



October 5, 2012

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

RE: *Eliminating the Prohibition Against General Solicitation and General Advertising
In Rule 506 and Rule 144A Offerings*

Dear Ms. Murphy:

AARP¹ appreciates the opportunity to provide comments to the Securities and Exchange Commission (the “SEC” or “Commission”) in response to the proposed rule to implement Section 201(a) of the Jumpstart Our Business Startups Act (the “JOBS Act”), which requires the Commission to lift the ban on general solicitation and advertising in Rule 506 private placements.²

Allowing general solicitation in the private offering market is a profound change in the laws governing the offers and sales of securities. Federal securities regulation relies primarily on registration and disclosure for most offers and sales of securities. General solicitation and advertising activities are generally permitted only if a registration statement has been filed. This acts as a strong practical constraint on the ease with which fraudulent offers can reach their victims and helps to ensure that investors have adequate information on which to base their investment decisions.

That is why the Commission, since at least 1962, has held that general solicitation and advertising are inconsistent with private offerings of securities. As Commissioner Aguilar observed, “When general solicitation is used, investors need access to the disclosure and other protections that registration affords. In the absence of registration, and the resulting required disclosure, general solicitation and advertising can all too readily become a tool for deception and misinformation.”³

Fortunately, the Commission retains both the authority and the responsibility to ensure that investors are adequately protected even as the general solicitation and advertising ban for private offerings is lifted.

¹ AARP is a nonprofit, nonpartisan membership organization that helps people 50+ have independence, choice, and control in ways that are beneficial and affordable to them and society as a whole. AARP advocates for policies that enhance and protect the economic security of individuals.

² Rule 506 is the broadest of the safe harbors under Regulation D. It permits offers and sales to be made, without registration, to an unlimited number of accredited investors. There is no limit on the amount of money that can be raised in an offering under Rule 506. If sales are made only to accredited investors, there are no information or disclosure requirements.

³ Statement of Commissioner Luis Aguilar, at the SEC Open Meeting, August 29, 2012, accessed at <http://www.sec.gov/news/speech/2012/spch092912laa.htm>.

While the Commission is required to lift the ban, it should do so in a way that not only facilitates capital formation, but also promotes investor protection and ensures the integrity of the capital markets.

We share the concerns that have been expressed by current and former securities regulators, investor advocates, and others that the Commission has not accomplished this balance in the rule proposal that is the subject of these comments. The Commission itself acknowledges the increased risk of fraud that comes with lifting the ban on widespread marketing of securities that⁴, by definition, are intended only for a specific segment of the investing public. Furthermore, the Commission's own experience after lifting the ban on general solicitation under Rule 504 of Regulation D in 1992 should instruct its rulemaking today. In that case, the Commission's action resulted in a wave of pump-and-dump schemes and other microcap frauds that damaged market integrity and ultimately led to a reinstatement on the ban in 1999.⁵ While acknowledging the increased risk of fraud, the proposed rules do nothing to minimize these risks.

Ensuring that investor vulnerability in these offerings is mitigated to the greatest extent possible is of tremendous interest to AARP. Older investors, with a lifetime of savings and investments, are disproportionately represented among the victims of securities fraud. The private placement marketplace already is a source of significant market abuse, even before the ban on general solicitation and advertising is lifted, according to the North American Securities Administrators Association (NASAA) and other experts.⁶ Unregistered securities, such as private placements, have emerged as one of the main vehicles for fraud involving older investors. Of the enforcement actions taken by state securities regulators in 2010 involving investors age 50 or older, cases involving unregistered securities outnumbered those related to ordinary stocks and bonds by a ratio of five to one, according to NASAA.⁷

The Commission should more effectively address the risk of potential harm to investors by: (1) updating the definition of accredited investor; (2) specifying clear and enforceable standards for verification of accredited investor status; and (3) requiring the filing of Form D as a condition for relying on the Regulation D exemption. Absent the critical investor protections recommended here, we should expect to see an increase in fraudulent activity in this marketplace.

⁴ Securities and Exchange Commission, 17CFR Parts 230 and 239, Release No. 33-9354; File No. S7-07-12, "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144 A Offerings," August 29, 2012, accessed at <http://www.sec.gov/rules/proposed/2012/33-9354.pdf>. Page 52 of the release "...eliminating the prohibition against general solicitation could make it easier for promoters of fraudulent schemes to reach potential investors through public solicitation and other methods previously not allowed. This could result in an increase in the level of due diligence conducted by investors in assessing proposed Rule 606(c) offerings, and in the event of fraud, would likely lead to costly lawsuits for investors seeking damages. In general, an increase in fraud in this market would harm investors who are defrauded, would undermine confidence in Rule 506 offerings and could negatively affect capital-raising by legitimate issuers – for example, by reducing investor participation in Rule 506 offerings – thus inhibiting capital formation and reducing efficiency."

