Oct 05, 2012

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

Via email to rule-comments@sec.gov

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

Dear Ms. Murphy:

The National Small Business Association is pleased to provide these comments on the proposed rule regarding "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings."[1]

The National Small Business Association (NSBA) was founded in 1937 to advocate for the interests of small businesses in the U.S. It is the oldest small business organization in the U.S. The NSBA represents more than 65,000 small businesses throughout the country in virtually all industries and of widely varying sizes.

Although the proposed rule is less than ideal, the NSBA supports the proposed rule and urges the Commission to adopt the rule as drafted. If changes to the rule prove to be necessary or advisable in the future, then the Commission can revisit the rule.

This letter contains our discussion of the proposed rule, ways that we believe that it could, in principle, be improved and why we believe that a number of changes proposed by various commentators would be highly counterproductive.

The JOBS Act

On Apr. 5, 2012, the President signed into law the Jumpstart Our Business Startups Act (the "JOBS Act").[2] This bi-partisan legislation is designed to substantially reduce the regulatory impediments to small firms' access to capital markets. Properly implemented, it will dramatically improve small companies' access to capital and reduce their cost of capital. It will

---

[1] Release No. 33–9354; File No. S7–07–12; RIN 3235–AL34. See *Federal Register*, Volume 77, Number 172 (Wednesday, September 5, 2012), pages 54464-54481.
[2] Public Law 112–106.

reduce the legal, accounting and other administrative cost of small businesses and reduce the need to pay substantial fees to investment bankers to access capital markets.

The importance of Title II of the Act is often underrated. Typically, small business owners or entrepreneurs know a limited number of accredited investors (i.e. very affluent people). They are thus effectively forced by the securities laws' pre-existing relationship requirements to either pay broker-dealers large fees to make introductions or to do without adequate capital to grow their businesses.[3] Title II of the Act will allow them, should they choose, to try to directly seek accredited investors. It is a very important step towards breaking the effective Wall Street cartel on raising small businesses capital from other than friends or family.

Specifically, Title II of the Act provides that the prohibition against general solicitation or general advertising contained in 17 CFR 230.502(c) shall not apply to offers and sales of securities made pursuant to 17 CFR 230.506, provided that all purchasers of the securities are accredited investors. It further requires the issuer "to take reasonable steps to verify" that purchasers of the securities are accredited investors, using such methods as determined by the Commission. The Act also provides, subject to various requirements, that no person shall be subject to registration as a broker or dealer solely because "that person maintains a platform or mechanism that permits the offer, sale, purchase, or negotiation of or with respect to securities, or permits general solicitations, general advertisements, or similar or related activities by issuers of such securities, whether online, in person, or through any other means."

General Discussion of Proposed Rule

The Commission was required by the JOBS Act to have issued a final rule by July 5. On August 29, the Commission agreed to a proposed rule. That rule effectively repeats the underlying statutory language[4] by allowing general solicitation and general advertising in Rule 506 offerings and requiring that "[t]he issuer shall take reasonable steps to verify that purchasers of securities sold in any offering under this § 230.506(c) are accredited investors."

Given the many questions posed to the public in the SEC discussion of the proposed rule regarding potentially different ways of addressing Title II, it is not clear whether the Commission is likely to adopt the proposed rule as written (or something substantially similar) or whether the proposed rule is really a placeholder and the Commission will go down the road of mandating a series of steps by issuers or creating a safe-harbor composed of specific steps similar to those outlined in the discussion accompanying the proposed regulation.[5]

[3] This effect is particularly dramatic for firms trying to raise less than $5 million (and especially less than $2 million) since the potential fees are often not enough to entice Broker-Dealers to even entertain the prospect of underwriting the offering and, in any event, the fee percentages are correspondingly high.
[4] See section 201(1)(a) of the JOBS Act and 15 USC 77d.
[5] These include use of publicly available information (such a proxy statements or IRS Form 990s), tax return information or third party verification (by, for example, a broker dealer, accountant or attorney). See Section II.B of the Supplementary Information, *Federal Register* pp. 54467-54471.

