

VIA FEDERAL EXPRESS AND ELECTRONIC MAIL DELIVERY

October 5, 2012

Ms. Elizabeth M. Murphy

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

Re: File Number S7-07-12

Dear Ms. Murphy:

My name is Andrew L. Schwartz, a current upper classman at the Maurice A. Deane School of Law at Hofstra University. With a foundational course load focused in business law and regulation, the writer followed and researched the facts and opinions surrounding the implementation of the Jumpstart Our Business Startups Act (the “JOBS Act”). The undersigned is writing to Comment on the proposed Section 201(a) and the elimination of the prohibition against general solicitation and general advertising (collectively referred to as “general solicitation”) in Rule 506.

The undersigned sincerely appreciates the Securities and Exchange Commission (the “SEC”) for permitting a public comment period on this issue. While the process is undeniably labor intensive, the opportunity for public commentary is a unique and important aspect of the democratic process which benefits the regulators and regulated alike.

This Comment Letter addresses the SEC Proposal referenced above.¹ The Comment Letter is divided into three parts: Educational Disclosure, Senior Fraud and Third-Party Databases.

As a preamble, the undersigned presents selected global thoughts on the issue:

Expanding the Customer Base and an Emphasis in Education

The JOBS Act is a significant achievement in government recognition of societal development.² Numerous areas of the law would benefit from such efforts to parallel the

¹ “Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings” Release No. 33-9354, (August 29, 2012)(the “Proposal”).

advancements of the people they govern. Additionally, the writer further applauds the SEC for proposing flexible rules that favor the undoubtedly complex and unthinkable circumstances that will arise as means of communication and overall technology evolve.

Understandably at this juncture, the SEC is currently not in a position to begin reforming the definition of an Accredited Investor.³ However, as mentioned in Section II herein, the allowance of general solicitation broadens the demographic and marketplace of potential investors. Often labeled as “broadening accesses to capital markets” it must equally be recognized in its fundamental buyer-seller form: broadening the potential customer base.⁴

The general thesis behind private markets is the established trust allowing for certain investors and entities to avoid government regulation that otherwise confines the rest. It is for this reason that exemptions like Rule 506, should be viewed as privileges and treated as such. Just as a minor knows he cannot enjoy the privilege of driving until he has obtained his driver’s license so must a non-Accredited Investor know that he cannot enter private markets without accreditation.⁵ This is not paternalism or exclusion, rather education and preemption.⁶ Similar to the contentions of many other commentators, the undersigned opines that dated notions largely

² Mainstream crowdsourcing and crowdfunding websites such as Kickstarter only began emerging recently in 2009. Anuli Akenegbu, *Kickstarter: A King Among Crowdfunding Paupers* (Sept. 26, 2012). <http://www.biztechmagazine.com/article/2012/09/kickstarter-king-among-crowdfunding-paupers-infographic>.

³ Such an undertaking would certainly meet stark public commentary and require lengthy deliberation.

⁴ The report, *Statistical Abstract of the United States*, found between 5 million to 7.2 million American adults were Accredited Investors in 2008. However only 10.5% of Accredited Investors had actually invested in a company. Scott Shane, *How Dodd’s Reform Plan Hurts Startup Finance* (March 19, 2010). http://www.businessweek.com/smallbiz/content/mar2010/sb20100318_367600.htm

⁵ With an emphasis on education, the writer suggests a simple test of financial and market basics, emphasizing an understanding of risks and rewards similar to the program recommended by the Cambridge Innovation Center. See Cambridge Innovation Center available at <http://www.sec.gov/comments/jobs-title-ii/jobstitleii-25.pdf>.

