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Submitted electronically to rule-comments@sec.gov

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

RE: Proposed Amendment of Rule 506
Release No. 33-9354 (File No. S7-07-12)

Dear Ms. Murphy,

As the Commissioner of Securities for the State of Missouri, I recognize the importance of Regulation D to smaller businesses. As established recently, Regulation D is serving its purpose as a vehicle for small business capital formation.[1] Consequently, it is important that such rules remain accessible to those businesses. However, such rules must not compromise investor protections.

This letter suggests that the Commission amend proposed Rule 506 in two ways. First, the Commission should include in proposed Rule 506(c) the bad actor prohibitions that the Commission proposed last year. Second, in proposed Rule 506(c), the Commission should require that an issuer file the Form D with the Commission before generally soliciting or advertising. Both of these suggestions have also been proposed by other commentators.[2] With this letter, I support those proposals.

I. Impounding the Bad-Actor Prohibitions in Proposed Rule 506(c)

Two years ago, section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act required the Commission to adopt rules to disqualify certain securities offerings from using Rule

[1] Vlad Ivano and Scott Bauguess, "Capital Raising in the U.S.: The Significance of Unregistered Offerings Using the Regulation D Exemption, (February 2012), hettp://www.sec.gov/info/smallbus/acsec103111_analysis-reg-d-offering.pdf (noting that "[c]onsistent with the original intent of Regulation D to target the capital formation needs of small business, there have been a large number of smaller offerings: 37,000 unique offerings since 2009").
[2] *See e.g.*, Letter from the North American Securities Administrators Association (Oct. 3, 2012) *and* Letter from the Consumer Federation of America (Oct. 3, 2012).

506 as an exemption from the registration requirements of the Securities Act of 1933.[3] In response, the Commission proposed corresponding amendments.[4] To date, however, these amendments have not been adopted.

As Commissioner Aguilar recently stated:

> Right now, anyone can participate in Rule 506 offerings. Even a convicted felon, fresh out of prison, could solicit millions of dollars from unsuspecting investors. This is a reality–convicted fraudsters really do participate in Rule 506 offerings. For example, last year, the SEC filed an emergency action to stop a convicted felon who was operating a multi-million dollar fraud in unregistered securities. Additionally, just two weeks ago the SEC sued a recidivist for defrauding investors in unregistered offerings.[5]

Unfortunately, those SEC actions came only after both defendants had already taken millions of dollars from their victims.[6] Further, a convicted securities fraudster can, a year after Commissioner Aguilar's statement, *still* file and use a Form D to raise millions of dollars from investors.[7] In fact, the only thing that has changed is that, with proposed Rule 506(c), the Commission is preparing to give such an individual a greater reach through generally soliciting his suspect offering.

As noted, the Commission has already proposed language to prohibit bad actors from using Rule 506. If the Commission must allow general solicitation of unexamined offerings, it only seems sensible to limit proven bad actors from greater access to the public.

II. Requiring the Form D to be Filed *before* Public Advertising

Under current Rule 506, general soliciting or advertising is not permitted.[8] And, because Rule-506 securities qualify as federal-covered securities and are thus preempted from state securities registration requirements, state securities regulators have limited authority under which to

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[3] Public Law No. 111-203.

[4] Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, Dodd-Frank Act Release No. 33-9211, 76 Fed. Reg. 31,518 (proposed June 1, 2011) (to be codified at 17 C.F.R. pts. 230, 239).

[5] Luis Aguilar, Speech by SEC Commissioner: Excluding Established Wrongdoers from Engaging in Rule 506 Transactions, (May 25, 2011) http://www.sec.gov/news/speech/2011/spch052511laa-item.htm.

[6] *See* Litigation Release No. 21584, SEC v. Robert Stinson, Jr. et al., U.S. Sec & Exch. Comm'n, (June 29, 2012), http://www.sec.gov/litigation/litreleases/2010/lr21584.htm, *and* Litigation Release No. 21969, SEC v. Jay L. LeBoeuf and New Castle Energy, LLC, U.S. Sec. & Exch. Comm'n, (May 11, 2011), http://www.sec.gov/litigation/litreleases/2011/lr21969.htm.

[7] As noted below (*see infra* note 12 and accompanying text), the Division of Corporation Finance for the United States Securities and Exchange Commission—that part of the SEC dedicated to overseeing the filing of the Form Ds—would not detect that a convicted securities fraudster had filed a Form D in anticipation of raising proceeds from investors. *See* SEC, Office of Inspector General, Report No. 459, *Regulation D Exemption Process* 8 (2009) (noting that "SEC staff does not substantively review the information in the Form D filings, and that the filings are only intended to be notice filings") (hereinafter "SEC Inspector General, *Regulation D Report*").