From a small business perspective, there are risks associated with any of these three approaches. If specific mandates are made, those mandates may well involve such expense or serve as such a disincentive to investors that Title II becomes of little value. If it costs thousands of dollars for investors to comply with the rules, then they are going to find other ways to make relatively small investments.[6] If a safe-harbor approach is adopted, then it is likely that attorneys will treat the safe-harbor requirements as effectively mandatory in order to avoid risk.[7] Yet if the current approach adopted by the proposed rule is adopted, we will not really know the legal contours of Title II for years as SEC enforcement actions and private party litigation outcomes provide the basis for knowing what is and is not required of issuers in connection with verification of accredited investor status.

On balance, after careful consideration of the likely outcome given the current situation, NSBA has decided to support the proposed rule in its current form. Although the proposed rule could be better, it is unlikely to improve. It is better to let practitioners, experience and courts work out the contours of the verification requirement over time. Perhaps the issue can be revisited after some years of experience with the proposed rule.

Rule 506 Bifurcation

We are pleased that the proposed rule does not modify Regulation D in such a way as to actually impede rather than enhance the ability of small firms to raise capital. This would certainly be the case if a new burdensome regulatory regime was created and applied to all Rule 506 offerings (including those that made no general solicitation). That would also be diametrically opposed to the intent of Congress. The proposed rule effectively bifurcates Rule 506 so that existing practices still apply to Rule 506 offerings not involving general solicitation or general advertising.

Reasonable Belief Standard

The reasonable belief standard regarding accredited investor status should be retained. We are pleased that the Commission retained this standard for all Rule 506 offerings.[8] Had it not done so, issuers would have, in effect, become insurers and the regulatory risk for issuers choosing to

---

[6] If third party verification of net worth is required, then due diligence by accountants or others will be expensive (particular with respect to determining liabilities). Moreover, and probably more importantly in the long run, third parties are likely to impose a surcharge to compensate for their potential liability (or defense of warrantless lawsuits) in connection with net worth certifications made in connection with securities offerings.

[7] The risk being, among other things, that if the verification procedures are found inadequate at some later date then the offering will then be determined to be outside the confines of the Regulation D safe harbor and therefore the substantial risk that the offering will be deemed an unregistered public offering triggering potential civil and potentially criminal liability. It would, of course, be much less likely that an offering involving a general solicitation or general advertising would be found to be within the confines of the general private placement exemption contained in the 33 Act (see new 15 USC 77d(a)(2)). A Regulation D offering under current rules, in contrast, may very well fall within the general private placement exemption because it does not involve general solicitation (i.e. does not involve "any public offering" within the meaning of the 33 Act exemption contained in 15 USC 77d(a)(2).

[8] See Section II.C of the Supplementary Information.

avail themselves of the new Rule 506(c) would have constituted a strong disincentive to use this JOBS Act provision.

Reasonable Steps to Verify

The verification issue is not about protecting innocent little old ladies from fraudulent issuers as some have alleged. Title II leaves all anti-fraud laws in place. Those advocating a complex regime regarding verification of accredited investor status are seeking to protect those who are willing to lie to issuers about their income or net worth. In order to protect those investors who are willing to fraudulently fill out investor suitability questionnaires and fraudulently attest to a false income or a false net worth, proponents of such a regime are willing to prevent countless job creating small businesses from raising the capital necessary to launch or grow their business. That is not what Congress had in mind when it passed Title II of the JOBS Act.

The costs of any potential verification regime should be very seriously considered and weighed against the unquantifiable and intangible benefits of protecting people willing to lie about their income or net worth. The costs are not just the administrative costs. They also include the economic losses caused by capital not raised and jobs not created by those who would have taken advantage of Title II but for the regulatory risks or costs of the regime established by the SEC. These losses could be very large.

<u>The Appropriate Rule</u>

The traditional and almost universal current practice of using investor suitability questionnaires combined with investor self-certification to establish accredited investor status should continue to be allowed and be deemed to constitute taking "reasonable steps to verify that purchasers of the securities are accredited investors" as required by the JOBS Act. Congress did not intend to dramatically undermine the laudable policy goals of the Act by changing the current long-standing practice with respect to verifying accredited investor status.

