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17 CFR Parts 200, 230, 239, et al.
Disqualification of Felons and Other ''Bad Actors'' from Rule 506 Offerings; Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings; Amendments to Regulation D, Form D and Rule 156; Final Rules and Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 230, and 239

[Release No. 33–9414; File No. S7–21–11]

RIN 3235–AK97

Disqualification of Felons and Other ''Bad Actors'' From Rule 506 Offerings

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting amendments to our rules to implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 926 requires us to adopt rules that disqualify securities offerings involving certain ''felons and other 'bad actors''' from reliance on Rule 506 of Regulation D. The rules must be ''substantially similar'' to Rule 262 under the Securities Act, which contains the disqualification provisions of Regulation A under the Securities Act, and must also cover matters enumerated in Section 926 of the Dodd-Frank Act (including certain state regulatory orders and bars).

DATES: *Effective Date:* September 23, 2013.

Comment Date: Comments regarding the collection of information requirements within the meaning of the Paperwork Reduction Act of 1995 should be received on or before August 23, 2013.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/final.shtml*);
- Send an email to *rule-comments@sec.gov*.
- Please include File Number S7–21–11 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments on the Paperwork Reduction Act analysis in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–21–11. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/final.shtml*). Comments will also be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Johanna Vega Losert, Special Counsel, Karen C. Wiedemann, Attorney Fellow, or Gerald J. Laporte, Office Chief, Office of Small Business Policy, Division of Corporation Finance, at (202) 551–3460, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–3628.

SUPPLEMENTARY INFORMATION: We are adopting amendments to Rules 145,[1] 147,[2] 152 [3] and 155;[4] Rules 501[5] and 506[6] of Regulation D;[7] and Form D[8] under the Securities Act of 1933[9] and to Rule 30–1[10] of our Rules of Organization and Program Management.

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I. Background and Summary

Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the ''Dodd-Frank Act''), entitled ''Disqualifying felons and other 'bad actors' from Regulation D offerings,'' requires the Commission to adopt rules to disqualify certain securities offerings from reliance on Rule 506 of Regulation D.[11] The Commission proposed rule amendments to implement Section 926 of the Dodd-Frank Act on May 25, 2011.[12] Today we are adopting amendments to Rules 501 and 506 and to Form D to implement Section 926. The disqualification provisions we are adopting, to be codified as new paragraph (d) of Rule 506,[13] are generally consistent with the proposal, but will apply only to triggering events occurring after effectiveness of the rule amendments (with pre-existing events

[1] 17 CFR 230.145.
[2] 17 CFR 230.147.
[3] 17 CFR 230.152.
[4] 17 CFR 230.155.
[5] 17 CFR 230.501.
[6] 17 CFR 230.506.
[7] 17 CFR 230.500 through 230.508.
[8] 17 CFR 239.500.
[9] 15 U.S.C. 77a *et seq.*
[10] 17 CFR 200.30–1.

[11] Public Law 111–203, sec. 926, 124 Stat. 1376, 1851 (July 21, 2010) (codified at 15 U.S.C. 77d note).

[12] *See Disqualification of Felons and Other ''Bad Actors'' from Rule 506 Offerings,* Release No. 33–9211 (May 25, 2011) [76 FR 31518 (June 1, 2011)].

[13] Because of the adoption of new Rule 506(c), the disqualification provisions we adopt today, which were proposed as Rule 506(c), will be adopted and codified as Rule 506(d).

subject to mandatory disclosure) and also reflect some changes in response to comments.

Rule 506 is one of three exemptive rules for limited offerings under Regulation D.[14] It is by far the most widely used Regulation D exemption, accounting for an estimated 90% to 95% of all Regulation D offerings [15] and the overwhelming majority of capital raised in transactions under Regulation D.[16] Rule 506 permits sales of an unlimited dollar amount of securities to be made without Securities Act registration, provided that the requirements of the rule are satisfied.

Rule 506 historically has permitted sales to an unlimited number of accredited investors [17] and up to 35 non-accredited investors, so long as there was no general solicitation, appropriate resale limitations were imposed, any applicable information requirements were satisfied, and the other conditions of the rule were met.[18] Section 201(a) of the Jumpstart Our Business Startups Act (''JOBS Act'') required the Commission to eliminate the prohibition against general solicitation and general advertising for offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify their accredited investor status.[19] In a separate release today, we are adopting amendments to Rule 506 and Form D, including adding new paragraph (c) to Rule 506 to implement JOBS Act Section 201(a).[20] As a result, offers and sales of securities involving the use of general solicitation will be permitted under Rule 506, provided that the requirements of new Rule 506(c) are satisfied.

''Bad actor'' disqualification requirements, sometimes called ''bad boy'' provisions, disqualify securities offerings from reliance on exemptions if the issuer or other relevant persons (such as underwriters, placement agents and the directors, officers and significant shareholders of the issuer) have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws. Rule 506 in its current form does not impose any bad actor disqualification requirements.[21] In addition, because securities sold under Rule 506 are ''covered securities'' under Section 18(b)(4)(D) of the Securities Act, state-level bad actor disqualification rules do not apply.[22]

Section 926 of the Dodd-Frank Act instructs the Commission to issue disqualification rules for Rule 506 offerings that are ''substantially similar'' to the bad actor disqualification provisions contained in Rule 262 of Regulation A,[23] and also provides an expanded list of disqualifying events, including certain actions by state regulators, enumerated in Section 926. The disqualifying events listed in Rule 262 cover the issuer and certain other persons associated with the issuer or the offering, including: issuer predecessors and affiliated issuers; directors, officers and general partners of the issuer; beneficial owners of 10% or more of any class of the issuer's equity securities; promoters connected with the issuer; and underwriters and their directors, officers and partners. Rule 262 disqualifying events include:

- Felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission (the same criminal conviction standard as in Section 926 of the Dodd-Frank Act) within the last five years in the case of issuers and ten years in the case of other covered persons;
- Injunctions and court orders within the last five years against engaging in or continuing conduct or practices in

[14] The others are Rule 504 and Rule 505, 17 CFR 230.504 and 230.505. Rule 504 permits offerings of up to $1 million of securities by issuers that are not (i) reporting companies under the Securities Exchange Act of 1934, (ii) investment companies or (iii) development stage companies with no specific business plan or purpose, or whose business plan is to engage in a merger or acquisition with an unidentified entity or entities. Offerings under Rule 504 must generally comply with Regulation D requirements regarding limitations on manner of sale (no general solicitation) and limitations on resale. The manner of sale and resale limitations do not apply, however, to offerings that are subject to state-level registration or that rely on state law exemptions permitting general solicitation so long as sales are made only to accredited investors. Rule 505 permits offerings of up to $5 million of securities annually, without general solicitation, to an unlimited number of accredited investors and up to 35 non-accredited investors. Rule 505 offerings are subject to the same conditions as apply to Rule 506 offerings, which are described elsewhere, except that non-accredited investors are not required to be sophisticated and such offerings are subject to bad actor disqualification provisions.

[15] In 2012, the Commission received 18,187 initial filings for offerings under Regulation D, of which 17,203 (approximately 95%) claimed a Rule 506 exemption.

[16] Staff of the Commission's Division of Economic and Risk Analysis estimates that, for 2009, 2010, 2011 and 2012, approximately $607 billion, $1.003 trillion, $850 billion and $899 billion, respectively, was raised in transactions claiming the Rule 506 exemption, in each case representing more than 99% of funds raised under Regulation D for the period, based on Form D filings with the Commission. The amount of capital raised through offerings under Regulation D and the number of Regulation D offerings may be considerably larger than what is disclosed in Form D filings because the filing of a Form D notice is a requirement of Rule 503(a) of Regulation D [17 CFR 230.503(a)], but is not a condition to the availability of the exemptions of Regulation D. We understand that some issuers, therefore, may not make Form D filings for offerings made in reliance on Regulation D. Further, once a Form D filing is made, the issuer is not required to file an amendment to reflect a change that occurs after the offering terminates or a change that occurs solely with respect to certain information, such as the amount sold in the offering. For example, if the amount sold does not exceed the offering size by more than 10% or the offering closes before a year has passed, the filing of an amendment to Form D would not necessarily be required. Therefore, the Form D filings for an offering may not reflect the total amount of securities sold in the offering in reliance on the exemption.

[17] Rule 501 of Regulation D lists eight categories of ''accredited investor,'' including entities and natural persons that meet specified income or asset thresholds. *See* 17 CFR 230.501.

[18] Except as provided under new Rule 506(c), offerings under Rule 506 are subject to all the terms and conditions of Rules 501 and 502, including applicable limitations on the manner of offering, limitations on resale and, if securities are sold to any non-accredited investors, specified information requirements. Where securities are sold only to accredited investors, the information requirements do not apply. *See* 17 CFR 230.502 and 230.506. In addition, any non-accredited investors must satisfy the investor sophistication requirements of Rule 506(b)(2)(ii). Offerings under Rule 506 must also comply with the notice of sale requirements of Rule 503. *See* 17 CFR 230.503.

[19] *See* Public Law 112–106, sec. 201(a), 126 Stat. 306, 313 (Apr. 5, 2012).

[20] *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings,* Release No. 33–9415 (July 10, 2013).

[21] Rule 507 of Regulation D imposes a different kind of disqualification specific to Regulation D offerings. Under Rule 507, any person that is subject to a court order, judgment or decree enjoining such person for failure to file the notice of sale on Form D required under Rule 503 is disqualified from relying on Regulation D. 17 CFR 230.507(a). We are not amending Rule 507 at this time but, in a separate release the Commission is issuing today, we are proposing amendments to Rule 507 that would disqualify an issuer from reliance on Rule 506 if the issuer or its predecessor or affiliates had conducted a previous securities offering in reliance on Rule 506 without complying with the Form D filing requirements of Rule 503. *See Amendments to Regulation D, Form D, and Rule 156,* Release No. 33–9416 (July 10, 2013).

[22] *See* 15 U.S.C. 77r(b)(4)(D). This provision of Section 18 was added by Section 102(a) of the National Securities Markets Improvement Act of 1996, Pub. L. No. 104–290,110 Stat. 3416 (Oct. 11, 1996) (''NSMIA''). NSMIA preempts state registration and review requirements for transactions involving ''covered securities,'' which include securities offered or sold in transactions that are exempt from registration under Commission rules or regulations issued under Securities Act Section 4(a)(2) (formerly Section 4(2)). Rule 506 was originally adopted as a safe harbor under Section 4(a)(2). Section 201(a) of the JOBS Act provides that Rule 506, as amended in accordance with the mandate of that provision, ''shall continue to be treated as a regulation issued under'' Section 4(a)(2) of the Securities Act.

[23] 17 CFR 230.262. Regulation A (17 CFR 230.251 through 230.263) is a limited offering exemption that permits public offerings of securities not exceeding $5 million in any 12-month period by companies that are not required to file periodic reports with the Commission. Regulation A offerings are required to have an offering circular containing specified information, which is filed with the Commission and subject to review by the staff of the Division of Corporation Finance.

connection with the purchase or sale of securities, or involving the making of any false filing with the Commission;

- U.S. Postal Service false representation orders within the last five years;
- Filing, or being named as an underwriter in, a registration statement or Regulation A offering statement that is the subject of a proceeding to determine whether a stop order should be issued, or as to which a stop order was issued within the last five years; and
- For covered persons other than the issuer:
  - ○ being subject to a Commission order:
    - ▪ revoking or suspending their registration as a broker, dealer, municipal securities dealer, or investment adviser;
    - ▪ placing limitations on their activities as such;
    - ▪ barring them from association with any entity; or
    - ▪ barring them from participating in an offering of penny stock; or
  - ○ being suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or national securities association for conduct inconsistent with just and equitable principles of trade.

The disqualifying events specifically required by Section 926 are:

- Final orders issued by state securities, banking, credit union, and insurance regulators, federal banking regulators, and the National Credit Union Administration that either
  - ○ bar a person from association with an entity regulated by the regulator issuing the order, or from engaging in the business of securities, insurance or banking, or from savings association or credit union activities; or
  - ○ are based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within a ten-year period; and
- Felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission.

On May 25, 2011, we proposed amendments to Rules 501 and 506 of Regulation D and Form D to implement Section 926.[24] We received 44 comment letters in response to our proposal.[25] In addition, we received three advance comment letters commenting on Section 926 before the publication of the proposing release.[26] These comment letters and advance comment letters came from a variety of individuals, groups and constituencies, including state securities regulators, professional and trade associations, lawyers, academics and individual investors. Most commenters expressed general support for the proposed amendments and the objectives that we articulated in the proposing release, but many suggested modifications to the proposals.

Today we are adopting amendments to Rules 501 and 506 of Regulation D and to Form D to implement Section 926 of the Dodd-Frank Act.[27] The amendments we are adopting are generally consistent with the proposal, with the following principal differences:

- Disqualification will apply only for triggering events that occur after the effective date of the amendments; however, pre-existing matters will be subject to mandatory disclosure;
- The rule includes additional disqualifying events for certain orders of the Commodity Futures Trading Commission (''CFTC'') and for Commission cease-and-desist orders arising out of scienter-based anti-fraud violations and violations of Section 5 of the Securities Act;
- Instead of covering all officers of the issuer and of any compensated solicitors of purchasers of securities, the rule is limited to executive officers and officers who participate in the offering;
- Rather than covering beneficial owners of 10% or more of any class of the issuer's securities, the rule covers beneficial owners of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;
- For issuers that are pooled investment funds, the rule covers the funds' investment managers and their principals; and
- Disqualification will not apply if the authority issuing the relevant judgment, order or other triggering directive or statement determines and advises the Commission that disqualification from reliance on Rule 506 should not arise as a result.

Part III of the proposing release requested comment on a number of potential further rule amendments that would result in more uniform bad actor disqualification rules, including the application of the new bad actor disqualification standards to offerings under Regulation A, Regulation E and Rules 504 and 505 of Regulation D. Commenters were divided in their views with respect to uniform bad actor standards. Some commenters supported uniformity on the basis that it would enhance investor protection, increase clarity and consistency in our regulations and avoid the creation of opportunities for regulatory arbitrage.[28] Others opposed it, generally arguing that attempts to impose uniformity would be premature or inappropriate given the limits of the Dodd-Frank Act mandate, and that uniformity should be considered, if at all, in a separate rulemaking.[29]

We note that the JOBS Act requires us to adopt rules for two new exemptions from the Securities Act—one for ''crowdfunding'' offerings, contained in Title III of the JOBS Act, and one for offerings of up to $50 million in a 12-month period under Section 3(b) of the Securities Act, contained in Title IV of the JOBS Act. The statutory requirements for these exemptions contemplate bad actor disqualifications with language similar to that in Section 926 of the Dodd-Frank Act.[30] We are

[24] *See Disqualification of Felons and Other ''Bad Actors'' from Rule 506 Offerings,* Release No. 33–9211 (May 25, 2011) [76 FR 31518 (June 1, 2011)].

[25] The comment letters we received on the proposal are available on our Web site at *http://www.sec.gov/comments/s7-21-11/s72111.shtml.* In this release, we refer to these letters as the ''comment letters'' to differentiate them from the ''advance comment letters'' described in note 26.

[26] To facilitate public input on its Dodd-Frank Act rulemaking before issuance of rule proposals, the Commission provided a series of email links, organized by topic, on its Web site at *http://www.sec.gov/spotlight/regreformcomments.shtml.* In this release, we refer to comment letters we received on this rulemaking project in response to this invitation as ''advance comment letters.'' These advance comment letters appear on the Commission's Web site under the heading ''Adding Disqualification Requirements to Regulation D Offerings, Title IX Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.''

[27] We are also adopting technical amendments to Rules 145, 147, 152 and 155 to update references to Section 4(2) of the Securities Act, which was renumbered as Section 4(a)(2) by Section 201(c) of the JOBS Act, Public Law 112–106, sec. 201(c), 126 Stat. 306, 314 (Apr. 5, 2012).

[28] *See* comment letters from the Federal Regulation of Securities Committee, Business Law Section of the American Bar Association (Oct. 4, 2011) (''ABA Fed. Reg. Comm.''); Chris Barnard (June 1, 2011) (''C. Barnard''); North American Securities Administrators Association, Inc. (July 25, 2011) (''NASAA''); SNR Denton LLC on behalf of The Depository Trust & Clearing Corporation (July 14, 2011) (''DTC''); Better Markets, Inc. (July 14, 2011) (''Better Markets''); Whitaker Chalk Swindle & Schwartz, PLLC (July 30, 2011 (''Whitaker Chalk''); and Professor J. Robert Brown, Jr. (Feb. 1, 2012).

[29] *See* comment letters from the Committee on Securities Regulation of the New York City Bar Association (July 14, 2011) (''NYCBA''); Cravath, Swaine & Moore LLP, Davis Polk & Wardwell LLP, Gibson, Dunn & Crutcher LLP, Skadden, Arps, Slate, Meagher & Flom LLP and Wilmer Cutler Pickering Hale and Dorr LLP (July 14, 2011) (''Five Firms''); SW. Coy Capital, Inc. (July 13, 2011) (''Coy Capital'').

[30] For crowdfunding, the Commission is directed to adopt rules establishing disqualification provisions for issuers, brokers and funding portals seeking to participate in crowdfunding transactions. The requirement in Section 302(d) of the JOBS Act

working on separate rulemakings for these new exemptions. In light of these additional rulemakings, we have decided to limit the disqualification provisions adopted today to Rule 506 offerings. At the time of those rulemakings, we will have an opportunity to consider to what extent any bad actor disqualification provisions to be adopted in connection with those rules should differ from those applicable to Rule 506 offerings. At a later time, we will also have an opportunity to consider to what extent bad actor disqualifications currently applicable to Regulation A and Rule 505 offerings should be more uniform or similar to those applicable to Rule 506 offerings.

II. Discussion of the Final Amendments

A. Introduction

Section 926(1) of the Dodd-Frank Act requires the Commission to adopt disqualification rules that are substantially similar to Rule 262, the bad actor disqualification provisions applicable to offerings under Regulation A, and that also cover the triggering events specified in Section 926. In general, we understand this mandate to mean that the provisions we adopt to implement Section 926 should have similar effects as Rule 262, except to the extent that circumstances, such as the different context for the use of Rule 506 compared to Regulation A and the need to update or otherwise revise the provisions of Regulation A, dictate a different approach.

B. Covered Persons

We proposed amendments to Rule 506 of Regulation D to apply the disqualification provisions required under Section 926 to the following categories of persons:

- The issuer and any predecessor of the issuer or affiliated issuer;
- Any director, officer,[31] general partner or managing member of the issuer;
- Any beneficial owner of 10% or more of any class of the issuer's equity securities;
- Any promoter connected with the issuer in any capacity at the time of the sale;
- Any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with sales of securities in the offering; and
- Any director, officer, general partner, or managing member of any such compensated solicitor.[32]

The proposal reflected the categories currently covered by Rule 262 of Regulation A, with two modifications. First, because Rule 506 transactions may involve the use of persons paid for solicitation of purchasers, such as placement agents and finders, rather than traditional underwriters, we added compensated solicitors as a category of covered persons.[33] In addition, we proposed to add managing members to the list of directors, officers and general partners of the issuer and any underwriter or compensated solicitor to standardize the treatment of controlling persons of limited liability companies for disqualification purposes.

In the proposing release, we solicited comment on whether the rules should cover a broader or narrower group of persons. We specifically requested comment on whether the new disqualification provisions should cover all officers of issuers and covered financial intermediaries, as Rule 262 currently does, or only some officers (such as executive officers[34] and/or officers actually participating in the offering). We also requested comment on a variety of possible modifications to the scope of the coverage of shareholders and the possible inclusion of investment advisers of pooled investment funds.

