Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Lift the Ban on General Solicitation and Advertising in Rule 506 Offerings: Efficiently Balancing Investor Protection, Capital Formation and Market Integrity

Preliminary Observations:

- The IAC recognizes the importance of Regulation D Rule 506 as a capital formation tool. In 2011, Rule 506 offerings accounted for $895 billion, as compared to $984 billion raised in registered offerings.

- The Jumpstart Our Business Startups Act (JOBS Act) requires that the Securities and Exchange Commission lift the ban on general solicitation and advertising in Rule 506 private placements.

- Keeping in mind the risks to investors, lifting the solicitation ban can and should be done in a manner that simultaneously promotes investor protection, facilitates efficient capital formation, and provides regulators with the tools they need to police the market effectively.[1]

- The Commission retains both the authority and the responsibility to ensure that investors are adequately protected as the ban on general solicitation is lifted.

- The rule proposal recently released by the Commission should more effectively address the risk of potential harm to investors, which we believe can be done without imposing a material burden on the capital formation process.

- A number of concrete proposals have been put forward to improve investor protections and enhance regulators' ability to police this market.

IAC Recommendations:

As the Commission fulfills its JOBS Act mandate to lift the ban on general solicitation and advertising in private offerings, it must carefully consider the potential harm to investors resulting from that action and the alternatives available to minimize that harm. In keeping with

1 In 2011, state regulators took more than 200 enforcement actions related specifically to Rule 506 offerings (more than 250 in 2010; 175 in 2009).

its own guidelines for economic analysis and its investor protection mandate, the Commission should give strong consideration to the following recommendations as part of the rulemaking process:

Recommendation 1

Require all issuers intending to rely on the new JOBS Act general solicitation exemption to file with the Commission either a new "Form GS" or a revised version of Form D. Filing the form should be a precondition for claiming the exemption. To reduce compliance costs, the form should be available for on-line completion. The form should request simple information regarding the identity of the entity seeking to rely on the exemption, the control persons of that entity (together with their addresses, telephone and contact information), counsel representing the entity (if any), the entity's accountants or auditors (if any), the amount sought to be raised, a brief description of the entity's general solicitation plans, and a brief description of the entity's proposed business and use of proceeds.

Supporting Rationale: These data would be used both for basic statistical purposes to help judge the effectiveness of the exemption and to help the SEC and state regulators monitor the market. Indeed, absent this form of information, the Commission will be unable to determine the extent to which the capital formation process is relying on the new JOBS Act exemption. This information may also be valuable in the event that enforcement issues arise in connection with an offering.

Recommendation 2

Require that all solicitation material prepared or disseminated by or on behalf of the issuer that is being disseminated to the public through a general solicitation or advertising campaign in reliance on the new exemption be furnished to the Commission. This requirement can be satisfied at very low cost to the capital formation process by having the Commission create an online electronic "drop box" into which all general solicitation material can be deposited, together with a cover form identifying the issuer using the general solicitation material and the circumstances under which the material is to be used. The drop box should be designed to be able to accept print, audio and video forms of general solicitation. A condition of the exemption should be that the copy of the solicitation materials be furnished either prior to first use or promptly after first use. The materials furnished to the Commission should be made available for prompt public view. The Commission should consider appropriate measures to ensure compliance with this requirement. The Commission should consider the degree of dissemination that would trigger this requirement.

Supporting Rationale: Again, absent access to information of this sort, the Commission will be unable, as a practical matter, to monitor the types of solicitations being used in practice. The Commission will therefore be unable to assess the potential benefits and risks of the solicitations. The Commission should keep the process of filing these materials as simple and as inexpensive as possible (it can and should be as easy as filing a comment to a Commission proposed rule and as simple as posting a video to YouTube). Further, Commission access to this database will allow it better to identify instances of

potential fraud in an efficient manner, and the simple knowledge that general solicitation material must be provided to the Commission may act as a deterrent against some potential forms of fraud. The Committee observes that by making these materials available to the public on a timely basis, the Commission would be simultaneously facilitating the retransmission of these general solicitation materials to a broader audience and "crowdsourcing" the public's ability to inform the Commission of potential fraud in this marketplace.

Recommendation 3

Adopt a safe harbor that provides clear and enforceable standards for verification, as opposed to reasonable belief, of accredited investor status, including standards to promote reliance on reliable third parties, such as broker-dealers, banks, and licensed accountants.

