It is difficult to provide any standardized estimates of the costs involved with the factual inquiry. There is no central repository that aggregates information from all federal and state courts and regulators that would be relevant in determining whether a covered person has a disqualifying event in his or her past. In this regard, we are currently unable to accurately estimate the burdens and costs for issuers in a verifiable way. We expect, however, that the costs to issuers may be higher or lower depending on the size of the issuer and the number and roles of covered persons. We realize there may be a wide range of issuer size, management structure, and offering participants involved in Rule 506 offerings and that different issuers may develop a variety of different factual inquiry procedures.

Where the issuer or any covered person is subject to an event listed in Rule 506(e) existing before the effective date of these rules, the issuer will be required to prepare disclosure for each relevant Rule 506 offering. The estimates include the time and the cost of data gathering systems, the time and cost of preparing and reviewing disclosure by in-house and outside counsel and executive officers, and the time and cost of delivering or furnishing documents and retaining records.

Issuers conducting ongoing or continuous offerings will be required to update their factual inquiry and disclosure as necessary to address additional covered persons. The annual incremental paperwork burden, therefore, depends on an issuer's Rule 506 offering activity and the changes in covered persons from offering to offering. For example, some issuers may only conduct one Rule 506 offering during a year while other issuers may have multiple, separate Rule 506 offerings during the course of the same year involving different financial intermediaries, may hire new executive officers or may have new 20% shareholders, any of which will result in a different group of covered persons. In deriving our estimates, we recognize that the burdens will likely vary among individual companies based on a number of factors, including the size and complexity of their organizations. We believe that some companies will experience costs in excess of this estimated average and some companies may experience less than the estimated average costs.

Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment to:

- evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;
- evaluate the accuracy of our estimate of the burden of the proposed collections of information;
- determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;
- evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- evaluate whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who wish to submit comments on the collection of information requirements should direct their comments to OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503 and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-31-10. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7-31-10 and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street NE, Washington, DC 20549-0213. Because OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if OMB receives them within 30 days of publication.

IV. ECONOMIC ANALYSIS

A. Background and Summary of the Rule Amendments

As discussed above, we are adopting amendments to implement the requirements of Section 926 of the Dodd-Frank Act, relating to the disqualification of "felons and other 'bad actors'" from participation in Rule 506 offerings. Section 926 of the Dodd-Frank Act requires the Commission to issue rules that disqualify issuers making securities offerings involving felons and other bad actors from relying on Rule 506 of Regulation D. These rules are required to be "substantially similar" to the disqualification rules in Rule 262 (which apply to Regulation A offerings as well as offerings under Rule 505 of Regulation D) and also to cover the matters enumerated in Section 926 (including certain state regulatory orders and bars). We believe the rules we are adopting comply with that mandate. The final rules include the following provisions not specifically required under Section 926:

- a reasonable care exception;

- mandatory disclosure of triggering events pre-dating the effective date of the rule amendments;
- the inclusion of additional triggering events for certain orders of the CFTC and for Commission cease-and-desist orders relating to scienter-based anti-fraud violations and violations of Section 5 of the Securities Act;
- the addition of coverage of investment managers of pooled investment funds and directors, executive officers, other officers participating in the offering, general partners and managing members of such investment managers and directors, executive officers and other officers participating in the offering of such general partners and managing members;
- narrower coverage of officers of issuers and financial intermediaries (covering only executive officers and officers participating in the offering, rather than all officers);
- narrower coverage of shareholders of the issuer (covering only beneficial owners of at least 20% of the issuer's outstanding voting securities, calculated on the basis of voting power, rather than 10% of any class of the issuer's equity securities); and
- a provision under which disqualification will not be triggered by regulatory orders if the authority that issued the order advises in writing that Rule 506 disqualification should not arise.

While commenters had differing views on whether disqualification under Rule 506 could or should be applied to events that occurred before the effective date of the rule amendments, we determined to apply disqualification only to events that occur after effectiveness of the rule amendments. As noted above, we are requiring disclosure of disqualifying events that pre-date effectiveness of the amendments.

We are sensitive to the costs and benefits imposed by our rules. The discussion below attempts to address both the costs and benefits of Section 926 of the Dodd-Frank Act itself, as well as the incremental costs and benefits of the rules and rule amendments associated with the exercise of our discretion in implementing Section 926. The costs and benefits attributable to the statutory mandate and those attributable to our discretion may not be entirely separable to the extent that our discretion is exercised to realize the benefits that we believe were intended by the Dodd-Frank Act.

Section 2(b) of the Securities Act[250] requires us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. We have considered those issues as part of this economic analysis.

B. Economic Baseline

The baseline analysis that follows is in large part based on information collected from Form D filings submitted by issuers relying on Regulation D to raise capital. As we describe in more detail below, we believe that we do not have a complete view of the Rule 506 market, particularly with respect to the amount of capital raised. Currently, issuers are required to file a Form D within 15 days of the first sale of securities, and are required to report additional sales through amended filings only under certain conditions. In addition, issuers may not report all required information, either due to error or because they do not wish to make the information public. Commenters have suggested and we also have evidence that some issuers do not file a

[250] 15 U.S.C. 77b(b).

Form D for their offerings in compliance with Rule 503.[251] Consequently, the analysis that follows is necessarily subject to these limitations in the current Form D reporting process.

1. Size of the Exempt Offering Market

Exempt offerings play a significant role in capital formation in the United States. Offerings conducted in reliance on Rule 506 account for 99% of the capital reported as being raised under Regulation D from 2009 to 2012, and represent approximately 94% of the number of Regulation D offerings.[252] The significance of Rule 506 offerings is underscored by the comparison to registered offerings. In 2012, the estimated amount of capital reported as being raised in Rule 506 offerings (including both equity and debt) was $898 billion, compared to $1.2 trillion raised in registered offerings.[253] Of this $898 billion, operating companies (issuers that are not pooled investment funds) reported raising $173 billion, while pooled investment funds reported raising $725 billion.[254] The amount reported as being raised by pooled investment funds is comparable to the amount of capital raised by registered investment funds. In 2012,

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[251] Many commenters asserted that non-compliance with Form D filing obligations is widespread. See, e.g., letters from Investor Advisory Committee (stating that "[i]t is generally acknowledged that a significant number of issuers do not currently file Form D..."); AARP (stating that "[s]imply adding a checkbox to a form that too often goes unfiled and then only after the fact is inadequate to the task at hand."); AFL-CIO and AFR (stating that "many issuers today flout the Form D filing requirement for such offerings, further limiting the Commission's ability to provide effective oversight"). See also Securities and Exchange Commission, Office of Inspector General, Regulation D Exemption Process (Mar. 31, 2009) ("OIG Report"), available at: http://www.sec-oig.gov/Reports/AuditsInspections/2009/459.pdf (stating that while the Commission staff "strongly encourage companies to comply with Rule 503, they are aware of instances in which issuers have failed to comply with Rule 503…"). Based on its analysis of the filings required by FINRA Rules 5122 and 5123 during the period of December 3, 2012 to February 5, 2013, DERA estimates that as many as 9% of the offerings represented in the FINRA filings for Regulation D or other private offerings that used a registered broker did not have a corresponding Form D.

[252] See Vladimir Ivanov and Scott Bauguess, Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012 (July 2013), available at http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf ("Ivanov/Bauguess Study").

[253] See id.

[254] See id.

registered investment funds (which include money market mutual funds, long-term mutual funds, exchange-traded funds, closed-end funds and unit investment trusts) raised approximately $727 billion.[255]

In 2011, the estimated amount of capital (including both equity and debt) reported as being raised in Rule 506 offerings was $849 billion compared to $985 billion raised in registered offerings.[256] Of the $849 billion, operating companies reported raising $71 billion, while pooled investment funds reported raising $778 billion.[257] More generally, when including offerings pursuant to other exemptions – Rule 144A, Regulation S and Section 4(a)(2) – significantly more capital appears to be raised through exempt offerings than registered offerings (Figure 1).[258]

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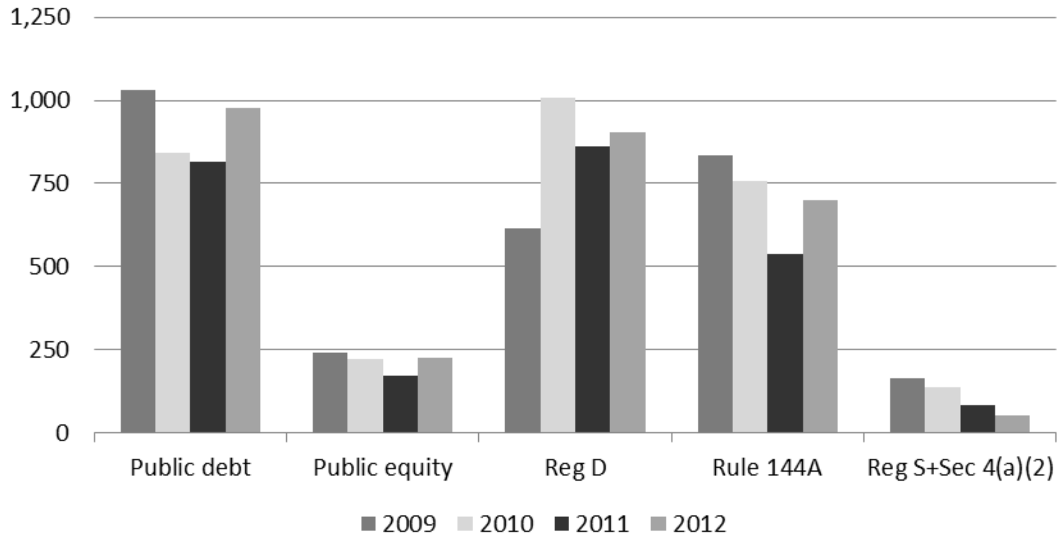
[255] In calculating the amount of capital raised by registered investment funds, we use the net amounts (plus reinvested dividends and reinvested capital gains), which reflect redemptions, and not gross amounts, by open-ended registered investment funds because they face frequent redemptions, and do not have redemption restrictions and lock-up periods common among private funds. In addition, we use the new issuances of registered closed-end funds and the new deposits of registered unit investment trusts. See 2013 Investment Company Institute Factbook, available at http://www.icifactbook.org.

[256] See Ivanov/Bauguess Study.

[257] See id.

[258] See id.

