal, as well as the differing burdens for various private fund strategies, we submit that requiring "most recent" performance data in general solicitation materials would be too difficult to comply with. The Proposed Rule would provide marginal, if any, incremental protection to investors, but it would significantly burden private fund issuers.

Performance data in formal offering materials is typically presented as of a date certain — usually the most recently completed fiscal period. This data is usually outdated the moment the advertisement is printed. As a result, sophisticated investors request and obtain more current data in the course of their due diligence. However, forcing issuers to publicly disclose their "most" recent information in printed materials may result in the presentation of data that was prepared for internal purposes with varying levels of informality. The most recent data may be unaudited and in some cases may not even have the benefit of a full internal controls check. Even if the data was accurate, imposing the requirement will be costly because it will slow down private fund issuers as they go to market since they will need to re-confirm their latest numbers and the underlying valuations. The rule may also force issuers to update their printed materials with greater frequency, even if their investors have otherwise received the current information (or would consider the update non-meaningful), solely to remain in compliance.

All private fund offering materials are currently subject to extensive antifraud requirements, including the constraints of Section 206 of the Advisers Act and the rules thereunder, most notably Rules 206(4)-1 and 206(4)-8, as well as Section 17(a) of the Securities Act and Section 10 of the Exchange Act and Rule 10b-5 thereunder. There is also considerable no-action and interpretive guidance available on fund advertising materials. These provisions and guidance are an integral part of the robust and long-established investor protection framework already applicable to private funds and their advisers under the federal securities laws. We believe this framework will continue to provide effective protection to private fund investors when general solicitations under Rule 506(c) begin.

Moreover, the suitability requirements for investors in private fund offerings are already heightened and considerable. Non-accredited investors may not participate in Rule 506(c) offerings and their participation in Rule 506(b) offerings is restricted and subject to additional, existing protective requirements. Given their investment programs and structures, most private funds also limit participation to investors who meet the heightened sophistication standards for "qualified purchasers" under Section 3(c)(7) of the Investment Company Act, "qualified clients" under Advisers Act Rule 205-3 or "qualified eligible persons" under CFTC Regulation 4.7. In view of their sophisticated investor base, it is unclear why the new proposed disclosures are necessary or appropriate for private funds. A proposal to impose so burdensome a requirement should be supported by a compelling regulatory rationale with a powerful linkage between the Proposed Rule and how it would reduce the incidence of fraud. The Release does not include this type of analysis.

In the event the Commission seeks to impose disclosure requirements of this kind, the Proposed Rule should be modified to require the disclosure only in final, formal offering documents such as private placement memoranda or offering circulars. The Commission should also provide greater guidance as to when an update is and is not required.

c. Proposed Penalties for Non-Compliance

We also submit that disqualification from reliance on Regulation D as a court-imposed penalty is too severe for violations of Rule 509, particularly in the case of an inadvertent solicitation. The effect of the penalty is further compounded by application of new Rule 506(d), which could also subject such an issuer (and its related parties) to "bad actor" disqualification. Given the large amount of written communications that many issuers will use during the course of a Rule 506(c) offering, which could be viewed as written general solicitation materials triggering Proposed Rule 509, the probability of inadvertent errors or omissions is high. For the reasons discussed in Part A.4 above, the disqualification penalty is too severe, and we believe the Commission should consider eliminating this Proposed Rule. In the alternative, the Commission should consider significantly reducing the penalty, limiting its application to intentional, repeated or fraudulent violations and providing meaningful opportunities to cure.

2. Proposed Amendments to Rule 156 to Extend Mutual Fund Anti-Fraud Content Standards to Private Fund Sales Materials

We cannot support the Commission's proposal to extend Rule 156 to the sales literature of private funds. Rule 156 is an interpretative rule that provides guidance to investment companies with respect to application of the antifraud provisions of the Securities Act in connection with the use of sales literature. The SEC's proposal to extend to private funds the guidance under Rule 156 currently applicable to retail investors in registered investment companies who are presumed to be unsophisticated and in need of extra protection does not make sense given the sophistication of investors in private funds. Further, it would superimpose requirements developed by the SEC to protect non-accredited retail investors, whose participation in Rule 506(c) transactions is prohibited, and in the case of Rule 506(b) transactions, generally limited. We also note that most of the larger private funds opt to rely on the exemption under Section 3(c)(7) of the Investment Company Act, which requires that all investors must be "qualified purchasers," a status that the SEC has previously acknowledged does not warrant heightened protections. In view of their sophisticated investor base, it is unclear why the Commission proposes to extend to private funds the antifraud guidance developed for non-accredited investors.