Officers. Commenters generally supported limiting the coverage of the disqualification provisions to executive officers rather than all officers, citing such issues as the policy benefits of focusing on role rather than title;[35] the fact that executive officers of an issuer are recognized within Regulation D as ''accredited investors'' by virtue of their participation in the policy-making functions of the issuer;[36] the fact that certain entities have a large number of titular officers who do not have a policy or decision-making role or any involvement in the relevant offerings;[37] the potentially heavy compliance burden associated with broad application, which may make it difficult for issuers to meet a ''reasonable care'' standard;[38] and the obligation it would create for compensated solicitors to disclose the identities of their employees to issuers.[39] Some commenters argued for limiting the rule further as it applies to executive officers of compensated solicitors, and covering only executive officers that are engaged in the relevant private placement activities[40] or that are responsible for the approval or supervision of Rule 506 offerings.[41]

Two commenters advocated that the new rules mirror Rule 262's coverage of ''officers,'' as proposed.[42] These commenters argued both that a rule ''substantially similar'' to Rule 262 must include officers and that, based on the presumption of control that attaches to officers, the ability of officers to set the tone of an organization and the risk that any officer may be involved with any given offering, coverage of ''officers'' is needed for the protection of investors.

We also requested comment on whether the coverage of ''officers'' should be limited to officers who participate in or are involved with the offering. Two commenters addressed this point, acknowledging that it may be appropriate to cover participating officers to address investor protection concerns[43] and that doing so may be preferable to covering all officers.[44] Both commenters, however, expressed concern about the potential difficulty of determining which officers were

is identical to the language of Section 926 of the Dodd-Frank Act. For the new $50 million offering exemption, Section 401(b)(2) of the JOBS Act states that the Commission may require the issuer to meet certain conditions including disqualification provisions that are substantially similar to the disqualification provisions contained in regulations adopted in accordance with Section 926 of the Dodd-Frank Act, which we are adopting today.

[31] Under Rule 405, the term ''officer'' is defined as ''a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization.'' 17 CFR 230.405. This definition is applicable to Rule 262 by virtue of Rule 261, 17 CFR 230.261.

[32] *See* Release No. 33–9211, Part II.B (May 25, 2011).

[33] This is modeled on the disqualification provisions for offerings under Rule 505 which, like Rule 506 offerings, may involve the use of placement agents and finders, rather than traditional underwriters. *See* 17 CFR 230.505(b)(2)(iii)(B).

[34] The term ''executive officer'' is defined in Rule 501(f) of Regulation D (and in Rule 405) to mean a company's ''president, any vice president . . . in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions.'' 17 CFR 230.501(f), 230.405.

[35] *See* comment letters from DTC; NYCBA; Sullivan & Cromwell LLP (July 14, 2011) (''S&C'').

[36] *See* comment letter from ABA Fed. Reg. Comm.

[37] *See* comment letters from ABA Fed. Reg. Comm.; S&C; Cleary Gottlieb Steen & Hamilton LLP (July 14, 2011) (''Cleary Gottlieb''); Lehman & Eilen LLP (July 14, 2011) (''Lehman & Eilen'').

[38] *See* comment letters from ABA Fed. Reg. Comm.; Cleary Gottlieb; Five Firms; S&C; *see also* comment letter from Kutak Rock LLP (July 8, 2011) (''Kutak Rock'') (noting that a narrower rule would be more workable).

[39] *See* comment letter from Cleary Gottlieb.

[40] *See* comment letters from ABA Fed. Reg. Comm.; NYCBA.

[41] *See* comment letter from Lehman & Eilen.

[42] *See* comment letters from Better Markets; NASAA.

[43] *See* comment letter from Cleary Gottlieb.

[44] *See* comment letter from S&C.

actually involved with or participating in an offering.[45]

We agree with the majority of commenters that, in the context of Rule 506 offerings, an ''officer'' test based solely on job title would be unduly burdensome and overly restrictive. Consequently, the final rule covers only executive officers of covered entities and officers who participate in the offering. We believe that this coverage is an appropriate adaptation of the Rule 262 list of covered persons, taking into account the larger and more complex organizations that are involved in many Rule 506 transactions [46] as compared to the smaller entities that have used Regulation A, and, on that basis, this provision of the final rule is ''substantially similar'' to Rule 262. We note that the term ''officer'' in Rule 262 was used as early as 1955, before we adopted the ''executive officer'' concept that we use in several of our rules.[47] It also reflects a consideration of costs and benefits, focusing on situations where the risks that Section 926 is intended to address are at their most pronounced (when bad actors are performing policy-making functions or are personally involved with a securities offering) while alleviating the potential compliance burden by limiting covered persons to a more manageable number who should generally be easier to identify.

Many issuers will already have determined who their executive officers are (among other reasons, to provide disclosure about executive officers in the offering materials), and the officers participating in an offering will be a question of fact. Participation in an offering would have to be more than transitory or incidental involvement, and could include activities such as participation or involvement in due diligence activities, involvement in the preparation of disclosure documents, and communication with the issuer, prospective investors or other offering participants. We anticipate that issuers should be able to determine which of their own officers are participating in an offering without undue difficulty, and can exercise control over which officers participate. We also believe that it is reasonable to expect that compensated solicitors should be prepared to confirm which of their officers are participating in an offering as part of any engagement.

Beneficial Owners of Issuer Equity Securities. The inclusion of holders of 10% or more of any class of the issuer's equity securities as covered persons was one of the areas of the proposing release that attracted the most comment. The majority of commenters did not support the inclusion of 10% beneficial owners as covered persons for purposes of the Rule 506 disqualification provisions.[48] Several commenters identified a range of potential burdens and costs issuers would face in identifying 10% beneficial owners. They described the inclusion of 10% beneficial owners in the context of Rule 506 offerings as unduly burdensome,[49] with 10% holders potentially a ''moving target'' for issuers engaged in continuous sales and regular redemptions.[50] Others pointed out that a person could acquire 10% or more of a class of securities while having no input or control over the company's management, or even having an adversarial relationship with management.[51] One commenter questioned whether public companies would be able to comply with the rule.[52] Two commenters urged the Commission not to include beneficial owners as covered persons at all in the new disqualification rule.[53] Some commenters suggested higher ownership thresholds, from 20% to majority ownership [54] or a test based on actual control,[55] while others argued against an actual control test and in favor of a bright-line standard based on a stated percentage of ownership.[56]

Some commenters also supported including only voting equity securities, rather than all equity securities, in determining which securityholders should be covered persons, generally arguing that only voting interests confer control.[57] More specifically, one commenter recommended that the disqualification provision incorporate the definition of ''voting security'' contained in Section 2(a)(42) of the Investment Company Act,[58] which includes only securities presently entitling the holder to vote for the election of directors, so that these rules would apply only to a beneficial owner of equity securities of an issuer who was entitled to vote for the election of directors (or their equivalents) of the issuer.[59] Another suggested that the provision be limited to voting securities, including general partner and managing member interests, and exclude passive interests.[60]

Other commenters supported the proposed inclusion of 10% beneficial owners of any class of the issuer's equity securities, based on their presumptive control of the issuer and the mandate to adopt rules that are ''substantially similar'' to Rule 262, which covers 10% beneficial owners.[61]

We are persuaded, with the majority of commenters, that the Rule 262 standard of 10% ownership of any class of the issuer's equity securities could be overinclusive, pulling in securityholders who do not control the activities of the issuer and whose prior bad conduct may not reflect on the issuer or the current offering. It may

[45] *See* comment letters from Cleary Gottlieb; S&C.

[46] There is no cap on the amount of proceeds that may be raised in an offering relying on Rule 506, and many Rule 506 offerings are larger—in some cases, considerably larger—than would be permitted under the $5 million aggregate proceeds cap of Regulation A. For 2012, approximately 41% of Rule 506 offerings raised more than $5 million, 14% raised more than $50 million and 10% raised more than $100 million.

[47] *See Revision and Consolidation of Regulation A and Regulation D,* Release No. 33–3555 (July 18, 1955) [20 FR 5401 (July 28, 1955)].

[48] *See* comment letters from ABA Fed. Reg. Comm.; Cleary Gottlieb; Five Firms; Lehman & Eilen; NYCBA; S&C; Whitaker Chalk; the Investment Program Association (July 14, 2011) (''IPA''); Katten Muchin Rosenman LLP (July 14, 2011) (''Katten Muchin''); the Real Estate Investment Securities Association (July 14, 2011) (''REISA''); Seward & Kissel (July 20, 2011) (''Seward & Kissel''); the Securities Industry and Financial Markets Association (July 14, 2011) (''SIFMA'').

[49] *See* comment letter from Seward & Kissel.

[50] *See* comment letters from ABA Fed. Reg. Comm.; IPA.

[51] *See* comment letter from Lehman & Eilen; *see also* comment letters from ABA Fed. Reg. Comm.; Five Firms; S&C.

[52] *See* comment letter from ABA Fed. Reg. Comm. (pointing out that 10% beneficial owners have no obligation to disclose whether they are bad actors).

[53] *See* comment letters from ABA Fed. Reg. Comm.; Seward & Kissel.

[54] *See* comment letters from ABA Fed. Reg. Comm. (25% ownership threshold, consistent with the ''control'' presumption in Section 2(a)(5) of the Investment Company Act); NYCBA (20% or 25%); IPA (20%); Lehman & Eilen (25%, consistent with the thresholds used in other contexts under the federal securities laws, including Form BD); Cleary Gottlieb (20%, consistent with the level at which reporting as a ''passive'' investor under Regulation 13D–G is no longer permitted); S&C (25%, consistent with the ''control'' presumptions in Form BD and Section 2(a)(9) of the Investment Company Act); Whitaker Chalk (at least 25%, and disregard if there is a controlling shareholder or group); SIFMA (at least 25%, which would accord with Form BD and Section 2(a)(9) of the Investment Company Act, but would prefer 50%); Seward & Kissel (if coverage of shareholders cannot be eliminated, increase threshold to a majority).

[55] *See* comment letters from Kutak Rock; REISA; Five Firms; *see also* comment letters from Whitaker Chalk (advocating use of the ''affiliate'' standard in Rule 144) *and* Seward & Kissel (remove 10% beneficial owners from the list of covered persons, or increase the ownership threshold to a majority interest).

[56] *See* comment letters from Cleary Gottlieb; NYCBA; S&C.

[57] *See* comment letters from ABA Fed. Reg. Comm.; Kutak Rock; Lehman & Eilen; NYCBA; Whitaker Chalk; *see also* Seward & Kissel (objecting to the disqualification of pooled investment funds based on the conduct of a 10% passive equity owner).Comment letter from NYCBA.

[58] 15 U.S.C. 80a–2(a)(42).

[59] *See* comment letter from ABA Fed. Reg. Comm.

[60] *See* comment letter from NYCBA.

[61] *See* comment letters from Better Markets; DTC; NASAA; Bybel Rutledge LLP (July 11, 2011) (''Rutledge'').

therefore impose costs and burdens that are not justified in relation to the potential benefits. We considered in particular the underlying objectives of the bad actor rules, as well as the potential administrative complexity of monitoring fluctuating ownership levels resulting from continuous sales or regular redemptions by certain issuers, and an issuer's inability to control the actions of an adversarial or non-compliant securityholder who does not disclose whether its relationship to the issuer may trigger disqualification.

We agree with most commenters that it would be appropriate to limit the coverage of securityholders under new Rule 506(d) to those having voting rights. In light of the range of possible structures and control arrangements among issuers relying on Rule 506, however, we have not adopted a specific definition of ''voting securities.'' We intend that the term should be applied based on whether securityholders have or share the ability, either currently or on a contingent basis, to control or significantly influence the management and policies of the issuer through the exercise of a voting right.[62] For example, we would consider that securities that confer to securityholders the right to elect or remove the directors or equivalent controlling persons of the issuer, or to approve significant transactions such as acquisitions, dispositions or financings, would be considered voting securities for purposes of the rule. Conversely, securities that confer voting rights limited solely to approval of changes to the rights and preferences of the class would not be considered voting securities for purposes of the rule.

We are also concerned that measuring ownership based on the percentage beneficial ownership of any class of an issuer's securities, rather than of the issuer's total outstanding securities, may be both overinclusive and underinclusive. Where a class of securities represents a very small percentage of the issuer's outstanding equity securities or voting power, even a large percentage ownership of the class may not confer the kind of control or influence over the issuer that the bad actor disqualification rules are intended to address. At the same time, in the case of a class of supervoting or high vote securities, ownership of a relatively small percentage of that class may carry with it control over a relatively large percentage of total voting power. Accordingly, rather than including beneficial owners of any class of the issuer's equity securities, the final rule includes beneficial owners of a specified percentage of the issuer's total outstanding voting equity securities, calculated on the basis of voting power. This change will focus the rule on securityholders that have or share the ability to direct a substantial portion of a vote, and will avoid the potential overinclusiveness and underinclusiveness of a share-based or class-based calculation.

After considering commenters' concerns, we have also determined to raise the beneficial ownership threshold from 10% to 20%, which we believe is a reasonable and measured approach in the context of Rule 506 offerings that preserves investor protection and provides an efficient and clear ''bright-line'' test.[63]

Accordingly, the rules we adopt today cover beneficial owners of 20% or more of the issuer's outstanding equity securities, calculated on the basis of voting power, rather than 10% beneficial owners of any class of securities, as originally proposed.

We considered, but are not adopting, a standard based on actual control of the issuer. We share the concern voiced by some commenters[64] that a facts-and-circumstances based standard such as actual control would significantly increase the burden of inquiry associated with determining whether an offering was disqualified, and may give rise to unnecessary cost and uncertainty in the application of Rule 506(d). We believe that keeping a ''bright-line'' standard based on a specified level of ownership reduces the burden of compliance and responds to the statutory mandate to adopt a rule that is ''substantially similar'' to Rule 262.

Assessing beneficial share ownership based on ownership of total outstanding voting securities, based on voting power, rather than ownership of any class, and increasing the ownership threshold from 10% to 20% should ease the burden of compliance because there will be fewer beneficial owners to track. Nevertheless, we do not believe that the change will diminish the investor protection benefits of Rule 506(d) in the circumstances posing the highest potential risk to investors, when securityholders exercise actual control over the issuer, because such securityholders are likely to be covered persons in some other capacity. Under the functional definitions of ''director'' and ''executive officer,'' anyone who performs the functions of a director; controls a principal business unit, division or function of the issuer or performs policy making functions for the issuer will be a covered person as a director or executive officer of the issuer. In addition, as discussed below, shareholders that are ''promoters'' involved with the issuer will be covered in that capacity.

Investment Managers of Pooled Investment Funds. After further consideration and review of comment letters, we have determined to expand the list of covered persons to include investment managers[65] of issuers that are pooled investment funds; the directors, executive officers, other officers participating in the offering, general partners and managing members of such investment managers; and the directors and executive officers of such general partners and managing members and their other officers participating in the offering.[66] We requested comment on whether to include investment advisers of private funds, but did not propose to include them. Three commenters supported such an expansion to promote investor protection,[67] while six opposed it on a variety of bases, including that investment advisers are already subject to fiduciary duties and an extensive regulatory regime;[68] that persons who actually control a pooled investment fund issuer would likely be covered in other capacities, for example as promoters or through a position with

[62] We note that securityholders that have the ability to control or significantly influence the management and policies of the issuer through other means will generally be covered by Rule 506(d) in another capacity, such as, for example, as the functional equivalent of an ''executive officer'' or ''director'' of an issuer.

[63] We note that the 20% threshold aligns with the level of ownership at which filing as a ''passive investor'' on Schedule 13G under Regulation 13D–G is no longer permitted. *See* 17 CFR 230.13d–1(c).

[64] *See* comment letters from Cleary Gottlieb; NYCBA; S&C.

[65] We are using the term ''investment manager,'' rather than ''investment adviser'' as discussed in the proposing release. Under Section 202(a)(11) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–2(a)(11)] ''(the ''Advisers Act'')'', an ''investment adviser'' is generally a person or firm that, for compensation, is engaged in the business of providing advice, making recommendations, issuing reports, or furnishing analyses on securities. Some pooled investment funds invest in assets other than securities, such as commodities, real estate and certain derivatives. In order to ensure that Rule 506(d) covers the control persons of these funds, we are using a more general term, which encompasses both investment advisers and other investment managers.

[66] We are not adopting a definition of the term ''pooled investment fund'' as it is used in Rule 506(d). The term has been used in Form D for years in its ordinary and commonly understood sense, and we intend to use it in Rule 506(d) in the same way. The term should not be confused with ''pooled investment vehicle,'' a term defined more narrowly in Rule 206(4)–8 under the Advisers Act, 17 CFR 275.206(4)–8.

[67] *See* comment letters from Better Markets; DTC; NASAA.

[68] *See* comment letters from ABA Fed. Reg. Comm.; SIFMA; Whitaker Chalk.

the fund's general partner;[69] and that extending the rule in this way would be premature, would require a separate rulemaking project or would violate the ''substantially similar'' requirement.[70] We agree that, depending on the circumstances, investment managers that actually control a pooled investment fund may already be covered persons as ''promoters'' (a concept discussed in greater detail below), or as ''directors'' or ''executive officers'' of the issuer. We also note that the regulation of investment advisers has been subject to recent change, so that many investment managers to pooled investment funds that invest in securities are subject to new reporting and other obligations.[71] As a result of our reconsideration and review of the comment letters, however, we have determined to include investment managers to pooled investment funds and their principals as covered persons in the Rule 506 disqualification rules.[72]

Most operating companies making Rule 506 offerings are corporations or limited liability companies that function through their officers, directors and managing members. By comparison, most pooled investment funds making Rule 506 offerings are partnerships or other flow-through entities that have few, if any, employees, and function through their investment managers and the managers' personnel. In order to provide equivalent treatment of operating companies and pooled investment funds, the final rule establishes a new ''bright-line'' category of presumed control persons for pooled investment fund issuers. This should make the final rule clearer and easier to apply, and will more effectively protect investors from bad actors that exercise influence or control over a pooled investment fund.

Some commenters argued that adding fund investment managers was unnecessary, given that fund investment advisers are generally subject to regulation either at the state or the federal level. We believe our Securities Act disqualification rules are, in many respects, designed to supplement and build upon other enforcement and regulatory efforts. For instance, registered broker-dealers subject to limitations on their activities as a result of disciplinary proceedings could separately be disqualified from participating in a Rule 506 offering under the amendments we adopt today. We do not believe that the regulatory scheme to which a pooled investment fund's investment manager may be subject is a substitute for bad actor disqualification.

We appreciate that the bad actor provisions in Rule 262 do not cover investment managers of issuers that are pooled investment funds. Regulation A, however, is generally not available to or used by pooled investment funds,[73] so its disqualification provisions do not have to address the structure and governance arrangements typical of pooled investment fund issuers. Analogous disqualification rules under the Securities Act and the Investment Company Act do, however, include investment managers of pooled investment funds. For example, the disqualification provisions of Regulation E (which, like Regulation A, is an exemption from registration under Section 3(b)(1) of the Securities Act,[74] but is designed for use by pooled investment funds and similar entities) include as covered persons both the investment adviser to a pooled investment fund issuer as well as partners, directors, and officers of the investment adviser.[75] Similarly, Section 9(a) of the Investment Company Act automatically disqualifies investment advisers of registered investment companies (and certain affiliated persons) based on criminal convictions and certain court orders.[76]

We also recognize that, depending on the circumstances, some investment managers of pooled investment funds and certain of their personnel would be covered already under Rule 506(d), even if we did not expand the coverage of the rule. For example, some investment manager firms would be deemed to be ''promoters'' of a pooled investment fund issuer, and some of their individual principals would be deemed the functional equivalent of ''directors,'' ''executive officers'' or ''promoters'' of the issuer. Nevertheless, since we have concluded that such persons should be covered, we believe it is preferable to cover them directly, rather than indirectly. This treatment will avoid the necessity for issuers or others to engage in a potentially time-consuming, fact-intensive inquiry to determine whether or not they are within another category of covered persons.

