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[redacted]

November 27, 2012

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

Re: File Number S7-07-12: Comment on *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*

Dear Ms. Murphy:

I welcome this opportunity to submit my concerns and suggestions in regards to the Securities and Exchange Commission's ("Commission") recently proposed rule, entitled "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings" ("Proposed Rule").[1] The Commission published the Proposed Rule to implement Section 201 of the Jumpstart Our Business Startups Act ("JOBS Act").[2] The JOBS Act in part removes the long-standing ban on general solicitation and advertising in unregistered offerings of securities – specifically, offerings to entities and individuals reasonably believed to be accredited investors.[3] The primary goal of the JOBS Act is to create more jobs by loosening Commission restrictions on the public offering process, thereby making it easier for small businesses, startups, and entrepreneurs to advertise and sell securities on the national exchange to raise capital. The Commission is confident that the Proposed Rule will accomplish Congress' objectives of permitting security issuers to communicate more openly within the market and facilitate increased capital formation.

[1] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, 77 Fed. Reg. 54,464 (proposed Sept. 5, 2012) (to be codified at 17 C.F.R. pts. 230, 239).
[2] *See* The Jumpstart Our Business Startups Act, H.R. 3606, 112th Cong. (2nd Sess. 2012) [hereinafter "JOBS Act"] (noting purpose of the Act is "[t]o increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.").
[3] Section 201(a)(1) of the JOBS Act directs the SEC "to amend Rule 506 of Regulation D . . . to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers are accredited investors." Section 201(a)(2) directs the SEC "to revise Rule 144A(d)(1) . . . to permit offers of securities pursuant to Rule 144A to persons other than [QIBs]."

I would first like to commend the Commission for implementing such a significant element of the JOBS Act, as the creation of jobs is imperative considering the current state of our economy. At the same time, however, I am concerned that a blanket lift on the ban of general solicitation and advertising with few limits and the use of a mere "reasonable belief" standard for identifying accredited investors, specifically under Rule 506, poses serious risks of fraud and abuse of the public offering process. In effect, the Proposed Rule removes a longstanding safeguard for investor protection as these unregistered offering exemptions will no longer be subject to the stringent SEC review that investors expect and rely on.

This Comment will first provide a brief background of the Commission's involvement and role in federal securities regulation. This Comment will then summarize potential effects—both good and bad—of the Proposed Rule within the public offering process. Finally, this Comment strongly urges the Commission to amend the Proposed Rule in regards to Rule 506 to provide better safeguards against exploitation of the lessened requirements in order to more effectively comply with Congress' purpose of making it easier for companies to raise capital through security offerings. The ideal way to address this concern is for the Commission to specify a method or methods that issuers *must* use to verify accredited investor status and to more closely monitor the advertising process. To support this recommendation, I will evaluate current market practices that currently exist to verify accredited investor status, provide examples of possible verification methods, and discuss means that can be utilized to supervise the way issuers engage in solicitation and advertising.

I submit this Comment as a potential investor and a third-year law student at Villanova University School of Law to express my concerns and offer suggestions regarding the Commission's Proposed Rule. Please note that the opinions expressed in this Comment are entirely personal and in no way reflect the viewpoints of Villanova University School of Law. I am aware that the deadline for submitting comments has passed; however, at this time I respectfully request that the Commission consider my comments and recommendations in amending the Proposed Rule.

I. Background

When the Commission promulgates rules it acts in accordance with its mission: "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[4] In regulating the world of investing, the Commission must provide a unique transparency to all investors and at the same time enable companies to effectively raise capital. The Proposed Rule brings the tension raised by these conflicting principles to the forefront and creates a disparity in this sought after balance. While the Proposed Rule serves to more easily generate capital formation, it does so at the expense of adequately protecting investors. In order to understand the implications of the Proposed Rule, it is first important to

[4] *See The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/about/whatwedo.shtml (last updated Oct. 10, 2012) (discussing purpose and mission of the Commission).

recognize how the Commission has authority to regulate and who will be affected by its actions.

