



The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

September 20, 2012

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

Re: Eliminating the Prohibition Against General Solicitation in Rule 506 and Rule 144A Offerings; Release No. 33-9354; File No. S7-07-12

Dear Ms. Murphy:

The Office of the Secretary of the Commonwealth, Massachusetts Securities Division appreciates this opportunity to comment on the Securities and Exchange Commission's (the "Commission") Release proposing rules under Title II of the JOBS Act permitting general solicitation in Rule 506 and Rule 144A offerings and determining the steps and methods that issuers in publicly-offered Rule 506 offerings must follow to verify that all purchasers are accredited investors.

The Massachusetts Securities Division submitted preliminary comments on the Commission's regulatory initiatives under Title II of the JOBS Act in a letter dated July 2, 2012. A copy of that letter is attached. The Division's letter, as well as the letters from other investor advocates, including the North American Securities Administrators Association, urged the Commission to adopt strict certification requirements to establish and verify investor accreditation. Unfortunately, the Commission has chosen to ignore those pleas for investor protection and in so doing has left investors at risk. Because the Commission has put the proposed rule out for comment, we hold out hope that the Commission is considering modifications to the rule and we once again urge the Commission to address the concerns and issues raised in the Division's prior letter as well as those raised by other investor advocates.

The Proposed Regulations Do Not Meet the Requirements of Title II of the JOBS Act and Fail to Protect Investors

In the proposed regulations, the Commission has failed to meet its obligations under Section 201 of the JOBS Act to establish ground rules for offerings under the Rule 506(c) exemption and methods for issuers to use to verify that investors are accredited. This failure will put the interests of retail investors and savers at risk in unprecedented ways. This failure will also place unnecessary burdens on issuers, who could benefit from the Commission's guidance on this important obligation.

We also foresee that the Commission's failure to adopt meaningful requirements for the Rule 506(c) exemption will impede state and federal enforcement in virtually all cases involving unregistered offerings.

There is also a serious risk that courts will draw the inference from the Commission's failure to issue meaningful rules that few or no standards are applicable to the Rule 506(c) exemption. This is likely to result in conflicting court decisions on issues relating to Title II, and to decisions that are contrary to the policies embodied in the Securities Acts.

The Language of Section 201 of the JOBS Act Mandates that the Commission Establish Methods and Steps for Issuers to Follow in Order to Verify that Purchasers Are Accredited Investors

Section 201 under Title II of the JOBS Act directs the Commission to revise its rules to provide that the prohibition against general solicitation shall not apply to offers and sales of securities under Rule 506 provided that all purchasers are accredited investors. Section 201 stipulates that “[s]uch rules shall 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.*”

The requirement that investors must be accredited is the sole protective mechanism built into the new exemption under Rule 506. As we have commented previously, the exemption does not carry any mandatory disclosure requirements in sales to accredited investors, and such offerings are not subject to review at the state level. For these reasons, it is vitally important that the Commission's regulations protect investors even as the rules for the offer and sale of unregistered offerings are liberalized.

Legislative History Demonstrates that Congress Intended for the Commission to Adopt Meaningful Rules to Implement the Verification Requirement

The verification requirement was added to Title II specifically to protect unsophisticated and unqualified investors by means of methods to be specified by the Commission. Representative Maxine Waters of California¹, the House sponsor of the amendment to a predecessor bill (H.R. 2940) that added what became Section 201(a)(1)'s “reasonable steps to verify” requirement, stated the following during a Subcommittee

¹ Rep. Waters is the Ranking Member of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises.

markup session for the bill:

But I am concerned about the process in which accredited investors verify that they are in fact accredited. As I understand it, it is currently a self-certification process. This obviously leaves room for fraud.

In testimony from the North American Securities Administration Association the state securities commissioner from Arkansas notes it is going to be impossible to limit the sale to only accredited investors when issuers advertise to everyone. Indeed, there will be no reason to believe that any investor seduced by public advertising will hesitate to be dishonest with completing the investor suitability questionnaire.

That is why I have offered this amendment. My amendment would require the SEC when issuing a rule to provide for the exemption under Representative McCarthy's bill [H.R. 2940, Title II's predecessor] to include a provision mandating that issuers take reasonable steps to verify investor status as an accredited investor.

If we are rolling back protections for our targeted audience of sophisticated individuals, we must take steps to ensure that those folks are in fact sophisticated.²

The Republican Chair of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, Rep. Scott Garrett of New Jersey, concurred, stating, "I believe that it is a good amendment. I also encourage support of the amendment."³

Clearly, the express purpose of Congress in adding this requirement was to strengthen and make meaningful the requirement that issuers should sell Rule 506(c) offerings only to accredited investors, because such offerings carry heightened risks. Instead of following this clear mandate, the Commission's proposed rules ignore and undercut the protections that Congress directed the Commission to design.