Promoters. Although ''promoters'' are included as covered persons in Rule 262[77] and were included as covered persons in the proposed rules for that reason, three commenters raised questions about the treatment of promoters under the new disqualification rules.[78] One suggested that directors, executive officers, general partners and managing members of promoters be included, so that promoters would be addressed in the rule in the same way as issuers and compensated solicitors.[79] The second questioned whether inclusion was necessary given the breadth of the other categories of covered persons, but suggested that if promoters are included, the term should be defined so as to include only persons who are involved with the offering and have a material financial interest in its outcome (or at a minimum, the rule should be revised to make clear that fund investment advisers are not deemed to be promoters).[80] The third argued that promoters should not be covered persons unless they are involved in the day-to-day management of the issuer or will be paid remuneration for the solicitation of purchasers.[81]

We determined not to make any changes in the definition or coverage of promoters. The category of ''promoter'' is broad, and captures all individuals and entities that have the relationships with the issuer or to the offering specified in Rule 405.[82] In particular, the definition requires issuers to look through entities and makes it

[69] *See* comment letter from Katten Muchin;

[70] *See* comment letters from Lehman & Eilen; Rutledge.

[71] *See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF,* Release No. IA–3308 (Oct 31, 2011) [76 FR 71128]; *Rules Implementing Amendments to the Investment Advisers Act of 1940,* Release No. IA–3221 (June 22, 2011) [76 FR 42950].

[72] *See* Rule 506(d)(1).

[73] Regulation A by its terms is not available to any pooled investment fund that is an ''investment company registered or required to be registered under the Investment Company Act of 1940.'' 17 CFR 230.251(a)(4). As a practical matter, it is not available to other pooled investment funds because most such funds attempt to maintain that status under either Section 3(c)(1) or Section 3(c)(7) of that statute, which prohibits them from engaging in public offerings like those under Regulation A. *See* Investment Company Act secs. 3(c)(1), 3(c)(7), 15 U.S.C. 80a–3(c)(1), 80a–3(c)(7).

[74] 15 U.S.C. 77c(b)(1).

[75] 17 CFR 230.602(c).

[76] *See* 15 U.S.C. 80a–9(a).

[77] Rule 262(b) covers ''any promoter of the issuer presently connected with it in any capacity.'' The term ''promoter'' is defined in Rule 405 to mean any person who: (i) Acting alone or together with others, directly or indirectly takes initiative in founding or organizing the business or enterprise of an issuer; or (ii) in connection with the founding or organization of the business or enterprise of an issuer, directly or indirectly receives 10% or more of any class of issuer securities or 10% or more of the proceeds from the sale of any class of issuer securities (not including securities received solely as underwriting commissions or solely in exchange for property). The Rule 405 definition applies to Rule 262 by virtue of Rule 261. 17 CFR 230.261.

[78] *See* comment letters from Cleary Gottlieb; SIFMA; S&C.

[79] *See* comment letter from Cleary Gottlieb.

[80] *See* comment letter from S&C.

[81] *See* comment letter from SIFMA.

[82] *See* note 77.

unnecessary for us to separately cover the officers, directors and other control persons of entities that qualify as promoters. Rule 405 defines a promoter as any person—individual or legal entity—that either alone or with others, directly or indirectly takes initiative in founding the business or enterprise of the issuer, or, in connection with such founding or organization, directly or indirectly receives 10% or more of any class of issuer securities or 10% or more of the proceeds from the sale of any class of issuer securities (other than securities received solely as underwriting commissions or solely in exchange for property). The test considers activities ''alone or together with others, directly or indirectly''; therefore, the result does not change if there are other legal entities (which may themselves be promoters) in the chain between that person and the issuer.

As adopted, the disqualification provisions of Rule 506(d) will cover the following persons, which we refer to in this release as ''covered persons'':

- The issuer and any predecessor of the issuer or affiliated issuer;
- Any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer;
- Any beneficial owner of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;
- Any investment manager to an issuer that is a pooled investment fund and any director, executive officer, other officer participating in the offering, general partner or managing member of any such investment manager, as well as any director, executive officer or officer participating in the offering of any such general partner or managing member;
- Any promoter connected with the issuer in any capacity at the time of the sale;
- Any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with sales of securities in the offering (which we refer to as a ''compensated solicitor''); and
- Any director, executive officer, other officer participating in the offering, general partner, or managing member of any such compensated solicitor.[83]

We are also adopting a provision under which events relating to certain affiliated issuers are not disqualifying if they pre-date the affiliate relationship.[84] Rule 262(a)(5) currently provides that orders, judgments and decrees entered against affiliated issuers before the affiliation arose do not disqualify an offering if the affiliated issuer is not (i) in control of the issuer or (ii) under common control, together with the issuer, by a third party that controlled the affiliated issuer at the time such order, judgment or decree was entered. We included a similar provision in the proposal, but clarified that it applied to all potentially disqualifying events that pre-date affiliation. All of the commenters that addressed that point were supportive of the proposal,[85] and we are adopting it as proposed.

We also solicited comment on whether we should apply the disqualification rules differently to entities that have undergone a change of control. Five commenters supported differential treatment following a change of control, primarily arguing that entities act only through their personnel, and disqualifying events would no longer be relevant if the persons responsible for the events are no longer in control.[86] Another commenter argued that disqualification should cease to apply following changes of policy, as well as changes of control.[87] Three commenters opposed providing different treatment for entities that have undergone a change of control, generally noting that it would be difficult to establish whether a change of control had occurred, that such a provision could be susceptible to abuse, and that change of control might more appropriately be considered in the context of an application for waiver of disqualification.[88] We have decided to adopt the rules as proposed, as advocated by the latter group of commenters, and are not providing different treatment for entities that have undergone a change of control or a change of policy. We wish to avoid both undue complexity in application of the rules and potential abuse by bad actors that may claim to have undergone a change of control when no bona fide change of control has in fact occurred. As discussed in Part II.E below, we are amending the existing delegation of authority to the Director of the Division of Corporation Finance so it will cover waivers of disqualification under Rule 506. We expect that staff will adopt procedures for the prompt issuance of waivers of Rule 506 disqualification upon a proper showing that there has been a change of control and the persons responsible for the activities resulting in a disqualification are no longer employed by the entity or exercise influence over such entity.

C. Disqualifying Events

Section 926 of the Dodd-Frank Act requires our Rule 506 disqualification provisions to be ''substantially similar'' to those set forth in Rule 262 of Regulation A, and also to cover certain criminal convictions and regulatory orders enumerated in Section 926. In the proposal, the disqualifying events from Rule 262 and Section 926 were combined and integrated in a proposed rule that included the following disqualifying events:

- Criminal convictions (felony or misdemeanor), entered within the last five years in the case of issuers and ten years in the case of other covered persons, in connection with the purchase or sale of any security; involving the making of a false filing with the Commission; or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;[89]
- Court injunctions and restraining orders, including any order, judgment or decree of any court of competent jurisdiction, entered within five years before such sale, that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice in connection with the purchase or sale of any security; involving the making of a false filing with the Commission; or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;[90]
- Final orders issued by state banking, credit union, and insurance regulators, federal banking regulators, and the National Credit Union Administration that either create a bar from association with any entity regulated by the regulator issuing the

[83] *See* Rule 506(d)(1).

[84] *See* Rule 506(d)(3).

[85] *See* comment letters from ABA Fed. Reg. Comm.; NYCBA; Rutledge; Whitaker Chalk; Alfaro Oil and Gas LLC (July 14, 2011) (''Alfaro'').

[86] *See* comment letters from ABA Fed. Reg. Comm.; Five Firms; Kutak Rock; Lehman & Eilen, Whitaker Chalk; *see also* comment letter from L. Burningham (June 29, 2011) (''Burningham'') (suggesting that issuers not be disqualified if they have removed bad actors).

[87] *See* comment letter from SIFMA (disqualification should apply only if senior management in control when disqualifying event arose are still employed by the issuer or a controlling affiliate continues in a senior management or executive role; disqualification should also cease to apply if issuer has implemented policies and procedures designed to prevent occurrence of activities that gave rise to disqualification, and such policies and procedures have been approved by a regulator or a court).

[88] *See* comment letters from DTC; NYCBA; Rutledge.

[89] *See* Proposed Rule 506(c)(1)(i).

[90] *See* Proposed Rule 506(c)(1)(ii).

order, or from engaging in the business of securities, insurance or banking or from savings association or credit union activities; or are based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the last ten years;[91]

- Commission disciplinary orders entered pursuant to Section 15(b) or 15(B)(c) of the Securities Exchange Act of 1934 (the ''Exchange Act'') or Section 203(e) or (f) of the Investment Advisers Act of 1940 (the ''Advisers Act'') that, at time of the sale, suspend or revoke a person's registration as a broker, dealer, municipal securities dealer or investment adviser; place limitations on the activities, functions or operations of such person; or bar such person from being associated with any entity or from participating in the offering of any penny stock;[92]
- Suspension or expulsion from membership in, or suspension or a bar from association with a member of, an SRO, *i.e.,* a registered national securities exchange or a registered national or affiliated securities association;[93]
- Stop orders applicable to a registration statement and orders suspending the Regulation A exemption for an offering statement that an issuer filed or in which the person was named as an underwriter within the last five years and being the subject at the time of sale of a proceeding to determine whether such a stop or suspension order should be issued;[94] and
- U.S. Postal Service false representation orders including temporary or preliminary orders entered within the last five years.[95]

We solicited comment on a number of possible modifications to the list of disqualifying events, such as including additional events and lengthening or shortening the look-back period associated with each event. Following is a discussion of each of the disqualifying events originally proposed, the comments on the proposal and the disqualifying event as adopted today.

1. Criminal Convictions

Section 926(2)(B) of the Dodd-Frank Act provides for disqualification if any covered person ''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 Commission.'' This essentially mirrors the language of Rule 262(a)(3), which covers criminal convictions of issuers, and Rule 262(b)(1), which covers criminal convictions of other covered persons. In the proposing release, we identified two differences between the felony and misdemeanor conviction provisions of Section 926(2)(B) and Rule 262. First, Section 926(2)(B) does not include a specific time limit (or ''look-back period'') on convictions that trigger disqualification, whereas Rule 262 provides a five-year look-back period for criminal convictions of issuers and a ten-year look-back period for criminal convictions of other covered persons. Second, Rule 262 includes a reference to criminal convictions ''arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser,'' which does not appear in Section 926.

The proposed rule was based on Rule 262, and provided that a covered person would be disqualified if such covered person has been convicted, within ten years before such sale (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor in connection with the purchase or sale of any security; involving the making of any false filing with the Commission; or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities.[96]

The proposed rule included look-back periods of five years for criminal convictions of issuers (including predecessors and affiliated issuers) and ten years for other covered persons, which correspond to Rule 262.[97] We requested comment on whether the scope of the provision should be broader or narrower, and whether a longer, or permanent, look-back period would be appropriate for either issuers or other covered persons.

Commenters were divided in their reaction to this aspect of the proposal. Most commenters argued that the Commission should stay close to the language of Section 926 and Rule 262.[98] One commenter criticized the proposal as overbroad and suggested ways to narrow it,[99] while two commenters urged expansion of the rule to cover a broader range of criminal convictions.[100] In an advance comment letter[101] and again in its comment letter, NASAA argued for extension of the disqualification rules to cover all criminal convictions involving fraud or deceit, as well as convictions involving the making of a false filing with any state, involving a commodity future or option contract, or any aspect of a business involving securities, commodities, investments, franchises, insurance, banking or finance. One other commenter supported extending coverage to all criminal convictions involving fraud or deceit.[102] Three commenters expressly opposed NASAA's suggested extension on the basis that it would create a vague and overbroad standard.[103]

On the length of look-back periods, some commenters argued for a uniform ten-year period,[104] some for longer or permanent disqualification in certain cases,[105] some for the five- and ten-year periods proposed,[106] and some for shorter periods for covered persons and issuers.[107] On whether convictions in foreign courts should be considered, most commenters objected, generally citing due process concerns and concerns about the cost and burden of inquiry into foreign proceedings.[108] Four commenters supported adding foreign convictions, generally on the basis that conduct outside the United States was as relevant as conduct within the United States for disqualification purposes.[109] One commenter suggested

[91] *See* Proposed Rule 506(c)(1)(iii).

[92] *See* Proposed Rule 506(c)(1)(iv).

[93] *See* Proposed Rule 506(c)(1)(v).

[94] *See* Proposed Rule 506(c)(1)(vi).

[95] *See* Proposed Rule 506(c)(1)(vii).

[96] Proposed Rule 506(c)(1)(i).

[97] Consistent with Rule 262, the look-back period is to the date of the conviction, not to the date of the conduct that led to the conviction. The measurement date is the date of the relevant order or other sanction, not the date of the conduct that was the subject of the order or other sanction.

[98] *See* comment letters from Rutledge; Five Firms; S&C; Seward & Kissel; SIFMA; NYCBA.

[99] *See* comment letter from REISA (suggesting limiting false filings provision to ''intentional, material and misleading'' false filings and limiting convictions ''arising out of the business'' to those ''directly related to the offer or sale of securities to investors'').

[100] *See* comment letters from NASAA; Better Markets.

[101] *See* advance comment letter from NASAA (Nov. 4, 2010).

[102] *See* comment letter from Better Markets.

[103] *See* comment letters from NYCBA; S&C; SIFMA.

[104] *See* comment letters from Better Markets; Kutak Rock; *see also* comment letters from NASAA (uniform look-back period of at least ten years); DTC (ten-year look-back except permanent disqualification for securities fraud and violations of Rule 506).

[105] *See* comment letters from DTC (permanent disqualification for securities fraud and Section 5 violations); J. Davis (June 13, 2011) (suggesting that conviction of any securities violation or felony should be permanently disqualifying).

[106] *See* comment letters from Cleary Gottlieb; Rutledge.

[107] *See* comment letters from REISA (uniform five-year period); D. Sarna (August 23, 2011) (uniform five-year period); SIFMA (uniform period not longer than one year).

[108] *See* comment letters from Cleary Gottlieb; Five Firms; NYCBA; S&C; Sullivan & Worcester LLP (July 1, 2011) (''S&W''); SIFMA; Whitaker Chalk.

[109] *See* comment letters from C. Barnard; DTC; Better Markets; advance comment letter from NASAA.

that Section 926(2)(B) could be read not to be limited to U.S. proceedings.[110]

In sum, most commenters agreed that the final rules should be closely based on Rule 262. To the extent that commenters advocated changes from the proposal, however, there was no consensus about what changes would be desirable or appropriate. We do not believe that the shift from Regulation A to potentially larger and more complex transactions under Rule 506 warrants either expanding or narrowing the scope of coverage of criminal convictions, or modifying the existing five- and ten-year look-back periods. Given that the rule is required to be ''substantially similar'' to Rule 262, and that there are no changes warranted by the application to the Rule 506 context, we are adopting the provision as proposed.

2. Court Injunctions and Restraining Orders

Under current Rule 262(a)(4), an issuer is disqualified from reliance on Regulation A if it, or any predecessor or affiliated issuer, is subject to a court injunction or restraining order against ''engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or involving the making of any false filing with the Commission.'' [111] Similarly, under current Rule 262(b)(2), an offering is disqualified if any other covered person is subject to such a court injunction or restraining order, or to one ''arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser.'' [112] Disqualification is triggered by temporary or preliminary injunctions and restraining orders that are currently in effect, and by permanent injunctions and restraining orders entered within the last five years.[113]

The proposed provision reflected the substance of these two provisions in a simplified, combined format. Rule 506 transactions may involve compensated solicitors, rather than traditional underwriters, so the proposed rule also covered orders arising out of the conduct of the business of such compensated solicitors. Under the proposal, an offering would be disqualified if any covered person is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before any sale in the offering that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice in connection with the purchase or sale of any security; involving the making of any false filing with the Commission; or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities.[114]

Five commenters recommended adoption of the provisions as proposed.[115] Two commenters suggested narrowing the coverage of orders arising out of the conduct of the business of the listed financial intermediaries, and limiting the provision either to cases where there is a finding of fraudulent, manipulative or deceptive conduct,[116] or to matters relating to a broker-dealer's activities of offering securities as a placement or selling agent or underwriter.[117] Two commenters argued that court orders and judgments should not trigger disqualification unless the defendant was afforded notice and an opportunity to appear.[118] One such commenter went further to recommend that all appeals should have been exhausted or the time for appeal expired before disqualification is triggered.[119]

One commenter requested clarification that disqualification will apply only for persons specifically named in an order, and not to all who may be within a class of persons brought within the scope of an order.[120] For example, an injunction may be issued against a named defendant ''and its agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice'' of the order. The commenter requested confirmation that, in these circumstances, only the named defendant, and not all members of the class of persons brought within the scope of the order, would be understood as ''subject to'' the order for disqualification purposes.

We are adopting the provision as proposed. We see no basis for departing from the coverage and look-back periods that apply under existing Rule 262. In particular, we have determined not to impose due process requirements, such as notice and an opportunity to appear, or to require that all appeals have been exhausted or the time for appeal expired, as a condition to disqualification. We are sensitive to the concerns raised by commenters about the risk that ex parte orders may trigger disqualification. Nevertheless, in light of the statutory mandate and the Commission's waiver authority, we are not narrowing the provision. We believe that disqualifying events that arise out of such circumstances are better addressed through the waiver process.

We are also not persuaded that the shift to potentially larger, more complex transactions under Rule 506 or other considerations justifies such a change from the Rule 262 standards. Nor do we want to add a significant new burden of inquiry, requiring issuers to determine not just that a covered person is subject to an order, but also that the order is procedurally adequate. On balance, we believe that the risk that disqualification may arise from ex parte proceedings could be better addressed through the waiver process, rather than through additional requirements for factual inquiry that would affect all offerings. As for appealable orders, as noted in the proposing release, we are concerned that suspending disqualification during the pendency of a potentially lengthy appeals process may significantly undermine the intended benefits of the rule.[121]

With regard to who would be viewed as subject to an order, we intend to apply the new provisions consistently with the way that Rule 262 has historically been applied. For disqualification purposes, the staff has interpreted Rule 262 to limit those considered ''subject to'' an order to only the persons specifically named in the order.[122] Others who are not specifically

[110] *See* comment letter from Rutledge.

[111] 17 CFR 230.262(a)(4).

[112] 17 CFR 230.262(b)(2).

[113] Disqualification is triggered only when a person ''is subject to'' a relevant injunction or order. Therefore, injunctions and orders that have expired or are otherwise no longer in effect are not disqualifying, even if they were issued within the relevant look-back period. For example, an injunction issued four years before the relevant securities offering (within the five-year look-back period), and then lifted before the offering occurred, would not be disqualifying. The look-back period functions as a cut-off for injunctions and orders that are still in effect at the time of an offering. For example, disqualification will not arise from an injunction issued more than five years before an offering, even if the injunction is permanent.

[114] Proposed Rule 506(c)(1)(ii).

[115] *See* comment letters from Cleary Gottlieb; Lehman & Eilen; NYCBA; Rutledge (arguing, as to look-back periods in particular, that ''substantially similar'' means that new rules should mirror as much as possible existing Rule 262 provisions); SIFMA.

[116] *See* comment letter from NYCBA (acknowledging that the limitation they recommend may not be ''substantially similar'' to Rule 262).

[117] *See* comment letter from SIFMA.

[118] *See* comment letters from ABA Fed. Reg. Comm.; R. Sherman (May 25, 2011).

[119] *See* comment letter from ABA Fed. Reg. Comm.

[120] *See* comment letter from ABA Fed. Reg. Comm.

[121] Disqualification would be terminated immediately, however, if the judgment or order were reversed or vacated.

[122] For a more general discussion of interpretations of the meaning of ''subject to'' an order, *see* note 156 and accompanying text.

named but who come within the scope of an order (such as, for example, agents, attorneys and persons acting in concert with the named person) will not be treated as ''subject to'' the order for purposes of disqualification.