A. The Securities Act of 1933

The process of offering securities is highly regulated by the Securities Act of 1933 ("1933 Act"). The 1933 Act, which is administered by the Commission, embodies a twofold purpose: it strives to protect investors while at the same time attempts to enable public companies to effectively raise capital. The 1933 Act mandates specific requirements companies must abide by if they chose to raise capital through the offering of securities. Creating a reasonable balance between capital formation and investor protection is an important task assigned to the Commission, and subsequently all of its promulgated regulations – including the Proposed Rule at issue today – should address this balance.

Generally, in order to sell securities on the public market, companies must either register their securities with the Commission or alternatively, rely on an exemption from registration as available in the 1933 Act.[5] The exemptions in particular currently prohibit companies from publicizing information that implicates their upcoming public offerings through general solicitation and advertising.[6] The basis of this ban rests on the theory that if companies were able to target investors directly to encourage them to purchase stock, these investors could potentially be harmed by the unknown effects of the offering if they do not fully understand the risks involved in investing in a public company. The two exemptions at issue today – Rule 506 of Regulation D and Rule 144A – allow companies to advertise their offerings to purchasers they reasonably believe to be accredited investors without having to comply with the complicated process of registering securities.[7]

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[5] *See* Press Release, Securities and Exchange Commission, SEC Proposes Rules to Implement JOBS Act Provision About General Solicitation and Advertising in Securities Offerings (Aug. 29, 2012) [hereinafter "Press Release"], *available at* http://www.sec.gov/news/press/2012/2012-170.htm.

[6] *See* 17 C.F.R. § 230.502(c) (2012) (noting non-exhaustive list of examples of general solicitation and advertising prohibitions under Regulation D of the 1933 Act). While "general solicitation and advertising" is not explicitly defined in the 1933 Act, examples include newspaper and magazine advertisements, television and radio communications, public seminars, and information that is publicly available on the Internet. *Id.*

[7] *See* 77 Fed. Reg. 54,464-65 (summarizing amendments to Rule 506 and Rule 144A under the Proposed Rule). Both of these exemptions are widely used by both foreign and U.S. issuers and currently account for billions of dollars raised by companies each year. *Id.* at 54,465. Studies show that in 2011, public offerings relying on Rule 506 and Rule 144A exemptions raised over one trillion dollars, as compared with only 984 billion dollars raised in registered offerings. *Id.*

B. Who Are Accredited Investors?

Accredited investors are a unique group of investors defined in the 1933 Act.[8] Presumed to be more sophisticated and capable of handling the potential financial consequences of high risk investments, a company may sell unregistered securities through a listed exemption to accredited investors that meet criterion set forth in the regulations.[9] Accredited investors include financial institutions and venture capital firms, corporations with assets exceeding five million dollars, certain insiders of the issuer, and certain wealthy individuals who meet income and net worth requirements.

Understanding who accredited investors are is important, as the Proposed Rule allows issuers to only target investors that fall into this category. So long as issuers "reasonably believe" the purchasers they are targeting are accredited investors, issuers can reach out to these purchasers and encourage them to invest in securities in whatever way the please. While the Commission provides factors issuers can take into consideration when determining whether a purchaser is an accredited investor, the Commission itself recognizes that this inquiry can be complex as accredited investor status is difficult to ascertain.[10] This raises issues regarding the verification of accredited investors under the Proposed Rule, and will be discussed further in the Concerns and Suggestions section of this Comment.