We believe that the current practice of investor suitability questionnaires combined with investor self-certification should be explicitly acknowledged and permitted by the final regulation.

<u>Alternative Approaches</u>

If, contrary to our strong recommendation and, we believe, the intent of Congress, the Commission nonetheless decides to change existing practice with respect to Rule 506 offerings that engage in general solicitation or general advertising, then NSBA has a number of suggestions.

Requiring investors to present W-2s to issuers is unworkable. Most investors are not employees of someone else. They either have their own business or are investors, often retired, relying on investment income. In other words, they rely on Schedule B, Schedule C, Schedule D, or Schedule K income to meet the accredited investor income requirements. That said, there will

1156 15th Street NW · Suite 1100 · Washington, DC 20005 · 202-293-8830 · Fax: 202-872-8543 · www.nsba.biz

be, of course, some cases where highly compensated employees can present W-2s to establish their status as an accredited investor.

Second, requiring investors to provide their entire tax return to issuers will radically reduce the number of investors willing to invest. People will be justifiably reluctant to give their tax returns to virtual strangers. They do not want their personal family, health and business lives to be disclosed and they cannot be sure that issuers will treat that information confidentially. As often as not, they will find some other way to invest their money.

Third, neither providing a W-2 nor a tax return will establish net worth for those investors relying on the net worth rather than the income test for meeting the accredited investor definition.

Thus, if there must be some kind of enhanced verification, we recommend that a certification by the investor's attorney, CPA, certified financial advisor or other licensed professional should be sufficient. This, of course, will add expense to the entire process (particularly if the investor is relying on net worth to meet the accredited investor standards). It will have a negative impact on investor returns and willingness to invest in Regulation D offerings. Moreover, unless there is a good faith provision in the rule absolving these professionals from liability for making such a certification if they did so in good faith having a reasonable basis for their certification, they will either be unwilling to make the certification or charge a great deal for doing so (if only to cover the increase in their malpractice premiums for being in the business of making Regulation D accredited investor certifications).

Obviously, this certification can only be with respect to income history or current net worth. It would be unreasonable to require these professionals to certify that the investor has 'a reasonable expectation of reaching the same income level in the current year" as currently required by Regulation D.[9] Only the investor can reasonably attest to his or her expectations as to future income.

As we have mentioned previously,[10] it would be possible to require investors to make their certifications under penalty of perjury. This should make investors less willing to lie on their certifications to issuers since a criminal penalty for doing so would attach to their fraudulent behavior. Section 1746 of Title 28 authorizes this approach. It reads:

> 28 USC § 1746 - Unsworn declarations under penalty of perjury
>
> Wherever, under any law of the United States or under any rule, regulation, order, or requirement made pursuant to law, any matter is required or permitted to be supported, evidenced, established, or proved by the sworn declaration, verification, certificate, statement, oath, or affidavit, in writing of the person making the same (other than a deposition, or an oath of office, or an oath required to be taken before a specified official other than a notary public), such matter

[9] 17 CFR 230.501(a)(6).
[10] See, e.g., footnote 68 of the proposed rule.

> may, with like force and effect, be supported, evidenced, established, or proved by the unsworn declaration, certificate, verification, or statement, in writing of such person which is subscribed by him, as true under penalty of perjury, and dated, in substantially the following form:
>
> > (1) If executed without the United States: "I declare (or certify, verify, or state) under penalty of perjury under the laws of the United States of America that the foregoing is true and correct. Executed on (date). (Signature)."
> > (2) If executed within the United States, its territories, possessions, or commonwealths: "I declare (or certify, verify, or state) under penalty of perjury that the foregoing is true and correct. Executed on (date). (Signature)."

To prevent investors from fraudulently asserting accredited investor status, the SEC may wish to require investors to sign such a form. Such a form would be only a few sentences long and the exact language required should be specified in the revised Regulation D. Such an approach is regularly used by the SEC Enforcement Division as a Google search of the SEC website demonstrates.

Requiring investors to provide to issuers an independent professional's certification as to the investor's accredited investor status and requiring the investor to certify his or her own status under penalty of perjury would provide a high degree of protection against non-accredited investors asserting accredited investor status in Regulation D offerings. It would also preserve the confidentiality of investors' personal information.