⁶ The writer’s current situation provides the quintessential example for the flawed Accredited Investor status: As a current law student with a pedigree of legal and financial education, the writer’s investment opportunities lay behind the like of uninformed teenage reality television stars, lottery winners, and those of fortunate inheritance. Given the writer’s investment may be minimal, today’s form of electronic crowd funding is grounded on an aggregation of small investments from users generally in their twenties and thirties.

discerning sophistication through identifiable assets cannot hold the same footing in the current age of information.⁷

I. Educational Disclosures

While the Proposal notably addresses many impending issues and concerns in removing the restrictions on general solicitations, there are a few additional forethoughts that could bare further analysis. Foremost, in discussing the definition of general solicitation and general advertising, the SEC recognized the absence of concrete meanings.⁸ With new platforms of communication emerging every day, it would be impractical at this time for the SEC to pinpoint one definition or regulate each individually.

Regardless of the ability to regulate the mediums of communication, the SEC can reasonably temper the message of the solicitation in whatever form it takes. Borrowing from state and federal law, the solicitation must be “complete and not misleading,” in efforts to provide “meaningful disclosure.” The writer acknowledges previous comments suggesting certain generic disclosures accompany general solicitations.⁹ However a simple risk/reward disclosure falls short of its full protective purpose.¹⁰

With an emphasis in substance (*education*) over form, the writer proposes a two-fold scheme to general solicitation disclosures. First, the SEC should mandate each general solicitation to disclose and direct each potential investor to seek out additional information regarding private investments on an informative SEC webpage or automated call center. The SEC webpage and automated call center should offer an educational general outline to Rule 506 and the nature of a private investment. The message should further describe the risks of investing in a security exempt from federal securities laws and identifiers to avoid fraudulent schemes. To

⁷ Recent events such as the Madoff scheme illustrate the susceptibility to fraud arguably rests equally as prevalent in the rich. *Madoff Victim's* (March 6, 2009).

http://s.wsj.net/public/resources/documents/st_madoff_victims_20081215.html

⁸ Proposal at 6. (Acknowledging examples of general solicitation and advertising were previously provided). See Use of Electronic Media for Delivery Purposes, Release No. 33-7233 (Oct. 6, 1995) [60 FR 53458] at Ex. 20; Use of Electronic Media, Release No. 33-7856 (Apr. 28, 2000) [65 FR 25843] at footnotes 79-80 and accompanying text. (examples include “publicly available media, such as unrestricted websites”).

⁹ See North American Securities Administrators Association, Inc. available at <http://www.sec.gov/comments/jobs-title-ii/jobstitleii-40.pdf>

¹⁰ Financial vernacular, even in discussing risks of investment, is often disregarded as boilerplate language. See Homer Kripke, *The Myth of the Informed Layman*, 28 Bus. Law. 631 (1973).

that end, even the unsophisticated and uneducated Accredited Investors would maintain a foundational understanding of the circumstances associated with their potential investment.^{11 12}

Second, the writer suggests a reference code or similar indicator to accompany every general solicitation. This in turn would allow potential investors to easily research the legitimacy of a general solicitation and the underlying issuer.¹³ This suggestion expands on, among others, Commissioner Elisse B. Walter's comments, calling for a rule that issuers file Form D as a condition to using the general solicitation exemption.¹⁴

Over time general solicitations for private companies will undoubtedly become a significant part of the American marketing mosaic.¹⁵ Unlike other, currently, advertised products and services, the lack of tangible evidence of any considerable exchange is especially unique to private offerings. As general solicitations begin to join the backgrounds of everyday communication mediums, it is important to provide for the presence of a distinction or reassurance to investors that their money is delivered to a legitimate and registered issuer. Much like the quickly dismissed predatory pop-ad scams that plague the internet, potential investors must be able to differentiate between fraudulent scams and legitimate offerings.¹⁶ To allow this,

¹¹ In place of a disclosure, the educational program could alternatively supplement an issuer's inquiry into an investor's accreditation status. A simple self-certification would provide the investor's acknowledgement that they were advised to consult with one of the mediums of education offered by the SEC.

¹² The webpage and automated call center would also instruct the potential investor as to the accreditation requirements needed to enter the solicited private offering. Educating the potential investor of accreditation requirements would serve as an initial deterrent to fraud and mistaken investments by non-Accredited Investors.

