

July 14, 2011

By email to rule-comments@sec.gov

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

Re: Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings
File Number S7-21-11

Dear Ms. Murphy:

We appreciate the opportunity, on behalf of our client, The Depository Trust & Clearing Corporation ("DTCC"), to provide comments to the Securities and Exchange Commission (the "Commission") on the proposed amendments to its rules relating to felons and other bad actors set forth in Securities Act Rel. No. 9,211 (May 25, 2011) (the "Release").

Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") requires the Commission to adopt rules to disqualify certain securities offerings involving felons and other bad actors from reliance on the safe harbor from registration provided by Rule 506 of Regulation D (limited offer and sale of securities without registration) under the Securities Act of 1933, as amended (the "Securities Act"). Section 926 of the Dodd-Frank Act requires that such rules must be substantially similar to Rule 262 of Regulation A (conditional small issues exemption) under the Securities Act, and must also cover certain other disqualifying events specified Section 926. The proposed amendments to Rules 501 and 506 of Regulation D set forth in the Release (the "Proposed Rule") would implement the requirements of Section 926.

A. DTCC and the Registered Clearing Agencies in the DTCC Group

DTCC is the parent company of a group of operating subsidiaries which provide clearance, settlement and information services for equity securities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and over the counter derivatives. The operating subsidiaries in the DTCC group help to automate, centralize, standardize and streamline processes that are critical to the safety and soundness of the capital markets. The operating subsidiaries in the DTCC group include The Depository Trust Company ("DTC") and National Securities Clearing Corporation ("NSCC"), which are clearing agencies registered under Section 17A of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). DTC and NSCC are regulated by the Commission.

- (a) DTC is a central securities depository that provides custody, asset servicing and book-entry settlement services for its participants. As a New York limited purpose trust company and

state member bank of the Federal Reserve System, DTC is also regulated by the New York State Banking Department and the Federal Reserve Bank of New York.

- (b) NSCC is a clearinghouse and central counterparty for equity securities, corporate and municipal bonds and other securities traded in the capital markets. NSCC processes substantially all broker-to-broker trades in equity securities and corporate and municipal bonds in the United States.

As registered clearing agencies, DTC and NSCC are required by Section 17A(b)(3)(F) of the Exchange Act to adopt and enforce rules designed to (i) promote the prompt and accurate clearance and settlement of securities transactions, (ii) assure the safeguarding of securities and funds in their custody or control or for which they are responsible, (iii) foster cooperation and coordination with other persons engaged in the clearance and settlement of securities transactions, (iv) remove impediments to, and perfect the mechanism of, a national system for the prompt and accurate clearance of securities transactions and (v) in general, protect investors and the public interest.

To be eligible for deposit in DTC, securities must (i) be registered with the Commission under the Securities Act or (ii) be exempt from registration pursuant to a Securities Act exemption that does not involve (or no longer involves) transfer or ownership restrictions or (iii) be eligible for resale pursuant to Rule 144A or Regulation S under the Securities Act. Securities which were originally issued without registration under the Securities Act and were therefore subject to transfer or ownership restrictions, but which are no longer subject to transfer or ownership restrictions at the time of deposit, are eligible for deposit in DTC. Accordingly, securities issued in reliance on the safe harbor from Securities Act registration provided by Rule 506 of Regulation D are eligible for deposit in DTC once applicable transfer restrictions have expired. At the same time, these securities may be cleared by NSCC.

DTCC believes that exempt offerings of securities play a vital role in capital formation in the United States and are particularly important for the funding of small business. This method of capital formation should be supported and encouraged. However, DTCC has found, from experience reviewing the eligibility of securities for deposit in to DTC, that certain exempt offerings, especially micro cap and penny stock offerings involving persons of questionable character and integrity, present problems in terms of fraud on the investing public and abuse of the services, facilities and resources of registered clearing agencies. Unfortunately, all too often, such exempt offerings have been used by such persons to circumvent the disclosure requirements of the securities laws and the eligibility requirements of registered clearing agencies, in order to introduce securities into the national clearance and settlement system which should not properly be in the system.

It is from this perspective -- and the obligations imposed on its clearing agency subsidiaries by Section 17A(b)(3)(F) of the Exchange Act described above -- that DTCC offers its full support of the amendments that the Commission has proposed to its Rules 501 and 506 of Regulation D. In particular, DTCC commends the Commission for not only carrying out the express mandate of Section 926 of the Dodd-Frank Act -- to include in Rule 506 of Regulation D the disqualification provisions of Rule 262 of Regulation A and the additional disqualifying events specified in Section 926 -- but also:

- (a) for simplifying the framework for disqualification by having just one list of potentially disqualified persons and one list of disqualifying events rather than three lists of potentially

disqualified persons, each with its own disqualifying events, as is the case with Rule 262 of Regulation A;

- (b) for looking to Rule 505 of Regulation D rather than Rule 262 of Regulation A for a more appropriate description of the types of financial intermediaries likely to be involved in private placements under Rule 506;
- (c) for clarifying certain provisions of Rule 262 of Regulation A, which are replicated in the Proposed Rule, with respect to, among other things, the treatment of entities organized as limited liability companies;
- (d) for proposing a strict but fair reasonable care exception to provide issuers with any necessary relief from what DTCC believes should otherwise be the broadest possible application of the felon and bad actor disqualification to Rule 506 offerings; and
- (e) for suggesting other possible amendments to Commission rules to make the felon and bad actor disqualification more uniform across its other exemptive rules.

