American Federation of Labor and Congress of Industrial Organizations

815 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 637-5000
www.aflcio.org

September 23, 2013

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

Re: File No. S7-06-13

Dear Secretary Murphy,

On behalf of the AFL-CIO, thank you for the opportunity to comment on the Securities and Exchange Commission's proposed rule, "Amendments to Regulation D, Form D and Rule 156." As the Commission is aware, investor advocates have expressed grave concerns that the previously adopted rules implementing the Jumpstart Our Business Startups Act ("JOBS Act") that permit general solicitation and advertising in offerings subject to Rule 506 did not incorporate provisions that would improve Commission oversight and strengthen investor protections.

We support the Commission's proposed rule to amend Regulation D, Form D and Rule 156 because we believe it is a small but positive step toward addressing the concerns of the investor community. At the same time, we believe there are significant weaknesses in the proposal that should be addressed. We encourage the Commission to strengthen its proposal and move quickly to implement an improved final rule.

We Support the Proposed Amendments Relating to Form D, and Encourage the SEC to Strengthen the Proposal by Increasing Penalties for Noncompliance

We support the Commission's proposal to strengthen Regulation D and Form D. We believe that requiring issuers to file Form D in advance of Rule 506(c) offerings, expanding the information included in Form D filings and requiring issuers to file a final amendment to Form D within 30 days of the end of an offering will help improve investor protection and prevent fraud. As discussed in the proposing release, advance Form D

filings will provide state securities regulators with basic information before a Rule 506 offering comes to market that could allow them to identify potentially fraudulent offerings and protect investors. It will also improve regulators' ability to identify offerings involving "bad actors" that are not, in fact, eligible to conduct Rule 506 offerings.

It has become common practice for issuers to flout the Form D filing requirements. For this reason, we are pleased that the Commission has proposed to increase the penalties for violations of the Form D filing requirements. The proposed rule appropriately prohibits an issuer from conducting a Regulation D offering for one year if the issuer has been found to have violated the filing requirements within the past five years. In order to improve compliance with the amendments to Regulation D and Form D, we urge the SEC to strengthen further the penalties for noncompliance by:

- Creating a mechanism that allows the Commission to quickly shut down an offering if the pre-filing requirement is not met;
- Providing for progressively harsher penalties for repeat offenders including permanent disqualification; and
- Strictly limiting the availability of waivers from the ban on conducting Regulation D offerings for those who have violated the filing requirements. Waivers must only be made available to issuers in limited circumstances, such as when the issuer's failure to meet the filing deadline was an honest mistake and was quickly remedied in good faith.

Proposed Legends to Be Included in General Solicitation Materials Are Insufficient to Adequately Protect Investors

The Commission has proposed two new legends to be included in general solicitation and advertising materials. The first legend, which would be required in all offerings under Rule 506(c), will require disclosure that, among other things, participation is limited to accredited investors and the securities are not registered under the Securities Act of 1933. The second legend, which would be included in written solicitation materials by private funds that include performance information, would indicate that performance disclosures are backward looking and not indicative of future results and that private funds do not use a standard methodology to calculate performance and reported results, therefore, may not be comparable across funds.

While we support the inclusion of the proposed legends, we believe the information required in these legends is too vague to adequately capture the risks unique to Rule 506 offerings, particularly of private funds. We note that the overwhelming majority of capital raised through Rule 506 is raised by private funds.

General solicitation and advertising of Rule 506(c) offerings by private funds exposes investors to unique risks. Like mutual funds, private funds are pooled investment vehicles. Private funds, however, operate under exemptions from regulation under the Investment Company Act of 1940 that protects the investing public from theft, self-dealing, fraud, excessive fees and breach of fiduciary duty.

Due to the prevalent use of Rule 506 by private funds and the unique risks of these offerings, the Commission must take special precautions to protect investors and ensure that advertising by Rule 506 offerings is not misleading. Investors may not understand the distinctions between private funds and registered investment companies, or the additional risks that go along with investing in a private fund. We are particularly concerned that private funds will not be held to meaningful standards with regard to reporting of fund performance. Performance disclosures may be technically accurate but still misleading if the private fund chooses to use a questionable methodology, limits public performance disclosure to a time period during which performance was uniquely positive, or reports performance gross of fees.