3. Final Orders of Certain Regulators

The text of Section 926(2)(A) of the Dodd-Frank Act provides that Commission requirements for Rule 506 offerings must disqualify any covered person that

(A) is subject to a final order of a State securities commission (or an agency or officer of a State performing like functions), a State authority that supervises or examines banks, savings associations, or credit unions, a State insurance commission (or an agency or officer of a State performing like functions), an appropriate Federal banking agency, or the National Credit Union Administration, that—

(i) bars the person from—

(I) association with an entity regulated by such commission, authority, agency, or officer;

(II) engaging in the business of securities, insurance, or banking; or

(III) engaging in savings association or credit union activities; or

(ii) 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 filing of the offer or sale.

As we noted in the proposing release, Section 926(2)(A) is essentially identical to Section 15(b)(4)(H) of the Exchange Act and Section 203(e)(9) of the Advisers Act. The only difference is that Section 926(2)(A)(ii) contains a ten-year look-back period for final orders based on violations of laws and regulations that prohibit fraudulent, manipulative and deceptive conduct, while the Exchange Act and Advisers Act provisions have no express time limit for such orders.

We proposed to reflect Section 926(2)(A) as new Rule 506(c)(1)(iii), with three changes from the text of Section 926(2)(A), which were intended to eliminate potential ambiguities and allow for easier application of the rule. First, the proposal specified that an order must bar the covered person ''at the time of [the] sale,'' to clarify that a bar would be disqualifying only for as long as it has continuing effect. Second, the provision measured the look-back period from the date of the relevant sale, not from ''the date of filing of the offer or sale,'' as provided in Section 926 of the Dodd-Frank Act, so it would align with the other look-back periods in the rule. Finally, the provision required that orders must have been ''entered'' within the look-back period, to clarify that the date of the order, and not the date of the underlying conduct, was relevant for that determination.

Under the proposal, an offering would be disqualified if any covered person is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; or the National Credit Union Administration that at the time of such sale, bars the person from association with an entity regulated by such commission, authority, agency, or officer; engaging in the business of securities, insurance or banking; or engaging in savings association or credit union activities; or constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct entered within ten years before such sale.[123]

We solicited comment on a number of aspects of the proposed provision, including the treatment of bars, the definition of the terms ''final order'' and ''fraudulent, manipulative and deceptive conduct,'' and the potential to cover orders of other regulators in addition to those mandated by Section 926 of the Dodd-Frank Act, particularly the Commission and the Commodity Futures Trading Commission (''CFTC''). As discussed in more detail below, we are adopting the provision substantially as proposed, but adding the CFTC to the list of regulators whose regulatory bars and other final orders will trigger disqualification.

CFTC Orders. The proposing release solicited comment on whether orders of the CFTC or any other regulator not referred to in Section 926 should result in disqualification from Rule 506 offerings. Four commenters favored adding CFTC orders as a disqualification trigger.[124] One noted that ''conduct that would typically give rise to a CFTC sanction is similar to the type of conduct that would result in disqualification if it were the subject of action by other regulators in the securities, banking and insurance fields.''[125] Others cited benefits such as improved investor protection, harmonization of the treatment of regulatory entities, and improved internal consistency of the bad actor rules.[126] Another asserted that it was ''obvious'' that at least some CFTC orders should be covered by the disqualification rules.[127] Two of these commenters also recommended that the rules cover orders of additional regulators.[128] Seven comment letters opposed adding CFTC orders, generally arguing that such an addition would not be ''substantially similar'' to Rule 262 and questioning the Commission's legal authority to add such a new disqualifying event.[129]

We are persuaded that appropriate CFTC orders should be included as a disqualification trigger in new Rule 506(d). As we noted in the proposing release, the conduct that would typically give rise to CFTC sanctions is similar to the type of conduct that would result in disqualification if it were the subject of sanctions by another financial services industry regulator. For that reason, CFTC orders trigger consequences under other Commission rules (for example, both registered broker-dealers and investment advisers may be subject to Commission disciplinary action based on violations of the Commodity Exchange Act).[130] In addition, the CFTC (rather than the Commission) has authority over the investment managers of pooled investment funds that invest in commodities and certain derivatives products; unless Rule 506(d) covers CFTC orders, regulatory sanctions against those investment managers are not likely to trigger disqualification. For these reasons, we believe that including orders of the CFTC will make the bad actor rules more internally consistent, treating relevant sanctions similarly for disqualification purposes, and should enable the disqualification rules to more effectively screen out felons and bad actors.

We have decided to include CFTC orders in the bad actor disqualification scheme by adding the CFTC to the list of regulators in Rule 506(d)(1)(iii). As a result, disqualification will be triggered

[123] Proposed Rule 506(c)(1)(iii).

[124] *See* comment letters from Better Markets, Cleary Gottlieb, NYCBA, NASAA.

[125] *See* comment letter from Better Markets.

[126] *See* comment letters from Cleary Gottlieb, NASAA.

[127] *See* comment letter from NYCBA.

[128] *See* comment letters from Better Markets (advocating addition of orders by other agencies with jurisdiction over misconduct in the financial services arena, including the Consumer Financial Protection Bureau and the Federal Trade Commission); NASAA (advocating addition of orders under state franchise, investment and finance laws).

[129] *See* comment letters from ABA Fed. Reg. Comm.; Five Firms; Katten Muchin; Lehman & Eilen; Rutledge; Schuyler Roche; SIFMA.

[130] *See, e.g.,* Section 15(b)(4)(D) of the Exchange Act (15 U.S.C. 80(b)(4)(C)) and Section 203(e)(5) of the Advisers Act (15 U.S.C. 80-b3(e)(5)).

only by CFTC orders that constitute ''bars'' or ''final orders'' relating to prohibitions on ''fraudulent, manipulative or deceptive conduct'' on the basis discussed below.

Bars. Our requests for comment focused on whether there was a need for the Commission to explicitly state that all orders that have the practical effect of a bar (prohibiting a person from engaging in a particular activity) should be treated as such, even if the relevant order did not call it a ''bar.'' We also requested comment on whether it would be appropriate to provide a cut-off date (for example, ten years) for permanent bars.

Several commenters urged us to provide additional guidance about what constitutes a bar.[131] We believe the statutory language is clear: bars are orders issued by one of the specified regulators that have the effect of barring a person from association with certain regulated entities; from engaging in the business of securities, insurance or banking; or from engaging in savings association or credit union activities. Any such order that has one of those effects is a bar, regardless of whether it uses the term ''bar.'' Orders that do not have any of those effects are not bars, although they may be disqualifying ''final orders,'' as discussed below.

Consistent with the proposal, the final rule provides that an order must bar the person ''at the time of [the] sale'' from one or more of the specified activities, to make clear that a bar is disqualifying only for as long as it has continuing effect.[132] Thus, for example, a person who was barred indefinitely, with the right to apply to reassociate after three years, would be disqualified until such time as he or she is permitted to reassociate, assuming that the bar had no continuing effect after reassociation. Several commenters argued that we should impose a cut-off date for permanent bars.[133] This would effectively treat permanent bars the same as other final orders, which are disqualifying only if issued during the look-back period. We are not, however, departing from the current standard under Rule 262 either by imposing a look-back period (making all regulatory bars issued within a specified period before a sale disqualifying, even if no longer in effect) or by imposing a cut-off date (which would make bars no longer disqualifying after the requisite time period has passed, even if the bar is permanent or otherwise still in effect). Under Rule 262, bars are disqualifying for as long as they are in effect but no longer, matching the period of disqualification to the duration of the regulatory sanction. We are adopting the same approach for Rule 506. Persons who are subject to an indefinite bar who do not wish to reassociate but do wish to participate in Rule 506 offerings could consider applying for a waiver.

We recognize that, in the proposal and in the final rule, the treatment of court injunctions and restraining orders, on one hand, and regulatory bars and orders, on the other hand, is different in some respects. Court injunctions and restraining orders are subject to a five-year look-back period, which functions as a cut-off (*i.e.,* injunctions and restraining orders issued more than five years before the relevant sale are no longer disqualifying, even if they are still in effect or permanent). The treatment of court injunctions and restraining orders is consistent with Rule 262, and therefore responds to the requirement to develop a ''substantially similar'' rule, while the treatment of regulatory bars and orders is specifically mandated by Section 926 of the Dodd-Frank Act. Commenters did not generally support harmonizing our approach to court injunctions and restraining orders with the mandated treatment of regulatory bars and orders, and we do not believe that the shift from Regulation A to Rule 506 offerings justifies extending the time period for disqualification associated with court injunctions and restraining orders.

Final Orders. Section 926 of the Dodd-Frank Act does not specify what should be deemed to constitute a ''final order'' that triggers disqualification. The proposal included an amendment to Rule 501 to provide a definition of ''final order,'' based on the definition that the Financial Industry Regulatory Authority (''FINRA'') uses in forms that implement language in Section 15(b)(4)(H) of the Exchange Act, which is identical[134] to the language used in Section 926.[135] Under the proposal, ''final order'' would mean ''a written directive or declaratory statement issued pursuant to applicable statutory authority and procedures by a federal or state agency described in § 230.506(c)(1)(iii), which constitutes a final disposition or action by that federal or state agency.''

The proposing release requested comment on other potential approaches to the term ''final order,'' such as whether the rule should consider orders final only if they are non-appealable, and whether the rule should cover only orders issued in a process that provides for certain due process rights, such as notice, a right to be heard, and a requirement for a record with written findings of fact and conclusions of law. We also queried whether disqualifying matters that arose in the context of a settlement with a regulatory authority should be treated the same as non-settled matters. The proposing release also discussed whether the Commission should defer to the regulator issuing the order to determine whether the issued order was a ''final order'' for purposes of disqualification in Rule 506.

Several commenters agreed that a definition of ''final order'' would be helpful in promoting uniform and predictable treatment of regulatory actions.[136] Four commenters were generally supportive of the proposed definition.[137]

Two commenters suggested adding minimum procedural standards to the definition of ''final order.''[138] One advocated building ''basic due process elements'' into the definition by adding the concept of notice and an opportunity for a hearing.[139] This commenter suggested that, in order to ensure that settled matters would be treated the same as litigated matters, the definition should require ''an opportunity for hearing'' rather than some specified actual proceeding.[140] The other commenter recommended that, for an order to constitute a ''final order,'' a regulator ''must have made a

[131] *See* comment letters from Alfaro; ABA Fed. Reg. Comm.; Rutledge; SIFMA; Whitaker Chalk.

[132] This accords with the Commission's interpretive position on Rule 262. *See* Release No. 33–6289 (Feb. 13, 1981) [46 FR 13505, 13506 (Feb. 23, 1981)] (Commission consistently has taken the position that a person is ''subject to'' an order under Section 15(b), 15B(a) or (c) of the Exchange Act or Section 203(e) or (f) of the Advisers Act only so long as some act is being performed (or not performed) pursuant to the order). *See* note 156 and accompanying text.

[133] *See* comment letters from ABA Fed. Reg. Comm.; Katten Muchin; Lehman & Eilen; Rutledge; Schuyler, Roche & Crisham, P.C. (July 14, 2011) (''Schuyler Roche''); SIFMA.

[134] Note, however, that Section 15(b)(4)(H) does not contain a look-back period, unlike the 10-year look-back period specified in Section 926(2)(A)(ii).

[135] The definition of ''final order'' used by FINRA applies to Forms U4, U5 and U6, which are used for reporting the disciplinary history of broker-dealers and associated persons under Exchange Act Section 15(b)(4)(H). Form U4 is the Uniform Application for Securities Industry Registration or Transfer, used by broker-dealers to register associated persons. Form U5 is the Uniform Termination Notice for Securities Industry Registration, used by broker-dealers to report the termination of an associated person relationship. Form U6 is the Uniform Disciplinary Action Reporting Form, used by SROs and state and federal regulators to report disciplinary actions against broker-dealers and associated persons.

[136] *See, e.g.,* letters from NYCBA; Rutledge; SIFMA.

[137] Letters from C. Barnard; Rutledge; Better Markets; Munck Carter, LLP (July 14, 2011) (''Munck Carter'').

[138] Letters from NYCBA; SIFMA.

[139] Letter from NYCBA.

[140] *Id.*

finding of fact and set forth conclusions of law on a record.'' [141]

Taking into account the potential impact of disqualification on issuers and other market participants, we are persuaded that the definition of ''final order'' should be limited to orders issued under statutory authority—including statutes, rules and regulations—that provides for notice and an opportunity for hearing.[142] As a result, under our final definition, *ex parte* orders issued under statutory authority that does not provide for notice and an opportunity for hearing will not trigger disqualification. We are not, however, imposing procedural requirements beyond a basic requirement that notice and opportunity for hearing be provided for in the statutes, rules and regulations under which an order is issued. The proceedings covered in Rule 506(d)(1)(iii) take many different forms, and it would not be appropriate for our rules to impose procedural requirements that may not be met by the proceedings of every state or federal regulator whose orders are required to trigger disqualification under Section 926 of the Dodd-Frank Act. We are also not requiring that a hearing actually have occurred. There may be no hearing, for example, in the context of a settled matter; however a settlement is considered for this purpose to have been made after an opportunity for hearing. The basic requirement we have included should be sufficient to address the fundamental fairness concern.

We believe that focusing on the nature of the relevant legal authority for an order rather than the particular facts and circumstances surrounding the order will provide more certainty to issuers seeking to determine whether a covered person subject to an order is in fact subject to a ''final order'' that would be disqualifying. An issuer would only need to determine whether the statutory authority provided for these procedural safeguards, not whether in fact notice was given and an opportunity for hearing was provided. This approach is consistent with comment we received stressing the importance of making the disqualification provisions clear and simple to administer, based on ''bright line'' provisions or an ''objective test'' wherever possible.[143] The focus on legal authority rather than the facts of each case will also likely reduce the incidence of covered persons, in an effort to participate in an offering, claiming procedural irregularities where such irregularities did not occur. A market participant that is subject to an order that was issued without in fact receiving notice and an opportunity for hearing will be able to challenge the order itself, and may also seek a waiver of disqualification from the Commission.

We do not believe that limiting final orders in this way will compromise investor protection because, in most instances, *ex parte* orders are of short duration and will either expire or be replaced by a subsequent order that would meet our procedural requirements.

Commenters were divided on the question of whether orders should be deemed final if they are still subject to appeal. Three commenters objected to adding a requirement that final orders be non-appealable, generally on the basis that the resulting delay could compromise investor protection.[144] Three other commenters argued that the definition of ''final order'' should be limited to non-appealable orders.[145] We remain concerned that delay incident to the appeals process could undermine the intended benefits of the rule, and are therefore adopting the definition of ''final order'' without a requirement that the order be non-appealable.[146]

As adopted, the definition of ''final order'' contained in new Rule 501(g) provides that ''final order'' shall mean a written directive or declaratory statement issued by a federal or state agency described in § 230.506(d)(1)(iii) under applicable statutory authority that provides for notice and an opportunity for hearing, which constitutes a final disposition or action by that federal or state agency.

Fraudulent, Manipulative or Deceptive Conduct. Section 926(2)(A)(ii) of the Dodd-Frank Act provides that disqualification must result from final orders of the relevant regulators that are ''based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct.'' In light of the specificity of the language of Section 926, the proposal did not include standards or guidance with respect to what constitutes ''fraudulent, manipulative or deceptive conduct.''

In the proposing release we solicited comment on whether the rule should provide a definition for ''fraudulent, manipulative or deceptive conduct'' and, if we provided a definition, what should be included in such a definition. Recognizing that Section 926(2)(A)(ii) refers to the final orders of the relevant regulators, the proposing release also requested comment on whether the ''fraudulent, manipulative or deceptive conduct'' determination should be considered and decided only by the relevant regulator issuing the final order. In particular, we asked whether ''fraudulent, manipulative or deceptive conduct'' should be understood to require knowing misconduct or scienter, and noted the concern expressed by some commenters that ''technical or administrative violations'' should not be a source of disqualification.[147]

Some commenters believed that the Commission should provide standards for fraudulent, manipulative or deceptive conduct to clarify and limit the types of orders by state and federal regulators that will trigger disqualification.[148] These commenters supported a definition that requires scienter, generally modeled on the scienter standards of Section 10(b) of the Exchange Act and Rule 10b–5.[149] Many of these commenters also argued that violations they characterized as ''technical'' or ''administrative,'' such as late filings and books and records violations, without a requirement of scienter, should not give rise to disqualification.[150] On the other hand, a commenter who opposed defining ''final order'' to include scienter pointed out that scienter is not required for all state securities law violations or for violations of federal banking regulations (where the standard is unsafe or unsound banking practices or breach of fiduciary duty), so limiting the definition of fraudulent, manipulative or deceptive conduct to scienter-based violations would potentially result in orders by those regulators not giving rise to disqualification even though they are explicitly mandated to be covered by Section 926. In the commenter's view, this would be contrary to Congressional

[141] Letter from SIFMA.

[142] *See* Rule 501.

[143] Letter from NYCBA

[144] Letters from C. Barnard; NYCBA; Rutledge.

[145] Letters from SIFMA; REISA; Alfaro.

[146] *See* Rule 501.

[147] *See* advance comment letter from Investment Program Association (Mar. 2, 2011) (available at *http://www.sec.gov/comments/df-title-ix/regulation-d-disqualification/regulationddisqualification-3.pdf*). *See also* Record of Proceedings of 29th Annual SEC Government-Business Forum on Small Business Capital Formation, at 18 (Nov. 18, 2010) (remarks of Deborah Froling) (available at *http://www.sec.gov/info/smallbus/sbforumtrans-111810.pdf).*

[148] *See* comment letters from Alfaro; ABA Fed. Reg. Comm.; Five Firms; the Managed Funds Association (Aug. 12, 2011) (''MFA''); NYCBA; REISA; SIFMA; S&C; Whitaker Chalk.

[149] *See* comment letters from ABA Fed. Reg. Comm.; Five Firms; MFA; NYCBA; REISA; SIFMA; S&C; Whitaker Chalk. *See also* comment letter from Cleary Gottlieb (supporting a scienter requirement for all regulatory orders, including orders of the Commission, with an exception for Commission orders related to violations of Section 5 of the Securities Act).

[150] *See, e.g.,* comment letters from Five Firms; MFA; SIFMA.

intent and the plain language of Section 926.[151]

We do not believe that Section 926(A)(ii) is limited to matters involving scienter. Scienter is not a requirement under Section 15(b)(4)(H) of the Exchange Act or Section 203(e)(9) of the Advisers Act, from which the language of Section 926 is drawn. Commission orders are issued under these sections based only on the existence of a relevant state or federal regulatory order; the Commission has stated that, while the degree of scienter involved is a factor in determining what sanction is appropriate,[152] the Commission can order sanctions even where scienter is not an element of the underlying state anti-fraud law violation.[153] Scienter may also not play a similar role in other areas of regulation specified in Section 926(A)(ii), such as insurance, banking and credit union regulation, as it does under the federal securities laws. We do not believe it is appropriate to limit the provision to matters involving scienter absent a clear statutory direction to do so, particularly when the relevant language has been construed in other contexts not to be so limited, and when imposing such a limitation may result in excluding regulatory orders that are explicitly mandated to be covered by the new rules. Accordingly, the final rules do not include a definition of ''fraudulent, manipulative or deceptive conduct'' and in particular do not limit ''fraudulent, manipulative or deceptive conduct'' to matters involving scienter.

Final Rule. As adopted, Rule 506(d)(1)(iii) provides that disqualification will arise if a covered person is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

- At the time of the sale, bars the person from association with an entity regulated by such commission, authority, agency, or officer; engaging in the business of securities, insurance or banking; or engaging in savings association or credit union activities; or
- Constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct entered within ten years before the sale.[154]

4. Commission Disciplinary Orders

Rule 262(b)(3) of Regulation A imposes disqualification on an issuer if any covered person is subject to an order of the Commission ''entered pursuant to section 15(b), 15B(a), or 15B(c) of the Exchange Act, or section 203(e) or (f) of the Investment Advisers Act.'' [155] Under these provisions (other than Section 15B(a), discussed below), the Commission has authority to order a variety of sanctions against registered brokers, dealers, municipal securities dealers and investment advisers and their associated persons, including suspension or revocation of registration, censure, placing limitations on their activities, imposing civil money penalties and barring individuals from being associated with specified entities and from participating in the offering of any penny stock.

