MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

August 12, 2011

Via Electronic Mail: rule-comments@sec.gov

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

Re: Managed Funds Association Comments on Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings, File. No. S7-21-11

Dear Ms. Murphy:

Managed Funds Association ("MFA")[1] appreciates the opportunity to comment on the proposed rule (the "Proposed Rule"), "Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings" issued by the Securities Exchange Commission (the "SEC"). Firms and persons that violate the securities laws harm not only their own investors and clients, but also undermine confidence in the financial services industry and capital markets as a whole. Accordingly, MFA strongly supports appropriate penalties and bars for persons in the securities industry who engage in inappropriate conduct. MFA is committed to working with the SEC to develop rules that accomplish this shared goal in a manner that avoids creating unintended consequences that could unduly impair capital formation.

Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") directs the SEC to issue rules disqualifying issuers from making offerings and sales of securities in reliance on the safe harbor in Rule 506 of Regulation D ("Rule 506") under the Securities Act of 1933, as amended (the "Securities Act"), if the issuer or persons affiliated with the issuer have engaged in conduct that is

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $2.0 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

600 14th Street, NW, Suite 900 | Washington, DC 20005 | 202.730.2600 | Fax 202.730.2601 | www.managedfunds.org

substantially similar to the provisions of Rule 262 under the Securities Act, or are subject to certain final orders of a state securities commission or other state authority.

Rules adopted by the SEC under Section 926 will apply to a broad range of firms and conduct. The wide scope of Section 926 could affect many firms that currently rely on Rule 506 in conducting private offerings. In implementing Section 926, we urge the SEC to limit the retroactive application of the final rule with respect to firms that entered into settlement agreements with regulators prior to enactment of the Dodd-Frank Act. In preparing rules under Section 926, the SEC also should consider providing generally applicable guidance to firms that wish to seek relief from the disqualification provision, as specifically permitted by Section 926. We further encourage the SEC to differentiate between technical violations and more egregious conduct, such as scienter-based violations.[2] We believe that all of these suggested changes are consistent with the statutory language and the underlying intent of Section 926. Further, we believe that these changes will better accomplish Congress's and the SEC's dual goals of protecting investors and facilitating capital formation while minimizing the potential for adverse, unintended consequences.

Retroactive Application of Proposed Rule

In the Proposed Rule release, the SEC expresses its view that, under the text of Section 926, past disqualifying events should be taken into account under the new disqualification rules. The text of Section 926 does not contain express language requiring the SEC rule to include conduct that occurred prior to enactment of the Dodd-Frank Act. Because Section 926 requires the SEC to issue rules that would disqualify certain persons from relying on Rule 506 because of conduct that occurred prior to the disqualification, it should be expected that the statutory text would use language that references prior conduct. Because Section 926 does not contain clear expression of intent to include regulatory orders entered into prior to enactment of the Dodd-Frank Act, we believe that the SEC has authority to decide not to include such orders the scope of the new disqualification rule. For the reasons discussed below, we encourage the SEC not to include as disqualifying events negotiated settlements that were entered into prior to the enactment of the Dodd-Frank Act.

To interpret the legislative intent underlying Section 926, the SEC in its Proposed Rule release references both the statute and floor statements of Senator Dodd. At note 93 of the Proposed Rule release, for example, the SEC quotes Senator Dodd and states:

> Senator Dodd's statement on the Senate floor, when he proposed adding this language, provides further support. ''New section 926 would disqualify felons and other ''bad actors'' who have violated Federal and State securities laws from continuing to take advantage of the rule 506

[2] We note that this approach would be similar to the SEC's treatment of insignificant deviations from the requirements of Regulation D pursuant to Rule 508 of Regulation D 17 C.F.R. §230.508.

> private placement process. This will reduce the danger of fraud in private placements.'' Statement of Sen Dodd, CR S3813 (May 17, 2010)]. It suggests an intention to prevent previous violators from continuing to rely on our exemptions, which can only be accomplished if pre-existing disqualifying events are taken into account.