⁵ Statement of Commissioner Luis Aguilar, at the SEC Open Meeting, August 29, 2012, accessed at <http://www.sec.gov/news/speech/2012/spch092912laa.htm>.

⁶ 2012 NASAA Top Investor Threats, accessed at <http://www.nasaa.org/3752/top-investor-threats/>: "In the most recent survey of state securities regulators, fraudulent private placement offerings were ranked as the most common product or scheme leading to investigations and enforcement actions. These offerings also are commonly referred to as Regulation D Rule 506 offerings (the exemption in federal securities laws that allows private placements to be sold to investors without registration). By definition these are limited investment offerings that are highly illiquid, generally lack transparency and have little regulatory oversight. While Regulation D Rule 506 offerings are used by many legitimate companies to raise capital, these investment offerings are high-risk and may not be suitable for many individual investors."

⁷ "Boomers Wearing Bull's-Eyes," Kelly Greene, The Wall Street Journal, December 14, 2011.

Definition of accredited investor

The current definition of accredited investor – someone with an income of \$200,000 and net worth of \$1 million – is unlikely to be effective in deterring the fraudulent activity that may arise when the ban on general solicitation and advertising is lifted for private placements. The income and net worth levels that apply to individuals for the purpose of satisfying the definition of accredited investor were adopted in 1982 as quantitative standards to identify investors who presumably could “fend for themselves” without the protections afforded by registration when investing in private offerings. While those standards may have made sense more than a quarter of a century ago, they are wholly inadequate today. This test now reaches deep into a population that has smaller real incomes. In testimony before Congress, Professor Robert Thompson of Georgetown University Law Center noted that as a percentage of the pool of individual taxpayers, the number of individuals whose income is above \$200,000 now is 20 times larger than at the time of enactment of Regulation D.⁸

It is instructive for this rulemaking that in 2007 the Commission went on record as viewing a higher accredited investor standard as a condition of relaxing the Rule 506 general solicitation and advertising ban.⁹ In that rulemaking, the Commission proposed to permit limited advertising of offerings that were sold only to “large accredited investors,” who were defined as natural persons with at least \$2.5 million in investments or \$400,000 in annual income. If the Commission believed that such an increase in thresholds for accredited investors would be necessary for a **limited relaxation** of the general solicitation and advertising ban, then it would be logical to assume that – at a minimum -- an increase on that scale would be necessary for a **complete elimination** of the general solicitation and advertising ban that this rulemaking contemplates.

We recognize that Section 413(a) of the Dodd-Frank Act requires that the Commission refrain until 2014 from changing the dollar amount of the \$1 million net worth minimum for individual accredited investors in private offerings. In a positive development, Section 413 of the Dodd-Frank Act also excluded from the net worth calculation the value of an individual’s primary residence. Rather than acting as a deterrent to revisions to the accredited investor standard, some commentators have suggested the opposite – that Section 413 of the Dodd-Frank Act was intended to spur an update of this antiquated standard.¹⁰ At the same time, there is nothing in the Dodd-Frank Act that prevents the SEC from making other immediate changes to the accredited investor standard under Rule 506.

There are several steps the Commission could take to tighten the accredited investor standard. The Commission could, for example, use this rulemaking to require that investors own securities with a minimum value to be considered accredited investors. Such an “investment owned” test was proposed by the Commission in 2007 and supported by NASAA. The Commission could require proof of an investor’s financial sophistication, as required for crowdfunding offerings by Section 302 of the JOBS

⁸ Joint Hearing with the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs of the Committee on Oversight and Government Reform and the House Subcommittee on Capital Markets and Government Sponsored Enterprises of the Committee on Financial Services entitled “The JOBS Act: Importance of Prompt Implementation for Entrepreneurs, Capital Formation, and Job Creation,” September 13, 2012. <http://financialservices.house.gov/uploadedfiles/hhrg-112-ba16-wstate-rthompson-20120913.pdf>

⁹ Securities and Exchange Commission, 17 CFR Parts 230 and 275, Release No. 33-8766; IA-2576; File No. S7-25-06, “Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles,” December 27, 2006 (noting that 1982 accredited investor standards have made investors eligible today who not have previously been eligible and the increasing complexity of investments), available at <http://www.sec.gov/rules/proposed/2006/33-8766.pdf>.