Our proposed rule was based on Rule 262(b)(3), but eliminated the anomalous reference to Section 15B(a), which is not a source of sanctioning authority, and codified the prior interpretive position that disqualification would continue only for as long as some act is prohibited or required to be performed pursuant to the order (with the consequence that censures and orders to pay civil money penalties, assuming the penalties are paid in accordance with the order, are not disqualifying, and a disqualification based on a suspension or limitation of activities expires when the suspension or limitation expires).[156] Under the proposed rule, an offering would be disqualified if any covered person is subject to an order of the Commission entered pursuant to section 15(b) or 15B(c) of the Exchange Act or section 203(e) or (f) of the Advisers Act that, at the time of such sale, suspends or revokes such person's registration as a broker, dealer, municipal securities dealer or investment adviser; places limitations on the activities, functions or operations of such person; or bars such person from being associated with any entity or from participating in the offering of any penny stock.[157]

We requested comment on the appropriateness of codifying the interpretive position and imposing any look-back period for Commission disciplinary sanctions. Specifically, we requested comment on whether the rules should provide that orders to pay civil money penalties are disqualifying if the penalties are not paid as ordered. The proposal drew relatively little comment, all of which was supportive.[158] We are adopting the rule as proposed, now numbered Rule 506(d)(1)(iv).

5. Certain Commission Cease-and-Desist Orders

Section 926 of the Dodd-Frank Act mandates that bad actor disqualification result from final orders issued within a ten-year period by the state and federal regulators identified in Section 926(2)(A) of the Dodd-Frank Act. The state and federal regulators listed in Section 926 include: State authorities that supervise banks, savings associations, or credit unions; state insurance regulators; appropriate federal banking agencies; and the National Credit Union Administration. The Commission is not included in the Section 926(2)(A) list of regulators. Although we did not propose specific amendments to the rule to include the Commission, we explained that adding the Commission's cease-and–desist orders to the disqualification provisions could further enhance the investor protection intent of the disqualification provisions and would contribute to creating an internally consistent set of rules that would treat relevant sanctions

[151] *See* comment letter from Rutledge.

[152] *Steadman* v. *SEC,* 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds,* 450 U.S. 91 (1981).

[153] *See In the Matter of Mitchell M. Maynard and Dorice A. Maynard,* Release No. IA–2875 (May 15, 2009).

[154] Rule 506(d)(1)(iii).

[155] 17 CFR 230.262(b)(3) (citing 15 U.S.C. 78o(f), 78o(4)(a), 78o(4)(c), 80b–3(e) and 80b–3(f)). Section 21B(a) of the Exchange Act, 15 U.S.C. 78u–2(a)(1), and Section 203(i)(1)(A) of the Advisers Act, 15 U.S.C. 80b–3(i)(1)(A), give the Commission authority to impose civil money penalties in these disciplinary proceedings.

[156] *See* Proposed Rule 506(c)(1)(iv); Release No. 33–6289 (Feb. 13, 1981) [46 FR 13505, 13506 (Feb. 23, 1981)] (in adopting amendments to Rule 252 of Regulation A, the predecessor to Rule 262, the Commission noted ''[i]n those instances where persons are subject to orders containing no definite time limitations, the Commission has consistently taken the position that a person is subject to an order only so long as some act is being performed pursuant to such order, [such as] establishing procedures to assure appropriate supervision of salesmen and reporting on such procedures.'') The staff of the Division of Corporation Finance has taken the same view. *See* Release No. 33–6455, Question 66 (Mar. 3, 1983) [48 FR 10045, 10053 (Mar. 10, 1983)] (in interpretive release on Regulation D, the staff advised that censure has no continuing force and thus censured person is not ''subject to an order of the Commission entered pursuant to section 15(b)'' within the meaning of Rule 505); Howard, Prim, Rice, Nemerovski, Canady & Pollak, SEC No-Action Letter, 1975 WL 11300 (Jan. 8, 1975, publicly available Feb. 11, 1975) (Rule 252 does not comprehend a situation where an underwriter of a Regulation A offering has stipulated to a consent order in a Commission administrative proceeding providing only for a censure, with no suspension or other sanction); Samuel Beck, SEC No-Action Letter, 1975 WL 11471 (May 15, 1975, publicly available June 24, 1975).

[157] Proposed Rule 506(c)(iv).

[158] *See* comment letter from Rutledge; *see also* comment letters from Lehman & Eilen; SIFMA.

similarly for disqualification purposes. In the proposing release, we pointed out in particular that orders issued in stand-alone Commission cease-and-desist proceedings [159] are not disqualifying under current bad actor disqualification provisions,[160] and the proposal did not include such orders as disqualifying for purposes of Rule 506 offerings.

Our request for comment covered a range of issues, including whether it was appropriate to include the Commission in the list of regulators and if so, what types of Commission cease-and-desist orders should give rise to Rule 506 disqualification. In the proposing release, we presented possible approaches to including Commission orders as a disqualifying event and requested comment on those approaches. We requested comment on whether it would be appropriate to include cease-and-desist orders issued by the Commission for violations of the anti-fraud provisions of the federal securities laws, and whether requiring scienter and including cease-and-desist orders related to violations of Section 5 of the Securities Act would be appropriate. Given that Rule 506 offerings provide an exemption from Section 5 registration, we noted that on that basis, persons who violate Section 5 should potentially lose the benefit of exemptive relief for some period afterward.

The request for comment generated a substantial response. Five comment letters favored covering all Commission orders, including cease-and-desist orders (subject in some cases to a scienter requirement).[161] One comment letter noted that although including Commission cease-and-desist orders could impair capital formation, the benefits of doing so would outweigh the risks because adding Commission orders would more effectively work to screen out bad actors and improve internal consistency of the rules.[162] This comment letter described the proposed rule and the absence of Commission orders as ''under-inclusive'' because the proposed amendments did not explicitly address all final orders issued by the Commission addressing fraudulent, manipulative or deceptive conduct.

Five comment letters opposed adding Commission cease-and-desist orders, generally arguing that the Commission lacks authority to expand on the Section 926 statutory scheme in that way.[163] One comment letter suggested the decision to include cease-and-desist orders would add a large class of regular and routine disciplinary proceedings to the disqualification provisions, expressing concern that including administrative cease-and-desist orders that do not require any showing or finding of intentional misconduct could be viewed as unnecessarily punitive by disqualifying an organization from particular types of capital formation activity.[164] This comment letter also noted that including cease-and-desist orders marked a departure from the disciplinary order provisions of Rule 262(b)(3) in which the Commission has historically interpreted Rule 262 ''to require disqualification only for as long as some act is prohibited or required to be performed pursuant to the order.'' [165] Another comment letter stated that cease-and-desist orders should not create a disqualification unless it imposes a limitation or restriction on conduct.[166] One commenter also opposed adding Commission cease-and-desist orders based on the legislative history of Section 15(b)(4)(H) of the Exchange Act, from which the language used in Section 926 is drawn.[167]

We believe that including certain Commission cease-and-desist orders in the bad actor disqualification scheme would enhance its investor protection benefits and make the overall scheme of Rule 506 of Regulation D more internally consistent. We believe an injunctive or restraining order issued by a federal court and a Commission cease-and-desist order arising out of the same legal violation equally demonstrate disqualifying conduct and should have the same consequences under our disqualification rules. The benefits associated with screening bad actors out of the Rule 506 market should not depend on whether a particular enforcement action is brought in court or through a Commission cease-and-desist proceeding. For that reason, the final rules include a provision that makes certain Commission cease-and-desist orders a disqualifying event.

We disagree with the commenters who argue that the Commission lacks authority, as part of this rulemaking, to add additional disqualification triggers not provided in Section 926. In our view, Section 926 does not limit the existing authority we previously used to create other bad actor provisions.

In expanding the list of disqualification triggers beyond those required in Section 926, we are mindful of our mandate to promote investor protection and capital formation. In particular, we are mindful of the concerns expressed by commenters about the potentially negative impact on capital raising of overbroad disqualification standards.[168] The concerns associated with including Commission cease-and-desist orders involved expanding the class of covered persons subject to disqualification and including administrative cease-and-desist orders that do not require any showing or finding of scienter. With those issues in mind, the additional disqualification trigger we are adopting covers only Commission orders to cease and desist from violations and future violations of the scienter-based anti-fraud provisions of the federal securities laws (including, without limitation, Section 17(a)(1) of the Securities Act,[169] Section 10(b) of the Exchange Act [170] and Rule 10b–5 thereunder,[171] Section 15(c)(1) of the Exchange Act,[172] and Section 206(1) of the Advisers Act [173]) and violations of Section 5 of the Securities Act.[174] The additional disqualification trigger for Section 5 violations will not require scienter, which is consistent with the strict liability standard imposed by Section 5.[175] As a policy matter, we do not believe that exemptions from

[159] In cease-and-desist proceedings, the Commission can issue orders against ''any person,'' including entities and individuals outside the securities industry, imposing sanctions such as penalties, accounting and disgorgement or officer and director bars. In contrast, administrative proceedings are generally limited to regulated entities and their associated persons.

[160] Current provisions also do not cover other types of Commission actions. For example, the Commission has authority under Section 9(b) of the Investment Company Act to bring proceedings against ''any person'' and may impose investment company bars, civil penalties and disgorgement under Sections 9(d) and (e) of the Investment Company Act. 15 U.S.C. 80a–9(b), (d) and (e). The Commission also has authority under Rule 102(e) of its Rules of Practice to censure persons (such as accountants and attorneys) who appear or practice before it, or to deny them the privilege of appearing before the Commission temporarily or permanently. 17 CFR 201.102(e). Orders under these sections are not disqualifying under Rule 262.

[161] *See* comment letters from Better Markets; Cleary Gottlieb (scienter required except for Section 5 violations); NYCBA; NASAA; Whitaker Chalk (scienter required; suggesting that Commission list the violations that lead to disqualification or adopt a willful violation standard).

[162] *See* comment letter from Cleary Gottlieb.

[163] *See* comment letters from ABA Fed. Reg. Comm.; Five Firms; Katten Muchin; Rutledge; SIFMA.

[164] *See* comment letter from Five Firms.

[165] *Id.*

[166] *See* comment letter from SIFMA.

[167] *See* comment letter from Rutledge.

[168] *See* notes 296–98 and accompanying text.

[169] 15 U.S.C. 77q(a)(1).

[170] 15 U.S.C. 78j(b).

[171] 17 CFR 240.10b–5.

[172] 15 U.S.C. 78o(c)(1).

[173] 15 U.S.C. 80b–6(1).

[174] 15 U.S.C. 77e.

[175] *See SEC* v. *North American Research and Development Corp.,* 424 F.2d 63, 8182 (2d Cir. 1970); *Swenson,* 626 F.2d at 424 (5th); *SEC* v. *Ross,* 504 F.3d 1130, 1137 (9th Cir. 2007); *SEC* v. *Pearson,* 426 F.2d 1339, 1343 (10th Cir. 1970).

registration based on Rule 506 should be available to persons whose prior conduct has resulted in an order to cease and desist from violations of Section 5's registration requirements.

The additional disqualification trigger will be subject to the same five-year look-back period that applies to court restraining orders and injunctions,[176] rather than the 10-year look-back that is mandated to apply to other regulatory orders under Section 926, which will provide consistent Commission treatment of cease and desist orders with court orders.

As adopted, Rule 506(d)(1)(v) imposes disqualification if any covered person is subject to any order of the Commission entered within five years before such sale that, at the time of such sale, orders the person to cease and desist from committing or causing a violation or future violation of any scienter-based anti-fraud provision of the federal securities laws (including without limitation Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b–5 thereunder, Section 15(c)(1) of the Exchange Act and Section 206(1) of the Advisers Act, or any other rule or regulation thereunder) or Section 5 of the Securities Act.[177]

6. Suspension or Expulsion From SRO Membership or Association With an SRO Member

Rule 262(b)(4) disqualifies an offering if any covered person is suspended or expelled from membership in, or suspended or barred from association with a member of, a securities self-regulatory organization or ''SRO'' (*i.e.,* a registered national securities exchange or national securities association) for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade.[178] The proposed rule added a reference to a registered affiliated securities association and applied the standard to all covered persons,[179] but did not otherwise change the substance of the rule. Under the proposed rule, an offering would be disqualified if any covered person is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade.[180]

The proposal drew little comment,[181] and we are adopting the text of the rule as proposed. It is now numbered Rule 506(d)(1)(vi) because of the addition of the new provision covering certain Commission cease-and-desist orders in Rule 506(d)(1)(v).

7. Stop Orders and Orders Suspending the Regulation A Exemption

Paragraphs (a)(1) and (2) of Rule 262 impose disqualification on an offering if the issuer, or any predecessor or affiliated issuer, has filed a registration statement or Regulation A offering statement that was the subject of a Commission refusal order, stop order or order suspending the Regulation A exemption within the last five years, or is the subject of a pending proceeding to determine whether such an order should be issued.[182] Similarly, paragraphs (c)(1) and (2) impose disqualification if any underwriter of the securities proposed to be issued was, or was named as, an underwriter of securities under a registration statement or Regulation A offering statement that was the subject of a Commission refusal order, stop order or order suspending the Regulation A exemption within the last five years, or is the subject of a pending proceeding to determine whether such an order should be issued.[183] The proposed rule incorporated the substance of these four paragraphs in a single paragraph that applied to all covered persons. Under the proposed rule, an offering would be disqualified if any covered person has filed (as a registrant or issuer), or was or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the Commission that, within five years before such sale, was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such sale, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued.[184]

The proposal drew only one comment,[185] which supported the proposal, and we are adopting the text as proposed, now numbered Rule 506(d)(1)(vii).

8. U.S. Postal Service False Representation Orders

Paragraphs (a)(5) and (b)(5) of Rule 262 impose disqualification on an offering if the issuer or another covered person is subject to a U.S. Postal Service false representation order entered within the preceding five years, or to a temporary restraining order or preliminary injunction with respect to conduct alleged to have violated the false representation statute that applies to U.S. mail.[186] Our proposed rule incorporated the substance of these paragraphs in a single paragraph, disqualifying an offering if any covered person is subject to a United States Postal Service false representation order entered within five years before such sale, or is, at the time of such sale, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.[187] The proposal drew only one comment,[188] which supported the proposal, and we are adopting the text as proposed, now numbered Rule 506(d)(1)(viii).

D. Reasonable Care Exception

1. Reasonable Care Standard

The proposal included an exception from disqualification for offerings where the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of another covered person.[189]

The proposal also included an instruction to the reasonable care exception explaining that an issuer would not be able to establish that it had exercised reasonable care unless it made a factual inquiry into whether any disqualifications existed. As proposed, the instruction noted that the nature and scope of the inquiry would vary based

[176] Rule 506(d)(1)(ii).

[177] Rule 506(d)(1)(v).

[178] *See* 17 CFR 230.262(b)(4).

[179] Proposed Rule 506(c)(1)(vi). Rule 262(b)(4) does not apply to issuers and their predecessors and affiliated issuers. 17 CFR 230.262(b)(4).

[180] Proposed Rule 501(c)(v).

[181] Three commenters responded to our request for comment on whether commodities exchanges and commodities self-regulatory organizations should be covered by the provision. One favored such an extension (comment letter from Better Markets) and two opposed it (comment letters from Lehman & Eilen, Rutledge). We have not included such an extension in the final rule.

[182] 17 CFR 230.262(a)(1) and (2).

[183] 17 CFR 230.262(c)(1) and (2).

[184] Proposed Rule 506(c)(1)(vi).

[185] *See* comment letter from Rutledge.

[186] Paragraph (a)(5) relates to issuers and their predecessors and affiliated issuers, and paragraph (b)(5) relates to other covered persons. Disqualification results if any covered person ''is subject to a United States Postal Service false representation order entered under 39 U.S.C. 3005 within 5 years prior to the filing of the offering statement, or is subject to a temporary restraining order or preliminary injunction entered under 39 U.S.C. 3007 with respect to conduct alleged to have violated 39 U.S.C. 3005.'' 17 CFR 230.262(a)(5) and (b)(5).

[187] Proposed Rule 506(c)(1)(vii)

[188] *See* comment letter from Rutledge.

[189] *See* Proposed Rule 506(c)(2)(ii).

on the circumstances of the issuer and the other offering participants. We proposed the reasonable care exception to preserve the intended benefits of Rule 506 and avoid creating an undue burden on capital-raising activities, by reducing the risk that issuers could lose the benefit of Rule 506 as a result of disqualifications of which they were unaware.[190]

The proposing release did not prescribe or delineate what steps an issuer would be required to take to show reasonable care. Rather, it noted that the steps an issuer would take would vary according to the circumstances of the covered persons and the offering, taking into account the risk of having a bad actor, the impact of other screening and compliance mechanisms already in place, and the cost and burden of the inquiry. We requested comment on the appropriateness of the reasonable care exception and whether the rule should specify what factual inquiry is required or provide examples of specific factual inquiries that would be deemed to constitute reasonable care. The proposing release also recognized that requiring large issuers or large financial institutions acting as compensated solicitors to conduct factual inquiries on potentially lengthy lists of officers could be burdensome, and therefore we requested comment on whether the rules should provide specific steps to establish reasonable care in these circumstances.

In the proposing release, we discussed the reasonable care exception in the NASAA-approved Model Accredited Investor Exemption (''MAIE''), which serves as a standard in blue sky law and has been adopted in some form by a majority of the states. The MAIE requires the issuer to conduct a ''factual inquiry'' before asserting the reasonable care exception but does not provide specific information on what steps are required for the factual inquiry. We also noted in the proposing release that, as part of the proposed amendments to Regulation D in 2007, the Commission proposed disqualification provisions that included a reasonable care exception based on the MAIE, without any express reference to factual inquiry.

The proposed reasonable care exception attempted to address the potential difficulty for issuers in establishing whether any covered persons are the subject of disqualifying events, particularly given that there is no central repository that aggregates information from all the federal and state courts and regulatory authorities that would be relevant in determining whether covered persons have a disqualifying event in their past. We believe such a reasonable care exception will facilitate the continued utility of Rule 506 in light of the new disqualification requirements.

Commenters who addressed the issue were unanimous in their support for a reasonable care exception.[191] Many, however, voiced concerns about the perceived vagueness of the proposed exception, and urged us to provide more guidance on what types of factual inquiry would constitute compliance.[192] Some commenters suggested that specific steps be presumed to establish reasonable care, such as obtaining questionnaires from appropriate persons (provided the issuer has no knowledge of undisclosed disqualifying events) [193] or use of a reputable background investigations firm.[194] Another suggested that issuers be permitted to rely on contractual representations from registered broker-dealers and other regulated entities, and that broker-dealers that adopt reasonable policies and procedures to identify disqualifications in respect of other offering participants should be presumed to satisfy the ''reasonable care'' test.[195] One commenter requested a cut-off date for the determination of bad actor involvement (*e.g.,* 15 days before commencement of the offering).[196] Three commenters who supported the reasonable care exception criticized the proposed factual inquiry requirement, suggesting it would impose undue burdens on issuers and recommending that we remove it from the adopted rule.[197] Another commenter suggested that the Commission look to the standards that were adopted by NASAA in the Uniform Limited Offering Exemption and endorsed by NASAA in the Uniform Securities Act, neither of which contains a factual inquiry component.[198]

Other commenters stressed the importance of conditioning the availability of the reasonable care exception on the issuer's factual inquiry.[199] These commenters viewed the factual inquiry as a way to ensure that investor protection is not compromised by issuers' taking minimal steps designed primarily to satisfy minimum requirements for the reasonable care standard rather than to ascertain whether disqualifications actually apply.[200]

We continue to believe that the concept of reasonable care necessarily includes inquiry by the issuer into the relevant facts, and we are adopting the provision and its accompanying instruction substantially as proposed.[201] There is a wide range of issuers involved in Rule 506 offerings, from large reporting companies, to private investment funds, to smaller private companies, all of which have different legal and ownership structures and may employ a wide range of financial intermediaries, in terms of size, number of employees and scope. As a result, we do not believe it is appropriate to prescribe specific steps as being necessary or sufficient to establish reasonable care.