II. The Proposed Rule

The Proposed Rule will significantly alter the current requirements of both the Rule 506 and Rule 144A exemptions. Under these proposed amendments, companies will now be able to use general solicitation and general advertising when they offer and sell securities on the public market. The Commission asserts that these new regulations will achieve the directives of the JOBS Act by increasing access to capital formation through public offerings, as well as ensuring that "this ability is not used to sell securities to those who are not qualified to participate in such offerings."[11]

A. Changes to Rule 506 and the Verification Mandate

The proposed rule will lift the ban on general solicitation and advertising and allow issuers to make public communications to attract investors for their offerings under Rule 506 provided that the purchases of the securities are accredited investors.[12] It is important to note that this relaxed capability to advertise and solicit an offering of securities is conditioned on

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[8] *See Accredited Investors*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/answers/accred.htm (last visited Nov. 25, 2012).
[9] *See* 17 C.F.R. 230.501(a) (2012) (providing definition of "accredited investor").
[10] *See* 77 Fed. Reg. 54,468 (discussing difficulties involved in verifying accredited investor status because what is reasonable is dependent on the "type of accredited investor the purchaser claims to be").
[11] *See* Press Release, *supra* note 5 (noting comments of SEC Chairman Mary Schapiro).
[12] *See* 77 Fed. Reg. 54,466-67 (discussing elements of Proposed Rule).

the requirement that the issuer takes "reasonable steps" to verify that purchasers of the securities are indeed accredited investors. The purchasers will be considered accredited investors if (1) the purchasers fall into the definition of accredited investor under Rule 501 or (2) the issuer reasonably believes the purchaser is an accredited investor at the time of the sale of the securities.[13]

It order to engage in general solicitation and advertising under the Proposed Rule, the JOBS Act instructs the issuer "to take reasonable steps to verify that purchasers of the securities are accredited investors, *using such methods as determined by the Commission*."[14] The Commission, therefore, is charged with developing methods to ensure that such "reasonable steps" are carried out. The Commission construes this reasonableness standard to be flexibly guided by a variety of factors, including the type of purchaser the accredited investor claims to be, the amount of information the issuer has about the purchaser, and the nature of the offering and the manner in which the purchaser was solicited.[15] Despite suggestions to the contrary, the Commission has declined to specify a uniform method of verification standards issuers must abide by in taking reasonable steps to ensure purchasers are accredited investors.[16]

B. Changes to Rule 144A

The Proposed Rule will also enable issuers offering securities under the Rule 144A exemption to engage in general solicitation and advertising in selling their securities to a qualified institutional buyer (QIB).[17] Additionally, so far as the issuers reasonably believe the purchaser is a QIB, an offer or sale utilizing avenues of communication prior to the sale will be permitted even if the purchaser in question is not a QIB.[18] Because Rule 144A always involves an intermediary and already provides a list of non-exhaustive list of factors that establish whether a purchaser has QIB status, my concerns associated with the Rule 506 amendments do not apply to this portion of the Proposed Rule. This Comment will not discuss the Rule 144A amendments further.

C. Potential Costs and Benefits

The Commission has conducted an extensive economic analysis of the potential costs and benefits associated with the Proposed Rule.[19] In its analysis, the Commission notes the

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[13] *Id.* at 54,467.
[14] JOBS Act, § 201(a)(1) (emphasis added).
[15] *See id.*
[16] *See* 77 Fed. Reg. 54,469-71 (assessing conflicting range of public comments regarding the current state of verification methods of accredited investors). "We are mindful of the differing views expressed by commentators to date on how the Commission should implement the verification mandate of Section 201(a)." *Id.* at 54,469.
[17] *Id.* at 54,473 (discussing proposed amendments to Rule 144A).
[18] *Id.* at 54,473-74.
[19] *See id.* at 54,476-79 (observing the various costs and benefits associated with this proposed rule).

positive effects the elimination of the ban on general solicitation and advertising will have on both issuers and investors. Under the Proposed Rule, issuers arguably will be able to reach a greater number of investors and thereby increase their access to capital. It will also enable issuers to reach potential investors directly, lowering the cost of solicitation efforts. Further, if issuers are able to openly communicate with accredited investors, these investors will be better equipped to identify potential investment opportunities.