[8] *See* 17 C.F.R. 230.502(c) (stating that offers and sales are disqualified from the Rule 506 registration exemption if the issuer or a person acting on its behalf "offer[s] or sell[s] the securities by any form of general solicitation or general advertising") *and* 17 C.F.R. 230.506(b)(1) (providing that offers and sales must satisfy all the terms and conditions of 230.501 and 230.502 to qualify for the Rule 506 registration exemption).

examine such offerings. But, because a generally-advertised securities offering—whether on the Internet, in a newspaper, or through other broadly-disseminated means[9]—is ineligible for the Rule 506 exemption, state securities regulators have historically recognized the value in prompt intervention upon discovering such an offering. Lacking the Rule-506 safe harbor, such offerings must either be registered under the state securities laws or eligible for another applicable registration exemption.[10]

Indeed, the immediate red flag of a publically-advertised, unregistered offering benefits investors and legitimate issuers: that is, it is in everyone's interest for securities regulators to be able to stop a noncompliant or fraudulent securities offering sooner rather than later. For instance, in the best-case scenario, the state securities regulator's quick response can alert a well-intentioned but inexperienced entrepreneur that his or her offering is violating the state's registration requirements. That entrepreneur benefits from being able to quickly rectify this sort of violation before his or her capital-raising efforts becoming irretrievably compromised. Importantly, only the state securities regulators are maintaining this communication with their states' issuers.[11]

On the other hand, a generally-solicited offering is often a hallmark of a fraudulent offering. That is, being intent upon extending the reach of their fraud, some bad actors will use broadly-disseminated means to lure their potential victims into their securities scam. Such blatant disqualifications from Rule 506 trigger the state securities regulators' investigatory authority and allow them to move more quickly to prevent investor losses.

In short, Rule 506's general-solicitation prohibition serves as a valuable threshold test that allows state regulators to monitor the Federal exemption's proper use and to ensure compliance with both Federal and state law. This is all the more important because the state securities regulators are doing most of the policing of Rule 506 offerings.[12] But, as currently drafted, proposed Rule 506(c) will render this enforcement tool obsolete and make it more difficult for state regulators to discern which publically-advertised, unregistered offerings qualify for the Rule-506 safe harbor.

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[9] *See* Risdall v. Brown-Wilbert, Inc., 753 N.W.2d 723, 726 (Minn. 2008) (ruling that an offering did not qualify for Rule 506 when notice of the offering was "posted on the Internet, circulated via e-mail, and mailed to potential investors").

[10] *See* Black Diamond Fund, LLLP v. Joseph, 211 P.3d 727, 733 (Colo. App. 2009) (holding that the evidence supported the "finding that respondents engaged in a general solicitation, and thus the offering was not conducted in accordance with Rule 506, [and consequently] respondents have not met their burden of proving that the . . . securities were exempt from the registration requirements" of the state's securities laws).

[11] *See* SEC Inspector General, *Regulation D Report* at 9 (noting that Corporation Finance staff "generally do not contact companies when the staff become aware that companies are misusing the Regulation D exemptions").

[12] In 2010, the states reported bringing 250 actions regarding Rule 506 or Regulation D violations. *See* North American Securities Administrators Association, *2010 Enforcement Report* 7, (October 2011), http://www.nasaa.org/wp-content/uploads/2011/08/2010-Enforcement-Report.pdf. *See also*, SEC Inspector General, *Regulation D Report* at 8 (noting that the SEC's Division of Corporation Finance staff do not "substantively review Form D filings, determine whether issuers appropriately use the Regulation D exemptions, [or] take action when [they] learn that issuers are non-compliant with the rules of Regulation D").

The purpose of the Form D is to put Federal and state regulators on notice of the offering.[13] Also, as the Commission itself has noted, filing the Form D better equips the state securities regulators to ensure compliance with Federal and state securities laws.[14] To allow general solicitation without requiring the Form D's filing, then, is to not only undermine the form's purpose but also hamstring the state securities regulators' important enforcement functions.[15]

A. Proposed Language:

To that end, it is recommended that the Commission amend Rule 503 to distinguish between Rule 506 offerings that do not use general solicitation or advertising and those that do. Specifically, Rule 503 could be amended thusly, with the bolded language indicating the additions:

> (a) When notice of sales on Form D is required and permitted to be filed.
>
> (1) An issuer offering or selling securities in reliance on § 230.504, § 230.505, or § 230.506**(b)** must file with the Commission a notice of sales containing the information required by Form D (17 CFR 239.500) for each new offering of securities no later than 15 calendar days after the first sale of securities in the offering, unless the end of that period falls on a Saturday, Sunday or holiday, in which case the due date would be the first business day following.
>
> **(2) An issuer offering or selling securities in reliance on § 230.506(c) must file with the Commission a notice of sales containing the information required by Form D (17 CFR 239.500) for each new offering of securities no later than 5 days before using general solicitation or general advertising, unless the end of that period falls on a Saturday, Sunday or holiday, in which case the due date would be the first business day following.**

Of course, Rule 503's current numbering would have to be amended to accommodate the new Rule 503(a)(2).