Such a regulatory regime would have an adverse impact on the efficacy of Title II but should not render it an effective nullity as, for example, SEC Regulation A has rendered the small issues exemption a dead letter.[11]

Legislative History Discussion

The SEC in its discussion states that:

> We believe that the purpose of the verification mandate is to address concerns, and reduce the risk, that the use of general solicitation under Rule 506 may result in sales to investors who are not, in fact, accredited investors.[12]

This is a fair representation of the limited legislative history that exists. The limited and somewhat conflicting legislative history that exists is entirely consistent with what the SEC has done in the proposed rule. It is, however, **not** consistent with creating a complex regulatory regime governing verification as the state regulators advocate and as the SEC appears to be

---

[11] See Regulation A and 15 USC 77c(b). See also "Factors That May Affect Trends in Regulation A Offerings," United States Government Accountability Office, July 2012 (GAO-12-839), a report required by the JOBS Act.
[12] *Federal Register*, Volume 77, Number 172 (Wednesday, September 5, 2012), page 54467.

considering, or at least open to, given the questions posed to the public in the discussion and more fully analyzed below.[13]

The verification language in the final Act is identical to the relevant language in the House bill. The relevant legislative history is the House report. There was no Senate report. The House report language states:

> To ensure that only accredited investors purchase the securities, H.R. 2940 requires the SEC to write rules on how an issuer would verify that the purchasers of securities are accredited investors.[14]

This is simply a paraphrasing of the underlying statutory language. Since the law requires a modification to the underlying rule, namely Regulation D, it is utterly unremarkable that the Committee in its report noted that the SEC would have to write rules implementing the requirements of the Act. There is quite literally **no** indication that the Congress contemplated a complex and burdensome regulatory regime governing the verification of accredited investor status that would effectively defeat the underlying purposes of the Act.

The comments of individual members of Congress are not true legislative history except, arguably, in the case of floor managers or the relevant committee chairpersons.[15] They reflect only the opinions of one member. Besides the Committee Report discussed above, the only "legislative history" that appear to exist regarding this provision are remarks from two Representatives and one Senator and a statement inserted for the record in House after the floor vote.

---

[13] For the 16 specific questions, see *Federal Register*, Volume 77, Number 172 (Wednesday, September 5, 2012), pp. 54473 and 54479.

[14] Access To Capital For Job Creators Act, Report from the Committee On Financial Services October 31, 2011, p. 2 and p. 5.

[15] This is, of course, even more true of the comments of a single member in committee. [In footnote 41 of the SEC discussion of the proposed rule, the SEC cites Rep. Waters remarks in Committee ''we must take steps to ensure that those folks are indeed sophisticated." This is hardly a definitive statement about what Congress intended. In fact, it is really little more than an inexact paraphrasing of the underlying statutory language. And sophisticated, of course, is not the same as accredited under Regulation D in any event.] Moreover, committee debate transcripts are rarely available to attorneys or courts since they are neither published in *U.S. Congressional and Administrative News* nor the *Congressional Record* nor by the Government Printing Office. Only committee hearings and reports are usually published. See, e.g., "Legislative History Research: A Basic Guide." Julia Taylor, Congressional Research Service, June 15, 2011. *Ergo*, the comments of a single member in committee is accorded virtually no weight as legislative history even by proponents of using legislative history as an aid in statutory interpretation. Justice Stephen Bryer, for example, is one of the foremost proponents of using legislative history as an aid in interpreting statutes. Even he, however, mentions only "congressional floor debates, committee reports, hearing testimony, and presidential messages." See, "On The Uses Of Legislative History In Interpreting Statutes," 65 S. Cal. L. Rev. 845 (1992). Many other leading jurists and scholars oppose using legislative history for purposes of interpreting statutes at all. See, e.g., *Reading Law: The Interpretation of Legal Texts*, Justice Antonin Scalia and Bryan A. Garner, West, 2012.