The Commission does not present in the Release tangible regulatory goals that would be advanced by extending the additional, and in some cases different, antifraud guidance under Rule 156 to private funds. As discussed above, the extension of Rule 156 to private fund sales materials would likely create confusion in the areas where the SEC's prior guidance under the Advisers Act is less and in some cases more restrictive. For example, information the SEC finds permissible in one-on-one meetings under the Advisers Act is less restrictive.[5] As noted in Part B.1 above, all private fund offering materials are currently subject to extensive antifraud requirements, as part of the robust and long-established investor protection framework already applicable to private funds and their advisers under the federal securities laws. We also note that the SEC is able to inspect and examine private fund managers registered with it and review all books and records required to be maintained by private fund managers (including all offering materials) in order to ensure compliance with the federal securities laws.

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[5] *See* Investment Company Institute, SEC No-Action Letter, File No. 132-3 (Sept. 23, 1988), *available at* http://www.sec.gov/divisions/investment/noaction/ici092388.htm.

Moreover, we believe that the SEC's recently adopted rules with respect to Rule 506(c) offerings, which limit sales only to sophisticated investors subject to heightened verification standards, should adequately mitigate any residual risk that non-accredited investors might be harmed as a result of a private fund's marketing initiatives. Investors in fund private placements are sophisticated enough to perform the due diligence that they believe is appropriate prior to making any investment. We accordingly see no reason for the Commission to add new requirements and burdens at this time.

3. Request for Comment on Manner and Content Restrictions for Private Fund Offerings

We commend the Commission's balanced position in the Release regarding manner and content restrictions for private fund offerings, as well as its request for comment.

As a general matter, the diverse variety of private funds and investment strategies would render a standardized set of performance calculation and disclosure requirements problematic. To the extent there is market demand for consistency with respect to a particular type of fund as to which an industry standard may be justified, we believe that managers are already responding in order to remain competitive, as indicated by many hedge fund managers' use of the Global Investment Performance Standards. Market practice is such that potential investors in private funds request and obtain the performance data that the investors find most informative. The premise of private placements is that sophisticated investors are in a position to request and obtain any useful information or they will not invest. We believe that either imposing a unitary standard or requiring such information to be audited is likely to result in a substantial increase in costs and burdens as advisers seek to present their data accordingly. On the other hand, given the safeguards built into Rule 506, as well as the various additional antifraud and sophistication requirements under the U.S. federal securities laws (*e.g.*, the "qualified purchaser" criteria for private funds relying on Section 3(c)(7) of the Investment Company Act), we believe that the risks to non-accredited investors from the absence of standardized rules are entirely marginal and unlikely to increase.

C. Proposed Temporary Rule for Mandatory Submission of Written General Solicitation Materials

The Commission has proposed a new Rule 510T that would require an issuer conducting an offering in reliance on Rule 506(c) to submit to the Commission any written general solicitation materials prepared by or on behalf of the issuer and used in connection with the Rule 506(c) offering ("Rule 510T material"). Rule 510T material would have to be submitted to the SEC no later than the date of first use in the relevant offering. Rule 510T material submitted to the Commission would not be treated as being "filed" or "furnished" for purposes of the Securities Act or Exchange Act, including the liability provisions of those Acts.

The Commission states that Proposed Rule 510T would facilitate the assessment of developments in the Rule 506 market after the effectiveness of Rule 506(c), including market practices through which issuers solicit potential purchasers of securities offered in reliance on Rule 506(c), and thereby assist the Commission in determining whether further action is warranted. The purpose of requiring submission (rather than filing) of Rule 510T material is, therefore, not to permit review of particular offerings but rather to provide information about market practices as a whole. That kind of information gathering does not require review of every piece of written material from every Rule 506(c) offering but only a review of a statistically significant sample, which may be a relatively small fraction of the written material used.