Further to its general support of the proposed amendments to Rules 501 and 506 set forth in the Release, DTCC would like to offer the following specific comments on particular aspects of the proposed amendments.

B. Comments With Respect to Covered Persons

The Proposed Rule provides that the disqualification provisions would apply to the following covered persons:

- the issuer and any predecessor of the issuer or affiliated issuer;
- any director, officer, general partner or managing member of the issuer;
- any beneficial owner of 10% or more of any class of the issuer's equity securities;
- any promoter connected with the issuer in any capacity at the time of the sale;
- any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with sales of securities in the offering; and
- any director, officer, general partner, or managing member of any such compensated solicitor.

1. Determination of 10% Beneficial Owner

The Proposed Rule includes as a covered person "any beneficial owner of 10% or more of any class of the issuer's equity securities". The Proposed Rule does not, however, provide any detail as to how the 10% interest is calculated. DTCC would suggest that, in determining whether a person is the owner of 10% or more of any class of the issuer's equity securities for purposes of Rule 506, there should be included all securities of such class that such person could acquire through the exercise of options or the conversion of other securities during the time period for which the issuer seeks to rely on Rule 506. In addition, DTCC would suggest that any person who has engaged in any plan or scheme to evade the 10% beneficial ownership interest threshold with respect to any class of the issuer's equity securities

should also be a covered person for purposes of the disqualification provisions, regardless of actual ownership.

2. Attorneys and Investment Advisers

As currently provided in the Proposed Rule, covered persons include "any director, officer, general partner or managing member" of the issuer or any compensated solicitor. DTCC would suggest that covered persons should also include (as no less important than any officer) any attorney acting for the issuer or any compensated solicitor in connection with the proposed issuance.

The Commission has requested specific comment on whether it would be appropriate to expand the coverage of the Proposed Rule to include investment advisers and their directors, officers, general partners and managing members. DTCC believes that such expansion is necessary and appropriate. Investment advisers, when involved in an exempt offering, are an integral part of the issuance and therefore should be included within the scope of covered persons. As is the case with issuers and compensated solicitors, this should include the directors, officers, general partners and managing members of such investment advisers. As suggested above by DTCC, this should also include attorneys acting for such investment advisers in connection with the proposed issuance.

DTCC believes that subjecting investment advisers to the disqualification provisions of the Proposed Rule, and including attorneys acting for issuers, compensated solicitors and investment advisers among the individuals covered by such provisions, would have the beneficial effect of causing issuers to carefully screen the key persons involved in the distribution and sale of their securities.

3. Officers

The Commission has requested specific comment on whether the reference to "officers", which is based on the current Rule 262, should be replaced with a reference to "executive officers" (as defined in Rule 501(f)). DTCC believes that the focus should be on the role of an officer rather than the title of the officer and that it would therefore be appropriate to refer to executive officers as defined in Rule 501(f), which includes both officers by title (president, vice president) and officers by function (officers who have a policy-making function).

4. Managing Members

The Commission has requested specific comment on whether it is appropriate to include managing members of limited liability companies in the scope of covered persons. Managing members of limited liability companies are not covered persons under Rule 262. DTCC believes that, for the same reasons that the general partners of partnerships are included in the scope of covered persons (they control the operations of the entity) so too should the managing members of limited liability companies (a newer form of legal entity) be included in the scope of covered persons.

C. Comments With Respect to Disqualifying Events

The Proposed Rule contains a listing of events and circumstances giving rise to disqualification: (i) criminal convictions, (ii) court injunctions and restraining orders, (iii) final orders of certain state regulators and federal regulators, (iv) commission disciplinary orders relating to brokers, dealers, municipal

securities dealers, investment advisers and investment companies and their associated persons, (v) suspension or expulsion from membership in, or suspension or bar from associating with a member of, a securities self-regulatory organization, (vi) commission stop orders and orders suspending a Regulation A exemption and (vii) U.S. Postal Service false representation orders. DTCC believes that all of these events and circumstances should give rise to disqualification, as the Proposed Rule currently provides.