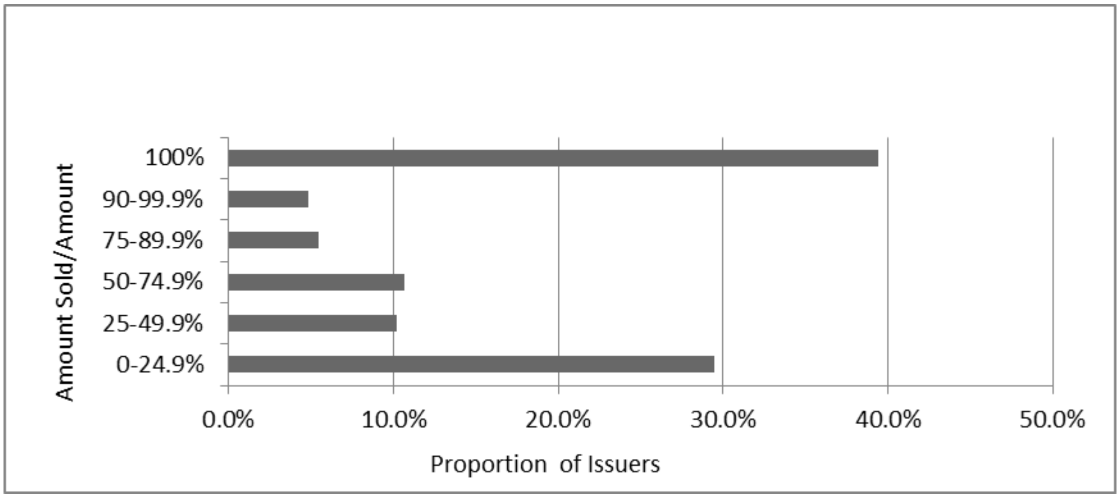
Figure 1: Capital Raised in U.S. Capital Markets during 2009-2012[259]



At present, issuers are required to file a Form D not later than 15 days after the first sale of securities in a Regulation D offering and an amendment to the Form D only under certain circumstances. Since issuers are not required to submit a filing when an offering is completed, and submit amendments only under certain circumstances, we have no definitive information on the final amounts raised. Figure 2, below, illustrates that at the time of the initial Form D filing, only 39% of offerings by non-pooled investment fund issuers were completed relative to the total amount sought. Separately, 70% of pooled investment funds state their total offering amount to be "Indefinite" in their Form D filings. As a result, the initial Form D filings of these pooled investment funds likely do not accurately reflect the total amount of securities offered or sold.

[259] The 2012 non-ABS Rule 144A offerings data is based on an extrapolation of currently available data through May 2012 from Sagient Research System's Placement Tracker database. For more detail, see the Ivanov/Bauguess Study.

Figure 2: Amount Sold as Percentage of Total Offering Amount by Non-Pooled Investment Fund Issuers in Regulation D Offerings at the Time of Form D Filing: 2009-2012



2. Affected Market Participants

The amendments to Rule 506 we are adopting today will affect a number of different market participants. Issuers of securities in Rule 506 offerings include both reporting and non-reporting operating companies and pooled investment funds. Investment advisers organize and sponsor pooled investment funds that conduct Rule 506 offerings. Intermediaries that facilitate Rule 506 offerings include registered broker-dealers, finders and placement agents. Investors in Rule 506 offerings include accredited investors (both natural persons and legal entities) and non-accredited investors who meet certain "sophistication" requirements. Each of these market participants is discussed in further detail below.

a. Issuers

Based on the information submitted in 112,467 new and amended Form D filings between 2009 and 2012, there were 67,706 new Regulation D offerings by 49,740 unique issuers during this four-year period.[260] The size of the average Regulation D offering during this period was approximately $30 million, whereas the size of the median offering was approximately $1.5 million.[261] The difference between the average and median offering sizes indicates that the Regulation D market is comprised of many small offerings, which is consistent with the view that many smaller businesses are relying on Regulation D to raise capital, and a smaller number of much larger offerings.

Some information about issuer size is available from Item 5 in Form D, which calls for issuers in Regulation D offerings to report their size in terms of revenue ranges or, in the case of certain pooled investment funds, net asset value ranges. All issuers can currently choose not to disclose this size information, however, and a significant majority of issuers that are not pooled investment funds declined to disclose their revenue ranges in the Forms D that they filed between 2009 and 2012. For those that did, most reported a revenue range of less than $1 million (Figure 3).[262] During the 2009-2011 period, approximately 10% of all public companies raised capital in Regulation D offerings; in 2012, approximately 6% of such companies did so.[263] These public companies tended to be smaller and less profitable than their industry peers, which

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[260] See Ivanov/Bauguess Study.

[261] See id. The average and median amounts are calculated based on the amounts sold by Regulation D issuers as reported in their Form D filings. A study of unregistered equity offerings by publicly-traded companies over the period 1980-1996 found that the mean offering amount was $12.7 million, whereas the median offering amount was $4.5 million. See M. Hertzel, M. Lemon, J. Linck, and L. Rees, *Long-Run Performance Following Private Placements of Equity*, 57 Journal of Finance (2002), 2595-2617.

[262] See Ivanov/Bauguess Study.

[263] Id. (explaining methodology of using listings in the Standard & Poor's Compustat database and the University of Chicago's Center for Research in Securities Prices database to determine which companies were public companies).

lead them to make larger investments than natural persons.[272] As for whether natural persons investing in these offerings are accredited investors or non-accredited investors, almost 90% of the Regulation D offerings conducted between 2009 and 2012 did not involve any non-accredited investors.[273]

While we do not know what percentage of investors in Rule 506 offerings are natural persons, the vast majority of Regulation D offerings are conducted without the use of an intermediary,[274] suggesting that many of the investors in Regulation D offerings likely have a pre-existing relationship with the issuer or its management because these offerings would not have been conducted using general solicitation. This category of investors is likely to be much smaller than the total number of eligible investors for Rule 506(c) offerings, which is potentially very large. We estimate that at least 8.7 million U.S. households, or 7.4% of all U.S. households, qualified as accredited investors in 2010, based on the net worth standard in the definition of "accredited investor" (Figure 6).[275]

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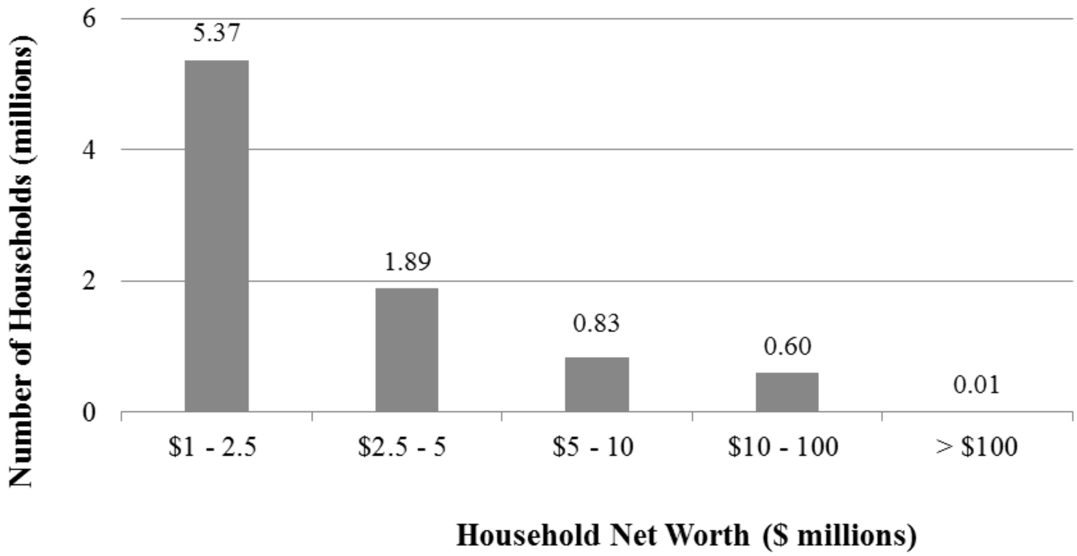
[272] See, e.g., George Fenn, Nellie Liang and Stephen Prowes, The Economics of Private Equity Markets. (1998); Steven Kaplan and Per Stromberg, *Leveraged Buyouts and Private Equity*, Journal of Economic Perspectives (2009).

[273] See Ivanov/Bauguess Study.

[274] An analysis of all Form D filings submitted between 2009 to 2012 shows that approximately 11% of all new offerings reported sales commissions of greater than zero because the issuers used intermediaries. See Ivanov/Bauguess Study. We assume that the lack of a commission indicates the absence of an intermediary.

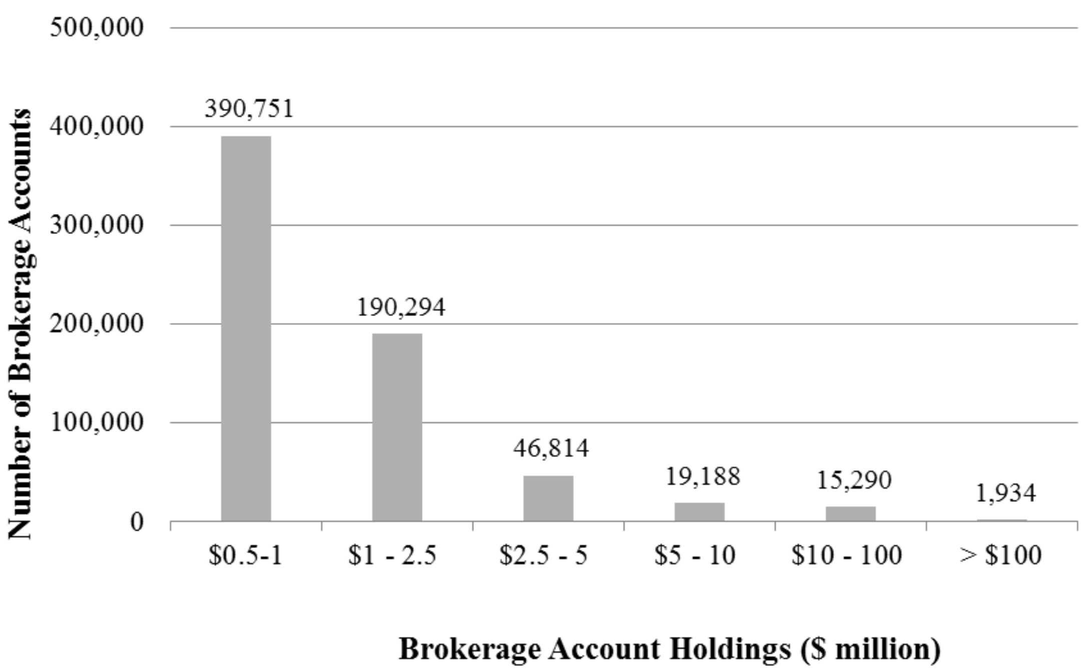
[275] This estimate is based on net worth and household data from the Federal Reserve Board's Triennial Survey of Consumer Finances ("SCF") 2010. Our calculations are based on 32,410 observations in the 2010 survey.