The Commission's Regulations Constitute Dangerous Inaction at a Time When the Methods for Offering Unregistered Securities Are Fundamentally Changing

The Commission has elected not to establish any steps or methods that issuers should follow to verify that investors are accredited. Instead of adopting such steps or methods, the Commission has announced that issuers are merely required to take "reasonable steps" in order to form a "reasonable belief" that purchasers are accredited. In fact, the Commission has even declined to describe safe harbor procedures that issuers

² House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises Holds Markup on HR 1965, HR 2167, HR 2930, HR 2940 and a Draft Bill Concerning Small Companies and Regulatory Relief, 112th Cong., 1st Sess. (Congressional Hearing held Oct. 5, 2011), Congressional Quarterly Transcripts at 8-9, *cited in*, Catherine T. Dixon, "Title II of the JOBS Act: Are Reports of the Death of General Solicitation Premature?" Insights, Vol. 26, No. 6, June 2012, p.2.

³ *Id.* at 9.

may follow to provide some assurance they have taken appropriate steps to verify that purchasers are accredited.

Ultimately, the Commission's proposed regulation is no rule at all: the regulation substantially restates the language of the statute by requiring that issuers shall take reasonable steps. The Commission's abrogation of its responsibilities under the statute would be disturbing under any circumstances, but it is especially alarming because the Commission is establishing ground rules for new practices of offering unregistered investments to the public via general solicitation.

Investor Protection Provisions Must Be Included in the Rule 506(c) Exemption

We gather from the Commission's rule release and its failure to adopt meaningful rules for the Rule 506(c) exemption that the Commission is simply unwilling to deal with the opposition and disputes that would arise if the Commission were to adopt rules that are more protective of retail investors.

In 1937, S.E.C. Chairman William O. Douglas said of the Commission, "We are the investors' advocate." The Commission has a proud history of protecting investors from fraudulent, abusive, and unduly risky offerings. In contrast to that history, the proposed rules under Title II represent a historic failure by the Commission to meet its responsibilities under the securities laws.

Title II of the JOBS Act permits unregistered offerings to be offered to the public, so long as the securities are sold only to accredited investors. Because the Commission's proposed regulations include insufficient safeguards, they will leave many retail investors vulnerable to fraud and abuse, particularly through investments offered over the Internet. It is not too late for the Commission to turn back from making a historic mistake in rule making. We respectfully urge the Commission to withdraw its vague and unworkable proposed regulations and to propose new regulations that, while balancing the interests and viewpoints expressed in the public comments, will give highest priority to the protection of investors and markets.

Thank you for your consideration of these comments. If you have questions or we can assist in any way, please contact me or Bryan Lantagne, Director of the Massachusetts Securities Division at (617) 727-3548.

Sincerely,



William F. Galvin
Secretary of the Commonwealth
Commonwealth of Massachusetts

Enclosure



The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

July 2, 2012

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

Re: Comments on the Securities and Exchange Commission's Regulatory Initiatives
under the JOBS Act: Title II

Dear Ms. Murphy:

The Office of the Secretary of the Commonwealth, Massachusetts Securities Division appreciates this opportunity to share our views and comments on the Commission's Regulatory Initiatives under the Jumpstart Our Business Startups Act ("JOBS Act") prior to the Securities and Exchange Commission's ("S.E.C.") official comment period for proposed regulations.

Title II of the JOBS Act modifies the exemption provided under Rule 506 of Regulation D to "provide that the prohibition against general solicitation or general advertising contained in [Rule 502(c) of Regulation D] shall not apply to offers and sales of securities made pursuant to [Rule 506], provided that all purchasers of the securities are accredited investors. Such rules shall 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."

This new exemption under Title II represents a fundamental change in the existing regime of securities regulation. Until the adoption of the JOBS Act, the securities laws and regulations have required that public offerings must be registered; and that exempt offerings must be offered and sold in a non-public manner to investors who can fend for themselves in the financial markets.

Abusive Offerings under Current Rule 506

For several years, the Securities Division has been seeing significant problems in offerings sold to large numbers of investors under S.E.C. Rule 506. This was exemplified by the Securities Division's *Securities America* case, which involved the sale of \$7,200,000 of investment notes to 60 Massachusetts investors.¹

Securities America typically marketed Medical Capital notes to conservative investors who were looking for a higher-yielding income investment. The Medical Capital note trusts collapsed due to significant fraud. Sale of the notes involved an array of problems, including: inadequate broker diligence; misleading disclosure to investors; inadequate financial statement information; and failures to meet basic suitability obligations.