¹³ While the Proposal directly states that it will not address suggestions of creating a filing condition to general solicitation, the undersigned respectfully requests the SEC reconsider the potential fraud possibilities and inability for investor reassurance. Even a sort of pre-solicitation online filing with basic company identification and available contacts information would suffice.

¹⁴ Commissioner Elisse B. Walter, *Opening Remarks Regarding the Proposal of Rules Eliminating the Prohibition against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings* (August 29, 2012) available at <http://www.sec.gov/news/speech/2012/spch082912ebw.htm>.

¹⁵ "In a world where general solicitation is permitted, fraud could be more difficult to detect and to prove." *Id.*

¹⁶ Despite going through the revealing requirements for a registered offering, almost completely fabricated public companies consistently manage to deceive investors. *See generally* Securities

each general solicitation is required to display a reference code or indicator. This code or indicator is then easily searchable on the SEC's EDGAR database in order to verify the company's requisite filing and overall legitimacy. The appearance of no reference at all serves as a first indicator and red flag for fraud.

II. Senior Fraud

Denise Voigt Crawford, past president of the North American Securities Administrators Association, aptly stated that “[e]lder financial abuse is becoming the crime of the 21st century.”¹⁷ Bolstering her claim, a recent SEC Staff Study evaluated a survey and report conducted by the Library of Congress concerning investor fraud. In the study the SEC acknowledged “investors lack critical knowledge about investment fraud. In addition, surveys demonstrate that certain subgroups, including...the elderly population, and those who are poorly educated, have an even greater lack of investment knowledge than the average general population.”¹⁸ The underlying Library of Congress report found that “elderly are especially susceptible to fraud because, according to a 2007 study by the Investor Protection Trust, almost half of them erroneously believe that securities registered with [the SEC] are safe.”¹⁹ Additionally, “[a]ccording to the 2006 AARP Michigan Investor Protection Trust Survey, 25 percent of AARP members in Michigan mistakenly believed that the law protects them against losses on stock and bond investments.”²⁰

The JOBS Act's expansion of capital markets undoubtedly includes millions of new potential Accredited Investors in the elderly/senior citizens.²¹ Currently senior citizens represent

and Exchange Commission v. *SinoTech Energy Ltd. et al.*, No. 12-CV-960, *complaint filed* (W.D. La. Apr. 23, 2012). <http://www.sec.gov/litigation/complaints/2012/comp-pr2012-74.pdf>.

¹⁷ Associated Press, *Elder Financial Abuse: 'The Crime of the 21st Century'* (June 24, 2012). <http://www.dailyherald.com/article/20120624/news/706249969/>.

¹⁸ SEC, *Study Regarding Financial Literacy Among Investors* (August 2012) available at <http://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf>

¹⁹ Library of Congress, *Financial Literacy Among Retail Investors In the United States* (December 30, 2011) available at <http://www.sec.gov/news/studies/2012/917-financial-literacy-study-part2.pdf>.

²⁰ *Id.*

²¹ Adriana Reyneri, *JOBS Act Undermines Accredited Investors Rules*, (March, 30, 2012). (“fundamentally opened up a whole can of worms for a greater range of very unsophisticated people” said Mary Wallace, a senior legislative representative on financial

twelve per cent of the United States population,²² yet make up thirty-five per cent of all victims to fraud.²³ By the year 2030 the number of seniors will double to seventy-one million people.²⁴ It is currently estimated that one of out every five citizens over the age of 65 fell victim to some type of financial scam with most estimates reaching above \$2.5 billion annually in money lost due to senior fraud.²⁵ Worst, of all the senior fraud, only one out of every one hundred cases is reported.²⁶ With the restrictions on general solicitations lifted, seniors are discernibly prime targets for the same fraudulent scams and mediums used to target them now: day-time television, home-shopping networks, telemarketers, door-to-door salesmen.²⁷

Acknowledging the change in definition of Accredited Investor is an ongoing process, the writer proposes a simple, proven virtually costless solution. A simple stop gap, allotting each senior investor, purchasing through an issuer utilizing solicitations under the new Rule 506, three days to cancel their investment. Borrowing from, among several states and other agencies, Federal Trade Commission law, this “cooling-off period” would allow an efficient protection for

security and consumer protection for AARP. “History has shown this ban is needed.”) available at <http://www.millionairecorner.com/article/jobs-act-undermines-accredited-investors-rules>.