Figure 6: Number of U.S. Households that Qualify as Accredited Investors Based on 2010 Net Worth



Our analysis, however, leads us to believe that only a small percentage of these households are likely to participate in securities offerings, especially exempt offerings. First, as mentioned above, data from Form D filings in 2012 suggests that fewer than 234,000 investors (of which an unknown subset are natural persons) participated in Regulation D offerings, which is small compared to the 8.7 million households that qualify as accredited investors. Second, evidence suggests that only a small fraction of the total accredited investor population has significant levels of direct stockholdings. Based on an analysis of retail stock holding data for 33 million brokerage accounts in 2010, only 3.7 million accounts had at least $100,000 of direct investments in equity securities issued by public companies listed on domestic national securities exchanges, while only 664,000 accounts had at least $500,000 direct investments in such equity securities (Figure 7).[276] Assuming that investments in publicly-traded equity securities are a gateway to investments in securities issued in exempt offerings, and accredited investors with investment experience in publicly-traded equity securities are more likely to participate in an exempt offering than accredited investors who do not, the set of accredited investors likely to be interested in investing in Rule 506(c) offerings could be significantly smaller than the total accredited investor population.

Figure 7: Direct Stock Holdings of Retail Investors, 2010



[276] This analysis by DERA is based on the stock holdings of retail investors from more than 100 brokerage firms covering more than 33 million accounts during the period June 2010-May 2011.

c. Investment Managers

Based on Form ADVs that were filed with the Commission as of June 2013, there were 7,772 SEC reporting investment advisers that have clients that are private funds, registered investment companies business development companies, or other pooled investment vehicles. These investment advisers include:

- Registered investment advisers. Data filed for 2012 show that there were approximately 5,400 Commission-registered investment advisers with pooled investment fund clients that filed Form ADV with the Commission. These 5,400 investment advisers represent approximately $45.3 trillion total assets under management for pooled investment funds, or average assets under management of $8.4 billion per adviser. Of these, 4,044 investment advisers had clients that were private funds, with total assets under management of $35.2 billion and average assets under management of $8.6 billion.
- Exempt reporting advisers. These are investment advisers that are required to report on Form ADV but not to register with the Commission (for example, investment advisers to venture capital funds). Based on ADV data, there were 2,303 exempt reporting advisers in 2012, all of which had pooled investment funds as clients, with approximately $1.6 trillion of assets under management.

We do not have information regarding investment advisers with assets under management of less than $100 million, which are not generally required to register with the Commission, or investment managers that advise pooled investment funds with respect to investments in assets other than securities, such as commodities or real estate.

d. Broker-Dealers

As of December 2012, there were 4,450 broker-dealers registered with the Commission who file on Form X-17A-5, with average total assets of approximately $1.1 billion per broker-dealer. The aggregate total assets of these registered broker-dealers are approximately $4.9 trillion. Of these registered broker-dealers, 410 are dually registered as investment advisers. The dually registered broker-dealers are larger (average total assets of $6.4 billion) than those that are not dually registered. Among the dually registered broker-dealers, we identified 24 that currently have or have had private funds that submitted Form D filings between 2002 and 2012.

3. Estimated Incidence of "Bad Actors" in Securities Markets Generally

The economic impact of the rule amendments primarily depends on the extent to which they succeed in reducing fraud in the Rule 506 marketplace. This, in turn, depends on multiple factors, including the incidence of bad actors in Rule 506 offerings, the recidivism rate of such bad actors and the potential deterrent effect of disqualification as a sanction.

The disqualification rules should reduce the participation of both new and existing bad actors in Rule 506 offerings. Offerings will no longer be eligible to rely on Rule 506 if they involve a covered person that becomes a bad actor because of a triggering event that occurs after the new rules take effect. While triggering events existing before effectiveness of the rule will not be disqualifying, issuers will be required to provide disclosure about such events to investors. Participation in Rule 506 offerings by bad actors not disqualified by the rules we adopt today may, therefore, also be limited if issuers or investors are reluctant to transact with bad actors or participate in transactions involving bad actors once they become aware of the bad act through the required disclosure.

The effects of disqualification also depend on the likelihood that participation of bad actors in Rule 506 offerings would lead to the recurrence in perpetration of triggering events. This depends on the recidivism rates among bad actors.

Finally, the passage of the rule, through the deterrent effect of a potential threat of disqualification, could have the indirect impact of reducing the number of bad actors in the securities markets and the conduct resulting in sanctions that trigger disqualification.

Although it is impossible to predict future market participant behavior that may arise in response to the adopted rules, we can quantify, in certain instances, past occurrences of certain triggering events to provide an estimate of the historical incidence of bad actors—as determined under the new rules—in securities markets as a general matter.

Identification of Triggering Events. To assess the incidence in the securities markets of potentially disqualifying "bad actors," we examined the legal proceedings brought by the Commission during the five-year period from 2007 to 2011 in which the sanctions imposed would constitute triggering events under the new rule. We searched records of public proceedings, including case name, defendant name, code section violation, and sanction. To conduct the search, we used search terms pertaining to:

- injunctions and court orders (which we refer to collectively as "injunctions") against conduct or practices in connection with the purchase or sale of a security, involving the making of a false filing with the Commission, or arising out of the conduct of business of certain financial intermediaries, as provided in Rule 506(d)(1)(ii);
- Commission disciplinary orders under Section 15(b) or 15B(c) of the Exchange Act or Section 203(e) or (f) of the Advisers Act that suspend or revoke registration, limit

activities or bar a person from association with a regulated entity or from participation in a penny stock offering, as provided in Rule 506(d)(1)(iv); and

- Commission cease-and-desist orders relating to violations of scienter-based anti-fraud provisions of the federal securities laws or violations of Section 5 of the Securities Act, as provided in Rule 506(d)(1)(v).

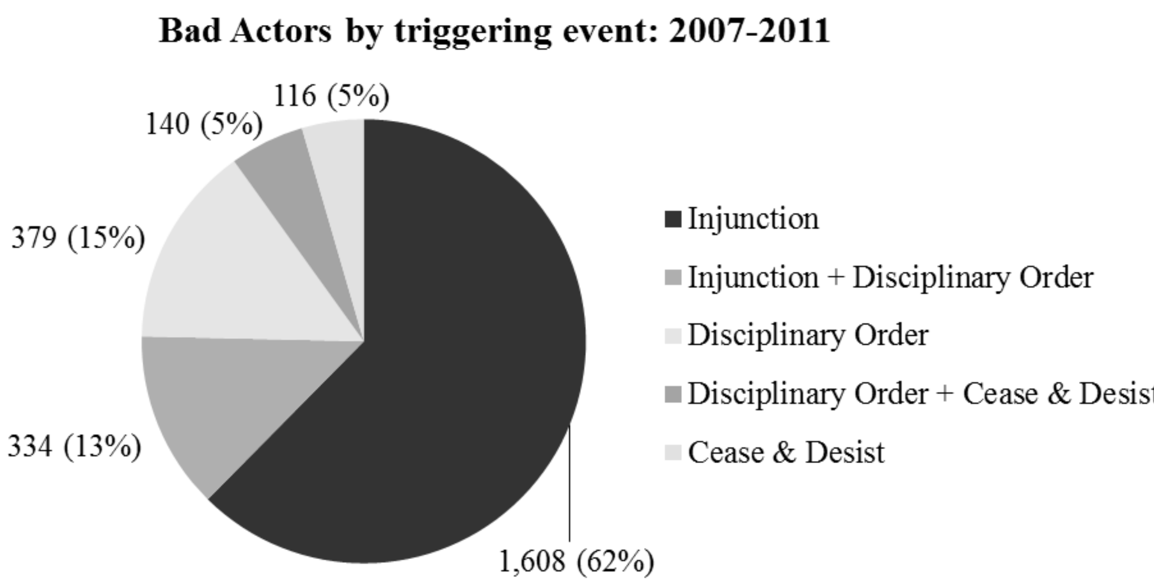
Our analysis did not consider other bad actor triggering events in Rule 506(d)(1), primarily because we do not have a comparable ability to search databases relevant to criminal convictions or the actions of relevant state and other federal regulators.[277] In addition, it is possible that the search techniques used by staff may not have identified all relevant potential triggering events and bad actors. Since our analysis is subject to these limitations, our estimates of the incidence of potential bad actors likely represent a lower bound. On the other hand, not all of the bad actors identified in our search would be expected to be involved with Rule 506 offerings.

Our search of Commission enforcement actions identified a sample of 2,578 persons, including both individuals and entities, that received injunctions, disciplinary orders, and/or cease-and-desist orders, issued in a total of 1,485 enforcement cases over the five-year period. We found that an aggregate of 3,053 disqualifying sanctions (1,943 injunctions, 853 disciplinary orders, and 257 cease-and-desist orders) were imposed upon these persons. In some instances, a person received more than one sanction, which in most cases consisted of a combination of an

[277] We have limited information available on enforcement activity by state securities regulators, discussed at the text accompanying note 283. Our analysis did not cover felony and misdemeanor convictions as provided in Rule 506(d)(1)(i); final orders of state authorities and Federal banking agencies and National Credit Union Association as provided in Rule 506(d)(1)(iii); disciplinary actions by a national securities exchange or an affiliated securities association, as provided in Rule 506(d)(1)(vi); and United States Postal Service orders as provided in Rule 506(d)(vii). We also excluded refusal, stop, or suspension orders pertaining to registration statements or Regulation A offering statements, as provided in Rule 506(d)(1)(vii), because they are too infrequent to affect our analysis.

injunction and a disciplinary order.[278] Each one of these sanctions would have constituted a triggering event under this rule, which would have disqualified any offering from relying on Rule 506 if the person were a "covered person," such as a director or executive officer of the issuer or a financial intermediary. The following chart shows the breakdown of triggering events by type:

Figure 8: Distribution of Bad Actors by Triggering Events, 2007-2011



In the cases we identified, between 70% and 78% of triggering events each year were against individuals, with the remainder against entities. With 83,521 offerings that relied on Rule 506 during the period under review, the incidence of detected bad actors is approximately 0.03 per offering. These numbers represent, however, only enforcement actions brought by the Commission. These numbers do not reflect enforcement action by other authorities (for example, state level regulators), nor do they include undetected bad actors.