Accordingly, as we stated in the proposing release, the steps an issuer should take to exercise reasonable care will vary according to the particular facts and circumstances. For example, we anticipate that issuers will have an in-depth knowledge of their own executive officers and other officers participating in securities offerings gained through the hiring process and in the course of the employment relationship, and in such circumstances,

[190] Rule 508 of Regulation D provides that ''insignificant deviations'' from the terms, conditions and requirements of Regulation D will not necessarily result in loss of the exemption from Securities Act registration requirements. Rule 508 provides that the exemption will not be lost with respect to any offer or sale to a particular individual or entity as a result of a failure to comply with a term, condition or requirement of Regulation D if the person relying on the exemption shows that: the failure to comply did not pertain to a term, condition or requirement directly intended to protect that particular individual or entity; the failure to comply was insignificant with respect to the offering as a whole (provided that certain Regulation D requirements, including limitations on general solicitation and any applicable limits on the amount of securities offered and the number of investors, are always deemed significant); and a good faith and reasonable attempt was made to comply. 17 CFR 230.508. We do not believe that Rule 508 would cover circumstances in which an offering was disqualified based on Rule 506(d).

[191] *See, e.g.,* comment letters from ABA Fed. Reg. Comm.; Angel Capital Association (July 14, 2011) (''Angel Capital Comment Letter 1''); Better Markets; DTC; Kutak Rock; Lehman & Eilen; NASAA; NYCBA; Rutledge; SIFMA; Seward & Kissel; S&C; S&W; Whitaker Chalk.

[192] *See, e.g.,* comment letters from ABA Fed. Reg. Comm.; Kutak Rock; NYCBA; S&C.

[193] *See* Angel Capital Comment Letter 1; *see also* comment letter from ABA Fed. Reg. Comm..

[194] *See* comment letter from S&W.

[195] *See* comment letter from NYCBA; *see also* comment letters from ABA Fed. Reg. Comm.; Angel Capital Comment Letter 1; Kutak Rock (issuers should be able to rely on registered broker-dealer's confirmation that no disqualification exists).

[196] *See* comment letter from Cleary Gottlieb.

[197] *See* Angel Capital Comment Letter 1; *see also* comment letters from Rutledge; S&C.

[198] Comment letter from Rutledge. The Uniform Limited Offering Exemption and the Uniform Securities Act provide exceptions from disqualification where the issuer shows that it did not know and in the exercise of reasonable care could not have known that a disqualification existed.

[199] *See* comment letters from Better Markets; NASAA.

[200] *E.g.,* comment letter from Better Markets.

[201] *See* Rule 506(d)(2)(iii) and instruction thereto.

further steps may not be required in connection with a particular offering. Factual inquiry by means of questionnaires or certifications, perhaps accompanied by contractual representations, covenants and undertakings, may be sufficient in some circumstances, particularly if there is no information or other indicators suggesting bad actor involvement.

The timeframe for inquiry should also be reasonable in relation to the circumstances of the offering and the participants. Consistent with this standard, the objective should be for the issuer to gather information that is complete and accurate as of the time of the relevant transactions, without imposing an unreasonable burden on the issuer or the other participants in the offering. With that in mind, we expect that issuers will determine the appropriate dates to make a factual inquiry, based upon the particular facts and circumstances of the offering and the participants involved, to determine whether any covered persons are subject to disqualification before seeking to rely on the Rule 506 exemption.

In general, issuers should make factual inquiry of the covered persons, but in some cases—for example, in the case of a registered broker-dealer acting as placement agent—it may be sufficient to make inquiry of an entity concerning the relevant set of covered officers and controlling persons, and to consult publicly available databases concerning the past disciplinary history of the relevant persons.[202] Broker-dealers are already required to obtain much of this information for their own compliance purposes. We anticipate that financial intermediaries and other market participants will develop procedures for assisting issuers in gathering the information necessary to satisfy the issuer's factual inquiry requirement.

If the circumstances give an issuer reason to question the veracity or accuracy of the responses to its inquiries, then reasonable care would require the issuer to take further steps or undertake additional inquiry to provide a reasonable level of assurance that no disqualifications apply.

2. Continuous and Long-Lived Offerings

Some commenters requested specific guidance from the Commission on factual inquiry procedures for continuous offerings such as those by hedge funds and some other pooled investment funds.[203] One commenter criticized the application of the factual inquiry requirement to offerings made on a continuous or delayed basis under Rule 506, arguing that reasonable factual inquiry for all covered persons could be interpreted to require continuous, real-time monitoring, which would be especially onerous for issuers in such offerings.[204] Others suggested permitting issuers to establish the reasonable care exception solely through an initial representation about the potential applicability of disqualifying events followed by subsequent periodic updates, such as annual negative consent letters relating to any changes to such representation on a basis consistent with FINRA Rules 5130 and 5131.[205]

We believe that for continuous, delayed or long-lived offerings, reasonable care includes updating the factual inquiry on a reasonable basis. Again, the frequency and degree of updating will depend on the circumstances of the issuer, the offering and the participants involved, but in the absence of facts indicating that closer monitoring would be required (for example, notice that a covered person is the subject of a judicial or regulatory proceeding or knowledge of weaknesses in an organization's screening procedures), we would expect that periodic updating could be sufficient. We expect that issuers will manage this through contractual covenants from covered persons to provide bring-down of representations, questionnaires and certifications, negative consent letters, periodic re-checking of public databases, and other steps, depending on the circumstances.

E. Waivers

Consistent with the requirement of Section 926 that the Commission promulgate disqualification provisions ''substantially similar'' to Regulation A, the proposal included a waiver provision based on current Rule 262, under which the Commission could grant a waiver of disqualification if it determined that the issuer had shown good cause ''that it is not necessary under the circumstances that the [registration] exemption . . . be denied.'' [206]

The proposing release requested comment on whether the proposed rule should include a provision such as in the one in the MAIE that provides an exception from disqualification if the state authority that issued the disqualifying order waives the disqualification. The proposing release also requested comment on whether the Commission should provide guidance as to the circumstances that would likely give rise to the grant or denial of a waiver and whether the Commission should exercise waiver authority for cases involving final orders of state regulators.

1. Waiver for Good Cause Shown

Under current rules, the Commission has delegated authority to grant disqualification waivers under Regulation A and Rule 505 to the Director of the Division of Corporation Finance.[207] Under the proposal, there would have been no delegation of authority for waivers of bad actor disqualification under the new Rule 506 disqualification provisions, and all such waivers would have been issued by a direct order of the Commission.

Commenters who addressed the issue were universally supportive of including a waiver provision in the bad actor disqualification provisions applicable to Rule 506.[208] We are adopting the waiver provision substantially as proposed, with the modifications discussed below.[209]

Given the expectation of a short time frame for many Rule 506 offerings, a number of commenters expressed concern over the timeliness of waiver application reviews by the Commission and the risk that a lengthy review process may disadvantage issuers seeking speedy access to capital.[210] Three commenters urged that authority be delegated to Commission staff to grant waivers, out of a concern for

[202] FINRA maintains BrokerCheck, an online tool that enables the public to check the professional backgrounds of current and former FINRA-registered brokerage firms and brokers, as well as investment adviser firms and representatives. The information included in BrokerCheck about brokers and brokerage firms is derived from the Central Registration Depository, the securities industry online registration and licensing database. The information about investment adviser firms and representatives made available through BrokerCheck is derived from the Commission's Investment Adviser Public Disclosure (IAPD) database.

[203] *See* comment letters from Lehman & Eilen; NYCBA; S&C.

[204] *See* comment letter from S&C.

[205] *See* comment letters from ABA Fed. Reg. Comm.; SIFMA; S&C; *see also* comment letter from NYCBA (semi-annual updates). FINRA Rules 5130 and 5131 permit reliance on written representations for up to 12 months, with annual negative consent letters thereafter, to confirm that accounts are not beneficially owned by certain ''restricted persons'' (Rule 5130) or by certain executive officers and directors or persons materially supported by them (Rule 5131).

[206] Proposed Rule 506(c)(2)(i).

[207] *See* 17 CFR 200.30–1(b), 200.30–1(c).

[208] *See* comment letters from ABA Fed. Reg. Comm.; Coy Capital; DTC; Five Firms; IPA; Katten Muchin; Lehman & Eilen Cotter; I. Linder (July 14, 2011); MFA; NYCBA; NASAA; REISA; Rutledge; SIFMA; Seward & Kissel; S&C; Whitaker Chalk.

[209] *See* Rule 506(d)(2)(ii).

[210] *See* comment letters from IPA; Seward & Kissel; Whitaker Chalk.

potential delays.[211] We are sensitive to concerns about delay in the waiver process, and believe that the staff has managed the process of granting waivers from Regulation A and Rule 505 disqualification appropriately in the past. Accordingly, we have determined to clarify the existing delegation of authority to the Director of the Division of Corporation Finance by amending it to cover waivers of Rule 506 disqualification.[212]

Several commenters requested clear guidance on circumstances that would give rise to the grant of a waiver from disqualification.[213] Three commenters argued that having clear disqualification waiver guidelines would result in greater efficiency for market participants and Commission staff, and encouraged the development of uniform standards that would prevent unfair application of the disqualification provisions.[214] We believe it would be premature to attempt to articulate standards for granting waivers, although we may consider doing so after we and the Commission staff have developed experience in handling waiver requests under the new Rule 506 disqualification rules. We have, nonetheless, identified in this adopting release a number of circumstances (such as a change of control, change of supervisory personnel, absence of notice and opportunity for hearing, and relief from a permanent bar for a person who does not intend to apply to reassociate with a regulated entity) that could, depending on the specific facts, be relevant to the evaluation of a waiver request. This is not an exhaustive list, and we expect that other factors would also be relevant to our consideration of waiver requests in particular cases.

2. Waiver Based on Determination of Issuing Authority

In response to our request for comment on how the Commission should handle waiver applications involving final orders of state regulators, three commenters recommended that the Commission retain its authority to waive disqualification arising out of such orders.[215] One commenter recommended that waivers should be permitted to be determined by the state or local authorities or the Commission, at the option of the issuer.[216] Several commenters recommended adoption of automatic exceptions from disqualification similar to those in the MAIE and Uniform Limited Offering Exemption (''ULOE'').[217] Under both the MAIE and ULOE, bad actor disqualification is waived if either (i) the person against whom an order is issued is licensed or regulated in the relevant state and is still permitted to conduct securities-related work in the state, or (ii) the regulator issuing the relevant order determines that disqualification is not necessary under the circumstances.[218] Another commenter recommended that the Commission not grant a waiver if such a grant would be prejudicial to an action by the state or regulator.[219]

We are persuaded that the second leg of the MAIE/ULOE exception to disqualification, under which disqualification does not apply if the regulator issuing the relevant order determines that Rule 506 disqualification is not necessary under the circumstances, strikes an appropriate balance. It allows the relevant authorities to determine the impact of their orders and conserves Commission resources (which might otherwise be devoted to consideration of waiver applications) in cases where the relevant authority determines that disqualification from Rule 506 offerings is not warranted. Accordingly, the final rule contains a provision based on MAIE paragraph (D)(2)(b), under which disqualification will not arise if, before the relevant sale is made in reliance on Rule 506, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing, whether in the relevant judgment, order or decree or separately to the Commission or its staff, that disqualification under Rule 506 should not arise as a consequence of such order, judgment or decree.[220] Because disqualification will not arise in those circumstances, no waiver need be sought from the Commission for a person subject to such an order, judgment or decree to participate in a Rule 506 offering. Even in the absence of such advice, however, the Commission may still exercise its discretion to grant waivers under Rule 506(d)(2)(ii) in cases where it considers it appropriate to do so.[221]

We are not, however, including a provision based on the first leg of the MAIE/ULOE test, which prevents disqualification if the triggering event occurs with respect to a regulated person, such as a broker-dealer, and such person continues to be licensed or registered to conduct securities-related business in the relevant state. As a practical matter, this approach eliminates from the MAIE/ULOE disqualification scheme all orders that are not bars or revocation of registration or licensure. We believe such an approach would be incompatible with the language of Section 926, which, by its terms, covers both bars and other final orders. For that reason, we have not adopted it. We may, however, take the fact that registration or licensure has not been suspended or revoked into account when considering waiver applications.

F. Transition Issues

1. Disqualification Applies Only to Triggering Events That Occur After Effectiveness of the Rule Amendments

Under the proposal, the new disqualification provisions would have applied to all sales made under Rule 506 after the effective date of the rule amendments. Offerings made after the effective date would have been subject to disqualification for all disqualifying events that occurred within the relevant look-back periods, regardless of whether the events occurred before enactment of the Dodd-Frank Act, or the proposal or effectiveness of the amendments to Rule 506.

We requested comment on this approach, both in broad terms and as to specific aspects, such as whether we should make special provision for orders issued in the context of negotiated settlements and whether we should provide for extensions of waivers granted with respect to bad actor disqualification under Regulation A, Rule 505 of Regulation D or

[211] *See* comment letters from ABA Fed. Reg. Comm.; MFA; Seward & Kissel.

[212] *See* 17 CFR 200.30–1(c).

[213] *See* comment letters from ABA Fed. Reg. Comm.; DTC; Lehman & Eilen; MFA; Rutledge; Whitaker Chalk.

[214] *See* comment letters from ABA Fed. Reg. Comm.; MFA; Rutledge.

[215] *See* comment letters from ABA Fed. Reg. Comm.; Coy Capital; NYCBA.

[216] *See* comment letter from REISA.

[217] *See* comment letters from ABA Fed. Reg. Comm.; Five Firms; IPA; I. Linder; Rutledge; SIFMA; Whitaker Chalk; *see also* comment letter from NYCBA. The Uniform Limited Offering Exemption was adopted by NASAA in 1983 and again in 1989. It is designed to provide a state-level exemption for offerings that are exempt from registration at the federal level under Rule 505 of Regulation D. Peter M. Fass and Derek A. Wittner, *Blue Sky Practice for Public and Private Direct Participation Offerings,* § 9.19 and Appendix 9A (Thomson Reuters/West 2008).

[218] *See* MAIE paragraphs (D)(2)(a)–(b) (available at *http://www.nasaa.org/wp-content/uploads/2011/07/24-Model_Accredited_Investor_Exemption.pdf*) *and* Fass and Wittner, note 205, at Appendix 9A, paragraph B.6.

[219] *See* comment letter from NASAA.

[220] *See* Rule 506(d)(2).

[221] Conversely, in cases where disqualification does not arise on the basis of an order, judgment or decree because the issuing authority advises that it should not, the Commission would not be precluded from pursuing its own enforcement action, which may result in a court order or judgment or a Commission order that constitutes an independent basis for disqualification.

Regulation E, so they would apply to Rule 506 disqualification as well. This section of the proposing release drew more comment than any other.

Five commenters supported including prior bad actor disqualifying events in the disqualification provisions, generally arguing, on investor protection grounds, that the purpose of the rule is to prevent all bad actors from participating in Rule 506 offerings.[222] For example, one such commenter asserted, ''[a]s between issuers and investors, it is far preferable that issuers face the delays or inconvenience necessary to cure disqualifications or register their offerings than for investors to be victimized by an issuer or promoter that was demonstrably unfit to invoke the Rule 506 exemption.'' [223] One commenter argued that contested proceedings should not be grandfathered because in those cases the respondent had no choice in the ultimate result of the proceeding.[224]

On the other hand, 15 comment letters requested that the Commission not apply the rules to past triggering events, or else provide for widespread grandfathering.[225] Critics of applying the rules to past events objected on the basis of statutory construction,[226] the Supreme Court decision in *Landgraf* v. *USI Film Products,*[227] and Congressional intent.[228] Many commenters also argued that such application of the new disqualification rules would unfairly upset previously negotiated civil and administrative settlements, or impose an unforeseeable new sanction in respect of prior conduct.[229] Several commenters recommended providing automatic waivers for settlements, or automatic extension of existing Regulation A and Rule 505 waivers if the new rules were to be applied to pre-existing events.[230] Another commenter argued that prospective application of disqualification provisions would be consistent with the Commission's approach to analogous bad actor disqualification provisions in the past, such as the ''ineligible issuer'' provisions of the Securities Offering Reform rule adopted in 2005 and the disqualification provisions adopted under the Private Securities Litigation Reform Act of 1995.[231]

In light of the views expressed by commenters, including concerns about potential unfairness, we have determined not to trigger Rule 506 disqualification on the basis of preexisting events. Accordingly, the amendments we are adopting today include a provision specifying that disqualification will not arise as a result of triggering events that occurred before the effective date of the rule amendments.[232] We will, however, require disclosure to investors regarding such events.

2. Mandatory Disclosure of Triggering Events That Pre-Date Effectiveness of the Rule Amendments

In the proposing release, we solicited comment on whether we should require disclosure, rather than disqualification, for bad actor triggering events that occurred before the effective date of the new rules. Several commenters were supportive.[233] One commenter viewed the disclosure requirement favorably as a way to balance fairness to issuers and other covered persons with the need for investor protection without impairing the effectiveness of the rule.[234] This commenter noted that any negative impact associated with applying disqualification only to events occurring after the effective date of the rule amendments would be ameliorated by requiring disclosure to investors of the existence of the event. Another commenter viewed disclosure as an appropriate method of dealing with past orders or convictions rather than imposing automatic disqualification since issuers would be unable to revisit the disqualifying conduct and alter the collateral consequences of those past convictions and orders as a result of the new disqualifying provisions.[235] In addition, one commenter argued more generally that the disqualification rules should be broadly reconsidered and a disclosure-based approach adopted instead.[236]

In lieu of imposing disqualification for pre-existing triggering events, the rule amendments require written disclosure of matters that would have triggered disqualification, except that they occurred before the effective date of the new disqualification provisions.[237] In light of Congress' concerns about the participation of certain felons and other bad actors in Rule 506 offerings, we believe this disclosure is important to put investors on notice of bad actor involvement in Rule 506 offerings that they are evaluating as potential investments. We believe this is particularly important after adoption of the new bad actor disqualification requirements for Rule 506 offerings because, as a result of the adoption of the new requirements implementing Section 926, investors may have the impression that all bad actors are now disqualified from participation in Rule 506 offerings. We expect that issuers will give reasonable prominence to the disclosure to ensure that information about pre-existing bad actor events is appropriately presented in the total mix of information available to investors.

The disclosure requirement in new Rule 506(e) will apply to all offerings under Rule 506, regardless of whether purchasers are accredited investors. Issuers will be required to provide disclosure ''a reasonable time prior to sale,'' which is the same timing that currently applies to disclosures to non-accredited investors under Rule 502(b)(1).[238]

If disclosure is required and not adequately provided to an investor, we do not believe that relief will be available under Rule 508, under which ''insignificant deviations'' from Regulation D requirements do not necessarily result in loss of the Securities Act exemption with regard to an offer or sale of securities to a particular individual or entity.[239] For Rule 508 to apply to an offer or sale of securities, the failure to comply with a Regulation D requirement must not pertain to a term, condition or requirement directly intended to protect that offeree or purchaser.[240] Disclosure of pre-existing triggering events under

[222] *See* comment letters from Anonymous (July 12, 2011); Better Markets; J. Davis (June 13, 2011); DTC; NASAA.

[223] *See* comment letter from Better Markets.

[224] *See* comment letter from Lehman & Eilen.

[225] *See* comment letters from Alfaro; ABA Fed. Reg. Comm.; Cleary Gottlieb; Coy Capital; Five Firms; IPA; Katten Muchin; Munck Carter; NYCBA; REISA; Rutledge; Seward & Kissel; SIFMA; S&C; Whitaker Chalk.