The information proposed to be required by the Rule 509(c) legend is insufficient to communicate to investors the risks unique to investing in private funds. For example, the proposal permits private funds to advertise performance metrics gross of fees as long as they disclose that fees have not been deducted. This is of particular concern given that investors accustomed to investing in registered investment companies are unlikely to anticipate the dramatic impact that the typical private fund fee structure, which includes an annual charge of 2% of assets under management and 20% of profits, can have on net returns. This “2 and 20” fee structure charged by private equity fund managers amounts to, on average, 6% each year in fees according to one independent estimate,[1] more than 7 times the average mutual fund annual fee.[2]

In addition, the proposed penalty for private funds that fail to include the required legend is too weak. Issuers would only be disqualified from using Rule 506 if the issuer has been subject to a court order prohibiting future issuances under Rule 506 due to failure to comply with the Rule 509 disclosure requirements. This is the same approach that is currently in place to penalize those who violate Form D filing requirements, which the SEC in this proposal acknowledges is inadequate.

---

[1] Phalippou, Ludovic and Gottschalg, Oliver, The Performance of Private Equity Funds (April 2009). The Review of Financial Studies, Vol. 22, Issue 4, pp. 1747-1776, 2009. Available at http://ssrn.com/abstract=1365687.

[2] Investment Company Institute, 2013 Investment Company Fact Book, Chapter 5. Available at http://www.icifactbook.org/fb_ch5.html#trends.

Our concerns are not addressed by the fact that investing in private funds is limited to accredited investors. In our view, misleading private fund advertising can also confuse sophisticated institutional investors. In order to adequately protect investors, the Commission should require private fund issuers that advertise performance to adhere to a standard methodology for calculating performance. This methodology should require performance to be disclosed for a variety of standard time horizons. In addition, performance should be disclosed net of fees. Finally, the Commission should impose strict penalties for failure to include the mandated legends and the Commission should be able to unilaterally impose penalties without a court order.

The Temporary Requirement That Issuers Submit Written General Solicitation Materials to the Commission Should Be Permanent

We support the Commission's proposal to require issuers conducting offerings under Rule 506(c) to submit written general solicitation materials to the SEC no later than the date the materials are first used. Under the proposed rule, this requirement will expire two years after it becomes effective. We agree with the Commission's stated rationale that collection of these materials will help the SEC understand the development of the Rule 506 market after Rule 506(c) is implemented. However, the Rule 506 market will not stop evolving two years after the SEC begins collecting general solicitation materials. For this reason, the Commission should not stop collecting the materials that will allow it to observe how the market is evolving and thereby protect investors. We urge the Commission to make the filing requirement permanent.

The Accredited Investor Definition for Individuals Must Be Strengthened

When the accredited investor standard was first adopted, natural persons meeting the income and net wealth definitions may have had the means to withstand significant investment losses and the financial sophistication to understand the risks of investing in unregistered securities. Over the years, however, the accredited investor standard for natural persons has eroded dramatically due to inflation. Adjusting the accredited investor definition to account for inflation is necessary but not sufficient to protect the investing public. Some degree of financial sophistication and experience in investing is also necessary to truly appreciate the risks of investing in unregistered securities. We encourage the Commission to continue exploring this issue and look forward to the opportunity to provide more detailed comments in the future.

Conclusion

In order to adequately protect investors in the Rule 506 offerings from fraud, it is necessary to improve the proposed rule before it is final. We encourage the Commission to strengthen the penalties for failure to comply with the Form D filing requirements, adopt performance reporting standards for private funds, make permanent the requirement to file written general solicitation materials, and strengthen the accredited investor standard. If you have any questions, please contact Heather Slavkin Corzo at hslavkin@aflcio.org or (202) 486-2967.

Sincerely,

Brandon J. Rees
Acting Director
Office of Investment