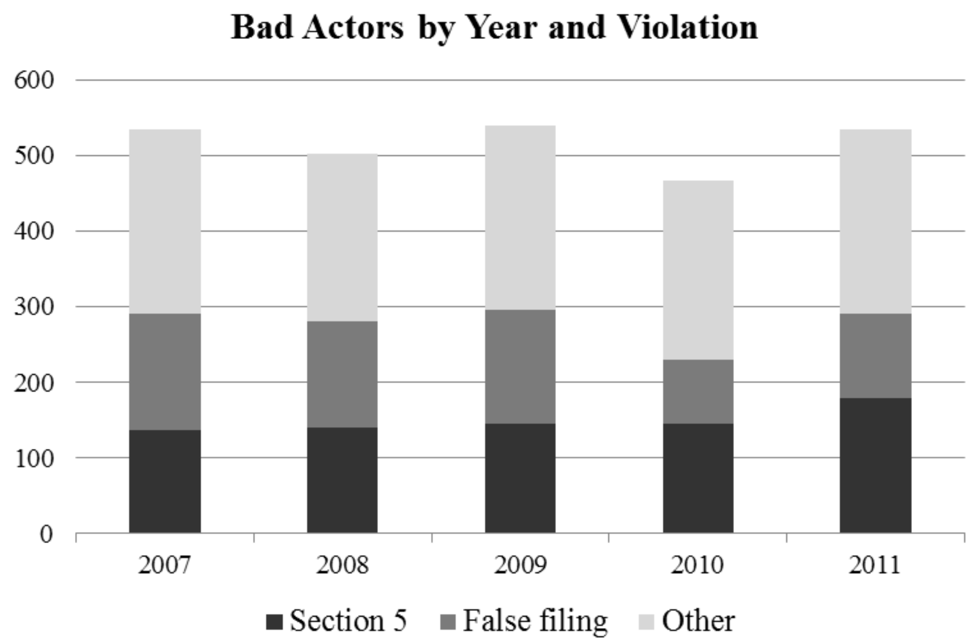
[278] One case involving both an injunction and a cease-and-desist order is not reflected in the chart titled "Triggering Events: 2007-2011" due to rounding.

While all of the 2,578 identified bad actors would disqualify any offering in which they were involved from reliance on Rule 506, not all of the bad actors would be expected to be involved with Rule 506 offerings. Many of the triggering events, such as insider trading, involve bad actors engaged in secondary market transactions. These persons may present a lesser risk of entering primary issuance markets such as Rule 506. Hence, the aggregate number of bad actors may overestimate the incidence of bad actors operating in the Rule 506 market. To more accurately estimate the likelihood that a bad actor might be involved in the issuance of securities, we identify triggering events involving a Section 5 violation.[279] As reflected in the chart "Bad Actors by Year and Violation" below, approximately 29% of the bad actors (a total of 748) were sanctioned for Section 5 violations. A similar percentage, approximately 25%, were sanctioned for the next-largest category of violations, those involving false filings.[280] The remaining bad actors fall into the "Other" category, of which insider trading-related violations represent the largest single sub-category. The following chart shows this breakdown:

[279] Bad actors included in the Section 5 category may have also violated other securities law provisions, such as anti-fraud provisions in Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. Using Section 5 violations as a proxy for involvement in a securities offering may be under inclusive, as there may be offering-related misconduct without a Section 5 violation.

[280] We define false filing as violations relating to errors and omissions in Commission filings, such as periodic reports, Form BD, Form ADV and beneficial ownership reports.

Figure 9: Bad Actors by Year and Violation, 2007-2011



To assess the quality of the search results, from the 1,485 cases previously identified, we selected a random sample of 190 cases, a sample that is large enough to provide a low margin of error. Because a single case produces multiple triggering events if multiple persons are named, the sample of 190 cases included 529 potential triggering events and allows for a margin of error of less than 5% in our analysis.[281] Commission staff reviewed the orders, releases, and other documentation for all 190 cases to determine whether each potential triggering event actually met the criteria specified in Rule 506(d)(1)(ii), (iv) or (v). The review of the search results showed that the search criteria applied produced relatively accurate results.[282]

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[281] The margin of error in these estimates based on the sample size of 529 potential triggering events is approximately 3.6% at the 90% confidence level. Taking these results together, there may be as many as 30 more or 30 fewer disciplinary orders than what is estimated at the 90% confidence level.

[282] The misclassification rate for injunctions, disciplinary orders, and cease and desist orders was 4%, 30%, and 0% respectively. While the misclassification rate for disciplinary orders was high, the sample results for disciplinary orders contained nearly the same number of false positives (events classified as disciplinary orders that did not

Incidence of Bad Actors Potentially Participating in Primary Offerings of Securities. Staff further refined the estimate of the likelihood that triggering events that were related to the Rule 506 market using the random sample of 190 cases. In particular, staff identified whether each of the cases involved an offering of securities by the issuer, which we refer to as a primary offering. For cases involving a primary offering, staff identified whether the offering was registered or unregistered. The review showed that 70 out of the 190 cases (or 37%) involved a primary offering, all of which were unregistered, and of the 529 potential triggering events included in the 190 cases, 251 (or 47%) involved a primary offering.

For purposes of the review, defendants or respondents were categorized as "issuers," "intermediaries," and "other persons." "Issuers" are entities that issue securities and the individuals who were affiliated with that issuer. "Intermediaries" are entities and individuals that facilitate securities offerings and investments, like brokers and non-affiliated investment advisers. "Other persons" are persons who are neither issuers nor intermediaries; the staff found that, in general, these were persons found liable for trading on inside information.

The following table summarizes the staff's findings with respect to these cases:

actually meet the criteria of Rule 506(d)(1)(iv)) as false negatives (events classified as injunctions and/or cease-and-desist orders that turned out to also include disciplinary orders), so the error in the total number of estimated disciplinary orders based on the sample review is significantly less than 30%. Accounting for offsetting misclassifications – i.e., false positives and false negatives – the error rate in the total number of estimated disciplinary orders falls to 1%.

Summary of Bad Actors and Case Type for 2007 to 2011 Period

	Random sample of enforcement cases	Subset of sample relating to unregistered offerings
Number of cases	190	70 (37%)
Number of triggering events	529	251 (47%)
-issuers	278	160
-intermediaries	189	76
-entities acting as both issuers and intermediaries	17	15
-other persons	45	0

Of the 529 bad actors in the sample, staff found that 278 were issuers, 189 were intermediaries, 17 were entities that could qualify as either an issuer or an intermediary (such as a promoter who is employed by an issuer), and 45 were other persons.

Based on projections from our review of this sample, we estimate that during the 2007 to 2011 review period, 549 cases (37% of the 1,485 total cases) involved an unregistered offering and approximately 1,212 bad actors (47% of the 2,578 total bad actors identified) participated in those unregistered offerings. We consider these estimates as a lower bound for the number of bad actors because our analysis does not take into account bad actor triggering events other than those in subsections (ii), (iv), and (v) of Rule 506(d)(1) or offerings involving bad actors that did not give rise to enforcement activity. Taking those into account, the total number of bad actors is likely to be higher.

We considered other data sources regarding the number of bad actor triggering events not involving Commission action. NASAA's 2012 Enforcement Report presents some data on orders by state securities regulators between 2009 and 2011,[283] which would pertain to

[283] North American Securities Administrators Association, 2012 Enforcement Report, Table 4 (available at

subsection (iii) of Rule 506(d)(1), relating to final orders and bars issued by state securities, insurance and banking regulators, federal banking regulators and the National Credit Union Administration. The report states that, as a result of state securities regulatory actions, 8,744 licenses were withdrawn and 1,952 licenses were denied, revoked, suspended, or conditioned in that three-year period. This data, however, may be over inclusive for purposes of establishing the number of bad actors under Rule 506(d) for a number of reasons. First, not all of the actions appear to be "final orders" under subsection (iii) of Rule 506(d)(1) (*e.g.*, some licenses were withdrawn rather than revoked). In addition, there is potential double counting in the NASAA survey when different states take action against the same person, as well as potential double counting between Commission and NASAA data for bad actors subject to both Commission and state sanctions. The data could also be under inclusive, in that it covers only actions by state securities regulators, whereas under subsection (iii) of Rule 506(d)(1), disqualification may also be triggered by orders of state insurance, banking, savings association and credit union regulators; appropriate federal banking regulators; and the National Credit Union Association. Staff were not able to identify comparable sources of data on these other types of orders.[284]

C. Analysis of Final Rules

Section 926 of the Dodd-Frank Act requires the Commission to adopt rules excluding felons and other bad actors from participation in Rule 506 offerings. The disqualification

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http://www.nasaa.org/wp-content/uploads/2011/08/2012-Enforcement-Report-on-2011-Data1.pdf).

[284] FINRA's BrokerCheck database includes this data for registered broker-dealers and their associated persons, as well as data on investment advisers and their associated persons drawn from the Commission's IARD database. See note 202. BrokerCheck is searchable only by the name of firms and individuals, however, not by the nature of past violations, which makes it impracticable for us to use it as a source of data in this review.

provisions of Rule 506 were intended to[285] and should lead to enhanced investor protection by reducing the number of offering participants who have previously engaged in fraudulent activities or who previously violated securities, insurance, banking or credit union laws or regulations, and by providing an additional deterrent to future fraudulent activities. Currently, persons covered by the disqualification provisions of these rules, such as issuers and compensated solicitors, are subject to a multilayered securities enforcement system that includes the Commission, state securities regulators and, for financial industry participants, FINRA. The disqualification rules we adopt today should alter industry practice by inducing issuers and other covered persons to implement additional measures to restrict bad actor participation in Rule 506 offerings.

In the proposing release, we solicited comment on the costs and benefits of the proposed rules. While no comment letters provided quantitative data or directly addressed the cost-benefit analysis included in the proposing release, a number of commenters did mention potential costs and benefits of the proposed rule. Our response to these comments is discussed in Section II above, and we briefly discuss these comments where they are relevant in the discussion below.

1. Effects of the Statutory Mandate

To the extent the new disqualification provisions result in a reduction of fraud in the Rule 506 offering market, investor losses to fraud will be reduced and investor willingness to participate in the Rule 506 market could increase. This should lower the issuance costs for Rule 506 offerings to the extent that new disqualification standards lower the risk premium

[285] Statement of Senator Christopher Dodd, 156 Cong. Rec. S3813 (daily ed. May 17, 2010).

associated with the presence of bad actors in securities offerings.[286] Lower costs in the Rule 506 offering market could improve conditions for capital formation, benefitting both issuers and investors. In this regard, commenters also emphasized investor protection[287] and increased participation in the private placement market as the main benefits of the rule.[288]

The new disqualification provisions may also benefit investors by reducing the burden of the "due diligence" investigation they conduct on persons and entities involved in the offerings in which they invest. Without bad actor disqualification, investors seeking information about the background of issuers and the people involved with them would have to perform separate investigations due to the cost of coordinating collective action. Requiring issuers to determine whether any persons or entities are subject to an event that triggers disqualification may, for some investors, obviate the need to do their own investigation, which may eliminate some of the redundancies in these separate investigations. Given the issuer's advantage in accessing much of the relevant information, issuers should be able to perform the task at a lower cost than most individual investors.