We have already stated our view that increasing the regulatory burdens on Rule 506 issuers is inconsistent with the purposes of the JOBS Act. The burdens on issuers of submitting every piece of written material used in connection with a Rule 506(c) offering by the date of first use will be significant. Issuers will, in many cases, need to consult their lawyers in order to determine whether particular types of materials constitute Rule 510T material. This is not always a simple question, as indicated, for example, by FINRA guidance to member firms concerning static and interactive communications on social media websites.[6] Under certain circumstances, interactive communications, which are not subject to the same filing and prior supervision requirements as static communications, may become static and treated like other written materials. While issuer personnel can learn to make the necessary distinctions themselves, they are likely to need assistance from lawyers at the beginning of the process and from time to time thereafter.

Rule 506(c) issuers will also need to have compliance procedures in place to track the use of written materials and make sure Rule 510T material is timely submitted. Issuers that assign the task to their lawyers will generally have to pay the lawyers for the service. And issuers that make the submissions themselves will need to bear the cost directly. For a small start-up company with few employees, any incremental increase in regulatory compliance burdens represents a reduction in human resource bandwidth to accomplish the company's business goals.

We believe that the added burden of the Rule 510T submissions is particularly unnecessary where the SEC Staff can accomplish its purpose in reviewing

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[6] FINRA, Regulatory Notice 11-39 *(Social Media Websites and the Use of Personal Devices for Business Communications)* (Aug. 2011), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124186.pdf.

market practices using a much smaller sample of materials. There are other, equally effective methods for obtaining the required information, including, for example, surveying materials posted online and requesting written materials from a random sample of issuers who have filed Form D indicating a Rule 506(c) offering.

Although we oppose the adoption of proposed Rule 510T, in the event that the Commission determines to adopt Rule 510T in some form, we wish to add the following comments:

- We support making the rule temporary, and indeed recommend no more than a one-year term, a period of time that should be sufficient to sample market practices.

- We strongly support denoting the requirement as one of "submitting" materials, rather than "filing" or "furnishing" materials. This is consistent with the purpose of Rule 510T, which is to permit an assessment of the market rather than of particular offerings.

- We also strongly support the SEC's position that compliance with proposed Rule 510T would not be a condition of Rule 506(c), and we agree that conditioning the availability of Rule 506(c) on such compliance would lead to disproportionate consequences in the event of non-compliance. Those consequences include not only the risk of civil liability and administrative penalties under the Securities Act, but similar civil liability and administrative penalties under state securities laws in the event that preemption under Section 18 of the Securities Act is lost.

- Rather than leaving the types of written materials subject to Rule 510T undefined, the SEC should clearly limit the submission requirement to formal printed offering materials such as offering memoranda, private placement memoranda and confidential offering circulars, if any. In order to help issuers quickly determine which documents are and are not subject to the requirement, the SEC should plainly except informal written advertising materials such as term sheets, flip books, teasers, slide decks, all oral, video and graphic reproductions, and e-mail communications. We do not support the use of the Rule 405 definition of "written communications." The definition included in Rule 405 is extremely broad and the question of which materials are covered often requires careful analysis and consultation with counsel. An approach that does not clearly limit the filing obligation would subject issuers to a costly and voluminous filing burden.

- If the purpose of requiring the submission of materials is to permit assessment of market practices rather than practices in particular offerings, there is no need to require submission by the date of first use. If Rule 510T material is required to be submitted at all, issuers should be permitted to submit it within 15 days after the first sale, at the same time as they make their ordinary course Form D filing. This would permit issuers to manage their time by allowing them to make their submissions on a date other than the one during which they are preparing and transmitting materials to prospective investors. It would permit issuers time to forward materials to third parties — lawyers, filing agents or others — to submit. And it would permit issuers, or persons acting on their behalf, to bunch submission of materials used on different days during a short period.

- Finally, we note that the proposed penalty is too high. Were the SEC to pursue enforcement and injunctive relief, the resulting order would also give rise to "bad actor" disqualification under Rule 506(d). Given the information-gathering rationale for the Proposed Rule, the penalty for non-compliance should not result in so heavy a sanction.

