July 14, 2011

U.S. Securities and Exchange Commission
100 F Street, N.E.
Room 3650
Washington, D.C. 20549-1090
Attn: Elizabeth M. Murphy

Re: Release No. 33-9211 File Number S7-21-11.

Dear Ms. Murphy:

On behalf of the Investment Program Association ("***IPA***")[1] this letter is respectfully submitted in order to provide comments to the Securities and Exchange Commission ("***SEC***") to the above referenced Release and File Number relating to the Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings. The proposed rules are required by Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 ("***Section 926***" and "***Dodd-Frank Act***" respectively).

Background

Section 926 of the Dodd-Frank Act requires the SEC to issue a rule no later than July 21, 2011 "for the disqualification of offerings and sales of securities made under section 230.506 of title 17, Code of Federal Regulations (the "***Disqualification Rule***" or "***Rule 506(c)"***). Under Section 926, the SEC is required to include provisions in the Disqualification Rule substantially similar to the disqualifications contained in Securities Act of 1933 Act (the "1933 Act"), Rule 262 (part of Regulation A under the 1933 Act) ("***Rule 262***"). Further, the Disqualification Rule must disqualify offerings by a person "subject to a final order" of a state securities regulator, a state agency supervising or examining banks, savings associations or credit unions, a state insurance commission, a state authority that supervises or examines banks, savings associations, or credit unions, a state insurance commission or the National Credit Union Administration. Such order would fall into the Disqualification Rule if the order: (a) bars the person from (I) association with an entity regulated by such governmental agency, (II) engaging in the business of securities, insurance, or banking, or (III) engaging in savings association or

[1] The IPA was formed in 1985 to provide the direct investment industry with effective national leadership, and today is the leading advocate for the inclusion of direct investments in a diversified investment portfolio. IPA members include direct investment product sponsors, FINRA member broker-dealer firms, and direct investment service providers.

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 within the 10 year period ending on the date of the filing of the offer or sale. Finally, the Disqualification Rule must disqualify an offering by a person who "has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the" SEC.

IPA Commentary

The IPA believes there are three broad areas, discussed below, to be considered:

- Potential problems with the proposed inclusion in the list of "Bad Actors" of 10% beneficial owners of any class of an issuer's equity,
- The need for more detail relating to the proposed waiver authority, and
- The need for a grandfathering clause for previous disciplinary events.

POTENTIAL PROBLEMS WITH THE PROPOSED INCLUSION IN THE LIST OF "BAD ACTORS" OF 10% BENEFICIAL OWNERS OF ANY CLASS OF AN ISSUER'S EQUITY

Rule 262 disqualifies offerings from utilizing the Regulation A exemption if the "issuer, any of its predecessors or any affiliated issuer… any director, officer or general partner of the issuer, beneficial owner of 10 percent or more of any class of its equity securities, any promoter of the issuer presently connected with it in any capacity, any underwriter of the securities to be offered, or any partner, director or officer of any such underwriter" that is or has been subject to any proceeding or to an order (within 5 years prior to filing an offering statement), or has been convicted within 10 years prior to the filing an offering statement "of any felony or misdemeanor in connection with the purchase or sale of any security, involving the making of a false filing with the" SEC "or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, or investment adviser."

The inclusion of beneficial owners of 10 percent or more of any class of securities, in the list of "Bad Actors" creates certain issues. First, in most cases, the initial purchaser in an offering will be *ipso* facto, a 10% equity holder of the issuer. This will require issuers and placement agents to perform due diligence on unaffiliated purchasers at the risk of losing their federal exemption for each subsequent purchaser. The same will be true each

subsequent purchaser who reaches the 10% ownership threshold. For issuers engaged in continuous sales and regular redemptions, the ebb and flow of securities in such offerings make the 10 percent trigger something of a moving target. With individual investors moving above or below at any moment in time, it would be difficult to determine which 10 percent holders are relevant at any point in time; therefore, any one 10 percent holder, subject to the disqualification rule may not be part of the mix from one day to the next. Second, not all 10 percent equity holders are equal. There may be instances in which such 10 percent equity holders may be holders of an equity class which does not have voting rights. In addition, a 10% equity holder may not really be a control person of an issuer if there are one or more holders of larger percentages of the issuer's equity.

The IPA respectfully suggests that a better test would be a beneficial owner of 20 percent or more of any class of equity securities in an issuer since a 20 percent equity holder will usually have the ability to influence or control the issuer. Such holders would be in a position to be active participants in an offering and thus a legitimate target of the Disqualification Rules.