However, as the Commission explicitly recognizes, there are certain dangers associated with the Proposed Rule that must not be ignored.[20] Allowing general solicitation and advertising under the Proposed Rule may inadequately address and fail to reconcile the two purposes of the 1933 Act—increasing capital formation but at the expense of protecting investors. The loosening of current requirements may also make it easier for fraudulent issuers to reach and harm potential investors. The Commission nonetheless disregards these concerns, and declares that requiring issuers to take "reasonable steps" to ensure investors are indeed informed accredited investors is enough mitigate these potential risks.[21] These dangers raise serious concerns because they directly jeopardize adequate investor protection.

III. Concerns & Suggestions

As noted above, the Commission has declined to adopt a method that issuers must abide by in determining whether the targeted purchasers of their general solicitation and advertising are indeed accredited investors. The Commission believes that a specific verification system would be impractical given the many different ways a purchaser can qualify as an accredited investor.[22] Because the facts and circumstances of each offering can differ widely, the Commission contends that they instead will carefully monitor verification practices by issuers.[23] I respectfully disagree, and believe the Commission should adopt a more streamlined method to the verification mandate and condition the relaxation of the general solicitation and advertising ban on bright line requirements.

A. Reason for Concern

The very purpose of the ban of general solicitation and advertising in the first place was to minimize potential harm to investors. If companies were able to target investors

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[20] *See id.* at 54,477-78 (observing potential risks of the Proposed Rule).
[21] *See* 77 Fed. Reg. 54,470 (declining to adopt a more stringent verification mandate). "We believe that the approach we are proposing appropriately addresses these concerns by obligating issuers to take reasonable steps to verify that the purchasers are accredited investors . . . but not requiring them to follow uniform verification methods . . . ." *Id.* Reasonable steps include considering factors such as the nature of the purchaser, information the issuer has about the purchaser, and the nature of the offering. *Id.* at 54,467.
[22] *See id.* at 54,470 (explaining why the SEC will not adopt specific measures issuers must implement in considering whether they reasonably believe a purchaser is an accredited investor). The SEC is concerned that "a prescriptive rule that specifies required verification methods could be overly burdensome in some cases." *Id.*
[23] *Id.* at 54,471.

directly to encourage them to purchase stock, these investors could be unduly influenced and harmed by the unknown effects of the offering if they did not fully understand the risks involved with investing in securities.[24] Thus, the lift on the solicitation ban under the Rule 506 exemption raises legitimate concerns.

First, due to the extreme relaxation of current advertising requirements, the Commission will expect a surge of solicitation efforts related to securities offerings even though the same and very limited number of accredited investors will actually be able to invest in these offerings.[25] The population of investors that fall into the "accredited" category will not change, and they will now be exposed to an influx of issuer solicitations, increasing chances of less informed decisions and lower value investments. Additionally, issuers offering securities pursuant to the Rule 506 exemption will now be able to target and encourage potential investors without disclosing facts investors need to make informed investment decisions. This would subsequently lead to an increase in fraud and misrepresentation, as issuers will be able to contact investors free of Commission oversight. Unregistered offerings under Rule 506 are risky as it is, and allowing widespread solicitation with no concrete prerequisites will only make it more difficult for investors to evaluate the legitimacy of an issuer's offering.[26]

Another concern raised by the Proposed Rule rests on the notion that not all individuals that meet the definition of an "accredited investor" are necessarily sophisticated enough to understand the implications of their investments in unregistered and risky securities. Other private placement exemptions under the 1933 Act require specific sophistication analysis in order to determine whether the investor is able to recognize the costs and benefits associated with their investment.[27] Such a sophistication inquiry is not required under the Proposed Rule, and allowing issuers to engage in uninhibited solicitation increases the likelihood that more investors will be harmed by investing in unregistered securities. The Commission itself stated in the Proposed Rule that "steps that would be reasonable for an issuer to take to verify whether a purchaser is an accredited investor . . .