[226] *See* comment letters from ABA Fed. Reg. Comm.; Coy Capital; Five Firms; MFA; NYCBA; S&C.

[227] *See* comment letters from ABA Fed. Reg. Comm.; Coy Capital; Five Firms.

[228] *See* comment letters from Five Firms; MFA.

[229] *See* comment letters from ABA Fed. Reg. Comm.; Coy Capital; IPA; Lehman & Eilen; MFA; Munck Carter; REISA; Rutledge; SIFMA; Whitaker Chalk.

[230] *See* comment letters from ABA Fed. Reg. Comm.; Cleary Gottlieb; Five Firms; Rutledge; S&C.

[231] *See* comment letter from ABA Fed. Reg. Comm.

[232] *See* Rule 506(d)(2)(i). The rule looks to the timing of the triggering event (*e.g.,* a criminal conviction or court or regulatory order) and not the timing of the underlying conduct. A triggering event that occurs after effectiveness of the rule amendments will result in disqualification, even if the underlying conduct occurred before effectiveness.

[233] *See* comment letters from Lehman & Eilen; Munck Carter; REISA.

[234] *See* comment letter from Munck Carter.

[235] *See* comment letter from REISA.

[236] *See* comment letter from ABA Fed. Reg. Comm.

[237] *See* Rule 506(e).

[238] 17 CFR 230.502(b)(1).

[239] *See* note 190.

[240] *See* 17 CFR 230.508(a)(1).

new Rule 506(e) is intended to benefit all investors by alerting them to any bad actors associated with the issuer or the offering, and, therefore, this condition of Rule 508 cannot be met where the required disclosure is not provided.

Rule 506(e) does, however, provide that the failure to furnish required disclosure on a timely basis will not prevent an issuer from relying on Rule 506 if the issuer establishes that it did not know, and in the exercise of reasonable care could not have known, of the existence of the undisclosed matter or matters. This ''reasonable care'' exception to the disclosure requirement is similar to the ''reasonable care'' exception to disqualification we are also adopting today, and will preserve an issuer's claim to reliance on Rule 506 if disclosure is required but the issuer can establish that it did not know and in the exercise of reasonable care could not have known of the matters required to be disclosed. The provision also includes an instruction, similar to the instruction to Rule 506(d)(2)(iv), clarifying that reasonable care requires factual inquiry.

3. Timing of Implementation

Under our proposal, the new bad actor disqualification rules would have been implemented without any deferral period. We solicited comment on whether deferral would be appropriate. While two commenters opposed any delayed implementation, citing investor protection concerns,[241] several others urged us to implement the rules on a delayed basis to permit issuers to put compliance procedures in place and allow time for obtaining any necessary waivers.[242]

As adopted, the bad actor disqualification provisions of Rule 506(d) will take effect 60 days after publication in the **Federal Register**, without any additional deferral period. We concluded that an additional deferral is not necessary or appropriate since disqualification will not be imposed in respect of pre-existing triggering events so, although issuers and other offering participants will need to make reasonable factual inquiries during this 60-day period, no additional time is needed for waivers to be sought in respect of such events. Accordingly, the new disqualification provisions of Rule 506(d) and the mandatory disclosure provision of Rule 506(e) will apply to each sale of securities made in reliance on Rule 506 after the rule amendments go into effect.

As we discussed in the proposing release, sales of securities made before the applicable effective dates will not be affected by any disqualification or disclosure requirement, even if such sales are part of an offering that continues after the relevant effective date. Only sales made after the effective date of the amendments will be subject to disqualification and mandatory disclosure.

Disqualifying events that occur while an offering is underway will be treated in a similar fashion. Sales made before the occurrence of the disqualification trigger will not be affected by it, but sales made afterward will not be entitled to rely on Rule 506 unless the disqualification is waived or removed, or, if the issuer is not aware of a triggering event, the issuer can rely on the reasonable care exception.[243]

This approach is consistent with our other rules and we believe provides appropriate incentives to issuers and other covered persons. We solicited comment on other possible approaches, including not applying the new rules to offerings that are underway at the time of effectiveness of the new disqualification provisions. Several commenters supported complete or partial grandfathering for offerings that are underway at the time of effectiveness.[244] We do not think such grandfathering would be necessary, given that pre-existing events will give rise only to a disclosure requirement and not to disqualification. Further, some ongoing offerings could continue for years after the rule amendments take effect. We do not believe it would be appropriate to implement Section 926 in a way that would exempt such offerings on a long-term basis. Issuers should be able to make reasonable factual inquiries and prepare any necessary disclosures during the 60 days before the rules become effective.

G. Amendment to Form D

We are adopting as proposed the conforming amendment to Form D. Under the amendment, the signature block of the Form D will contain a certification, similar to the current certification by Rule 505 issuers, whereby issuers claiming a Rule 506 exemption will confirm that the offering is not disqualified from reliance on Rule 506 for one of the reasons stated in Rule 506(d).

III. Paperwork Reduction Act

A. Background

The mandatory disclosure provisions required under the final rules contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[245] The title for the collection of information is:

- ''Regulation D Rule 506(e) Felons and Other Bad Actors Disclosure Statement.'' We are requesting comment on the collection of information requirements in this adopting release, and are submitting these requirements to the Office of Management and Budget (''OMB'') for review in accordance with the PRA and its implementing regulations.[246] We are applying for an OMB control number for the proposed new collection of information in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13, and OMB has not yet assigned a control number to the new collection. Responses to the new collection of information would be mandatory. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

As adopted, the amendments to Rule 506 require that the issuer furnish to each purchaser, a reasonable time prior to sale, a written description of any matters that occurred before effectiveness of the final amendments and within the time periods described in the list of disqualification events set forth in Rule 506(d)(1) of Regulation D, in regard to the issuer or any other ''covered person'' associated with the offering. For purposes of the mandatory disclosure provision of Rule 506(e), issuers will be required to ascertain whether any disclosures are required in respect of covered persons involved in their offerings, prepare any required disclosures and furnish them to purchasers.

The Commission adopted the Regulation D Rule 506(e) Felons and Other Bad Actors Disclosure Statement under the Securities Act. The Regulation D Rule 506(e) Felons and Other Bad Actors Disclosure Statement required to be furnished to investors does not involve submission of a form

[241] *See* comment letters from DTC; NASAA.

[242] *See, e.g.,* comment letters from ABA Fed. Reg. Comm.; Five Firms; Kutak Rock; NYCBA; SIFMA.

[243] Disqualifying events that exist at the time the offering is commenced but are only discovered later will be disqualifying, and the sales will not be eligible for reliance on Rule 506, subject to the application of the reasonable care exception.

[244] *See* comment letters from Katten Muchin; Whitaker Chalk; Coy Capital; Rutledge.

[245] 44 U.S.C. 3501 *et seq.*

[246] In the proposing release, we did not submit a PRA analysis because we did not propose mandatory disclosure of past disqualifying events. At this time, we do not have any comments regarding overall burden estimates for the rule amendments. This release is requesting such comments.

filed with the Commission and is not required to be presented in any particular format, although it must be in writing. The hours and costs associated with preparing and furnishing the Regulation D Rule 506(e) Felons and Other Bad Actors Disclosure Statement to investors in the offering constitute reporting and cost burdens imposed by the collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The disclosure or paperwork burden imposed on issuers appears in Rule 506(e) and pertains to events that occurred before effectiveness of the final rules but which would have triggered disqualification had they occurred after effectiveness. Issuers relying on Rule 506 must furnish disclosure of any relevant past events listed in Rule 506(e) that relate to the issuer or any other covered person. If there are any such events, a disclosure statement is required to be furnished, a reasonable time before sale, to all purchasers in the offering. The disclosure requirement serves to protect purchasers by ensuring that they receive information regarding any covered persons that were subject to such disqualifying events.

The disclosure requirement does not apply to triggering events occurring after the effective date of the rule amendments adopted today, because those events will result in disqualification from reliance on Rule 506 (absent a waiver or other exception provided in Rule 506(d)), rather than any disclosure obligation.

The steps that issuers will take to comply with the disclosure requirement are expected to mirror the steps they take to determine whether they are disqualified from relying on Rule 506. We expect that issuers planning or conducting a Rule 506 offering will undertake a factual inquiry to determine whether they are subject to any disqualification. Disqualification and mandatory disclosure are triggered by the same types of events in respect of the same covered persons, with disqualification arising from triggering events occurring after these rules take effect and mandatory disclosure applicable to events occurring before that date. Therefore, we expect that factual inquiry into potential disqualification can simply be extended to cover the period before the rules become effective. On that basis, we expect that the factual inquiry process for the disclosure statement requirement will impose a limited incremental burden on issuers.

As stated earlier, we expect that the size of the issuer and the circumstances of the particular Rule 506 offering will determine the scope of the factual inquiry and require tailored and offering-specific data gathering approaches. It should not generally be necessary for any issuer or any compensated solicitor to make inquiry of any covered individual with respect to ascertaining the existence of events that require disclosure more than once, because the period to be covered by the inquiry ends with the effective date of the new disqualification rules (so future events are unlikely to affect the inquiry or change the disclosures that have to be made). We do, however, expect that issuers may be required to revise their factual inquiry for each Rule 506 offering due to changes in management or intermediaries, other changes to the group of covered persons or if questions arise about the accuracy of previous responses. We also expect that the disclosure requirement may serve the additional function of helping issuers develop processes and procedures for the factual inquiry required to establish reasonable care under the disqualification provisions of Rule 506(d), which will be effective prospectively.

B. Burden and Cost Estimates Related to the Adopted Amendments

We anticipate that the disclosure requirement will result in an incremental increase in the burdens and costs for issuers that rely on the Rule 506 exemption by requiring these issuers to conduct factual inquiries into the backgrounds of covered persons with regard to events that occurred before effectiveness of the final bad actor disqualification rules. For purposes of the PRA, we estimate the total annual increase in paperwork burden for all affected Rule 506 issuers to comply with our proposed collection of information requirements to be approximately 22,108 hours of company personnel time and approximately $264,000 for the services of outside professionals. These estimates include the incremental time and cost of conducting a factual inquiry to determine whether the Rule 506 issuers have any covered persons with past disqualifying events. The estimates also include the cost of preparing a disclosure statement that issuers are required to furnish to each purchaser a reasonable time prior to sale.[247]

In deriving our estimates, we assume that:

- Approximately 19,908 Rule 506 issuers[248] relying on Rule 506 of Regulation D will spend on average one additional hour to conduct a factual inquiry to determine whether any covered persons had a disqualifying event that occurred before the effective date of the rule amendments; and
- On the basis of the factual inquiry, approximately 220[249] Rule 506 issuers will spend ten hours to prepare a disclosure statement describing matters that would have triggered disqualification under Rule 506(d)(1) of Regulation D had they occurred on or after the effective date of the rule amendments; and
- For purposes of the disclosure statement, 220 Rule 506 issuers will retain outside professional firms to spend three hours on disclosure preparation at an average cost of $400 per hour.

The increase in burdens and costs associated with conducting the factual

[247] 17 CFR 230.502(b)(2)(iii).

[248] Filing data reviewed by the staff of the Commission's Division of Economic and Risk Analysis indicate that for 2012, 15,028 issuers claiming the Rule 506 exemption filed one Form D and 1,250 such issuers filed more than one Form D. For purposes of the PRA estimates, we assume that all initial filers and approximately one quarter of repeat filers will conduct a factual inquiry, with the remaining repeat filers relying on prior factual inquiries. There is evidence that some issuers are not filing Form D for their offerings in compliance with Rule 503 as discussed in Part IX.B.4.a. of *Amendments to Regulation D, Form D and Rule 156 under the Securities Act,* Proposing Release No. 33–9416, (July 10, 2013). In addition, we estimate that the amendments to Rule 506(c) adopted today will result in a 20% increase in Form D filings relying on the Rule 506(c) exemption. *See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings,* Adopting Release No. 33–9415, Part V.B. (July 10, 2013). For purposes of our PRA estimates, we have assumed that the estimated 20% increase in the number of Form D filings corresponds to a 20% increase in the number of issuers that will need to conduct a factual inquiry to determine whether a disclosure statement is necessary.

[249] Staff estimates that there were at least 549 SEC enforcement cases involving an unregistered offering in which someone who would be disqualified as a bad actor participated in the five years from 2007 through 2011, *see* Part IV.B.3, or at least 110 such offerings per year. This is a lower bound estimate based on a review of triggering events arising from Commission action only, and not other triggering events such as criminal convictions and state regulatory action. For purposes of the Paperwork Reduction Act analysis, we are doubling the number of Rule 506 offerings estimated to involve a bad actor, to account for such other triggering events. We are not aware of any database that would allow us to estimate with precision the number of other triggering events or the number of additional bad actors associated with them. Some data on state enforcement actions indicate that there would be a substantial number of other triggering events (*see, e.g.,* NASAA's 2012 Enforcement Report, discussed at text accompanying note 283); however, the data do not allow us to determine how many state enforcement actions are unique, as more than one state may take regulatory action against the same person and some state actions may overlap with Commission actions.

inquiry for the disclosure statement requirement should pose a minimal incremental effort given that issuers are simultaneously required to conduct a similar factual inquiry for purposes of determining disqualification from the Rule 506 exemption.

It is difficult to provide any standardized estimates of the costs involved with the factual inquiry. There is no central repository that aggregates information from all federal and state courts and regulators that would be relevant in determining whether a covered person has a disqualifying event in his or her past. In this regard, we are currently unable to accurately estimate the burdens and costs for issuers in a verifiable way. We expect, however, that the costs to issuers may be higher or lower depending on the size of the issuer and the number and roles of covered persons. We realize there may be a wide range of issuer size, management structure, and offering participants involved in Rule 506 offerings and that different issuers may develop a variety of different factual inquiry procedures.

Where the issuer or any covered person is subject to an event listed in Rule 506(e) existing before the effective date of these rules, the issuer will be required to prepare disclosure for each relevant Rule 506 offering. The estimates include the time and the cost of data gathering systems, the time and cost of preparing and reviewing disclosure by in-house and outside counsel and executive officers, and the time and cost of delivering or furnishing documents and retaining records.

Issuers conducting ongoing or continuous offerings will be required to update their factual inquiry and disclosure as necessary to address additional covered persons. The annual incremental paperwork burden, therefore, depends on an issuer's Rule 506 offering activity and the changes in covered persons from offering to offering. For example, some issuers may only conduct one Rule 506 offering during a year while other issuers may have multiple, separate Rule 506 offerings during the course of the same year involving different financial intermediaries, may hire new executive officers or may have new 20% shareholders, any of which will result in a different group of covered persons. In deriving our estimates, we recognize that the burdens will likely vary among individual companies based on a number of factors, including the size and complexity of their organizations. We believe that some companies will experience costs in excess of this estimated average and some companies may experience less than the estimated average costs.

Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;
- Evaluate the accuracy of our estimate of the burden of the proposed collections of information;
- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;
- Evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- Evaluate whether the proposed amendments will have any effects on any other collections of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who wish to submit comments on the collection of information requirements should direct their comments to OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503 and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090, with reference to File No. S7–31–10. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7–31–10 and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street NE., Washington, DC 20549–0213. Because OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if OMB receives them within 30 days of publication.

IV. Economic Analysis

A. Background and Summary of the Rule Amendments

As discussed above, we are adopting amendments to implement the requirements of Section 926 of the Dodd-Frank Act, relating to the disqualification of ''felons and other 'bad actors' '' from participation in Rule 506 offerings. Section 926 of the Dodd-Frank Act requires the Commission to issue rules that disqualify issuers making securities offerings involving felons and other bad actors from relying on Rule 506 of Regulation D. These rules are required to be ''substantially similar'' to the disqualification rules in Rule 262 (which apply to Regulation A offerings as well as offerings under Rule 505 of Regulation D) and also to cover the matters enumerated in Section 926 (including certain state regulatory orders and bars). We believe the rules we are adopting comply with that mandate. The final rules include the following provisions not specifically required under Section 926:

- A reasonable care exception;
- Mandatory disclosure of triggering events pre-dating the effective date of the rule amendments;
- The inclusion of additional triggering events for certain orders of the CFTC and for Commission cease-and-desist orders relating to scienter-based anti-fraud violations and violations of Section 5 of the Securities Act;
- The addition of coverage of investment managers of pooled investment funds and directors, executive officers, other officers participating in the offering, general partners and managing members of such investment managers and directors, executive officers and other officers participating in the offering of such general partners and managing members;
- Narrower coverage of officers of issuers and financial intermediaries (covering only executive officers and officers participating in the offering, rather than all officers);
- Narrower coverage of shareholders of the issuer (covering only beneficial owners of at least 20% of the issuer's outstanding voting securities, calculated on the basis of voting power, rather than 10% of any class of the issuer's equity securities); and
- A provision under which disqualification will not be triggered by regulatory orders if the authority that issued the order advises in writing that Rule 506 disqualification should not arise.

While commenters had differing views on whether disqualification under Rule 506 could or should be applied to events that occurred before the effective date of the rule amendments, we determined to apply disqualification only to events that occur after effectiveness of the rule amendments.

As noted above, we are requiring disclosure of disqualifying events that pre-date effectiveness of the amendments.

We are sensitive to the costs and benefits imposed by our rules. The discussion below attempts to address both the costs and benefits of Section 926 of the Dodd-Frank Act itself, as well as the incremental costs and benefits of the rules and rule amendments associated with the exercise of our discretion in implementing Section 926. The costs and benefits attributable to the statutory mandate and those attributable to our discretion may not be entirely separable to the extent that our discretion is exercised to realize the benefits that we believe were intended by the Dodd-Frank Act.

Section 2(b) of the Securities Act [250] requires us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. We have considered those issues as part of this economic analysis.

B. Economic Baseline

The baseline analysis that follows is in large part based on information collected from Form D filings submitted by issuers relying on Regulation D to raise capital. As we describe in more detail below, we believe that we do not have a complete view of the Rule 506 market, particularly with respect to the amount of capital raised. Currently, issuers are required to file a Form D within 15 days of the first sale of securities, and are required to report additional sales through amended filings only under certain conditions. In addition, issuers may not report all required information, either due to error or because they do not wish to make the information public. Commenters have suggested and we also have evidence that some issuers do not file a Form D for their offerings in compliance with Rule 503.[251] Consequently, the analysis that follows is necessarily subject to these limitations in the current Form D reporting process.

1. Size of the Exempt Offering Market

Exempt offerings play a significant role in capital formation in the United States. Offerings conducted in reliance on Rule 506 account for 99% of the capital reported as being raised under Regulation D from 2009 to 2012, and represent approximately 94% of the number of Regulation D offerings.[252] The significance of Rule 506 offerings is underscored by the comparison to registered offerings. In 2012, the estimated amount of capital reported as being raised in Rule 506 offerings (including both equity and debt) was $898 billion, compared to $1.2 trillion raised in registered offerings.[253] Of this $898 billion, operating companies (issuers that are not pooled investment funds) reported raising $173 billion, while pooled investment funds reported raising $725 billion.[254] The amount reported as being raised by pooled investment funds is comparable to the amount of capital raised by registered investment funds. In 2012, registered investment funds (which include money market mutual funds, long-term mutual funds, exchange-traded funds, closed-end funds and unit investment trusts) raised approximately $727 billion.[255]

In 2011, the estimated amount of capital (including both equity and debt) reported as being raised in Rule 506 offerings was $849 billion compared to $985 billion raised in registered offerings.[256] Of the $849 billion, operating companies reported raising $71 billion, while pooled investment funds reported raising $778 billion.[257] More generally, when including offerings pursuant to other exemptions—Rule 144A, Regulation S and Section 4(a)(2)—significantly more capital appears to be raised through exempt offerings than registered offerings (Figure 1).[258]

[250] 15 U.S.C. 77b(b).

