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Rule-Comments@sec.gov
File No. S7-06-13

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

RE: Comments on Proposed Amendments to Regulation D, Form D, and Rule 156 under the Securities Act, File No. S7-06-13

Dear Ms. Murphy:

I am tendering these comments on behalf of our firm, Pepper Hamilton LLP, and various interested market commentators.

First, we would like to applaud the Commission for its extraordinary efforts to implement, fairly, Congress' intent to facilitate capital formation through the adoption of regulations regarding the relaxation of the General Solicitation and General Advertising Prohibitions with respect to Rule 506 and Rule 144A Offerings, as set forth in the Jump Start Our Business Start-Ups Act, Section 201. The comments below relate specifically to File No. S7-06-13 and in particular the proposed rules requiring additional information, filings, and compliance (the "Proposed Rules").

1. **General Observations and Comments**

As a general proposition, we believe that the multitude of anti-fraud rules set forth in the applicable federal securities laws, and coupled with the Commission's plenary examination authority and rules specifying what information must be maintained, collected, and, in certain cases, submitted to the Commission, provide more than enough data and information for the Commission adequately to enforce the law and protect investors. While many of the proposals set forth in the Proposed Rules are "nice to haves," they do not, in our view, rise to the level of "must haves" to enable the SEC to administer the JOBS Act – mandated relaxation of the general solicitation prohibition (the "JOBS Act Mandate"). As evidence of that, one need only consider the fact that the Proposed Rules -- if adopted -- would be effective several months after the relaxation of the prohibitions on general solicitation go into effect. Obviously, the Commission felt that the potential adverse effects would be manageable and otherwise absorbed by the market, until the Proposed Rules would take effect if adopted.

We believe this proposed, unprecedented tightening, immediately following the relaxation required by the JOBS Act Mandate has the potential to cause significant confusion on the part of issuers, funds, placement agents and investors. We therefore urge the Commission to reconsider promulgation of the Proposed Rules and adopt a "wait and see" approach to determine if in fact the additional burdens that would be imposed as a result of compliance with the Proposed Rules is warranted in light of the market's experience with the JOBS Act Mandate.

While we are mindful of the notion that with regard to the application of the federal securities laws and securities offerings, "every dog does *not* get one bite free," we do believe that current anti-fraud rules and investigatory powers are sufficient to the task. Should they prove inadequate, the Commission is always free to promulgate targeted regulations and to use the exemptive letter and exemptive rule process to drive normative behavior.

2. **Pre-filing of Form D**

Specifically, the Proposed Rules require that issuers file Form D 15 days before the commencement of a general solicitation under Rule 506(c) under Regulation D. This appears to be inconsistent with the statutory intent of the JOBS Act. The statute does not evince any Congressional purpose to require a pre-clearance or pre-filing requirement. Imposition of such a requirement on the heels of the relaxation of the non-solicitation rule will be unnecessarily confusing to the market place and will pose an unnecessary trap for the unwary. If the Commission deems it appropriate that private placement memoranda be filed with the Commission, it would appear more consistent with the statute to require the filing on the same day as, or perhaps, the next business day following, the commencement of a general solicitation under Rule 506(c), and forgo the currently proposed file-within-15-day-before-use requirement.

Pre-filing is even more complicated in the context of private funds, where the starting and ending points of a private placement are not always clearly defined. The JOBS Act is targeted at capital raising by corporations and other non-fund issuers where traditional transactions have a beginning and definite pricing/closing dates. In the private fund context, these dates are not well-defined, resulting in the possibility that such funds will inadvertently file late. The punishment of a one-year ban, which could essentially drive such funds out of business, appears extreme, especially given the lack of definitive guidance available and the apparent lack of statutory intent to punish firms in this way (see below for further discussion).

3. **Submission of all Marketing Materials**

The proposed requirement that all "marketing materials" be delivered to the SEC will result in both a deluge of unnecessary information to the SEC as well as an unnecessary skittishness on behalf of the issuer community. That skittishness arises because "submission bespeaks review," despite assurances to the contrary. Also, the statute appears not to require, or even suggest, pre-review of marketing materials.