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[24] *See The Unsafe World of Investing*, N.Y. TIMES, Aug. 17, 2012, *available at* http://www.nytimes.com/2012/08/18/opinion/the-unsafe-world-of-investing.html (discussing potential dangers posed by the Proposed Rule). "Before the JOBS Act, general solicitations were banned, a measure that shielded the general public from offerings that are difficult, if not impossible, to evaluate without special inside knowledge — and that are prone to fraud." *Id.*

[25] *See* Jack Herstein, *SEC Private Placement Rule Threatens to Put Investors at Great Risk*, ADVISORONE (Aug. 20, 2012), http://www.advisorone.com/2012/08/20/sec-private-placement-rule-threatens-to-put-invest

[26] *See* Melanie Waddell, *Rule 506's Lifting of Ban on Private Offering Advertising Will Create 'Chaos': Industry Groups*, ADVISORONE (Oct. 10, 2012), http://www.advisorone.com/2012/10/10/rule-506s-lifting-of-ban-on-private-offering-adver (stating that Rule 506 offerings are "already are the most frequent financial product at the heart of state enforcement investigations and actions").

[27] *See* Edward Fletcher, III, *Sophisticated Investors Under the Federal Securities Laws*, 1988 DUKE L.J. 1081, 1088-89 (December 1988) (discussing relevance of investor sophistication analysis in conducting regulation of the federal securities market).

would likely vary depending on the type of accredited investor that the purchaser claims to be."[28] Lack of a bright-line method to verify this status will only result in confusion among issuers and investors and contribute to both fraudulent offerings and deficient investments.

It is also important to note that the Commission has previously lifted the general solicitation ban with regards to a different private placement exemption.[29] This attempt "led to an immediate upsurge in fraud" and the Commission was forced to reinstate the restriction.[30] Almost twenty years later, the process of offering and investing in securities has only become more complex. With more money and more information at risk it is likely that if lifting the ban on general solicitation and advertising did not work then, it will not work now.

B. Differentiating Current Market Practices

The Commission discusses current practices of accredited investor verification in the Proposed Rule and recognizes that self-certification of accredited investors is the "procedure that has been followed by the industry for decades."[31] In adopting such a broad and flexible verification system of "reasonable steps", the Commission employs this current standard, allowing issuers to verify completely on their own whether potential purchasers are accredited investors. However, current market practices should be enhanced considering the significant relaxations provided by the Proposed Rule. The blanket lift on the prohibition against general solicitation and advertising immensely loosens usual disclosure methods required under the 1933 Act. Because the rules are so loosened, enhanced oversight is required. The oversight can executed by implementing methods to be discussed further below, such as heightening verification requirements and placing conditions on advertising. Permitting issuers to target investors with so little disclosure will result in a greater likelihood of issuer misrepresentations and faulty security investments. As such, current verification methods should be adjusted to account for the relaxed requirements of the Proposed Rule.

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[28] *See* 77 Fed. Reg. 54,468 (discussing widespread differences among the types of companies and individuals who hold accredited investor status under the regulatory definition).

[29] *See Release No. 3307644; S7-14-98: Revision of Rule 504 of Regulation D, the Seed Capital Exemption*, U.S. SECURITIES AND EXCHANGE COMMISSION, *available at* http://www.sec.gov/rules/final/33-7644.txt. In the 1990's the Commission lifted the ban on general solicitation and advertising under Rule 504, another registration exemption of Regulation D, but later reinstated the ban when investors were faced with fraudulent offerings offered under Rule 504. *Id.*

[30] *See* Malanie Waddell, *SEC Backs Off Issuing Private Offering Rule*, ADVISORONE (Aug. 20, 2012), http://www.advisorone.com/2012/08/20/sec-backs-off-issuing-private-offering-rule (calling attention to previous attempts at removing the ban on general solicitation and advertising in private offerings).

[31] *See* 77 Fed. Reg. 54,469, fn 57 (summarizing comments regarding self-certification of accredited investor status) (internal quotations omitted).