D. Request for New Provisions Regarding Inadvertent General Solicitation

Inadvertent "general solicitation" has been a frequent and recurring problem for issuers conducting private placement transactions. Because the Securities Act concept of "offer" is extremely broad, many forms of company publicity, including those intended for non-investor audiences, can raise a "general solicitation" concern. This problem has only become more serious as electronic communications media have grown and evolved. We think that the adoption of Rule 506(c) presents an opportunity to address this problem in a new way that neatly balances the promotion of efficient capital raising with investor protection concerns. We would therefore urge the Commission to add a new subsection to Rule 506, providing a cure mechanism to issuers conducting a private placement who, following a potential inadvertent general solicitation, subject themselves to the conditions of Rule 506(c) relating to any future sales in that particular offering. Under this new provision, an issuer electing to use the cure could make future sales only to accredited investors, and would be subject to the verification requirement of Rule 506(c) relating to those future sales.

We think that Rule 433(f), addressing a form of inadvertent free writing prospectus, is a good precedent for the provision we are proposing, particularly in the way that it balances relief for the issuer (from a possible Section 5 violation) with an element of investor protection (in that case, required filing of the press piece or related issuer information). But we think that the new Rule 506 provision, to be most effective, would need to be tailored to the private offering context in a number of ways:

- Since many private offerings involve sales made over a period of time, the cure provision should provide that the Rule 506(c) conditions apply only to sales made after the issuer became aware of the inadvertent communication. We think this is only reasonable — the issuer cannot change how prior sales were effected, or to whom, but neither were those sales generally subject to the possible influence of that inadvertent communication.

- The cure provision (similar to Rule 433(f)) should afford the issuer some reasonable period of time to analyze and assess a communication, before having to elect to use the cure. Inadvertent general solicitation questions are often close calls, requiring judgment, so it is only reasonable to allow the issuer some number of business days before having to decide. We recommend ten business days after discovery of the inadvertent general solicitation.

- The cure provision should explicitly provide that it is non-exclusive, so that the electing issuer retains the ability to take the position that the communication in question was not in fact a general solicitation relating to the offered securities. We think this (i) is only fair to issuers (who may wish to claim, in the alternative, compliance with Rule 506(b) or Section 4(a)(2)), (ii) better advances the policy objective underlying Section 102(b) of the JOBS Act, pursuant to which Rule 506(c) was adopted, and (iii) would also encourage use of the cure provision, which (because the Rule 506(c) conditions would then apply) should be seen as promoting investor protection.

- We think that the cure provision could reasonably require the submission, to the Commission on a confidential basis, of the inadvertent communication or the issuer information provided to a third party that made that communication (again, in the manner of Rule 433(f)). This might give the Commission Staff insights into market practices, and perhaps a greater ability to police the market. We do not see any purpose served by having such materials filed publicly; indeed, public filing would potentially undercut the non-exclusive nature of the cure provision that we suggest above.

We believe that a cure provision of the sort we propose would be of great benefit to issuers conducting private offerings, and would also promote investor protection objectives.

E. Definition of "Accredited Investor"

We commend the Commission's position in the Release regarding its request for comment on the current definition of "accredited investor." As a general matter, the Committee believes that the income and net worth tests remain useful standards in assessing what a purchaser can bear financially, and should continue to help define whether a natural person qualifies as an "accredited investor." However, we also encourage the SEC to explore and propose additional, alternative criteria intended to measure, more directly than the income and net worth tests, a purchaser's knowledge and understanding of the risks associated with investing in private placements.

1. Need for Alternative Accreditation Criteria

Investor protection requires an assessment of an individual's ability to both "bear" and "understand" the risks associated with investing in private placements.[7] While the income and net worth tests constitute a direct indication as to a purchaser's ability to withstand a partial or complete loss of investment, such tests serve, and were intended to serve, "as proxies for financial experience, sophistication, and adequate bargaining power."[8] Thus, while the Committee believes that the income and net worth tests remain useful standards in assessing what a purchaser can "bear," we believe the SEC should develop alternative criteria that permit other investors with the requisite sophistication, if not the financial wherewithal, to qualify as "accredited investors."