The disqualification requirements also impose costs on issuers, covered persons and investors. In our analysis under the Paperwork Reduction Act in Part III.B above, we estimate that most issuers will bear an additional cost of $400 to conduct a factual inquiry to determine whether any covered persons had a disqualifying event that occurred before the effective date of

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[286] In a related framework, Karpoff et al. (2008) show that the marketplace imposes significant penalties on firms targeted by SEC enforcement actions for financial misrepresentation, where for each dollar of misrepresentation the firm loses an additional $3.08 due to expected legal penalties and loss of reputation. See J. Karpoff, D. Lee & G. Martin, The Cost to Firms of Cooking the Books, 581-611 Journal of Financial & Quantitative Analysis (Sept. 2008).

[287] See comment letters from M. Zhu; DTC; Better Markets; NASAA.

[288] See comment letter from Better Markets.

the rule amendments.[289] We also estimate that approximately 220[290] Rule 506 issuers will spend $5,200 on average for using in-house and outside professional services in preparing a disclosure statement describing matters that would have triggered disqualification under Rule 506(d)(1) of Regulation D had they occurred on or after the effective date of the rule amendments. These cost estimates are based on assumptions outlined in Part IV.B.3 above and represent lower bound estimates, given that our analysis in Part IV.B.3 did not cover all possible bad actor triggering events. We note, in addition, that the Paperwork Reduction Act analysis is not required to, and does not, consider all potential costs that market participants may incur in complying with Rule 506(d). Further, we cannot predict how issuers will respond to the possibility of having to disclose the participation of a bad actor in an offering; the issuer could disclose, remove the person from the offering, abandon the offering, or conduct an offering that does not require disclosure.

Issuers that are disqualified from reliance on Rule 506 will bear costs to the extent that alternative means of raising capital are unavailable or involve higher transaction costs that result in a higher cost of capital. In some circumstances, issuers may postpone or forgo capital raising, deferring engagement in potentially value-enhancing projects. This could entail forgone investment opportunities for disqualified issuers and for investors who otherwise would have invested in such issuers. Issuers that pursue alternative capital raising methods may incur higher costs associated with their capital raising. For example, all other things being equal, transaction

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289 We assume the cost of in-house attorney services to be $400 per hour. This estimate is based on data provided in the report titled Management and Professional Earnings in the Securities Industry–2012, which is published by the Securities Industry and Financial Markets Association.

290 Staff estimates that there were at least 549 SEC enforcement actions involving an unregistered offering in which someone who would be disqualified as a bad actor participated in the five years from 2007 through 2011. See Part IV.B.3.

costs are likely to be higher for issuers that raise capital in reliance on Section 4(a)(2) of the Securities Act outside of Rule 506 because of higher costs to comply with state securities law requirements and greater legal uncertainty about the requirements of the exemption. In addition, issuers eligible to rely on new Rule 506(c) will be able to use general solicitation and general advertising to find potential investors if all purchasers in their offering are accredited investors and the issuer takes reasonable steps to verify their accredited investor status,[291] whereas issuers seeking an exemption under Section 4(a)(2) outside of Rule 506(c) will continue to be constrained by the incompatibility of a claim of exemption under Section 4(a)(2) and general solicitation or general advertising.[292] This may further differentiate transaction costs and cost of capital between Section 4(a)(2) offerings and Rule 506(c) offerings. Registered securities offerings can also result in higher transaction costs than private offerings, and in addition trigger ongoing reporting responsibilities.[293] As highlighted above, 22% of Rule 506 issuers that reported revenues on Form D indicated that their revenues were less than $1 million. For these and similarly sized issuers, going public through a registered offering may not be a feasible substitute for a Rule 506 offering.[294]

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[291] As discussed above, we are adopting new Rule 506(c), 17 CFR 230.506(c), today. See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33-9415 (July 10, 2013).

[292] Id. at note 42 and accompanying text.

[293] A 2011 report prepared by a group called the "IPO Task Force," which consisted of a group of professionals, including venture capitalists, experienced CEOs, public investors, securities lawyers, academics and investment bankers, estimated that the cost of going and staying public are high. Chart H of the IPO Task Force Report estimates that the average cost to go public is $2.5 million and the annual cost of staying public is $1.5 million. See Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth (publicly available at http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf).

[294] For example, if an issuer intends to raise a small amount of capital to fund its operations, the costs of conducting a registered offering may make a registered offering impracticable. In addition, private funds that rely on exemptions from investment company registration under Section 3(c)(1) or 3(c)(7) of the Investment Company Act are not permitted to conduct public securities offerings.

Issuers may also incur costs in connection with changes to personnel, governance structures and capital raising plans as a result of disqualification. For example, issuers may incur costs from terminating disqualified individuals or from reassigning them to positions where they will not trigger a disqualification in the context of an offering, and hiring new personnel or retraining existing personnel to replace them. They may also incur costs incident to restructuring their governance and control arrangements if, for example, a general partner, managing member or investment manager of a pooled investment fund issuer is a bad actor whose involvement would result in the disqualification of the offering. Issuers may also incur costs in connection with terminating an engagement with a placement agent or other covered financial intermediary, and entering into a new engagement. Smaller issuers and issuers with limited operating histories may not be able to readily find a new placement agent or other financial intermediary.

The final rule will include as covered persons the beneficial owners of 20% or more of the issuer's outstanding voting equity, calculated on the basis of voting power. This reflects a change from the 10% or more beneficial ownership of any class of the issuer's equity originally proposed. The higher ownership standard, limitation to voting securities and calculation focused on voting power would increase the likelihood that the disqualified investor is more closely affiliated with the issuer and has greater input or control over the management of the issuer.[295] In our judgment, the higher threshold will therefore provide greater certainty that the investor has some level of influence with the issuer. In addition, because issuers cannot necessarily prohibit a bad actor from establishing a large ownership position, particularly when an issuer's security is traded among non-affiliates or in a secondary market, a higher threshold is expected to reduce

[295] It would also be in line with the level at which filing as a passive investor is no longer permitted on Schedule 13G under Regulation 13D-G. See 17 CFR 230.13d-1(c).

the likelihood of a disqualifying event affecting an issuer in cases where a securityholder with a disqualifying bad act meets the beneficial ownership threshold in the rule but does not in fact exercise control or influence over the issuer. Lower uncertainty and relatively fewer "covered persons" arising from the amendment would reduce the costs of monitoring and due diligence for complying with the rule, and should limit the circumstances in which issuers must seek waivers from disqualification based on the involvement of bad actor investors that do not exercise influence or control over the issuer.

At the same time, determining whether a securityholder is covered based on ownership of voting securities, calculating ownership based on voting power across all outstanding securities rather than a single class and raising the threshold from 10% to 20% could reduce investor protection benefits, as securityholders whose ownership does not meet the threshold provided in the final rule, but who exercise control of an issuer, would not be covered. The inclusion of directors, officers and their functional equivalents under the definition of covered persons, however, may mitigate this effect; the rule will cover investors who serve those functions in relation to the issuer, regardless of their level of ownership.

With respect to 20% beneficial owners that are subject to triggering events, issuers may incur costs to buy out or otherwise induce such persons to reduce their ownership positions. Issuers may also incur costs in connection with taking steps to prevent bad actors from becoming 20% beneficial owners, such as exercising rights of first refusal and excluding bad actors from financing rounds. For certain issuers, finding investors to replace the capital represented by these shareholders or potential investors, as the case may be, could be challenging and expensive. Some commenters also expressed concerns about the aggregate costs of the proposed bad actor rule, saying that its provisions are generally unduly complex, unclear or not based on objective, bright-line standards.[296] Others expressed concerns about the potential burdens on capital raising,[297] and that it could undermine the overall utility of Rule 506.[298]

Issuers may also incur costs in connection with seeking waivers of disqualification from the Commission, or determinations by other authorities (such as state securities regulators) that their orders should not give rise to disqualification under Rule 506(d).

The new disqualification standards may also impose costs on other market participants that are subject to triggering events, such as financial intermediaries, by making them ineligible to participate in the market for Rule 506 offerings. For affected individuals, this may result in demotion or termination of employment, limitations on career advancement and fewer employment opportunities generally. For affected firms, this may result in revenue reductions and loss of market share, and could threaten the continued operation of firms that are heavily dependent on Rule 506 offerings as a source of revenue. Firms that are not themselves disqualified but whose officers, directors, general partners and managing members are subject to disqualifying events may incur additional costs from terminating or reassigning such individuals and from hiring new personnel or retraining existing personnel to replace them.

Bad actor disqualification rules may also impose costs on issuers and other market participants beyond the context of Rule 506 offerings. For example, imposing a new disqualification standard only on offerings under Rule 506, rather than on a more uniform basis, may result in higher costs for issuers relying on other exemptive rules, to the extent that differing

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[296] See comment letters from ABA Fed. Reg. Comm.; NYCBA; Cleary Gottlieb.

[297] See comment letters from B. Nelson; Coy Capital; Five Firms; S&C.

[298] See Angel Capital Comment Letter 1; see also comment letters from ABA Fed. Reg. Comm.; Karr Tuttle; SIFMA; S&C.

disqualification standards create confusion and a more difficult compliance regime. Adopting uniform disqualification provisions throughout the Securities Act was cited by some commenters as a benefit, in that it could simplify compliance and increase overall investor protection.[299]

In addition, non-uniform application of the new disqualification standards may encourage bad actors to migrate to offerings under other exemptions. Investors may perceive a higher risk of fraud in such offerings, which would be detrimental to their marketability and result in greater issuance costs of all offerings under the exemptions that are not subject to the new standards, whether or not bad actors are involved. This could have an effect on competition by putting issuers that are not eligible to use Rule 506 at a competitive disadvantage.

Finally, there is a potential cost to investors of overreliance on Rule 506(d) in assessing the risks associated with an offering. Fraud can still occur without prior incidence of bad acting on the part of the issuer or covered persons, and in some cases it is possible that prior bad actions went undetected or did not otherwise result in a sanction, or may have resulted in a sanction that does not constitute a triggering event for disqualification.

2. Discretionary Amendments

The amendments not specifically required under the Section 926 mandate involve costs and benefits as analyzed below.

Reasonable Care Exception. The "reasonable care" exception allows continued reliance on the Rule 506 exemption, despite the existence of a disqualification with respect to a covered person, if the issuer can show that it did not know and, in the exercise of reasonable care, could not have known that the disqualification existed at the time of the sale of securities. We

[299] See comment letters from ABA Fed. Reg. Comm.; C. Barnard; Better Markets; NASAA.

anticipate that the "reasonable care" exception will provide benefits to the efficiency of the private placement and capital formation process by removing a significant disincentive to issuers' use of Rule 506 that would have arisen if disqualification were applied on a strict liability basis. Without a reasonable care exception, issuers might choose not to undertake offerings in reliance on Rule 506, because of the risk of Section 5 or blue sky law violations in circumstances that the issuer cannot reasonably predict or control. In those circumstances, alternative approaches to capital raising may be more costly to the issuer or not available at all. Given that Rule 506 is the most frequently relied-upon Securities Act exemptive rule, the impact of issuers shifting away from it could be significant. We believe that the reasonable care exception provides a measured and balanced approach to preserve the intended benefits of Rule 506, which might otherwise be impaired because of issuer concerns about strict liability for unknown disqualifications.