C. Verification Method Suggestions

In light of the aforementioned concerns, I urge the Commission to provide a safe harbor for what constitutes "reasonable steps" in verifying the status of a purchaser as an accredited investor. Security offerings under the Proposed Rule are exempt from disclosure and transparency processes normally required by the Commission—and subsequently are more susceptible to fraud—and should only be available to accredited investors that truly understand the financial risk at stake. Therefore, general solicitation methods advanced by the Proposed Rule should be adjusted to account for these possible harms and risk.

One way for the Commission to provide for more secure verification of accredited investors under the Proposed Rule is to mandate a more comprehensive description of what constitutes "reasonable steps." The Commission has offered an extensive discussion of factors they consider to be possibly relevant to investor verification, but have declined to adopt "specified methods of verification" so as not to burden investors and because the facts and circumstances of each offering under Rule 506 can differ dramatically.[32] While this is an accurate observation, I believe issuers should be held to a somewhat higher standard when analyzing purchaser status and that this can be accomplished in a way that is not unduly burdensome. Instead of merely listing factors that can be possibly considered by issuers, information that will unquestionably affect the offering at issue *must* be considered before they solicit investors, including:

- The type of accredited investor the purchaser is (i.e. broker-dealer, bank, officer or director of the issuer, natural person or individual, etc.);
- Whether the purchaser has invested in private placement offerings previously; and
- Proof of the purchaser's financial health, net worth, and income (W-2 forms, public audits, organizational documents, balance sheets, tax returns, etc.).

Mandatory consideration of and compliance with the above factors prior to reaching out to accredited investors will up the ante for issuers and result in more efficient and profitable investments. It will also reduce the risk of misrepresentation and fraudulent offers of securities.

D. Advertising Safeguards

The Proposed Rule currently does not contain any guidance regarding how and by what means issuers can engage in general solicitation and advertising when reaching out to accredited investors. The verification mandate of the JOBS Act can provide for investor protection by implementing guidelines and restrictions on the type of advertising used within the Proposed Rule. For example, the Commission could require all issuers to explicitly disclose the rewards *and* risks associated with their offering on their advertising and solicitation materials. This disclosure should be clear and upfront and written in "plain

[32] *See id.* at 54,470 (stating specified methods of verification would be "ineffective" and "impractical" given the many different ways a purchaser can qualify as an accredited investor).

English" so there is less confusion of investors regarding exactly what type of transaction they are getting involved in. The Commission should mandate that overt disclosures accompanying advertising and solicitation materials must clearly note the following types of caveat information:

- That there is a higher possibility that investors could lose money in investing in this type of private placement offering;
- That this offering of securities is unregistered and held to a lesser standard of Commission oversight; and/or
- That the offering is only meant for "accredited investors" as defined in the Code of Federal Regulations.

Requiring that advertising materials are candid and that issuers accurately balance the rewards and risks of investing will result in greater transparency and also increase investor confidence in choosing to invest in securities offered under the Proposed Rule. This is turn will support the end goal of the Commission and the JOBS Act by making it easier for companies to raise capital in lifting the ban on general advertising and solicitation. Issuers will still be able to advertise their offering under the Proposed Rule; however, requiring issuers to implement simple safeguards in the method of this advertising will also satisfy the Commission's obligation to protect investors.

IV. Conclusion

Allowing small and startup businesses to raise capital more easily through the offering of securities is important, especially considering the current state of our economy. However, the Proposed Rule implements this command of the JOBS Act by removing longstanding safeguards for investor protection by allowing broad solicitation and advertising under Rule 506. These unregistered offering exemptions will no longer be subject to the stringent Commission review that investors expect and rely on and thus will be prone to heightened fraud and misrepresentation. So far as the capital formation desired by the Commission will result substandard Commission oversight and jeopardize investor confidence in the market, the overall purpose of the JOBS Act will ultimately fail. I respectfully request that you consider my concerns and suggestions in order to publish a more effective rule that enables companies to raise capital but also considers the special protection investors are entitled to under the 1933 Act. Thank you for your consideration.

Sincerely,

Sally Braeuer
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