Supporting Rationale: The JOBS Act requires the Commission to adopt standards to ensure that issuers take reasonable steps to ensure that only accredited investors invest in these offerings. The "facts and circumstances" based approach proposed by the Commission does not do enough either to ensure this outcome or to provide issuers with the certainty they need to develop appropriate procedures. On the one hand, investors may be unwilling (and unwise) to provide sensitive financial information to issuers with whom they have no relationship in order to provide proof of their accredited investor status. As a result, reliable third parties, such as brokers, accountants, and attorneys, may play a central role in providing that verification. Without clear guidelines for such third-party verification, however, these professionals may be reluctant to provide these services on terms that are beneficial to investors and issuers alike. In addition, Section 5 of the Securities Act creates strict liability for the sale of unregistered securities. Prudent counsel and issuers seeking to assure compliance with the law will, in many circumstances, be unwilling to take the risk associated with a "facts and circumstances" test, particularly when there is no precedent that offers meaningful guidance as to facts and circumstances likely to qualify for the safe harbor. Non-exclusive safe harbor guidelines will therefore help promote reliance on the new statutory provisions by issuers who are risk averse and seek responsibly to comply with the federal securities laws. Indeed, the Committee observes that an equivalent rationale supported the Commission's initial decision to adopt Regulation D.

Recommendation 4

The filing of Form D should be made a condition for relying on the Regulation D exemption. In implementing this recommendation, which is intended to encourage broad compliance with the filing requirement, the Committee encourages the Commission also to consider incorporating measures to ensure that it does not impose undue penalties for inadvertent violations by small, unsophisticated issuers.

Supporting Rationale: While Form D is required to be filed, its filing is not a condition of relying on the Regulation D exemption. It is generally acknowledged that a significant number of issuers do not currently file Form D, depriving the Commission of important information and inhibiting its ability to provide effective market oversight. Moreover,

absent reliable data from Form D it will be difficult for the Commission to compare the performance of private placements that rely on the new JOBS Act exemptions with the performance of private placements that do not rely on those exemptions. These data will be valuable to the Commission and to Congress in assessing the performance of these new exemptions. Again, a variety of mechanisms are available to minimize the costs of compliance, and the Commission should adopt these mechanisms.

Recommendation 5

The Commission should take steps to ensure that any performance claims in materials used as part of general solicitations are based on appropriate performance reporting standards.

Supporting Rationale: Investors need the assurance that performance claims they rely on as a part of a general solicitation campaign are based on a clear, well-defined, and auditable standard. The Committee observes that there are several private sector standards that can be applied to govern the presentation of such data and that the Commission should be able to designate the appropriate standards in a manner that imposes little if any marginal cost to market participants complying with industry norms.

Recommendation 6

The Commission should amend the natural persons prong of the definition of accredited investor to better reflect a population that has the financial sophistication to analyze the risks in private offerings and/or the wealth to withstand potential losses. The Committee believes this is essential in the absence of the procedural protections afforded by the general solicitation and advertising ban.

Supporting Rationale: The Committee observes that there has long been a debate regarding the adequacy of the definition of "accredited investor" which currently relies exclusively on asset and income tests, and is invariant to the investor's actual investment sophistication (with the exception of situations requiring reliance on a purchaser representative). To the extent that the JOBS Act places greater reliance on the ability of investors to "fend for themselves" under the federal securities laws, it seems prudent to explore alternative formulations of the accredited investment standard that might be more suitable to the new regulatory environment. It is the view of the Committee that the Commission has clear authority to amend the accredited investor definition at this time, except with regard to the net worth component of the definition where the Commission is precluded from acting until 2014.

Recommendation 7

SEC rulemaking mandated pursuant to Dodd-Frank Act Section 926 has not concluded. Section 926 mandates rulemaking disqualifying felons and other "bad actors" from reliance on the safe harbor from Securities Act registration provided by Rule 506 of Regulation D. This provision is particularly relevant to bolstering investor protection in connection with Rule 506 offerings. In conjunction with the rulemaking to lift the ban on general solicitation and advertising, we recommend adoption of the "bad actors" rule proposed in May 2011, and already past the statutory deadline for adoption.

Supporting Rationale: As the Commission moves forward to implement the regulations mandated by the JOBS Act, it is sensible that all related regulations be adopted on a simultaneous basis, unless there is substantial reason to phase in certain regulations. There appears to be no reason to phase in the "bad actor" provision. Accordingly, it is appropriate that this provision be operative at the same time that the other rules and regulations relating to the general solicitation and private placement process take effect.