The only discussion of the verification issue on the Senate floor during the JOBS Act debate appears to be a discussion by Sen. Levin in support of the Reed-Landrieu-Levin amendment (SA 1833) that was **not** adopted by the Senate.[16] Sen. Levin stated:

> The Reed-Landrieu-Levin amendment would direct the SEC to revise its rules to allow companies to offer and sell shares to a credited investor (sic), but it then directs the SEC to make sure those who offer or sell these securities take reasonable steps to verify that the purchasers are actually accredited investors. It requires the SEC to revise its rules to make sure these sales tactics are appropriate. There are not going to be, under our language, billboards or cold calls to senior living centers. I wish I could say the same about the House bill.[17]

This clearly implies that Sen. Levin thought the House bill (which is the language that was signed into law) did not require all of these things.

In its discussion, the SEC (in its footnote 41) cites the Remarks of Representative Maloney.[18] Rep. Maloney said:

> This bill before us today would end this contradiction by removing the restrictions on general solicitation and advertising for certain private securities offerings. It will help companies attract potential investors and raise the capital that they need to be successful. This bill accomplishes this task in a balanced way.
>
> During the committee markup and work on this bill, we incorporated numerous ideas from both sides of the aisle, including a provision requiring that issuers verify that an investor is actually eligible to purchase the offered securities. The Waters amendment made sure that the investors were credible and accredited.
>
> Today, as it stands, investors only self-certify that they have a million in assets or make $200,000 a year to qualify to purchase the private security. Now, with this bill, we will have additional safeguards in place to make sure that investors are qualified and that these financial transactions are safer.
>
> I support this bill today. I urge my colleagues to join in supporting it. And I feel that this is really an investment in the American Dream.

Rep. Maloney accurately informed the Congress that the Act contained "a provision requiring that issuers verify that an investor is actually eligible to purchase the offered securities." But that fact, also noted in the Committee Report, does not add anything to the discussion of what specifically is meant by the statutory language that is the subject matter of the proposed rule. The

---

[16] Cloture on amendment SA 1833 (the Reed-Landrieu-Levin amendment) was not invoked in Senate by Yea-Nay Vote. 54 - 45. See Record Vote Number 51.

[17] *Congressional Record* S1727 (March 15, 2012).

[18] *Congressional Record* H7291 (Nov. 3, 2011).

only indication of what she believes the language actually means is her remark that the bill language constituted "additional safeguards" beyond self-certification.

The SEC also cites the Remarks of Representative Jackson Lee (shown below).[19] Importantly, as the *Congressional Record* shows, these remarks are an insert, submitted after debate, after the vote and not heard by other members of Congress. They do, of course, reflect the views of Rep. Jackson Lee herself.

> Mr. Speaker, I rise today in support of H.R. 2940, ``Access to Capital for Job Creators Act," to remove the prohibition against general solicitation or advertising on sales of non-publicly traded securities, provided that all purchasers of the securities are ``accredited investors." Requires the Securities Exchange Commission to write rules on how an issuer would verify that the purchasers of securities are accredited investors.
>
> ***
>
> In addition, it mandates SEC to write rules requiring issuers using general solicitation to verify that investors are accredited, rather than rely on investor self-certification, as is currently permitted. In addition to a number of different types of institutions, an ``accredited investor" is an investor with more than $1 million in assets excluding the primary residence, or an annual income greater than $200,000 for an individual and $300,000 for a couple.
>
> Before us is a measure that will allow companies to more easily raise capital by removing restrictions on general solicitation and advertising for certain private securities. It fairly balances the need to ease capital formation to spur job creation, with a provision to better protect investors by putting greater responsibility on the issuer.
>
> One of the more important provisions in the bill is to ensure the identities of investors. The onus is on the issuer to verify that an investor actually is eligible to purchase the offered securities. Currently, investors only self-certify that they have $1 million in assets or make $200,000 a year to qualify to purchase the private security.
>
> This has created the balance we need to ease restrictions on capital formation with protecting investors from fraud. NASAA continues to oppose the private offering process generally, which does not provide notice to the States, and therefore opposes this bill. This bill will ease a regulation that implements stipulations on garnering investors and capital.

[19] *Congressional Record* H7294 (Nov. 3, 2011).