Of course, any formulation of the rule will disqualify persons from relying on Rule 506 because of conduct that occurred prior to the disqualification. But disqualifying persons for that type of prior conduct is not the same as disqualifying persons for prior actions (or settlements) that occurred at any time in the past, whether before or after Congress's enactment of the Dodd Frank Act. We think a better reading of Senator Dodd's statement is that Congress meant prospectively to ban bad actors who engage in specified disqualifying conduct after the date of enactment, from subsequently being permitted to rely on Rule 506.[3]

The Proposing Rule release further cites to another part of Senator Dodd's statement and a 2010 letter from the North American State Securities Administrators as evidence that Section 926 should be applied retroactively. In the release, the SEC argues that the adopted version of Section 926 replaced a provision that would have retroactively disqualified issuers from making offerings in certain states following a proposed elimination of the federal pre-emption of Rule 506 offerings. We respectfully disagree with the SEC's interpretation and inference regarding the relevance of the provision from an earlier draft of the legislation. The earlier provision did not include an express statement that it was intended to be applied retroactively and, as such, it is far from certain that the earlier provision should be interpreted to broadly apply to all conduct and settlements entered into prior to the enactment of the Dodd-Frank Act.

Moreover, even if the earlier iteration were viewed as applying retroactively, it would be inappropriate to automatically infer that the same intent should be read into Section 926, which was amended significantly from the earlier provision. In addition to the language from Senator Dodd's statement noted in the SEC release, Senator Dodd's statement also provided in relevant part, "The purposes of sections 412 and 926 of the bill have been to better protect investors while facilitating capital formation. This amendment more completely accomplishes these goals."[4] This statement suggests that the amended Section 926 better achieved the dual goals of investor protection and capital formation than the prior version. While the SEC suggests Senator Dodd's statement should be interpreted to support retroactive application of Section 926, it could also be interpreted to suggest that the amendments to Section 926 were made to accomplish the same

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[3] For example, if a person committed securities fraud on January 1, 2011, and a court convicted that person of a felony on March 15, 2012, a ban on participating in Rule 506 offerings "would disqualify felons and other 'bad actors' who have violated Federal and State securities laws from continuing to take advantage of the rule 506 private placement process," in accordance with Senator Dodd's comment. Accordingly, we do not believe that the SEC's interpretation of Senator Dodd remark is necessarily the only reading and, indeed, for reasons discussed below, we believe it is not the better reading.

[4] Statement of Senator Christopher Dodd, CR S3813 (May 17, 2010).

investor protection goals of the prior version in a manner that better promoted capital formation. Accordingly, we do not believe that his statement provides clear evidence of statutory intent that the SEC should broadly apply the disqualification rules to all prior conduct, including negotiated settlements. Because neither the statutory text nor the legislative history express a clear intent for the SEC to implement Section 926 in a way that includes all prior regulatory orders within the scope of the SEC's rule, the SEC has authority to determine not to include prior negotiated settlements within the scope of disqualifying conduct under the new rules.

We encourage the SEC to use its discretionary authority to exclude prior negotiated settlements from the scope of the new rule to avoid creating unnecessary uncertainty for market participants who conduct private offerings in reliance on Rule 506. Retroactive application of the new rule to prior negotiated settlements would disrupt the expectations of market participants who previously settled enforcement actions on the understanding that they would be able to engage in Rule 506 offerings would following their settlement.

Negotiated settlements are an important aspect of the enforcement process in both federal and state law enforcement. Companies regularly settle enforcement proceedings in an effort to end or avoid costly and disruptive litigation and the associated uncertainties. These settlements generally involve a compromise of claims and defenses, with the settling party agreeing to sanctions in response to allegations or administrative findings of misconduct, typically on a neither-admit-nor-deny basis. Settling firms assess the effect on their future activities that would result from particular charges or sanctions and often seek waivers from disqualifications that may, in light of the alleged violations, disproportionately and unfairly impede their ongoing operations or access to the capital markets. The certainty achieved by a negotiated settlement is of great importance to both regulators and the settling parties whose ongoing business operations require some predictability. These settlements also benefit investors, as they conserve corporate assets and avoid unnecessary expense.

Interpreting Section 926 to apply retroactively to all prior regulatory orders would create significant uncertainty for market participants who have previously entered into settlement agreements, thereby requiring market participants and the SEC to expend substantial resources to resolve the appropriate application of new Rule 506. Moreover, applying Section 926 retroactively is not mandated by Congress for the reasons noted above and unfairly subjects parties to prior negotiated settlement to penalties that were not applicable at the time of the settlement. When parties negotiate a settlement, they do so with an understanding of the implications of the settlement in other contexts. Imposing a ban retroactively means that the settling party is now banned from Rule 506 offerings when the party might never have agreed to a settlement with such implications. We believe that such a result is inconsistent with the goal of facilitating capital formation and would also impose an unnecessary strain on the SEC's limited resources. Accordingly, we urge the SEC to amend the Proposed Rule so as not to apply it retroactively with respect to prior negotiated settlements between market participants and regulators.