1. *Look-Back Period*

Consistent with Rule 262, the Proposed Rule has, with respect to disqualifying events, a look-back period of five years for issuers, their predecessors and affiliated issuers and a look-back period of ten years for all other covered persons. The Commission has requested specific comment on whether a longer look-back period would be appropriate in certain circumstances. DTCC believes that all look-back periods with respect to disqualification events should be consistent and that a ten year look-back period for all covered persons, including issuers, their predecessors and affiliated issuers, would be appropriate. In addition, DTCC would suggest that, in instances in which an individual or entity has been convicted of securities fraud and/or any violation of Rule 506, such individual or entity should be permanently disqualified.

2. *Change of Control*

The Commission has requested specific comment on whether there should be different treatment of entities that have undergone a change of control since the occurrence of a disqualifying event. DTCC does not believe that the Commission should provide for any different treatment of entities that have undergone a change of control; the same disqualification standards should apply uniformly to all entities. A change of control, without more, does not provide any assurance that the events and circumstances which gave rise to a disqualifying event are no longer relevant.

3. *Foreign Convictions*

The Proposed Rule currently provides for disqualification in the case of certain specified convictions in U.S. courts and certain specified actions taken by U.S. regulators. The Commission has requested specific comment on whether convictions in foreign courts should trigger disqualification on the same basis as criminal convictions in U.S. courts. DTCC believes that the scope of disqualifying events under the Proposed Rule should be expanded to include convictions for comparable offenses in foreign courts and comparable actions taken by foreign regulators. In an increasingly globalized world, with free movement of people and capital across borders, foreign convictions and regulatory actions are no less relevant than domestic convictions and regulatory actions to the essential objectives of the Proposed Rule, i.e., to disqualify securities offerings involving felons and other bad actors from reliance on the safe harbor from registration provided by Rule 506 of Regulation D. DTCC acknowledges that difficult issues may arise in determining whether foreign convictions or regulatory actions are comparable to U.S. convictions or regulatory actions, but DTCC believes that this determination is something that may be left to the discretion of the Commission. DTCC would request, however, that the Commission provide guidance on how it would exercise such discretion in the circumstances.

D. Comments With Respect to Other Matters

1. Waivers

Under Rule 262, an issuer may seek a waiver from disqualification from the Commission. The Commission may grant such waiver if it determines that the issuer has shown good cause that it is not necessary under the circumstances that the registration exemption be denied. The Proposed Rule would carry over the waiver provisions of Rule 262. DTCC believes that it is appropriate for the Commission to have the discretion to grant waivers. DTCC would request, however, that the Commission provide guidance on how it would exercise such discretion in the circumstances.

2. Phase-in Period

The Proposed Rule would apply to all issuances proposed to be made under Rule 506 after the effective date of the amendments without regard to whether the disqualifying events occurred before the enactment of the Dodd-Frank Act or the effective date of the amendments. The Proposed Rule does not contemplate any phase-in period or other delay before the amendments would apply. The Commission has requested specific comment on whether there should be some phase-in period. DTCC believes that, consistent with the objective of the Proposed Rule -- to stop the flow of potentially tainted offerings as soon as possible -- there should not be any phase-in period or other delay in the implementation of the amendments.

3. Uniformity Across Exempt Offerings

In addition to the matters set forth above, the Commission has requested specific comment on whether it should apply the provisions of the Proposed Rule uniformly to exempt offerings under Regulations A, D and E. DTCC would urge the Commission to do so in order to prevent issuers from engaging in regulatory arbitrage by choosing to use another exemption under Regulation D or an exemption under Regulations A or E that has the least restrictive disqualification provisions.* DTCC believes that there is no logic in having different disqualification provisions apply to different exempt offerings and that having a single set of disqualification provisions apply to all exempt offerings will facilitate an understanding of the applicable rules and compliance by issuers.

*Rule 262 of Regulation A and Rule 505 of Regulation D (which incorporates by reference the disqualification provisions of Rule 262) do not include the additional disqualifying events specified in Section 926 of the Dodd-Frank Act, which are included in the Proposed Rule. Rule 504 of Regulation D does not include any disqualification provisions. The disqualification provisions of Section 262 of Regulation E are similar to the disqualification provisions of Rule 262 of Regulation A (and Rule 505 of Regulation D) but also do not include the disqualifying events specified in Section 926 of the Dodd-Frank Act, which are included in the Proposed Rule.

We appreciate the opportunity, on behalf of our client, DTCC, to comment on the Release. If you have any questions, please do not hesitate to contact me at (212) 768-5393 or Walter Van Dorn at (212) 768-6985.

Very truly yours,



Charles Douglas Bethill

cc: Larry E. Thompson, Managing Director and General Counsel, DTCC
Mihal Nahari, Managing Director and Chief Compliance Officer, DTCC
Lois Radisch, Managing Director and Deputy General Counsel, DTCC
Walter G. Van Dorn, Jr., SNR Denton US LLP