From her inserted statement, Rep. Jackson Lee expresses her view that she believes the law to require something more than self-certification in the case of Rule 506 offerings involving general solicitation. She does not indicate what that something more might be. She also expressed her view that the legislation eases regulation to assist firms to garner investors and capital. Furthermore, she accurately notes that the North American Securities Administrators Association (NASAA) remained opposed to the bill but that she supported it nonetheless. This is relevant because state regulators are the most aggressive proponents of creating a complex regulatory regime that will render Title II a dead letter. And it clear from the record that she rejected their point of view.

Although not cited by the SEC, Rep. Waters did address the issue briefly on the floor of the House. She said:

> An amendment I offered in subcommittee, which was accepted, directs the SEC to write rules requiring issuers to verify that purchasers are accredited investors. I think this will substantially improve the potential fraud issues identified by the State regulators.
>
> Given this improvement, I'd like to offer my support for this legislation. This bill will make it just a bit easier for some companies to raise funds in the private market, enabling them to grow their businesses.[20]

This, of course, also does not add to our understanding of what specifically is meant by the statute.

In short, there is very little legislative history on the issue at hand. What does exist is entirely consistent with what the SEC has done in the proposed rule. It is not consistent with creating a complex regulatory regime governing verification as the state regulators advocate, as was explicitly rejected by Congress and as the SEC appears to be considering, or at least open to, given the questions discussed below.

Responses to Certain Specific Questions Posed

The Commission posed a number of specific questions in its discussion of the proposed rule.[21] We have undertaken to answer most of them below.

Q. Will the Commission's proposed approach to implementing the verification mandate of Section 201(a) be effective in limiting issuers' sales to only accredited investors in Rule 506 offerings that use general solicitation?

A. We believe that the Commission's proposed approach to implementing the verification mandate will be effective in limiting issuers' sales to only accredited investors in Rule 506 offerings that use general solicitation. This is not a significant problem with respect to current

---

[20] *Congressional Record* H7290 (Nov. 3, 2011).

[21] See *Federal Register*, Volume 77, Number 172 (Wednesday, September 5, 2012), pp. 54473 and 54479.

Rule 506 offerings. Issuers will continue to have a strong incentive to protect the integrity of their offering and will not want to risk having non-accredited investors making investments in their Rule 506 offerings. Allowing non-accredited investors would endanger the exemption of their Regulation D offering and substantially impede their ability to undertake an IPO. In the very unlikely event that this becomes a problem of any significance, then the verification rule can be revisited.

Q. Should the Commission adopt a rule that specifies the methods that issuers must use or could use to verify accredited investor status? Would such an approach provide greater certainty for issuers than the approach that we are proposing?

A. We believe that specific rules constitute a significant risk of being inappropriate in many contexts and of being overly burdensome. As discussed in detail above, if specific rules are adopted, we believe that using a third-party professional to verify the investor's status or requiring a certification by the investor under penalty of perjury is sufficient given the legislative history, the incentives for issuers to comply and the underlying purpose of the JOBS Act.

Q. Would the inclusion of a specified list result in an assumption or practice that the listed methods are "de facto" requirements, thereby inappropriately reducing flexibility and effectiveness of the new rule?

A. We believe that is highly likely. If a safe-harbor is provided, it is likely to become the de facto rule. That said, if the safe harbor is reasonable (third-party verification or certification by the investor under penalty of perjury) it may not prove to be a large burden on issuers.

Q. What are the benefits and costs of each approach? In the case of the latter, if the Commission were to adopt such a rule, should it be in the form of a safe harbor for compliance with the verification requirement? What would be examples of the types of methods that issuers could use to verify accredited investor status, and what would be the merits of each such method?

A. Third party verifiers will not want to risk their professional license, future business and other sanctions by making false verifications. The central problem is the cost to the investor. This will not be just the billed time involved. Inevitably, third party verifiers are going to charge enough to justify the risk that they will be sued. Third-party verifiers may see their malpractice premiums increase substantially. The cost of making an income verification will be relatively low. The cost (and regulatory risk) associated with making a net worth verification may prove to be quite high (primarily because of the difficulty of adequately verifying indebtedness). This will substantially reduce the number of people willing to make investments in general solicitation offerings and tend to defeat the purposes of the JOBS Act.