Issuers that are managed by investment advisers subject to registration under the Investment Advisers Act of 1940 already are required to maintain complete records of the materials that they use to promote interests in comingled vehicles. Other issuers (i.e., non-fund issuers or fund issuers whose managers are not registered under the Advisers Act) could simply be required to maintain copies of the salient information. If the relaxation occasioned by the JOBS Act Mandate results in significant use of the internet for purposes of making private placement offerings (as most industry participants anticipate), then the provision of marketing materials to the Commission becomes much more problematic. As a minimalist alternative, especially given the dynamic nature of some issuers' websites, a "sampling" approach should be adopted: for example, a copy of a screen shot of a web page once per month, or if there is a material change made, etc. A bright line rule in this context would be much more appreciated than a vague reference to "marketing materials."

Moreover, it would make sense for such information to be maintained by the issuer (or the adviser in an appropriate context) for review by the Commission's Staff on examination. Clear, administrable rules would go a long way to reaching the normative conduct that a submission would suggest, but not necessarily achieve.

4. **Application of Securities Act of 1933 Rule 156 to Private Funds**

a. General Observations

The potential application of Rule 156 (under the Securities Act of 1933) principles to offerings of private funds is problematic as well. Rule 156 is not additive; the prohibitions against making false and misleading statements already exist in the generally applicable provisions of the Securities Act of 1933 and other federal securities laws, and, in the case of private funds and their managers, the Investment Advisers Act of 1940 and the Investment Company Act of 1940, to the extent applicable. While extension of Rule 156 might be viewed by certain persons as a leveling of the playing field with registered products, the bottom line is private funds are not registered products, they are not designed for the mass audience, and as Rule 506(c) makes clear, only accredited investors can invest.

Private fund managers labor extensively over their marketing materials and over their private placement memoranda, assuring that the statements contained are truthful and accurate. This is one of those instances where a few cases of inappropriate conduct should not dictate increased compliance burdens for the generally compliant. For these reasons, we respectfully request that the Commission not go forward with the extension of Rule 156 to private funds.

b. SBIC Funds Should Be Exempt from the Extension of Rule 156

The Commission specifically asks at fn. 77 in the Release for comments as to which types of private funds these rules should apply to and why. When a private fund is in fundraising mode, there is no material distinction between a venture capital fund, a private equity fund, a fund of funds, or a hedge fund, with the possible exception of small business investment company ("SBIC") funds. SBICs are subject to extraordinary regulation by the U.S. Small Business Administration ("SBA") and should be exempted from any extension of Rule 156 to the private fund arena. Rather, in this instance, the Commission should defer to SBA regulations.

In support of that suggestion, consider that the licensing process for a fund that wishes to become an SBIC requires two steps. The first is submission of a Management Assessment Questionnaire ("MAQ") to the SBA. The MAQ must contain the elements of the fund's business plan and detailed information concerning the principals who will make the investment decisions for the fund, including their track record and history of working together. SBA reviews the strength of the team, as well as its proposed investment strategy. If, after review, the fund and its team appear to meet the standards, the principals of the fund are interviewed by SBA's Investment Committee. After that interview, SBA will either turn down the fund or gives it permission to file a license application. It is almost always only after this in-depth vetting that a fund that wants to seek an SBIC license will begin seeking investors for its interests.

The formal SBIC license application requires additional documents and information and the submission of fingerprint cards and detailed personal history and references. The fingerprint cards are sent to the FBI for clearance. References are carefully checked. The grant of a license requires review and approval by two senior SBA committees.

In addition, an important metric for an SBIC is "Regulatory Capital," which is basically paid in capital and unfunded commitments from investors that SBA deems sufficiently financially worthy as to be able to fund their commitments (so-called "Institutional Investors," *see* 13 CFR Sec. 107.50). The standard to qualify as an Institutional Investor is generally more rigorous than that for an accredited investor under Regulation D.

After licensing, an SBIC must, throughout its life, comply with applicable SBA regulations, submit detailed periodic reports to SBA and be audited and inspected yearly by SBA.

We believe these unique characteristics of SBICs should result in the SBICs and funds applying to be SBICs being exempted from the coverage of Rule 156.

c. <u>Investors in Private Funds Are Quite Capable of Fending for Themselves</u>

The Commission will undoubtedly recognize that investors in private funds have the sophistication and wherewithal to enforce their rights (this is the primary reason why the law exempts certain private funds from mutual fund regulation, because the persons involved can fend for themselves, and more importantly, know how to do so). Given the attention to detail paid by lead investors, institutional investors, founding investors, and other investors in private funds, and given the substantial resources that such institutional and accredited investors have, it is hard to see how more (or better) information will be "ferreted out" by applying Rule 156 to private funds.

Unintended consequences of the application of a rule like Rule 156 will be an increase in the barriers to entry for private funds (undercutting the whole point of the JOBS Act Mandate), and standardization of disclosure which would essentially make private funds indistinguishable from others. Private funds generally hope to avoid their private placement memoranda from becoming homogenous. It might make sense for the Commission to remind and admonish private fund advisors and promoters of their responsibilities under the federal securities laws rather than layering on yet another rule that is not additive.

d. Suggested Alternatives

A useful addition by the Commission (instead of applying Rule 156) would be the adoption of a specific method to compute and present fund performance. That would standardize performance reporting across all asset classes and eliminate much of the optionality that the extension of Rule 156 is supposedly intended to avoid. For example, the Institutional Limited Partner Association has provided a "best practice" example of such reporting (http://ilpa.org/ilpa-standardized-reporting-templates/).

Further, adoption of a simple "internal rate of return" computation that relies on cash in and cash out to compute fund performance over time could fairly easily be accomplished. Cash in and cash out of fund investments should be on a gross and net IRR basis; reporting out to investors of their cash in and cash out can also be done by the fund and will be very meaningful to the investor. Another approach would be to adopt the GIPS standard proffered by the CFA Institute (http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n5.1).

5. **A One Year Ban is too Draconian; Disqualification of Affiliates is Too Broad**

The "one size fits all" approach to the imposition of a one year ban in the case of a defective filing any time *during the previous 5 years* is too long for entities that engage in continuous offerings (like hedge funds and funds of funds). It is important that any penalty be narrowly tailored to the offense, and that any look-back is limited to the issuer involved, not its affiliates, manager or general partner. Moreover, markets can change dramatically in 5 years and management teams and investors in issuers can also turn over several times during that same period. A five year look back appears to be both punitive and not particularly constructive or protective of investors. If an issuer engages in repeated defective private placements, the Commission has sufficient tools available under the federal securities laws to deal with them and need not punish the very same investors (who will now be locked into the investment) that the rule is purportedly intended to protect.

A ban may be appropriate for repeated and flagrant infractions, but not merely due to a missed filing, especially if that mistake was inadvertent. Recall that the purpose of the JOBS Act Mandate is to aid in capital formation and deployment; it is inevitable that mistakes will occur. A draconian penalty for what amounts to a foot-fault -- and unless the rule is narrowed, for the foot-fault of an affiliate (see discussion below) -- does not appear to serve the Congressional purpose.

Perhaps, a process whereby the determination a violation would require the issuer to submit its solicitation materials to the SEC in advance of use for a period of time, for example, 6 months following the determination of the violation, would be more narrowly tailored and consistent with the Congressional purpose of fostering capital formation.

We also strongly recommend that the Commission modify the definition of "affiliate" with regard to the draconian consequences that befall a missed filing by the member of an affiliated group of companies. *See,* in particular fn. 28 and the accompanying text. This is particularly acute where a fund is a member of a family of investment funds managed by the same manager and/or general partner. Under generally applicable definitions, these entities would likely be affiliates (although they would not be integrated for certain purposes under the Investment Company Act or the Securities Act of 1933 unless the facts suggested integration).

The private fund industry has applauded the JOBS Act Mandate for many reasons, but one of the more significant ones is the elimination of traps for the unwary and so-called regulatory "foot faults," where an inadvertent public disclosure by a private fund could be deemed to have cost a Section 3(c)(1) or Section 3(c)(7) exemption, or required an offering to be registered under the Securities Act of 1933 and the Investment Company Act of 1940. It also eliminates difficult definitional issues such as who fits in the circle of the so-called "friends and family" who could be contacted for purposes of a private placement offering.

A draconian cross-default rule like the one that has been proposed essentially makes individual issuers responsible for the sins of their brothers and sisters. For example, a private fund complex with multiple, unrelated subadvisers managing separate funds but under the control of the same general partner or sponsor, could see itself banned under the proposal because of one subadviser's actions. This appears to penalize unintentionally investors in unrelated products simply because they are in the same family of sponsored funds.

Instead, we would urge that the Commission re-examine its commentary contained in the proposal at page 70 which relies on the disqualification of *the issuer* from reliance on Rule 506 as providing issuers "with sufficient incentive to comply with the requirements of Rule 509, without penalizing them unduly for an inadvertent error in, or the omission of, a legend or other required disclosure in written general solicitation materials." The proposed rule would hold that issuer hostage for a foot-fault by one of its affiliates. A predecessor in interest makes logical sense; the inclusion of affiliates appears just to have a punitive effect. For that reason, we suggest that the reference to affiliate be deleted. Each issuer should stand on its own. If, of course, the Commission determined that a particular sponsor appeared to be abusing this rule of separateness, it could deal with that behavior through other already applicable statutory and regulatory processes.

6. **No Need to Change the Accredited Investor Thresholds at This Time**

The Commission also asked for comment on whether the current financial thresholds in the net worth tests and the income tests are still appropriate thresholds for determining whether a natural person is an accredited investor. It is our view that the Commission's own statistics support the contention that they are. If only 7.4% of all U.S. households qualify as accredited investors (see text accompanying footnote 216 in SEC File No. S7-07-12), and as long as issuers are held to the standard of ensuring that the investors are in fact accredited, the potential impact of any given issuance on the investing public and markets is likely to be very small.

While it is fashionable to suggest that the financial thresholds have not been changed since the promulgation of Regulation D and therefore, given inflation, they are out of date, an equally valid proposition is that at the time that the thresholds were set on the original promulgation of Regulation D, they were set too high and that the market has finally "grown into them." While the issue requires further study, there does not appear to be any present evidence to suggest that the accredited investor standards are set too low, especially given the statistical evidence cited by the Commission, and noted above. Additionally, we have not observed any investor difficulties with understanding and dealing with the qualification thresholds currently in place.

Moreover, in the case of private funds that take performance fees or allocations, the managers of such funds already are likely to be subject to a higher standard – the qualified client standard – of Rule 205-3 under the Investment Advisers Act of 1940.

For these reasons, we again recommend that the Commission adopt a "wait and see" approach before changing the accredited investor definitions.

Indexing these thresholds to inflation also raises questions of grandfathering and administrability. If they were to be indexed to inflation, it would be necessary for the Commission to adopt a grandfather rule for those investors already in place at the time that the thresholds rise; and then, one must deal with add-on investments by investors who were accredited at the time that the original investment was made but who no longer are due to growth in the thresholds. A clear, understandable and easily administered threshold makes much more sense and given the relatively small number of persons who fit into the accredited investor category to begin with, this does not appear to be a burning issue requiring the immediate attention of the Commission.

The $1 million net worth test and the $200,000/$300,000 income tests are well known and have become part of the investment industry lexicon. Muddying the water with moving target numbers increases the risk that (unnecessary) mistakes will happen. In addition, fundraising periods often span years and an investor could be in the off position of qualifying one week and not qualifying the next, making it very difficult for the fund manager to interact consistently with that investor. All of this destabilizes the relationship between fund manager and investor which hurts the investor – a goal not within the JOBS Act Mandate. We recommend that the standards not be modified without extensive analysis on how such modifications will affect capital formation.

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Should you have any questions, or if we can be of further assistance in any way, please contact the undersigned at [redacted] or the other members of the Pepper Hamilton Investment Funds Industry Group.

Very truly yours,

Gregory J. Nowak

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