²² Julie Meyer, *Census 2000 Brief* (October 2001), available at <http://www.census.gov/prod/2001pubs/c2kbr01-12.pdf>.

²³ Federal Bureau of Investigation, *Common Fraud Schemes - Fraud Target: Senior Citizens* available at <http://www.fbi.gov/scams-safety/fraud/seniors>.

²⁴ 12 U.S. Dep’t of Transp., *Safe Mobility For A Maturing Society: Challenges And Opportunities* (2003), available at <http://www.eyes.uab.edu/safemobility/SafeMobility.pdf>.

²⁵ Investor Protection Trust, *Survey: 1 Out of 5 Older Americans are Financial Swindle Victims* (June 15, 2010) available at http://www.investorprotection.org/downloads/pdf/learn/research/EIFFE_Press_Release.pdf.

²⁶ *Id.*

²⁷ In his testimony regarding the JOBS Act Mr. Van Winkle of the NSBA stated “This is not about protecting innocent little old ladies from fraudulent issuers. Title II leaves all anti-fraud laws in place.” Jeffery J. Van Winkle on behalf of the National Business Association (September 13, 2012). <http://www.sec.gov/comments/jobs-title-ii/jobstitleii-51.pdf>. Although likely meant facetiously, the writer still tends to disagree with the exaggeration’s premise. Protecting innocent “little old ladies” from fraudulent issuers should be a discussion. Assuming no pre-filing condition to solicitation stands, many fraudulent issuers will likely not file any paperwork, leaving no trace of their company behind and creating a virtual impossibility for any anti-fraud litigation.

seniors to avoid high pressure sales situations, in person, on television, and over the phone.²⁸ During the cool-off period seniors retain the ability to consult with friends, family, financial consultants or seek out further information from an educational source described above in Section I.²⁹

III. Third-Party Databases

The writer is further concerned with inevitable compilations of Accredited Investors in third-party databases. The Proposal explains the role of third-parties under the new rules in several contexts. In first mention, the Proposal provides an example of what “constitute[s] reasonable steps to verify a purchaser’s accredited investor status”, listing “verification of a person’s status as an accredited investor by a third party, such as a broker-dealer, attorney or accountant, provided that the issuer has a *reasonable basis* to rely on such third-party verification.”³⁰ A supplemented footnote explains “[f]or example, in the future, services may develop that verify a person’s accredited investor status for purposes of proposed Rule 506(c) and permit issuers to check the accredited investor status of possible investors, particularly for web-based Rule 506 offering portals that include offerings for multiple issuers. This third-party service, as opposed to the issuer itself, could obtain appropriate documentation or otherwise verify accredited investor status.”³¹ The Proposal later clarifies, “we believe an issuer would be entitled to rely on a third party that has verified a person’s status as an accredited investor, provided that the issuer has a reasonable basis to rely on such third-party verification.”³² After outlining comments related to third-parties, the Proposal states “[w]e believe that the approach

²⁸ Surveys show that original “opponents’ [of the cooling off period] fears about the cost of cooling-off rules were considerably overstated...65%, of those answering the question “What, if anything, has the right to cancel cost your business?” responded “nothing,”...Another 26, or 18%, indicated that the cost had been very little. In all, 83% reported that the rules right to cancel had cost them either nothing or very little.” Jeff Sovern, *Written Notice of Cooling-Off Periods: A Forty-Year Natural Experiment in Illusory Consumer Protection and the Relative Effectiveness of Oral and Written Disclosures* (July 12, 2012).

²⁹ The undersigned suggests a requirement for self-certification of understanding be required of every investor. However, above all else seniors are highly susceptible to fraudulent schemes as a result of the Proposal.

³⁰ Proposal at 19. (emphasis added).