Self-certification under penalty of perjury creates a significant legal down-side to investors making false certifications.

Q. Some commentators have recommended that the Commission look to current market practices in determining the methods that should be required or permitted for verifying accredited investor status. As noted above, we anticipate that many practices currently used by issuers in connection with existing Rule 506 offerings would satisfy the verification requirement proposed for offerings pursuant to Rule 506(c). How effective have these practices been in assessing the eligibility of purchasers to participate in an offering made under Regulation D? Are certain practices more effective than others? If so, please describe these practices with specificity. What are the costs and benefits of these practices (to issuers, investors and other market participants)?

A. We do not believe that non-accredited investors investing in Regulation D offerings is a significant problem.

Q. Under what circumstances, if any, should an issuer be deemed to have taken "reasonable steps to verify" if the only action taken by the issuer is to request a representation from a purchaser that it is an accredited investor, as some have suggested? Should the Commission provide that an issuer is deemed to have taken "reasonable steps to verify" if the issuer "reasonably believes" that such a purchaser is an accredited investor, as some have suggested? What are the potential benefits and potential harms of such an approach?

A. We believe that the combination of a suitable investor suitability questionnaire, an investor self-certification and appropriate warranties in a subscription agreement is sufficient absent some clear indication or actual knowledge that the investor is not accredited.

Should the Commission disagree, we believe that either receiving third-party verification or certification by the investor under penalty of perjury is sufficient absent some clear indication or actual knowledge that the investor is not accredited.

Q. As we noted above, depending on the facts and circumstances, we believe there is merit to the view that the ability of a purchaser to satisfy the high minimum investment amount required to participate in an offering may be a relevant factor in determining whether that purchaser is an accredited investor. At the same time, we also believe that issuers must be mindful of any indications that the purchaser, despite the ability to provide the funds needed to satisfy a high minimum investment amount requirement, may not actually be an accredited investor. We have noted that the financing of a purchaser's cash investment by the issuer or a third party is a factor that an issuer should consider. Are there other factors? In light of these considerations, should the Commission specifically provide that a high minimum investment amount is sufficient, in and of itself, to satisfy the requirement that the issuer has taken reasonable steps to verify a purchaser's accredited investor status, provided that the high minimum investment amount is not being financed by the issuer or any third party? If so, should the rule specify an amount, and, if so, what amount would be appropriate?

A. We do not have a position regarding this issue. We would note, however, that such a provision will tend to encourage accredited investors to make larger investments in fewer companies and therefore to not have a diversified portfolio of investments. The Commission may want to consider whether encouraging accredited investors to inadequately diversify is a sound policy goal.

Q. Verification methods could include obtaining information from prospective purchasers, such as Forms W-2, personal bank and brokerage account statements and similar documentation. We are cognizant that prospective purchasers may have privacy concerns when undergoing a verification process by issuers. Do any other concerns in addition to privacy concerns arise from a requirement to provide such information? How, if at all, could the Commission address these concerns? What other documentation could be used to verify accredited investor status while minimizing privacy concerns? Does use of a reasonably reliable third party to provide this information respond to those concerns?

A. We believe that the use of reasonably reliable third parties to conduct verification addresses the primary privacy concerns provided that the investor retains the right to choose the third-party verifier.

Q. Currently, Rule 508 of Regulation D provides that the exemption in Rule 506 will not be lost due to an “insignificant” deviation from a term, condition, or requirement of Regulation D. Should Rule 508 be amended to include any additional provisions specifically related to proposed Rule 506(c)?

A. Yes. Insignificant deviations should not have catastrophic adverse legal effects. If they do, then Rule 506(c) will rarely be used. This would defeat the purpose of the Act.

Q. Is it likely that the removal of the prohibition against general solicitation would increase fraudulent activity in these markets? If so, to what extent, and what form is this fraudulent activity likely to take? Please provide data where possible.

A. There will always be those that attempt to defraud investors no matter what the type of offering. Certainly, many public companies and broker-dealers commit fraud even though they are heavily regulated. The securities laws exist to prevent, deter and punish such fraud.