In the *Securities America* case, the Securities Division was able to require the brokerage to pay restitution to Massachusetts investors. This result was possible because the broker was registered to do business in Massachusetts and had the resources to pay such restitution. We are concerned that in offerings under the liberalized Rule 506, there will be even greater opportunities for issuer and selling person misconduct, but rarely if ever will there be a financially responsible party who will be able to repay investors' losses.

Accredited Investor Definition

The requirement that investors in offerings under the new Rule 506 exemption must be accredited is the sole substantive protection built into the exemption. In a Rule 506 offering that is limited to accredited investors, other protective requirements are waived. For instance, there is no information requirement (no mandated disclosures to investors); no financial statement requirement; no requirement that investors must be sophisticated; and no S.E.C. or state review of either the offering materials or the terms of the offering.

Going forward, the Regulation D definition of accredited investor will serve as the sole determinant of whether an investor can invest in unregistered publicly-offered securities transactions. The accredited investor definition was not designed for this purpose, and based on our experience it is clear that the definition has not been sufficient to delineate the class of investors who do not need the benefits of securities registration. State and federal regulators have seen significant abuse and fraud in Rule 506 offerings to accredited investors. In the *Securities America* case, the purchasers of Medical Capital Notes included a married couple of retired school teachers, one of whom was severely disabled. The unrestricted solicitations that will be permitted under the amended Rule

¹ *In the Matter of Securities America*, Massachusetts Securities Division, Docket No. E-2009-0085.

506 make it vitally important that the accredited investor definition be strengthened and improved as soon as possible.²

It is foreseeable that the new exemption will result in aggressive solicitations for Rule 506 offerings circulating in the marketplace. We anticipate that some issuers will engage in aggressive “Wild West” marketing campaigns for their offerings, because the only restrictions on these advertisements and solicitations are the anti-fraud provisions of the securities laws. To balance against the impact of such marketing, we urge the Commission to update the financial benchmarks in the accredited investor exemption to reflect the impact of inflation since 1982. We also urge the Commission to address the fact that individual investors in Rule 506 offerings often are unsophisticated. In view of this, it would be appropriate to require that accredited investors have knowledge in financial and business matters such that they are capable of evaluating the merits and risk of the investment.

Requirement that All Investors Be Accredited

The statutory language for the new exemption requires that “*all investors are accredited.*” We urge the Commission to adhere to the plain, clear language of the statute, and not to effectively read this requirement out of the exemption through rulemaking. Strict application of this requirement will uphold the key principles of the exemption because the accredited investor requirement is the sole investor protection standard built into the exemption.

In the sentence following the requirement that all investors must be accredited, Title II also requires issuers to *verify* that investors are accredited. The language of the statute makes the requirements of accredited investor status and verification separate and free-standing requirements. We urge the Commission not to subsume the requirement that investors be accredited into the verification requirement. To do so would be to ignore or effectively delete the requirement that “all investors are accredited investors.”

Failure to meet this standard should result in the loss of the exemption. Strict application of this requirement will create a strong deterrent against issuers, platforms, or brokers selling these offerings to unqualified and vulnerable non-accredited investors.

Verification of Accredited Status

Because the language of the new Rule 506 exemption calls for verification, it is clear that Congress intends this responsibility to be a step up from the current requirement that issuers have reasonable belief that investors are accredited. Other language in the JOBS Act also demonstrates that verification is a heightened requirement for issuers: the Section 201(a)(2) language relating to sales to Qualified Institutional Buyers (QIBs) under Rule 144A requires only “reasonable belief” that a purchaser is a QIB. This contrasting language makes it clear that Congress’s use of the term “verify” is

² We note that pursuant to Section 413 of the Dodd-Frank Act, the Commission may not undertake a review of the accredited investor definition until four years after the enactment of that Act.

purposeful, and we urge the Commission to make the verification requirement robust and meaningful.

While there are some who advocate that the verification process should be as quick and frictionless as possible and regulatory standards should be relaxed, we urge that the verification requirement be construed to actually protect non-accredited investors from risky unregistered offerings.

The American Heritage Dictionary definitions of “verify” are: **1.** To prove the truth of by presentation of evidence or testimony; substantiate. **2.** To determine or test the truth or accuracy of, as by comparison, investigation, or reference: *experiments that verified the hypothesis*.

The definition clearly indicates that verification should require issuers to determine whether investors are accredited based on *documentary evidence*, rather than just representations from potential investors. The statute does not call for investors to simply certify or attest that they are accredited or have a given level of income or net worth. We urge the Commission not to adopt rules that would reduce the requirement to that level. Permitting issuers to accept mere representations from investors would allow them to rely on unverified assertions.