³¹ *Id.*

³² *Id.*

we are proposing appropriately addresses these concerns by obligating issuers to take reasonable steps....We also expect that such an approach would give issuers and market participants the flexibility to adopt different approaches to verification depending on the circumstances, to adapt to changing market practices, and to implement innovative approaches to meeting the verification requirement, such as the development of third-party databases of accredited investors.”³³

Indeed such a conduit for forming a reasonable belief would minimize costs to the issuer; however the application poses several potential problems:

- There would be the occasional, but harmful case of a third-party forming lists ‘straight from the phonebook.’ These falsified listings, unbeknownst to the issuer, would in turn form a “reasonable belief.”
- Generally, sufficiently researched databases worth purchasing may take time to compile. If a third-party starts compiling a list in January of any given year, by the time the list is completed in December, those names obtained in January may be since un-accredited.
- A third-party may distribute the same list for a period of time, and fail to update its information. Again fluctuations in wealth may change accreditation status, but not the reliability of the database.

These scenarios beg the broader question of the temporal period allowed between the formation of a reasonable belief and the actual investment- i.e. the length of time an issuer can maintain its reasonable belief once it is formed, both internally and through a third-party’s provided information. Furthermore, there exist legitimate questions concerning the limited professions accepted as “reasonably reliable” third-parties outside of the few examples named in the Proposal (broker-dealers, accountants or lawyers) and the method in establishing the reasonable basis to rely on those third-parties.

Issuer reliance on third-party further raises concerns of accountability. In even the most extreme situations of third-parties submitting fraudulent databases, the SEC lacks jurisdiction. However, to limit third-party reliance to those professions mentioned in the Proposal, ignores the web-based Rule 506 offering portals also mentioned in the Proposal and the likely marketing companies closely associated with those portals.

The writer respectfully requests clarity as to an issuer’s use of third parties. The writer suggests the SEC require issuers to verify any Accredited Investor information obtained through a third-party database not be older than three years from the date of accreditation verification. The writer further proposes the SEC implement similar rules to the bad actor rules of Section 926 of the DoddFrank Wall Street Reform and Consumer Protection Act by maintaining a bad actors

³³ Proposal at 25.

list of third-parties.³⁴ Once labeled as a bad actor, an issuer is no longer allowed to develop a “reasonable basis” to rely on the specified third-party.³⁵ A third-party becomes a bad actor through such examples, but not limited to: lack of database maintenance, potential investor harassment, fraudulent information, and unreasonable means of obtaining investor information.

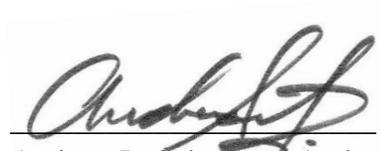
The minimal stays of responsibility on the issuer provides for a minimal burden while ensuring those databases, purchased through third-parties services, are not relied on wholesale.

Conclusion

The writer echoes appreciation for opening up the comment period to the rules proposed under the JOBS Act. In short, eliminating the restrictions on general solicitations holds the potential to greatly expand a staggering economy. Increased exposure to a once believed esoteric corner of the market now invites the involvement of millions of investors. However, the opportunity and outlets for fraud are clear. It would be in the SEC’s and public’s interest to take preemptive measures to limit such activity at this time.

The writer sincerely thanks the Securities and Exchange Commission for the opportunity to share the thoughts included herein.

Sincerely,



Andrew L. Schwartz | AndrewSchwartz88@gmail.com

³⁴ SEC Release No. 33-9211, *Disqualification of Felons and Other “Bad Actors” from Rule 506 Offerings* available at <http://www.sec.gov/rules/proposed/2011/33-9211.pdf>.

³⁵ The writer takes a similar approach to that suggested by Sigelman Law Corporation (asserting that third-party verification of accredited investor status should not be limited to broker-dealers but that independent third-party professional intermediaries “registered with the Commission and sworn to follow the protocol rules” should be allowed to provide such services). Proposal at 24. However instead of creating an exclusive barrier of entry, the writer’s suggestion creates a flexible over inclusive system which can be regulated as needed.