The above language would still allow an issuer to raise capital even before filing the Form D, as long as the issuer was not using any general solicitation or advertising. That is, even under the language proposed above, the issuer could approach those with whom the issuer had a preexisting substantive relationship in order to raise capital. Then, once the 5-day, postfiling period had passed, the issuer could also generally solicit or advertise to reach further offerees. And that 5-day time period could be used for preparing the public advertising materials.

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[13] *See* Electronic Filing and Revision of Form D, Securities Act Release No. 33-8891, 73 Fed. Reg. 10,592, 10,593 (Feb. 6, 2008).

[14] *Id.*

[15] Surely, many diligent Rule-506 issuers will obviate such problems by sending in the Form D before publically advertising. Such issuers know that the state securities administrator's search of its records will reveal that that issuer is properly conducting its offering in accordance with Rule 506(c).

Notably, nothing in the JOBS Act directive prevents the SEC from requiring a presale Form D filing when using general solicitation or advertising.

B. Benefits from Requiring the Form D before Generally Soliciting or Advertising

There are several benefits from requiring the filing of the Form D before any general solicitation or advertising. Importantly, these benefits are not offset by the cost of filing the Form D because, properly, the Form D must be filed in any case.

1. Benefits to Issuers

Issuers benefit because filing the Form D beforehand obviates the potential of an investigation by a state securities regulator looking into the public advertising.

Second, requiring the Form D would have a channeling effect, encouraging issuers unfamiliar with Regulation D's complexities to gain a modicum of understanding of those rules. That is, although small businesses' use of Regulation D is obvious,[16] it is not equally obvious that issuers using Rule 506 are always compliant with Regulation D's other requirements (such as the intricacies of purchaser representatives). Depending on its timing, a postsale Form D filing can indicate compliance or merely an after-the-fact attentiveness to Rule 506's filing requirements.

Requiring the Form D ahead of time would thus channel issuers' attention—at least, those who are unable to afford securities counsel, as many start-ups and entrepreneurs are—to Regulation D's other aspects, such as the definition of an accredited investor. And being aware of those requirements and proposed Rule 506(c)'s reasonable-steps verification requirement will be doubly important now that issuers will be able to reach many more offerees through general solicitation. This enhanced awareness of Regulation D also benefits issuers by ensuring that their offering begins in a legally compliant way, reducing the chances of later civil suits.

Also, issuers filing the Form D before engaging in any general solicitation send an initial signal to regulators and investors of the issuer's securities law compliance. This especially benefits small issuers in the private offering context where public information–and thus transparency–regarding the issuer is scant. This can only increase public confidence in the offering.

2. Benefits to securities regulators

With the Form D filed before any general solicitations or advertising, state securities regulators will be better able to properly allocate their limited resources.

Discovering the Form D on EDGAR or having the issuer's corresponding notice filing will prevent state securities regulators from looking into an offering that is fully compliant with Rule 506(c). On the other hand, with the suggested amendment, a state regulator would know that any offering that is publically made but does not within EDGAR or otherwise in the regulator's

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[16] *See supra* note 1 and accompanying text.

records is properly subject to investigation. This will only enhance investor protection and further the state securities regulators as proper stewards of state resources.

3. Benefits to Investors

Most importantly, a rule requiring the Form-D filing before any general solicitation benefits investors as such a rule allows state regulators to be responsive to those investors' inevitable inquiries regarding publically-advertised offerings. Frequently, state regulators receive notification regarding generally solicited securities offerings–whether in the form of mailings, Internet postings, or cold calls—from the public. Often, these individuals are calling not to report a suspect offering but instead to check on an offering's legitimacy. These potential purchasers know that their state regulator can tell them whether the offering is properly registered or notice filed, which is a useful piece of information in deciding whether to invest. State regulators with more information regarding offerings in the state thus lower transaction costs for investors. In short, a knowledgeable investor knows that his or her state securities regulator can be an important resource in wise and safe investing.

However, proposed Rule 506(c) undermines that regulator's ability to provide information to an investor doing his due diligence. As such, the proposed rule, as drafted, hampers an investor's ability to discern legitimate offerings from illegitimate ones (again, assuming that the filing of the Form D is at least a *prima facie* signal that the issuer is attempting to comply with the securities laws).

Ultimately, I and other state securities regulators recognize that Congress has mandated that the Commission amend Rule 506 to allow for general solicitation and advertising. However, the above suggestions do not interfere with that mandate and still put into place important and efficient investor protections. I urge you to consider those suggestions as well as those of my fellow state securities regulators. Thank you for your consideration.

Sincerely,

Matt Kitzi
Commissioner of Securities