Commenters uniformly supported the reasonable care exception, but also urged the Commission to provide greater clarity and specificity about what steps would constitute reasonable care. Some commenters raised concerns about compliance costs if the requirements of the "reasonable care" exception are too burdensome.[300] We do not believe it is appropriate to delineate and prescribe specific steps as being necessary or sufficient to establish reasonable care. We believe issuers should consider the totality of the offering taking into account the circumstances of the offering, the covered persons involved in the offering and the rule's requirements, which include specific disqualifying events and covered persons subject to those disqualifying events. The flexibility in permitting issuers to determine their own methodology

[300] See Angel Capital Comment Letter 1; see also comment letter from S&C.

for factual inquiry is a benefit that promotes efficiency to the extent the issuer is able to tailor its own inquiry without adherence to uniform standards that may not be applicable or appropriate in the context of a particular issuer or particular offering.

A potential cost of a reasonable care exception is that it may increase the likelihood that bad actors will be able to participate in Rule 506 offerings, because issuers may take fewer steps to make inquiry about offering participants than they would if a strict liability standard applied. If this occurs, it will decrease the deterrent effect of the bad actor disqualification rules. To the extent that the reasonable care exception fails to prevent participation by bad actors in Rule 506 offerings, the effectiveness of the new disqualification standard will be impaired.

Issuers may also incur costs associated with conducting and documenting their factual inquiry into possible disqualifications, so they can demonstrate the exercise of reasonable care. The fact that the rule does not specify what steps are required may increase such costs to the extent that issuers do more to conduct and document their inquiry than otherwise may be necessary, because of this uncertainty.

Disclosure Requirement for Triggering Events That Predate the Effectiveness of the Rule Amendments. As adopted, the amendments include a disclosure requirement designed to increase investor protection by requiring disclosure of events that would have been disqualifying had they occurred after the effective date of the amendments. This is a change from the proposal, under which disqualification would have arisen with respect to events that occurred before the amendments took effect.

Under the amendments we are adopting, issuers will be subject to disqualification only for triggering events that occur after the new rules take effect. On one hand, this approach will reduce costs that would otherwise have been incurred by issuers and other market participants subject to pre-existing triggering events, had they been disqualified from participating in Rule 506 offerings. On the other hand, this approach will permit offerings involving past bad actors to proceed under Rule 506, exposing investors to the risks that arise when bad actors are associated with an offering. While it is difficult to determine the net impact of implementing the new disqualification standards in this way, investors will benefit by having access to information about events that would be disqualifying if they had occurred after the effective date. Investors will be able to make their own determination of the relevance and risks associated with past bad acts, including recidivism risk, and can request additional information, elect not to pursue the investment opportunity or negotiate different terms based on this information.

We anticipate that the decision to require disclosure will provide a benefit to issuers and investors. We believe the disclosure requirement will serve as a useful tool to alert investors to the presence of certain participants in offerings under Rule 506 and allow them to make more informed investment decisions. Without a disclosure requirement, investors may have the mistaken impression that bad actors are no longer allowed to participate in Rule 506 offerings. As there is no prescribed format, the disclosure could be inserted in a non-prominent manner, such that an investor who reads the material in a cursory fashion could remain unaware of the participation of bad actors in the offering. Issuers could benefit from having flexibility in the manner of disclosure. In addition, because we have imposed a disclosure requirement rather than disqualification for pre-existing events, issuers will not be required to revisit past negotiated settlements or incur additional costs to request waivers for disqualification. Issuers will, however, incur costs in connection with the factual inquiry to determine whether disclosure is required and, if applicable, in preparing the mandatory disclosure for investors, which we have described in Section III above. Also, rather than provide the mandatory disclosure, we expect some issuers may decide to take steps to avoid having to make a disclosure, such as making changes to personnel or retaining different compensated solicitors, and in that respect may incur costs similar to those associated with avoiding or removing a potential disqualification.

We also recognize that issuers that disclose triggering events may have greater difficulty attracting investors to their offerings and may incur a higher cost of capital as a result. We do not have data with respect to current issuer practices involving disclosure of the participation of persons with a history of regulatory or other legal sanctions for securities law violations and, as such, we are unable to determine the extent to which the disclosure requirement will impact issuers' cost of capital. If investors are unwilling to participate in offerings involving prior bad actors, some issuers and other market participants will, as a practical matter, be excluded from the Rule 506 market and will experience some or all of the impact of disqualification.

Commission Cease-and-Desist Orders Involving Scienter-Based Anti-Fraud Violations and Violations of Securities Act Section 5. Under the rule amendments we adopt today, disqualification will be triggered by Commission cease-and-desist orders based on violations of scienter-based anti-fraud provisions of the federal securities laws or Section 5 of the Securities Act. The addition of these categories of Commission orders as a new triggering event is intended to provide a benefit to investors by screening out additional bad actors, while reducing the risk that disqualification would be imposed on securities law violators who do not pose a significant investor protection concern.

We believe the investor protection benefits of adding Commission cease-and-desist orders to the disqualification provisions of Rule 506 justify the potential costs to issuers and other covered persons. The benefits associated with screening bad actors out of the Rule 506 market should not depend on whether a particular enforcement action is brought in court or through a Commission administrative proceeding. Clearly, the absence of Commission cease-and-desist orders from an investor protection rule that includes federal judicial proceedings addressing the same legal violations, and orders by state and other federal regulators addressing the same conduct, would lead to asymmetry in the administration of disqualification under Rule 506. We also do not believe that the addition of Commission cease-and-desist orders is likely to impose a significant cost to issuers and other covered persons because these groups may already be subject to other disqualifying orders issued by the states, federal banking regulators and the National Credit Union Administration.

It is difficult to predict the extent to which adding these Commission cease-and-desist orders to the list of disqualifying events will increase the number of bad actors subject to disqualification from Rule 506 offerings. In our analysis of disqualifying events from 2007 through 2011 discussed earlier, we attempted to assess the number of individuals or entities that would be disqualified as bad actors based solely on Commission cease-and-desist orders described in subsection (v) of Rule 506(d)(1). We identified 116 cease-and-desist orders against respondents that were not otherwise subject to a disqualifying injunction, disciplinary order or felony conviction during the 2007 to 2011 period.[301] To the extent that these historical levels project future levels of disqualifying Commission cease-and-desist orders, we estimate that on an annual basis, there may be approximately 23 individuals or entities disqualified by cease-and-desist orders and not also by some other triggering event. To provide a context, there were in excess of 83,521 Rule 506 offerings during the period 2007-2011. With 116 cease and desist

[301] As there is no comprehensive database of triggering events, the analysis included a review of litigation releases and other documentation for information on other events that would have disqualified these respondents. Some of these documents provided short disciplinary histories, but they are not comprehensive and in any case would not capture subsequent triggering events.

orders during the same period, the potential disqualification incidence created by Commission cease-and-desist orders would appear to be quite low (using these inputs, less than 0.15%).

In addition, inclusion of Commission cease-and-desist orders as a triggering event for bad actor disqualification may change how settlement negotiations are conducted between respondents and the Commission. Even after the Commission imposes a disqualifying cease-and-desist order upon a covered person, the Commission may grant an appropriate waiver from disqualification based on settlement negotiations or other remedial measures and steps taken by the covered person to comply with the Commission cease-and-desist order. We believe that issuers and other covered persons will be able to consider the practical consequences of a future Commission cease-and-desist order and alter their conduct to avoid committing the behavior causing the violation. Alternatively, they can seek to obtain a waiver of disqualification in enforcement settlement negotiations.

We anticipate that this additional triggering event will add minimal incremental costs for issuers, given the requirement in the rule as adopted to conduct factual inquiry to determine whether the offering is subject to bad actor disqualification. To the extent that the addition of a disqualifying event broadens the type and the number of covered persons who will be disqualified from participation in Rule 506 offerings, it may have a detrimental effect on capital raising activity by delaying or deterring offerings, or causing issuers to incur higher transaction costs.

CFTC Orders. Under the rule amendments we adopt today, disqualification will be triggered by orders issued by the CFTC to the same extent as orders of the regulators enumerated in Section 926 of the Dodd-Frank Act (*e.g.*, state securities, insurance and banking regulators, federal banking agencies and the National Credit Union Administration). We believe that including orders of the CFTC will result in the treatment of comparable sanctions similarly for disqualification purposes, and should enable the disqualification rules to more effectively screen out felons and bad actors. We note in that regard that the conduct that would typically give rise to CFTC sanctions is similar to the type of conduct that would result in disqualification if it were the subject of sanctions by another financial services industry regulator. In addition, the CFTC (rather than the Commission) has authority over the investment managers of pooled investment funds that invest in commodities and certain derivatives products; unless Rule 506(d) covers CFTC orders, regulatory sanctions against those investment managers are not likely to trigger disqualification.

We have a limited ability to quantify the impact of including CFTC orders as a new disqualification trigger under Rule 506(d). While we have access to general information about CFTC enforcement activity,[302] we have no systematic way to filter CFTC orders for connection to Rule 506 offerings or private placements or to isolate situations in which a participant in a Rule 506 offering would be subject to disqualification solely on the basis of a CFTC order. While registered broker-dealers are required to report CFTC proceedings and orders on Form BD, we have no systematic way to filter Form BD data on that basis or to identify registered broker-dealers that are likely to participate in Rule 506 offerings or private placements.

We were able to review disclosures concerning CFTC orders on Form ADV by registered investment advisers and exempt reporting advisers with pooled investment fund clients. In on our review of 384 Forms ADV (as described in detail below), we found six investment adviser

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[302] See e.g., Commodity Futures Trading Commission Annual Performance Report, Fiscal Year 2012 at Appendix A (available here: http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2012apr.pdf). A summary of CFTC enforcement proceedings from 2005 through 2008 is available here: http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/file/pbproceedingsbulletin.pdf.

firms associated with pooled investment funds that were subject to CFTC orders that would constitute triggering events under Rule 506(d).