Guidance on Waiver Applications

To the extent that the SEC decides to apply the rule retroactively to prior negotiated settlements, we encourage the SEC to provide guidance to market participants regarding terms and conditions that firms generally must meet to be granted waivers under the final rule. Providing such guidance would provide some clarity to market participants who would be subject to the disqualification provisions absent an SEC waiver and would also minimize the burdens on the SEC, which likely would be required to consider numerous requests for waivers to avoid unfair application of the disqualification provisions, as it is authorized to do under Section 926.

First, we encourage the SEC to extend grants of relief it has previously provided to firms from the disqualification provisions of Rules 262 and 505 to those firms in connection with the disqualification provisions of proposed Rule 506. The standard for issuing waivers under new Rule 506 and Rules 262 and 505 are similar as are the types of conduct that trigger disqualification under each of the rules. As such, the rationale for granting waivers under each of the rules also should be similar. Extending the relief previously granted under Rules 262 and Rule 505 would avoid unnecessarily imposing on the SEC the administrative burdens associated with processing relief applications that essentially duplicate waivers already granted by the SEC based on similar standards.

Further, we encourage the SEC to facilitate the waiver process by delegating authority to SEC staff, as appropriate, to alleviate the burden and potential for delays in the waiver process that would result from requiring direct orders by the Commission in all circumstances. We also encourage the SEC to help expedite the application process by describing the conditions that firms generally would need to meet to be eligible for such relief. We believe these changes would limit unnecessary disruption to firms that ultimately receive waivers.

Technical versus Substantive Violations

Finally, we encourage the SEC to avoid an overly broad implementation of the disqualification rules as they apply to final orders of a state securities commission, a state banking authority, a state insurance commission, a federal banking agency, or the National Credit Union Administration. Under Section 926, final orders from these regulators trigger a disqualification if they are "based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct." We are concerned that, without further clarification regarding the types of underlying conduct that would give rise to disqualification under Rule 506, this provision will create significant uncertainty and interpretive difficulties because of the varying formulations used in state and federal laws to address prohibited conduct. We believe that, consistent with the standard set out in Section 926, technical violations of state securities codes that do not by their terms require any intentional misconduct or scienter should not result in disqualification under the rule.

Many state and federal agencies issue orders that cite generally to broad statutory enforcement authority permitting a disciplinary action without specifying a rule or statutory section. Further, statutory or regulatory authority cited to by these agencies regarding a particular action can be ambiguous. Some state codes, for example, contain antifraud provisions and provisions addressing other types of conduct, sometimes within the same statutory section. As such, we urge the SEC to clarify that application of proposed Rule 506(c)(1)(iii)(B) will be limited to those violations that involve violations of scienter-based laws or regulations or are otherwise plainly identified as implicating a prohibition against “fraudulent, manipulative, or deceptive conduct” as those terms are commonly understood. We believe that a scienter-based limitation on this provision would appropriately capture the type of conduct intended to disqualify firms under Section 926 without unintentionally disqualifying firms that are subject to orders because of technical or other non-fraudulent conduct.

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Conclusion

MFA appreciates the opportunity to provide comments on the Proposed Rule. While we support the underlying goals of Section 926 and the Proposed Rule, we are concerned that retroactive application of the Proposed Rule to previously negotiated settlements would cause significant disruption to many market participants and unduly impair capital formation by those firms. We believe that retroactive application of the rule is not required by Section 926 and would ultimately conflict with the dual goal of protecting investors and facilitating capital formation. We also believe that it is important for the SEC to limit the scope of disqualifying orders under Section 506(c)(1)(iii)(B) to those that involve violations of scienter-based laws. We believe this appropriately captures the intended scope of disqualifying conduct under the statute and avoids the potential for unintended consequences of an overly broad disqualification rule.

If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other regulatory issues, please do not hesitate to contact Stuart J. Kaswell or me at (202) 730-2600.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO