Council of Institutional Investors
The Voice of Corporate Governance

Via Email

September 27, 2012

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

Dear Ms. Murphy:

I am writing on behalf of the Council of Institutional Investors ("Council") in response to the Securities and Exchange Commission's ("SEC" or "Commission") proposed rule, *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings* ("Proposal").[1]

The Council is a nonprofit, nonpartisan association of public, corporate and union pension funds, and other employee benefit plans, foundations and endowments with combined assets that exceed $3 trillion.[2] Our member funds are major, long-term investors committed to protecting the retirement savings of millions of American workers. With that commitment in mind, we have taken a strong interest in the Jumpstart Our Business Startups Act ("JOBS Act").[3]

Our interest in the JOB's Act is evidenced, in part, by the commissioning and release of a series of "Issue Briefs" designed to educate Council members on key elements of the JOBS Act. That series includes an Issue Brief authored by Professor James Cox, Duke University School of Law, entitled "General Solicitations for Certain Private Offerings" ("Cox Brief")[4]

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[1] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 9354, 77 Fed. Reg. 54,464 (proposed Sept. 5, 2012), http://www.gpo.gov/fdsys/pkg/FR-2012-09-05/pdf/2012-21681.pdf [hereinafter Proposal].

[2] For more information about the Council of Institutional Investors ("Council"), including its members, please visit the Council's website at http://www.cii.org/about.

[3] *See, e.g,* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Ms. Elizabeth M. Murphy, Secretary, Securities and Exchange Commission 1-2 (August 9, 2012), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2012/08-09-12%20JOBS%20Act%20Letter%20doc(final).pdf.

[4] James Cox, JOBS Act Issue Brief: General Solicitations for Certain Private Offerings 1-4 (July 2012) (on file with Council).

We share the concern referenced in the Cox Brief[5] and explicitly raised in the Proposal that the removal of the prohibition against general solicitation mandated by Section 201(a) of the JOBS Act may "increase fraudulent activity."[6] Our concern is only heightened by the Proposal's failure to specify the verification methods that an issuer must or could use in taking, as Section 201(a) requires, "reasonable steps to verify that purchasers of the securities are accredited investors."[7]

We note that the Commission acknowledges that the Proposal's "flexible" approach to the proposed verification method "could result in less rigorous verification, thus allowing some unscrupulous issuers to more easily sell securities to purchasers who are not accredited investors and perpetrate fraudulent schemes."[8] If the uptick in fraudulent activity resulting from the removal of the ban on general solicitation is significant, the unfortunate result may be erosion in the integrity of our capital markets to the detriment of Council members, the beneficiaries of Council member funds, and other market participants.[9]

We can probably all agree that the Proposal must strive to put in place a verification approach that avoids a repeat of what occurred in 1992, when the Commission relaxed the ban on general solicitation under Rule 504 of Regulation D.[10] In that instance, the Commission's action incited a wave of pump-and-dump schemes and other penny-stock frauds that damaged market integrity and ultimately led to a reinstatement of the ban.[11]

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[5] *Id.* at 3 (Commenting that the removal of the ban on general advertisements and solicitations my "create problems if the JOBS Act unleashes a barrage of predatory advertisements and solicitations").

[6] Proposal, *supra* note 1, at 54,479.

[7] Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 201(a)(1), 126 Stat. 306 (Apr. 5, 2012), http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

[8] Proposal, *supra* note 1, at 54,478.

[9] *See, e.g.,* Commissioner Luis A. Aguilar, U.S. SEC, Remarks at the SEC Open Meeting on Increasing the Vulnerability of Investors 1 (Aug. 29, 2012), http://sec.gov/news/speech/2012/spch082912laa.htm ("true capital formation and economic growth . . . requires investors to both have confidence in the capital markets and access to the information needed to make good investment decisions").

[10] *Id.* at 2 n.9.

[11] *See Id.*

In reviewing the Proposal, we are less confident than the Commission that the increase in fraudulent activity that may result from the removal of the prohibition against general solicitation under Section 201(a) will be mitigated by (1) the "requirement that issuers sell only to accredited investors . . . who may be better able to assess their ability to take financial risks and bear the risk of loss than investors who are not accredited,"[12] and (2) the deterrent effect of potential legal actions against fraudulent issuers under the "federal securities laws . . . ."[13]

Accredited Investors

The antiquated definition of accredited investors—income threshold ($200,000) and net worth threshold ($1,000,000)—is no longer likely to be an effective mitigating factor in deterring the fraudulent activity that may arise from the removal of the ban on general solicitation.[14] As Professor Robert B. Thompson of Georgetown University Law Center recently explained in testimony before Congress:

> In 1982, an income of $200,000 or millionaire status in terms of net worth covered a relatively limited number of very well-off people, and did not affect all that many retail investors. That dollar amount hasn't changed in the three decades since even though inflation has brought more and more individuals within its definition, effectively extending its reach deeper into the cohort of those with smaller real incomes. Indeed measured as a percentage of the pool of individual taxpayers, the number of individuals whose income is above $200,000 is now *20 times larger than at the time of enactment of Regulation D.*[15]

Moreover, as indicated, even if the definition of accredited investors was updated and improved, without strong safeguards to ensure that Rule 506 private offerings are only sold to accredited investors, the number of unsophisticated investors that may be subjected to fraudulent activities may increase.

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[12] Proposal, *supra* note 1, at 54,478

[13] *Id.*

[14] *See, e.g.,* Hearing on the JOBS Act Before the H. Subcomm. on TARP, Fin. Servs. & Bailouts of Pub. & Private Programs of the Comm. on Oversight & Gov't Reform & H. Subcomm. on Capital Mkts. & Gov't Sponsored Enters. of the Comm. on Fin. Servs., 112th Cong. 6 (Sept. 13, 2002) (Statement of Professor Robert B. Thompson, Peter P. Weidenbruch Jr. Professor of Business Law, Georgetown University Law Center), http://financialservices.house.gov/uploadedfiles/hhrg-112-ba16-wstate-rthompson-20120913.pdf [hereinafter Thompson].

[15] *Id.* at 7 (emphasis added).

As explained in the Cox Brief:

> [T]he JOBS Act's removal of the ban on general advertisements and solicitations may encourage eager investors to bring pressure on the offering parties to sell the security to them, regardless of their level of sophistication. Experience has shown that investors, who do not qualify as accredited investors may, if presented with what they perceive as a particularly attractive investment opportunity, falsely claim that they are accredited investors.[16]

Federal Securities Laws

The potential for legal actions brought under the federal securities laws by defrauded investors against unscrupulous issuers is also no longer likely to be an effective mitigating factor against an increase in fraud. Professor Thompson's recent Congressional testimony also focused on this important point, explaining:

> [T]he Supreme Court's 1995 decision in Gustafson v. Alloyd Co. . . . that excluded private offerings from the reach of Section 12(a)(2) under the '33 Act, . . . relegat[es] those transactions to a fraud-only regime under Rule 10b-5 or common law fraud. *Such a liability regime could well be justified in a negotiated transaction with a small group of concentrated investors, but less so in a world where there is aggressive selling to a large number of unconnected investors*.[17]

We note that even though an action can still be brought under the antifraud provisions of the federal securities laws or under common law fraud, it is well recognized that in most cases, much of the investors' monies are long gone by the time the fraud is identified and the lawsuit can be filed.[18]

For all the above reasons, we respectfully request that the Commission reconsider the Proposal's flexible approach to implementing the verification mandate of Section 201(a) of the JOBS Act. We encourage the Commission to adopt a final rule that specifies the methods that issuers must use or could 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 that can understand and bear the financial risks of those investments.

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[16] James Cox at 3.

[17] Thompson, *supra* note 14, at 7 (emphasis added).

[18] *See, e.g.,* Commissioner Luis A. Aguilar at 2 ("In most cases, much of the investors' monies are long gone by the time the fraud is identified and an action can be brought.").

Should you have any questions about this letter or our view on the Proposal, please feel free to contact me at 202.261.7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney
General Counsel