Definition of "final order." The change in the definition of "final order" limiting it to orders under statutory authority that provides for notice and an opportunity for hearing should have marginal economic impact for issuers. We do not believe that the incremental burden of inquiry to determine whether an order was issued under such authority will have a significant impact. The change could have the effect of reducing the number of disqualifying events for which issuers or other market participants might seek waivers which, in cases where the waiver would have been granted, would reduce costs and could facilitate capital formation. The economic impact on investors from this change will depend primarily on the extent to which the additional procedural requirement results in bad actors that would otherwise be disqualified remaining eligible to participate in Rule 506 offerings, and the recidivism rates of those bad actors.

Investment Managers. Under the rule amendments we adopt today, investment managers of issuers that are pooled investment funds (that is, investment advisers of pooled investment funds and persons who provide similar investment advisory services to pooled investment funds with respect to assets other than securities) have been added as a new category of covered person. We believe that this approach will reduce compliance costs, in that it represents a "bright-line" category of presumed control persons based on governance and control structures that are typical for pooled investment fund issuers, replacing a potentially costly fact-intensive inquiry into whether such persons should be deemed the equivalent of "directors" or "executive officers" of an issuer organized in corporate form. The addition of this new category facilitates equivalent treatment of operating companies and pooled investment funds under new Rule 506(d).

Incidence of Bad Actors Among Investment Advisers.

i. Analysis of Triggering Events Based on Enforcement Actions Initiated by the Commission

In the review described above in Section IV.B.3, we found that 47 of the random sample of 529 identified cases involved investment advisers (18 of these 47 were also broker-dealers). None of these 47 investment advisers was sanctioned in connection with a private offering. This, however, would represent only a lower bound for the incidence of bad actor triggering events among investment advisers, as the analysis was based on a random sample drawn from the legal proceedings that were brought before the Commission during the period 2007-2011. In addition, our analysis does not take into account bad actor triggering events other than those in subsections (ii), (iv), and (v) of Rule 506(d)(1) or offerings involving bad actors that did not give rise to enforcement activity.

ii. Form ADV Data

We analyzed all Form ADVs filed by investment advisers for 2012 to determine the reported incidence of disqualification triggering events. We limited our review to forms filed by investment advisers that:

- advise a private fund or have clients that are registered investment companies, business development companies or other pooled investment vehicles;
- provided disclosure reporting pages on their current Form ADV; and
- indicated that some of the disclosure reporting pages are for the adviser itself or its supervised persons.

We considered only orders whose status was reported as final. Based on these criteria, we identified 384 investment advisers that disclosed matters that may have constituted a triggering event under Rule 506(d).

Looking at the cases and the regulatory and court actions involved, we determined whether the reported sanctions would constitute triggering events under Rule 506(d). Most of the sanctions would not because the criteria for providing disclosure reporting pages for Form ADV include many events that do not constitute bad actor triggering events under new Rule 506(d). For example, we excluded cases that were initiated by a foreign court or regulator, cases that involved an affiliate firm or cases that involved an individual employee of an affiliate who is not a control person in the parent advisory firm. We also excluded cases where a sanction fell outside the relevant look-back period, such as a Commission cease-and-desist order that is more than five years old. In addition, we excluded cases in which an action did not meet the relevant substantive criteria, such as Commission cease-and-desist orders for violations other than Section 5 of the Securities Act or a scienter-based anti-fraud provision, or felonies that were unrelated to the criteria of Rule 506(d), such as traffic violations.

After these exclusions, we found that approximately 1% of reporting investment advisers associated with pooled investment funds reported bad actor triggering events in their 2012 Form ADV. The results of our analysis are presented in the table below.[303]

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[303] Note that since an investment adviser can be subject a combination of criminal, regulatory and civil sanctions, the sum of the three categories of sanctions may exceed the number of investment advisers that are subject to sanctions.

	Number of investment advisers
Total investment advisers	13,173
Investment advisers advising pooled investment funds	7,772
Pooled investment fund investment advisers with disclosure reporting pages	435
Pooled investment fund investment advisers subject to final orders	384
Pooled investment fund investment advisers with 'bad actor' triggering events	**48**
Criminal sanctions	1
Regulatory sanctions	42
Civil sanctions	11

Analysis of Costs and Benefits. Investment managers play a significant role in the management of pooled investment funds. We have included them in the definition of covered persons so that entities or individuals that exercise control over fund management are subject to bad actor disqualification under Rule 506(d). It will therefore provide consistency for covering 'control persons' of both pooled investment fund issuers and issuers that are not pooled investment funds.

Additional issuer costs arising from the addition of investment managers as covered persons will arise from conducting factual inquiries and, in some cases, restructuring governance and control arrangements, preparing disclosure or obtaining waivers from disqualification for having an investment adviser with a history of bad acting. Our analysis shows that the incidence of disqualifying events is low (less than 1%) for investment advisers. So their inclusion in the list of covered persons should not be generally burdensome for issuers. On the other hand, covering investment managers directly will obviate the need for issuers to conduct a fact-intensive inquiry to determine whether an investment manager would be regarded as a *de facto* director or executive officer of a pooled investment fund, or as a promoter of such fund. As a result, the additional costs from this new category of covered person are not likely to be high.

Narrower Coverage of Officers of Issuers and Financial Intermediaries. Some commenters raised concerns that the compliance costs associated with monitoring a potentially large class of covered persons may be high.[304] The rules we are adopting limit the pool of covered persons by covering only executive officers and officers participating in the offering, rather than all officers, of issuers, underwriters, compensated solicitors and investment managers of pooled investment funds. This should reduce compliance costs by limiting covered persons to a more manageable number who should generally be easier to identify. It should also reduce or eliminate costs, such as lost employment opportunities, for individuals who are subject to potentially disqualifying events but are not executive officers of issuers, compensated solicitors or investment managers to pooled investment fund issuers and are not personally involved in Rule 506 offerings. We do not believe it will significantly compromise the intended investor protection benefits of the rule, because all officers performing policy-making functions or personally involved with the offering will be covered.

No Disqualification Where the Relevant Regulatory Authority Advises that Disqualification is Not Warranted. The amendments we are adopting include a provision under which disqualification will not arise if a state or federal regulator issuing an order advises in writing that Rule 506 disqualification is not necessary under the circumstances. We believe this provision will create cost savings for affected covered persons such as issuers, individuals and compensated solicitors by eliminating the need to seek waivers from the Commission or pursue

[304] See comment letters from SIFMA; NYCBA; Five Firms; S&C.

other means of raising capital. We expect that some issuers and other covered persons will adjust their settlement negotiations to bargain for an express determination that disqualification from Rule 506 is unnecessary.[305] As the provision applies only where state or federal regulators have determined that Rule 506 disqualification is not necessary, we do not believe it is likely to impair the intended investor protection benefits of the bad actor disqualification scheme.

V. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

This final regulatory flexibility analysis has been prepared in accordance with 5 U.S.C. 603. It relates to amendments to Rule 506 of Regulation D under the Securities Act that disqualify certain offerings where "felons and other 'bad actors'" are participating or present from relying on Rule 506 for an exemption from registration under the Securities Act, or impose disclosure requirements in respect of such offerings.

A. Reasons for, and Objectives of, the Action

The primary reason for the amendments is to implement the requirements of Section 926 of the Dodd-Frank Act. Section 926 requires the Commission to issue rules under which certain offerings where "felons and other 'bad actors'" are participating or present will be disqualified from reliance on Rule 506 under Regulation D for an exemption from registration under the Securities Act. Under the amendments adopted today, offerings will be disqualified for triggering events that occur after the effective date of the amendments, and disclosure to investors will be required in respect of triggering events that occur before the effective date.

Our primary objective is to implement the requirements of Section 926 of the Dodd-Frank Act. In general, the rule we are adopting implements the statutory requirements. We have

[305] See Rule 506(d)(2)(iii).

included a “reasonable care” exception in the final amendments, which we believe will make the rule easier for issuers to use, and should encourage continued use of Rule 506 over exempt transactions outside of Rule 506. We have also added an additional disqualifying event for certain Commission cease-and-desist orders, which we believe will make the overall regulatory scheme more consistent and will increase the investor protection benefits of the amendments. We are requiring disclosure, rather than disqualification, for triggering events occurring before effectiveness of the final amendments as a means of enhancing protection of investors participating in offerings involving bad actors, without giving rise to the fairness and other concerns associated with applying the new disqualification provisions in respect of preexisting events.

B. Significant Issues Raised by Public Comment

In the proposing release, we requested comment on every aspect of the initial regulatory flexibility analysis (“IRFA”), including the number of small entities that would be affected by the proposed amendments, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed amendments. We did not receive comments specifically addressing the IRFA. One commenter suggested exempting offerings below a certain size from the new disqualification provisions based on concerns about the cost of Securities Act registration if Rule 506 were unavailable,[306] but we do not believe that would be consistent with the requirements of Section 926 of the Dodd-Frank Act.

[306] See comment letter from Burningham.

C. Small Entities Subject to the Rule Amendments

The amendments will affect issuers (including both operating businesses and investment funds that raise capital under Rule 506) and other covered persons, such as financial intermediaries, that are small entities. For purposes of the Regulatory Flexibility Act under our rules, an entity is a "small business" or "small organization" if it has total assets of $5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities that does not exceed $5 million.[307] For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.

The final amendments will apply to all issuers that conduct offerings under Rule 506 and will affect small issuers (including both operating businesses and pooled investment funds that raise capital under Rule 506) relying on this exemption from Securities Act registration. All issuers that sell securities in reliance on Regulation D are required to file a Form D with the Commission reporting the transaction. For the year ended December 31, 2012, 16,067 issuers made 18,187 new Form D filings, of which 15,208 relied on the Rule 506 exemption. Based on information reported by issuers on Form D, there were 3,958 small issuers[308] relying on the Rule 506 exemption in 2012. This number likely underestimates the actual number of small issuers relying on the Rule 506 exemption, however, because over 50% of issuers declined to report their size.

[307] 17 CFR 230.157.

[308] Of this number, 3,627 of these issuers are not investment companies, and 331 are investment companies. We also note that issuers that are not investment companies disclose only revenues on Form D, and not total assets. Hence, we use the amount of revenues as a measure of issuer size.

D. Reporting, Recordkeeping and Other Compliance Requirements

The final amendments will impose a disclosure requirement with respect to triggering events that occurred before the effective date of the new disqualification provisions and would have triggered disqualification had they occurred after that date.[309] Such disclosure must be in writing and furnished to each purchaser a reasonable time prior to sale. There is no prescribed form that such disclosure must take.

In addition, we expect that issuers will exercise reasonable care to ascertain whether a disqualification exists with respect to any covered person, and document their exercise of reasonable care. The steps required will vary with the circumstances, but we anticipate would generally include making factual inquiry of covered persons and, where the issuer has reason to question the veracity or completeness of responses to such inquiries, further steps such as reviewing information on publicly available databases. In addition, issuers will have to prepare any necessary disclosure regarding preexisting events. We expect that the costs of compliance would generally be lower for small entities than for larger ones because of the relative simplicity of their organizational structures and securities offerings and the generally smaller numbers of individuals and entities involved.