¹⁰ May 24, 2012 letter on JOBS Act Rulemaking (Title II) from Fund Democracy, Consumer Federation of America, Consumer Action. AFL-CIO and Americans for Financial Reform, accessed at <http://www.sec.gov/comments/jobs-title-ii/jobstitleii-14.pdf>

Act. The Commission could consider whether there should be a limit on how much even an accredited investor can invest in a Regulation D 506 offering. This suggestion is derived from the JOBS Act itself, which in the context of the crowdfunding exemption, would permit an investor with \$1 million in investments to invest only 10 percent (\$100,000) of such investments in all crowdfunding offerings combined. Under the proposed rulemaking that we are commenting on today, an investor is free to invest 100 percent of his or her net worth in a single private offering. To impose more stringent limits on crowdfunding offerings where general solicitation and advertising is not permitted than is imposed on private offerings where general solicitation and advertising is permitted defies common sense.

There is nothing to prevent the Commission from making immediate changes to the accredited investor standard under Rule 506 other than to the \$1 million net worth standard. Updating and strengthening the accredited investor standard to ensure that it fairly reflects the financial sophistication of an investor is a key way in which the Commission can counter the adverse effects on investor protection and efficient markets that eliminating the general solicitation and advertising ban is likely to cause.

Verification of accredited investor status

Under the JOBS Act, the Commission is directed to adopt standards to require the issuer “to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission.” That language seems to assume that the SEC would specify acceptable methods for determining accredited investor status. But, that is not what has been proposed by the Commission in this rulemaking. Instead, the proposed rule calls for an approach in which a determination of whether the steps taken to confirm the purchasers of the securities are accredited investors is based exclusively on the particular facts and circumstances of the transaction.

The “facts and circumstances” approach proposed by the SEC will not ensure that only accredited investors invest in these private offerings, nor will it give the issuers the certainty they need to develop appropriate procedures for confirming the accredited investor status of the purchaser. Of course, investors may be reluctant to turn over sensitive financial information to an issuer with whom they have no relationship. A number of commentators have suggested that reliable third parties, including brokers, accountants, attorneys or bankers may be well positioned to verify whether an investor meets the accredited investor threshold.

Whether it is a reliable third party or some other acceptable verification process, AARP encourages the Commission to adopt a final rule that specifies the methods that issuers must use to verify accredited investor status and that provides sufficiently strong safeguards to ensure that Rule 506 private offerings are sold only to sophisticated investors who can understand and shoulder the financial risks of these investments.

Filing requirements

Currently, issuers offering or selling securities in reliance on Rule 504, 505 or 506 must file a notice of sales on Form D with the Commission for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering. In this rulemaking, the Commission proposes to add a checkbox indicating whether the issuer plans to engage in general solicitation and advertising in connection with the rule.

Simply adding a checkbox to a form that too often goes unfiled and then only after the fact is inadequate to the task at hand. Instead, AARP recommends that the SEC require that issuers file Form D before using any type of general solicitation or advertising. To make this requirement meaningful, the failure to file a Form D should result in the loss of the exemption. In addition to making the filing of Form D

mandatory prior to solicitation, AARP supports changes to the information reported on the Form so that regulators and investors have access to details regarding the issuer's plans to engage in general solicitation and, if so, how it will do so and how the issuer will verify the accredited status of investors.

We agree with Commissioner Aguilar that such an approach would provide a mechanism for potential investors to identify the source of an offer and facilitate some degree of due diligence and a mechanism for regulators to be made aware of a mass marketed offering before it is launched.

Conclusion

Allowing widespread marketing of investments under an exemption designed for private offerings is a significant change in the securities regulatory framework and has the potential to greatly increase the risk to investors of fraud and abuse. Given the current "accredited investor" standard, many retirees and those nearing retirement with a lifetime of savings and investments are likely to be the targets of unscrupulous operators who may take advantage of the relaxed standards under which these offerings may be marketed.

The SEC has the authority to impose reasonable investor protections as it implements the mandate of the JOBS Act to lift the ban on general solicitation and advertising in Rule 506 offerings. AARP encourages the Commission to strengthen the investor protections in the rule currently under consideration before it is finalized.

Please contact Mary Wallace of our Government Affairs staff at (202) 434-3954 or mwallace@aarpp.org if you have questions or need additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "David Certner", with a long horizontal flourish extending to the right.

David Certner
Legislative Counsel and Legislative Policy Director