Existing fraud protections remain unchanged under Title II. We do not believe that allowing small businesses and entrepreneurs to seek accredited investors through general solicitation will materially increase fraudulent activity. Those that seek to engage in fraudulently activity will continue to be subject to severe sanctions and Title II does not change that fact.

Q. How costly is it to comply with the existing requirements of Rule 506(b)? What would the incremental cost be to comply with the proposed requirements of Rule 506(c)? What would be the impact, if any, of the proposed Rule 506(c) check box on Form D? Please provide data where possible.

A. The costs of undertaking a Regulation D filing are significant but, of course, much less than the costs of a public offering or a Regulation A offering.

The central point we would like to convey in response to this question is that the additional administrative cost associated with the verification rule is the proverbial tip of the iceberg. The real cost to the small business community and the economy as a whole will be the cost associated with the capital not raised, the jobs not created, the businesses not launched or grown because small businesses and entrepreneurs were not able to reach an adequate number of accredited investors. This will be the case if the verification procedures become so burdensome that issuers and investors cannot cost-effectively take advantage of the opportunities created by Title II.

If the SEC adopts a costly and burdensome regulatory regime as is being advocated by state regulators and other commentators (who almost universally opposed the JOBS Act), then the cost to the economy may well be in the hundreds of billions, rendering the administrative costs trivial.

The costs of the verification regime should be very seriously considered and weighed against the unquantifiable, intangible benefits of protecting people willing to lie about their income or net worth. The costs are not just the administrative costs. They also include the economic losses caused by capital not raised by those who would have taken advantage of Title II but for the regulatory risks or costs of the regime established by the SEC. These losses could be very large.

Q. Are there any other benefits or costs associated with the accredited investor verification requirement in proposed Rule 506(c) that the Commission has not identified?

A. Yes. The proposed rule, as written, implements Title II in a reasonable way. In that sense, it does not impose additional costs or offer other benefits. The statute, of course, offers the prospect of tremendous economic benefits but that is not a function of the rule per se. And it is the statute (not the rule) that imposes the verification requirement itself.

What the Commission has **not** explicitly considered is the extremely high costs that various proposed burdensome alternatives would have. And the central cost, not considered, would be the economic impact of the capital not raised.

Assuming, for example, that Title II will increase Regulation D Rule 506 offerings by only ten percent, then that would amount to roughly $90 billion annually. This, in turn, using a discount rate of five percent, means the present discounted value of the additional capital raised would be $1.8 trillion. The impact on GDP and employment would be large. Our point is not to posit a specific figure (or to recommend a specific discount rate) but to indicate that adopting a complex and burdensome rule would have a very important economic effect – an impact that dwarfs the magnitude of the administrative costs. It is also to indicate that the alleged increase in fraud would have to be very large (indeed implausibly large) to justify cutting off so much capital from entrepreneurs and destroying so many jobs.

We are, of course, aware that estimating the likely impact of the JOBS Act and the proposed rule and various alternatives to it involves making educated guesses based on limited data. But it is much better to be approximately correct than precisely wrong about the economic effects of the proposed rule. A sensitivity analysis can show how sensitive the results are to different assumptions.

We believe that the cost estimates in section VI and VII are radically too low. They reflect, in effect, the time it takes to fill out the Form D form (four hours according to the SEC). As anyone who has ever done a Reg. D offering can attest, that does not reflect the countless hours necessary to comply with the requirement of Regulation D. The number of hours involved in complying with Regulation D will often amount to many hundreds of hours, not four.

In addition, the compliance cost estimates should include the time required by the issuer and their advisors to familiarize themselves with the rule and to comply with the additional verification requirements and the time and costs of investors to comply (for example, with a third-party verification requirement).

Thank you for your consideration of the small business perspective. We believe that small firms' perspective is particularly salient in this case because the very purpose of Congress and the President in enacted the JOBS Act was to improve small firms' access to capital.

Sincerely,

David R. Burton
General Counsel

[redacted]
([redacted]

Celebrating 75 Years · 1937 - 2012
1156 15th Street NW · Suite 1100 · Washington, DC 20005 · 202-293-8830 · Fax: 202-872-8543 · www.nsba.biz