Issuers and other persons carrying out the verification process should be required to designate a “key person” who will have the responsibility to assure that verification of accredited status is done properly. The key person should be trained to properly verify that potential investors are accredited. If the verification is not done properly, there must be consequences: the key person, the issuer, and the platform should be subject to strict sanctions, including fines and potential disqualification from participating in future exempt offerings.

Many issuers and platforms may not wish, or feel they are not competent, to verify the accredited status of potential investors. We urge the Commission to establish as a safe harbor or best practice the use of an independent party that would verify the accredited status of potential investors. This work could be carried out by qualified broker-dealer firms, banks, or other financial institutions, which have the expertise to carry out this verification and which have procedures in place to protect investors’ personal financial information.³

Because incomes and net worths fluctuate, we urge the Commission to require that the verification of accredited status be kept up to date. The Securities Division does not support the approach that an investor may be presumed accredited if the investor buys a large dollar amount of securities. While a large

³ We note that there are currently systems that provide for third-party certifications of information to facilitate commercial transactions; for instance, the Medallion Signature Guarantee system for the validation of signatures on stock transfer documents.

investment amount may indicate that the investor is wealthy, it also might indicate that a non-wealthy investor is over-concentrated in the investment.

Form D and Filing Requirements

The filing of a Form D should be a *condition* of the availability of the new Rule 506 exemption. The new statutory exemption means that Rule 506 is no longer just a safe harbor under Section 4(2) of the Securities Act of 1933. Because Congress has created a new exemption under Rule 506, it is appropriate for the Commission to revisit the contents of the Form D and the timelines for filing the form.

We urge the Commission to revise Form D to require that issuers that propose to offer securities under Rule 506 indicate that they are using the exemption that permits general solicitation and advertising. The Commission should also require the issuer to file the Form D *prior* to the first use of general advertising or general solicitation, and *prior* to the first offer of securities. These requirements will notify federal and state regulators that these offerings are in the marketplace, and they will give potential investors an opportunity to obtain basic information about the issuer and the offering.

We also urge the Commission to require that all general advertising and general solicitation material be filed as an exhibit to the Form D.

The Form D should indicate whether the offering will be offered by means of a platform and should identify the platform.

To provide regulators and potential investors with timely information about the status of these offerings, we urge the Commission to require annual Form D filings and to require the filing a final Form D when the offering ends.

Consistent with the Commission's current practice, the Form Ds should be made available to regulators and the public through the EDGAR system. This will permit regulators and the public to know that an offering is on file and will permit users to obtain some basic information about the issuer and the offering.

Selling Person Regulation: Rule 506 Platforms

Title II of the JOBS Act creates a new exemption from the broker registration requirement for a new type of "platform or mechanism" that will post listings for Rule 506 offerings that may be sold using general solicitation or advertising. These platforms may facilitate an offer, sale, purchase, or negotiation involving these securities. Title II prohibits compensation in connection with the purchase or sale of such security, prohibits custody, and includes a bad actor disqualification; however, it specifically allows the platform to provide "ancillary services" relating to offerings, including due diligence and the provision of standardized offering documents.

Title II permits unlicensed platforms to carry out certain activities that traditionally have been carried out by licensed brokers or investment advisers, so we believe the exemption should be conservatively construed. To protect against the

platforms improperly entering into the businesses of licensed brokers and investment advisers, we urge the Commission to clearly delineate the limited activities the platforms can engage in and still maintain their exemption from the broker registration requirements.

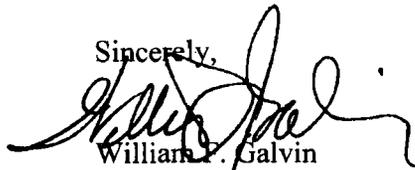
Additionally, we urge the Commission to clearly state that the payment of any direct *or indirect* selling compensation, and certainly any transaction-based compensation, will cause the loss of the exemption. We also ask the Commission to specifically declare, by rule or otherwise, that direct or indirect selling compensation in connection with ancillary services will cause the loss of the exemption.

The Act permits platforms to co-invest in the offerings they list. In view of this permitted activity, we also ask the Commission to declare that the payment of selling compensation to the platform by means of options, warrants, or other securities will also cause the loss of the exemption.

We urge the Commission to adopt a set of conduct rules, or at a minimum a set of prohibited practices, that would apply to platforms. We believe the Commission has the authority to spell out acts and practices that are contrary to the language and purposes of the platform exemption, and that would cause the loss of that exemption.

Thank you for your consideration of these comments. If you have questions or we can assist in any way, please contact me or Bryan Lantagne, Director of the Massachusetts Securities Division at (617) 727-3548.

Sincerely,



William F. Galvin
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