An equally distressing aspect of including purchasers whose purchase may be of such a size as to put them over the threshold of the proposed rule is the effect that disqualification would have on previous sales in the offering. If an individual, subject to one of the disqualifications listed in the proposed rule, were to purchase in the offering, by reason of integration, all previous sales in the offering might be deemed to be outside the scope of the safe harbor. Surely that was not the intent of Congress in adopting Section 926. It is therefore respectfully suggested that the proposed rule make clear that, despite the usual indicia of integration, a sale which falls outside the safe harbor by reason of the proposed rule will not effect the availability of the safe harbor for previous sales in the same offering.

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PRESERVATION OF WAIVER AUTHORITY

The preamble to Rule 262 states that "upon a showing of good cause and without prejudice to any other action" by the SEC, the SEC has the authority under the Rule to waive any applicable disqualification. The IPA applauds the SEC's decision to provide for waiver authority. The question is how to structure such authority. If the application for waiver and the approval of the waiver involves a lengthy process, the net effect would be the same as if there were no waiver provision at all because offerings are often conducted within a relatively short timeframe.

In order to make such waiver authority practical to potential issuers as well as regulators, the IPA respectfully recommends that the Disqualification Rule contain language similar to that found in Paragraph 1(B)(6) - (7) of the Uniform Limited Offering Exemption ("ULOE") as adopted by the North American Securities administrators Association ("NASAA") on September 21, 1983. Paragraph 1(B)(6) states that "The prohibitions of [disqualifications other than those that deny the subject the right to rely on a registration exemption] shall not apply if the person subject to the disqualification is duly licensed or registered to conduct securities related business in the state in which the administrative order or judgment was entered against such person or if the broker/dealer employing such party is licensed or registered in this state and the Form B-D filed with this state discloses the order, conviction, judgment or decree relating to such person. Paragraph 1(B)(7) states that "any disqualification caused by [ULOE] is automatically waived if the state securities administrator or agency of the state which created the basis for disqualification determines upon a showing of good cause that it is not necessary under the circumstances that the exemption be denied." This form of automatic waiver would also mitigate the problem in certain states where even minor violations of a state's statute, rules, or regulations could be considered per se fraud resulting in a disqualifying event, but for the proposed automatic waiver authority described above, as well as the issue of having to suspend offerings while seeking a waiver of disqualification. An example can be found in New York State's Martin Act. Specifically, Martin Act, Section 359-g(2) provides that, unless provided elsewhere, a person violating the Martin Act, <u>including failing to file short form notices on Form M-3, State Notices, Further State Notices, etc.,</u> "shall be guilty of a misdemeanor, except where otherwise provided herein, punishable by a fine of not more than five hundred dollars, or imprisonment for not more than one year or both." The denial of such exemption is based upon the equivalent of certain disqualifying events proposed pursuant to proposed Rule 506(c). This automatic waiver relates to the waiver authority, as well as a mechanism by which to consider such waivers. The nature of a Rule 506 offering makes the adoption of such a mechanism important from both a timing perspective as well as from the perspective of an issuer in a Rule 506 offering, receiving timely notice of its ability to access the private capital markets.

THERE IS A NEED FOR A SUBSTANTIAL GRANDFATHERING CLAUSE

The IPA believes that there is a need for a grandfathering clause for certain consent orders from the various states as well as the SEC. We believe this is needed because consent orders in which there is no admission of guilt entered into before contemplation of proposed Rule 506(c) were agreed to without the knowledge that such consent orders could create a substantial bar to using Regulation D, Rule 506 as a method for raising funds in the private market. Further, the IPA respectfully suggests that only those consent orders entered into (in which there is no admission of guilt) within 90 days prior to the effective date of proposed Rule 506(c) be considered a disqualifying event subject to the waiver authority proposed above. We believe that this result is mandated by concerns of fundamental fairness as well as both substantive and procedural due process. It should be noted that the 90 day proposed limit may need to be extended further depending on the actual effective date.

In conclusion, the IPA appreciates the opportunity to provide comments to the SEC on proposed Rule 506(c) and we thank the SEC staff for its Herculean efforts in creating proposed Rule 506(c) while drafting so many other rules as required by the Dodd-Frank Act. The IPA welcomes the opportunity to discuss our comments with SEC staff and stands ready to participate in a collaborative effort to ensure that proposed Rule 506(c) provides the investor protection required by the Dodd-Frank Act and which will instill confidence in investors desiring to invest in legitimate private offerings.

Respectfully submitted,

Jack L. Hollander
Chairman, Investment Program Association

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