For example, the SEC should allow an issuer's "knowledgeable employees" (as defined in Rule 3c-5 of the Investment Company Act) to invest in that issuer's offerings. Directors, executive officers and partners already meet the "accredited investor" requirement; expanding the definition to include knowledgeable employees also would allow trustees and advisory board members, or others serving in a similar capacity, and certain investment professionals, to participate. Such individuals would be expected to have much greater sophistication and knowledge as to the risks of that particular investment, which makes the minimum wealth criteria far less critical. In contrast, Rule 506(c) as proposed unjustifiably sidelines these investors.

We also believe that an investor that has previously qualified as an accredited investor with respect to a particular issuer should be able to make additional investments in that issuer so long as the investor continues to meet the accredited investor standards in effect at the time of the initial investment, even if the standards for accredited investors in Rule 501(a) increase in the interim.

The Committee also recommends exploring a sliding scale whereby a greater showing of investment knowledge and sophistication would allow a purchaser to make a lesser showing as to financial wherewithal. For example, an investor who did not meet the net worth or income tests but had passed the Series 7 or CFA Charter Holder examinations or the equivalent could be accredited. This would represent a positive step towards improving investor protection by not only addressing concerns as to an investor's

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7 *See* U.S. Gov't Accountability Office, *Alternative Criteria for Qualifying As An Accredited Investor Should be Considered*, GAO-13-640 at 29 (July 18, 2013), *available at* http://www.gao.gov/products/GAO-13-640.

8 *Id.*

ability to bear financial loss, but also by fostering an investment environment where decisions are more likely based on a better comprehension of the risks.

Finally, the Committee recommends that the Commission consider adding an additional test for individual investors to qualify as "accredited investors," based on ownership of a minimum amount of investment securities or other investment assets. Such tests are used in other similar contexts (for example, in the Commission's Rule 144A, in the definition of "qualified institutional buyer," and in the CFTC's Rule 4.7, providing exemptions in respect of "qualified eligible persons"), and one could easily be crafted to be of much simpler application than the existing Rule 501 net worth test. We think that the addition of such an "investment assets" test would therefore represent a real step toward facilitating capital raising under Regulation D.

2. Expansion of Rule 506(c)(2)(ii)(D)

Rule 506(c)(2)(ii)(D) offers the following method by which an issuer shall be deemed to have taken reasonable steps to verify a purchaser's status as an accredited investor:

> In regard to any person who purchased securities in an issuer's Rule 506(b) offering as an accredited investor prior to [September 23, 2013] and continues to hold such securities, for the same issuer's Rule 506(c) offering, obtaining a certification by such person at the time of sale that he or she qualifies as an accredited investor.

The Committee recommends expanding this method so that any purchaser whom an issuer verified using a method other than the self-certification method described in Rule 506(c)(2)(ii)(D) could thereafter rely on that provision in follow-on rounds from that same issuer. As the SEC has acknowledged, such an accredited investor "would presumably participate in any subsequent offering by the same issuer conducted pursuant to Rule 506(c) based on their pre-existing relationships with the issuer".[9] The Committee perceives no need to distinguish in this context between Rule 506(b) accredited investors and Rule 506(c) accredited investors — the latter, in fact, having been afforded greater protection through verification other than self-certification.

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[9] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 9415, Exchange Act Release No. 69959, Investment Advisers Act Release No. 3624 (July 10, 2013) at 41, *available at* http://www.sec.gov/rules/final/2013/33-9415.pdf.

3. Adjustment of Existing Thresholds

The Committee is not making any specific recommendations as to the amount or percentage of inflation-adjusted increases, if any, except to acknowledge the concern that any such adjustments should not be so severe as to unduly chill capital formation for small businesses. While robust data may not be available to assess with precision the effect that any adjustment to the income and net worth thresholds will have on the availability of accredited investors, an inverse relationship clearly exists and should be a primary consideration in determining any adjustments.

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We are grateful for the opportunity to provide these comments on the Proposed Rules and for the Commission's attention and consideration. We hope that our comments, observations, and recommendations contribute to the important work of the Commission in carrying out the regulatory initiatives under the Dodd-Frank and JOBS Acts. We would be happy to discuss these comments further with the Staff.

Respectfully submitted,

SECURITIES REGULATION COMMITTEE

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