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[309] As discussed in Part II.G of this Release, we are also changing the form of the signature block of Form D.

E. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap or conflict with the final amendments to Rules 145, 147, 152 and 155; Rules 501 and 506 of Regulation D; and Form D under the Securities Act and to Rule 30-1 of our Rules of Organization and Program Management.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives of our amendments, while minimizing any significant adverse impact on small entities. In connection with the final amendments, we considered the following alternatives:

- the establishment of different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- the clarification, consolidation, or simplification of the rule's compliance and reporting requirements for small entities;
- the use of performance rather than design standards; and
- an exemption from coverage of the amendments, or any part thereof, for small entities.

With respect to the establishment of different compliance requirements or timetables under our final amendments for small entities, we do not think this is feasible or appropriate. The amendments are designed to exclude "felons and other 'bad actors'" from involvement in Rule 506 securities offerings, which could benefit small issuers by protecting them and their investors from bad actors and increasing investor trust in such offerings. Increased investor trust could reduce the cost of capital and create greater opportunities for small businesses to raise capital.

Likewise, with respect to potentially clarifying, consolidating, or simplifying compliance and reporting requirements, the amendments do not impose any new reporting requirements. To the extent they may be considered to create a new compliance requirement to exercise reasonable care to ascertain whether a disqualification exists with respect to any offering and to furnish a written description of preexisting triggering events, the precise steps necessary to meet that requirement will vary according to the circumstances. In general, we believe the requirement will more easily be met by small entities than by larger ones because we believe that their structures and securities offerings are generally less complex and involve fewer participants.

With respect to using performance rather than design standards, we note that the "reasonable care" exception is a performance standard.

With respect to exempting small entities from coverage of these final amendments, we believe such an approach would be impracticable and contrary to the requirements of Section 926. Regulation D was designed, in part, to provide exemptive relief for smaller issuers. Exempting small entities from bad actor provisions could result in a decrease in investor protection and trust in the private placement and small offerings markets, which would be contrary to the legislative intent of Section 926. We have endeavored to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives, and have included a "reasonable care" exception and waiver authority for the Commission to give issuers and other covered persons additional flexibility with respect to the application of these amendments.

VI. STATUTORY AUTHORITY AND TEXT OF AMENDMENTS

We are adopting the amendments to 17 CFR Parts 230 and 239 contained in this document under the authority set forth in Sections 4(a)(2), 19 and 28 of the Securities Act, as amended,[310] and Section 926 of the Dodd-Frank Act.[311] We are adopting the amendments to 17 CFR Part 200 contained in this document under the authority of Sections 4A and 4B of the Securities Exchange Act of 1934.[312]

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organization and functions (Government agencies),

Reporting and recordkeeping requirements.

17 CFR Parts 230 and 239

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, Title 17, Chapter II of the Code of Federal Regulations is hereby amended as follows:

PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The general authority citation for Part 200, Subpart A, continues to read, in part, as follows and the sectional authority for § 200.312 is removed.

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[310] 15 U.S.C. 77d(a)(2), 77s and 77z-3.

[311] 15 U.S.C. 77d note. Although Pub. L. No. 112-106, sec. 201(a), 126 Stat. 313 (2012) is not an authority for the amendments in this release, it is being included in the instruction below for the general authority citation for Part 230 to ensure that the Code of Federal Regulations is correctly updated for purposes of the final rule also published today.

[312] 15 U.S.C. 78d-1, 78d-2.

Authority: 15 U.S.C. 77*o*, 77s, 77sss, 78d, 78d−1, 78d−2, 78w, 78*ll* (d), 78mm, 80a–37, 80b–11, and 7202, unless otherwise noted.

*   *   *   *   *

2. Section 200.30-1(c) is revised to read as follows:

§ 200.30-1 Delegation of authority to Director of Division of Corporation Finance.

*   *   *   *   *

(c) With respect to the Securities Act of 1933 (15 U.S.C. 77a et seq.) and Regulation D thereunder (§§ 230.500 through 230.508 of this chapter), to authorize the granting of applications under §§ 230.505(b)(2)(iii)(C), 230.506(d)(2)(ii), and 230.507(b) of this chapter upon the showing of good cause that it is not necessary under the circumstances that the exemption under Regulation D be denied.

*   *   *   *   *

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

3. The general authority citation for Part 230 is revised to read as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77d note, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. No. 112-106, § 201(a), 126 Stat. 313 (2012), unless otherwise noted.

*   *   *   *   *

4. Amend § 230.145 by:

a. Removing the reference to "and 4(2)" in the second paragraph of the Preliminary Note and adding in its place "and 4(a)(2)"; and

b. Removing the phrases "Note 1:" and "Note 2:" and transferring the sentences previously designated as "Note 1" and "Note 2" to the end of the introductory paragraph following the Preliminary Note.

5. Amend § 230.147(b)(2) by removing the reference to "section 4(2)" and adding in its place "section 4(a)(2)".

6. Amend § 230.152 by removing the reference to "section 4(2)" and adding in its place "section 4(a)(2)".

7. Amend § 230.155 by removing the phrase "Preliminary Note:" and redesignating that note as the introductory text, and removing the reference to "section 4(2)" from paragraph (a) and adding in its place "section 4(a)(2)".

8. Amend § 230.501 by:

a. Redesignating paragraphs (g) and (h) as paragraphs (h) and (i), respectively, and adding new paragraph (g); and

b. Redesignating Notes 1, 2, and 3 at the end of the section as Note 1 to § 230.501, Note 2 to § 230.501, and Note 3 to § 230.501, respectively.

The addition reads as follows:

§ 230.501 Definitions and terms used in Regulation D.

* * * * *

(g) *Final order. Final order* shall mean a written directive or declaratory statement issued by a federal or state agency described in § 230.506(d)(1)(iii) under applicable statutory authority that provides for notice and an opportunity for hearing, , which constitutes a final disposition or action by that federal or state agency.

* * * * *

9. Amend § 230.506 by:

a. Redesignating the Note following paragraph (b)(2)(i) as "Note to paragraph (b)(2)(i)";

b. Adding and reserving paragraph (c); and

c. Adding paragraphs (d) and (e).

The additions read as follows:

§ 230.506 Exemption for limited offers and sales without regard to dollar amount of offering.

* * * * *

(c) [Reserved]

(d) *"Bad Actor" disqualification.* (1) No exemption under this section shall be available for a sale of securities if the issuer; any predecessor of the issuer; any affiliated issuer; any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer; any beneficial owner of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; any promoter connected with the issuer in any capacity at the time of such sale; any investment manager of an issuer that is a pooled investment fund; any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities; any general partner or managing member of any such investment manager or solicitor; or any director, executive officer or other officer participating in the offering of any such investment manager or solicitor or general partner or managing member of such investment manager or solicitor:

(i) Has been convicted, within ten years before such sale (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor:

(A) In connection with the purchase or sale of any security;

(B) Involving the making of any false filing with the Commission; or

(C) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(ii) Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before such sale, that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:

(A) In connection with the purchase or sale of any security;

(B) Involving the making of any false filing with the Commission; or

(C) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(iii) Is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

(A) At the time of such sale, bars the person from:

(*1*) Association with an entity regulated by such commission, authority, agency, or officer;

(*2*) Engaging in the business of securities, insurance or banking; or

(*3*) Engaging in savings association or credit union activities; or

(B) Constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct entered within ten years before such sale;

(iv) Is subject to an order of the Commission entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(b) or 78*o*-4(c)) or section 203(e) or (f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(e) or (f)) that, at the time of such sale:

(A) Suspends or revokes such person's registration as a broker, dealer, municipal securities dealer or investment adviser;

(B) Places limitations on the activities, functions or operations of such person; or

(C) Bars such person from being associated with any entity or from participating in the offering of any penny stock;

(v) Is subject to any order of the Commission entered within five years before such sale that, at the time of such sale, orders the person to cease and desist from committing or causing a violation or future violation of:

(A) Any scienter-based anti-fraud provision of the federal securities laws, including without limitation section 17(a)(1) of the Securities Act of 1933 (15 U.S.C. 77q(a)(1)), section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and 17 CFR 240.10b-5, section 15(c)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(c)(1)) and section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6(1)), or any other rule or regulation thereunder; or

(B) Section 5 of the Securities Act of 1933 (15 U.S.C. 77e).

(vi) Is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade;

(vii) Has filed (as a registrant or issuer), or was or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the Commission that, within five years before such sale, was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such sale, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued; or

(viii) Is subject to a United States Postal Service false representation order entered within five years before such sale, or is, at the time of such sale, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

(2) Paragraph (d)(1) of this section shall not apply:

(i) With respect to any conviction, order, judgment, decree, suspension, expulsion or bar that occurred or was issued before [insert date 60 days after publication in the Federal Register];

(ii) Upon a showing of good cause and without prejudice to any other action by the Commission, if the Commission determines that it is not necessary under the circumstances that an exemption be denied;

(iii) If, before the relevant sale, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing (whether contained in the relevant judgment, order or decree or separately to the Commission or its staff) that disqualification under paragraph (d)(1) of this section should not arise as a consequence of such order, judgment or decree; or

(iv) If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed under paragraph (d)(1) of this section.

Instruction to paragraph (d)(2)(iv). An issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(3) For purposes of paragraph (d)(1) of this section, events relating to any affiliated issuer that occurred before the affiliation arose will be not considered disqualifying if the affiliated entity is not:

(i) In control of the issuer; or

(ii) Under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

(e) *Disclosure of prior "bad actor" events.* The issuer shall furnish to each purchaser, a reasonable time prior to sale, a description in writing of any matters that would have triggered disqualification under paragraph (d)(1) of this section but occurred before [insert date 60 days from publication in the Federal Register]. The failure to furnish such information timely shall not prevent an issuer from relying on this section if the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known of the existence of the undisclosed matter or matters.

Instruction to paragraph (e). An issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

10. The authority citation for Part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78*l*, 78m, 78n, 78*o*(d), 78*o*-7 note, 78u-5, 78w(a), 78*ll*, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

11. Amend Form D (referenced in § 239.500) by revising the third indented paragraph under the heading "Terms of Submission" in the "Signature and Submission" section following Item 16 to read as follows:

> Certifying that, if the issuer is claiming a Regulation D exemption for the offering, the issuer is not disqualified from relying on Regulation D for one of the reasons stated in Rule 505(b)(2)(iii) or Rule 506(d).

Note: The text of Form D does not, and the amendments will not, appear in the Code of Federal Regulations.

By the Commission.

Elizabeth M. Murphy
Secretary

Dated: July 10, 2013