[251] Many commenters asserted that non-compliance with Form D filing obligations is widespread. *See, e.g.,* letters from Investor Advisory Committee (stating that ''[i]t is generally acknowledged that a significant number of issuers do not currently file Form D. . .''); AARP (stating that ''[s]imply adding a checkbox to a form that too often goes unfiled and then only after the fact is inadequate to the task at hand.''); AFL–CIO and AFR (stating that ''many issuers today flout the Form D filing requirement for such offerings, further limiting the Commission's ability to provide effective oversight''). *See also* Securities and Exchange Commission, Office of Inspector General, *Regulation D Exemption Process* (Mar. 31, 2009) (''OIG Report''), available at: *http://www.sec-oig.gov/Reports/AuditsInspections/2009/459.pdf* (stating that while the Commission staff ''strongly encourage companies to comply with Rule 503, they are aware of instances in which issuers have failed to comply with Rule 503 . . .''). Based on its analysis of the filings required by FINRA Rules 5122 and 5123 during the period of December 3, 2012 to February 5, 2013, DERA estimates that as many as 9% of the offerings represented in the FINRA filings for Regulation D or other private offerings that used a registered broker did not have a corresponding Form D.

[252] *See* Vladimir Ivanov and Scott Bauguess, *Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009–2012* (July 2013), available at *http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf* (''Ivanov/Bauguess Study'').

[253] *See id.*

[254] *See id.*

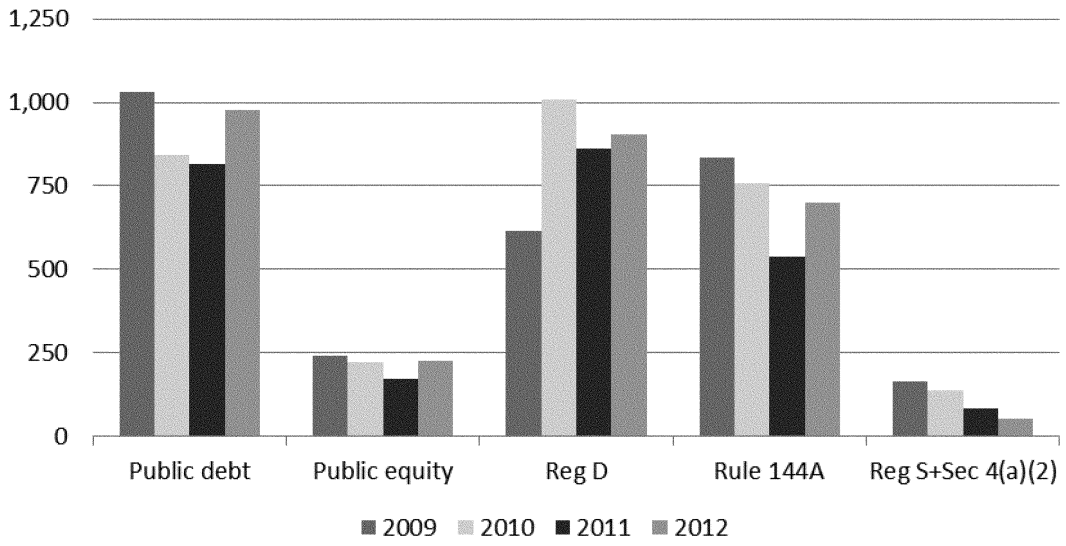
[255] In calculating the amount of capital raised by registered investment funds, we use the net amounts (plus reinvested dividends and reinvested capital gains), which reflect redemptions, and not gross amounts, by open-ended registered investment funds because they face frequent redemptions, and do not have redemption restrictions and lock-up periods common among private funds. In addition, we use the new issuances of registered closed-end funds and the new deposits of registered unit investment trusts. *See* 2013 Investment Company Institute Factbook, available at *http://www.icifactbook.org.*

[256] *See* Ivanov/Bauguess Study.

[257] *See id.*

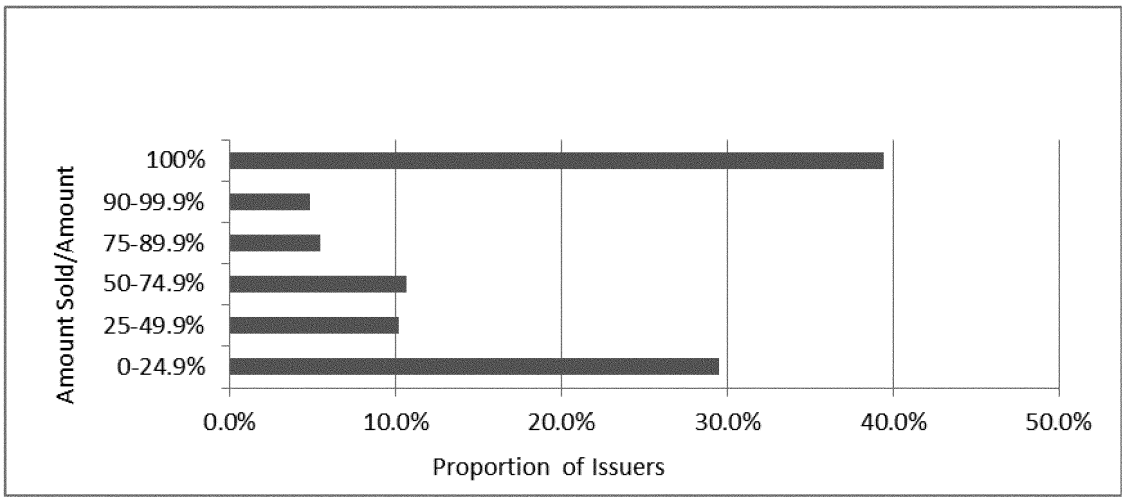
[258] *See id.*

Figure 1: Capital Raised in U.S. Capital Markets during 2009-2012[259]



At present, issuers are required to file a Form D not later than 15 days after the first sale of securities in a Regulation D offering and an amendment to the Form D only under certain circumstances. Since issuers are not required to submit a filing when an offering is completed, and submit amendments only under certain circumstances, we have no definitive information on the final amounts raised. Figure 2, below, illustrates that at the time of the initial Form D filing, only 39% of offerings by non-pooled investment fund issuers were completed relative to the total amount sought. Separately, 70% of pooled investment funds state their total offering amount to be ''Indefinite'' in their Form D filings. As a result, the initial Form D filings of these pooled investment funds likely do not accurately reflect the total amount of securities offered or sold.

Figure 2: Amount Sold as Percentage of Total Offering Amount by Non-Pooled Investment Fund Issuers in Regulation D Offerings at the Time of Form D Filing: 2009-2012



2. Affected Market Participants

The amendments to Rule 506 we are adopting today will affect a number of different market participants. Issuers of securities in Rule 506 offerings include both reporting and non-reporting operating companies and pooled investment funds. Investment advisers organize and sponsor pooled investment

[259] The 2012 non-ABS Rule 144A offerings data is based on an extrapolation of currently available data through May 2012 from Sagient Research System's Placement Tracker database. For more detail, see the Ivanov/Bauguess Study.

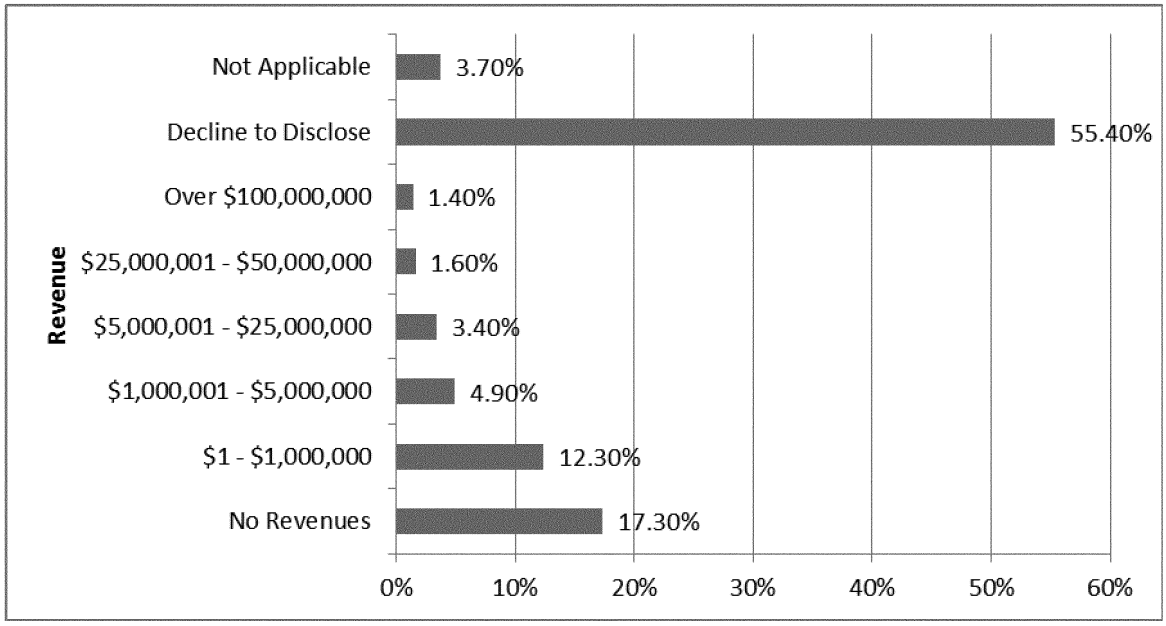
funds that conduct Rule 506 offerings. Intermediaries that facilitate Rule 506 offerings include registered broker-dealers, finders and placement agents. Investors in Rule 506 offerings include accredited investors (both natural persons and legal entities) and non-accredited investors who meet certain ''sophistication'' requirements. Each of these market participants is discussed in further detail below.

a. Issuers

Based on the information submitted in 112,467 new and amended Form D filings between 2009 and 2012, there were 67,706 new Regulation D offerings by 49,740 unique issuers during this four-year period.[260] The size of the average Regulation D offering during this period was approximately $30 million, whereas the size of the median offering was approximately $1.5 million.[261] The difference between the average and median offering sizes indicates that the Regulation D market is comprised of many small offerings, which is consistent with the view that many smaller businesses are relying on Regulation D to raise capital, and a smaller number of much larger offerings.

Some information about issuer size is available from Item 5 in Form D, which calls for issuers in Regulation D offerings to report their size in terms of revenue ranges or, in the case of certain pooled investment funds, net asset value ranges. All issuers can currently choose not to disclose this size information, however, and a significant majority of issuers that are not pooled investment funds declined to disclose their revenue ranges in the Forms D that they filed between 2009 and 2012. For those that did, most reported a revenue range of less than $1 million (Figure 3).[262] During the 2009–2011 period, approximately 10% of all public companies raised capital in Regulation D offerings; in 2012, approximately 6% of such companies did so.[263] These public companies tended to be smaller and less profitable than their industry peers, which illustrates the significance of the private capital markets to smaller companies, whether public or private.[264]

Figure 3: Distribution of Non-Pooled Investment Fund Issuers in Regulation D Market by Revenue: 2009-2012



During this period, pooled investment funds conducted approximately 24% of the total number of Regulation D offerings and raised approximately 81% of the total amount of capital raised in Regulation D offerings.[265] More than 75% of pooled investment funds declined to disclose their net asset value range.

[260] *See* Ivanov/Bauguess Study.

[261] *See id. The average and median amounts are calculated based on the amounts sold by Regulation D issuers as reported in their Form D filings.* A study of unregistered equity offerings by publicly-traded companies over the period 1980–1996 found that the mean offering amount was $12.7 million, whereas the median offering amount was $4.5 million. *See* M. Hertzel, M. Lemon, J. Linck, and L. Rees, *Long-Run Performance Following Private Placements of Equity,* 57 Journal of Finance (2002), 2595–2617.

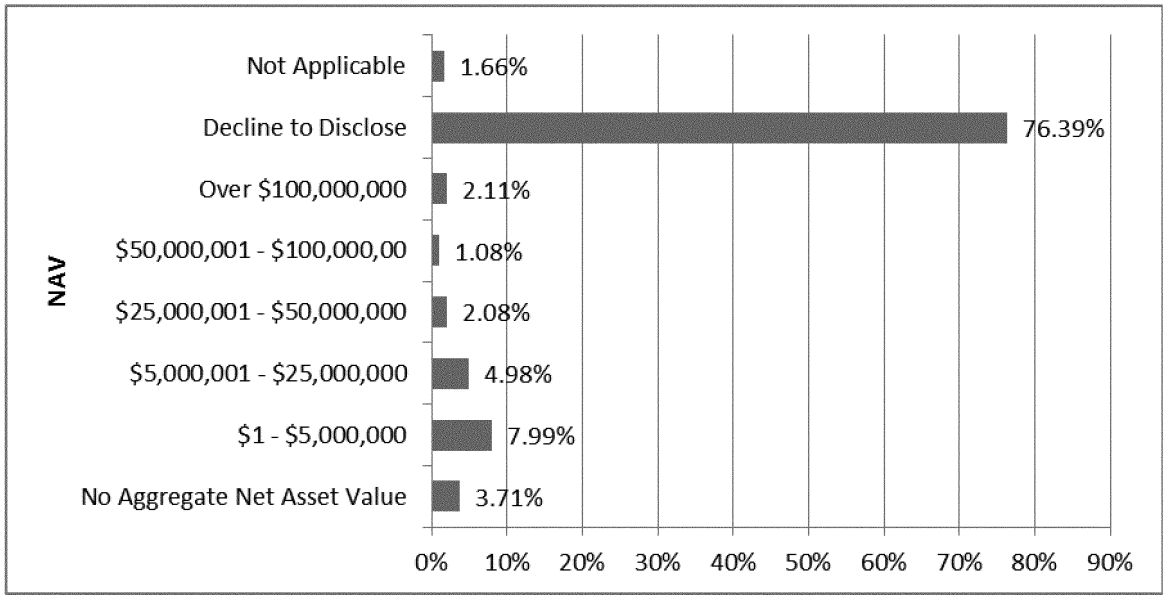
[262] *See* Ivanov/Bauguess Study.

[263] *Id.* (explaining methodology of using listings in the Standard & Poor's Compustat database and the University of Chicago's Center for Research in Securities Prices database to determine which companies were public companies).

[264] *Id.*

[265] *Id.*

Figure 4: Distribution of Pooled Investment Fund Issuers in Regulation D Market by Net Asset Value: 2009-2012



Between 2009 and 2012, approximately 66% of Regulation D offerings were of equity securities, and almost two-thirds of these were by issuers other than pooled investment funds.[266] Non-U.S. issuers accounted for approximately 19% of the amount of capital raised in Regulation D offerings, indicating that the U.S. market is a significant source of capital for these issuers.[267]

b. Investors

We have relatively little information on the types and number of investors in Rule 506 offerings. Form D currently requires issuers in Rule 506 offerings to provide information about the total number of investors who have already invested in the offering and the number of persons who do not qualify as accredited investors.[268] In 2012, approximately 153,000 investors participated in offerings by operating companies, while approximately 81,000 investors invested in offerings by pooled investment funds.[269] Because some investors participate in multiple offerings, these numbers likely overestimate the actual number of unique investors in these reported offerings. In offerings under Rule 506(b), both accredited investors and up to 35 non-accredited investors who meet certain sophistication requirements are eligible to purchase securities. In offerings under new Rule 506(c), only accredited investors will be eligible to purchase securities.

Information collected from Form D filings indicates that most Rule 506 offerings do not involve broad investor participation. More than two-thirds of these offerings have ten or fewer investors, while less than 5% of these offerings have more than 30 investors. Although Rule 506 currently allows for the participation of non-accredited investors who meet certain sophistication requirements, such non-accredited investors reportedly purchased securities in only 11% of the Rule 506 offerings conducted between 2009 and 2012.[270] Only 8% of the offerings by pooled investment funds included non-accredited investors, compared to 12% of the offerings by other issuers.[271]

[266] *Id.*

[267] *Id.*

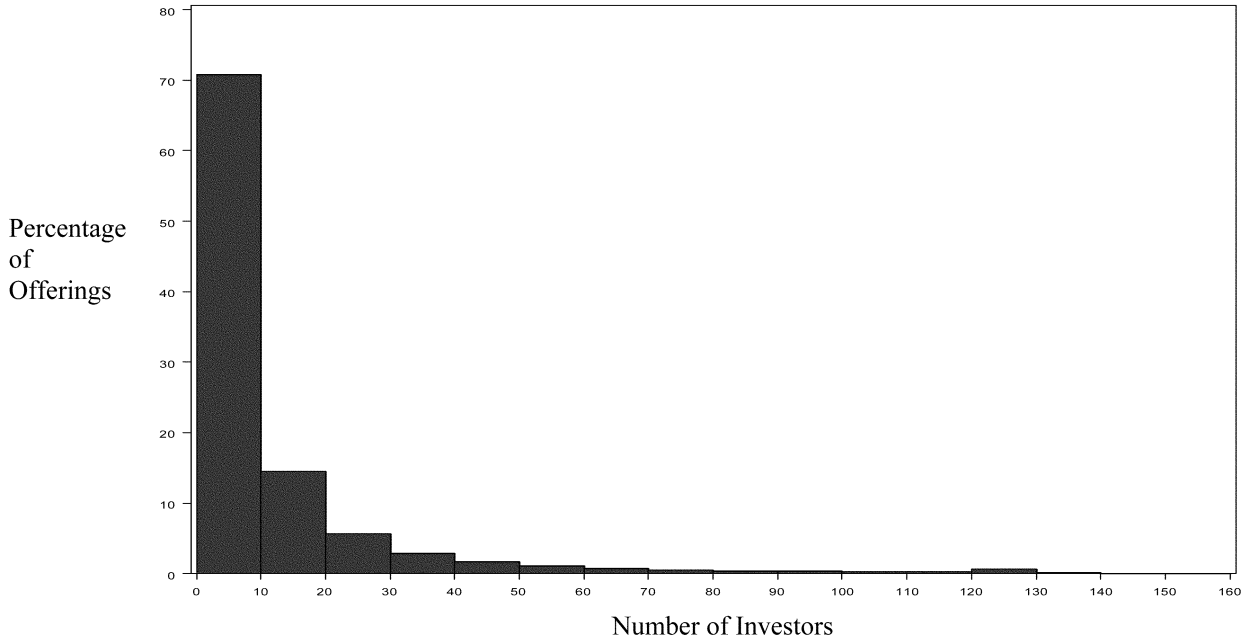
[268] *See* Item 14 of Form D. Form D does not require any other information on the types of investors, such as whether they are natural persons or legal entities.

[269] These numbers are based on initial Form D filings submitted in 2012.

[270] *See* Ivanov/Bauguess Study.

[271] *Id.*

Figure 5: Distribution of Regulation D Offerings by Number of Investors: 2009-2012



As stated above, between 2009 and 2012, the size of the median Regulation D offering, based on the information in Form D filings, was approximately $1.5 million. The presence of so many relatively small offerings suggests that a sizable number of current investors in Rule 506 offerings are natural persons or legal entities in which all equity owners are natural persons. This is because smaller offerings may not provide sufficient scale for institutional investors to earn a sizable return. Institutional investors typically have a larger investible capital base and more formal screening procedures compared to investors who are natural persons, and the associated costs of identifying potential investments and monitoring their investment portfolio lead them to make larger investments than natural persons.[272] As for whether natural persons investing in these offerings are accredited investors or non-accredited investors, almost 90% of the Regulation D offerings conducted between 2009 and 2012 did not involve any non-accredited investors.[273]

While we do not know what percentage of investors in Rule 506 offerings are natural persons, the vast majority of Regulation D offerings are conducted without the use of an intermediary,[274] suggesting that many of the investors in Regulation D offerings likely have a pre-existing relationship with the issuer or its management because these offerings would not have been conducted using general solicitation. This category of investors is likely to be much smaller than the total number of eligible investors for Rule 506(c) offerings, which is potentially very large. We estimate that at least 8.7 million U.S. households, or 7.4% of all U.S. households, qualified as accredited investors in 2010, based on the net worth standard in the definition of ''accredited investor'' (Figure 6).[275]

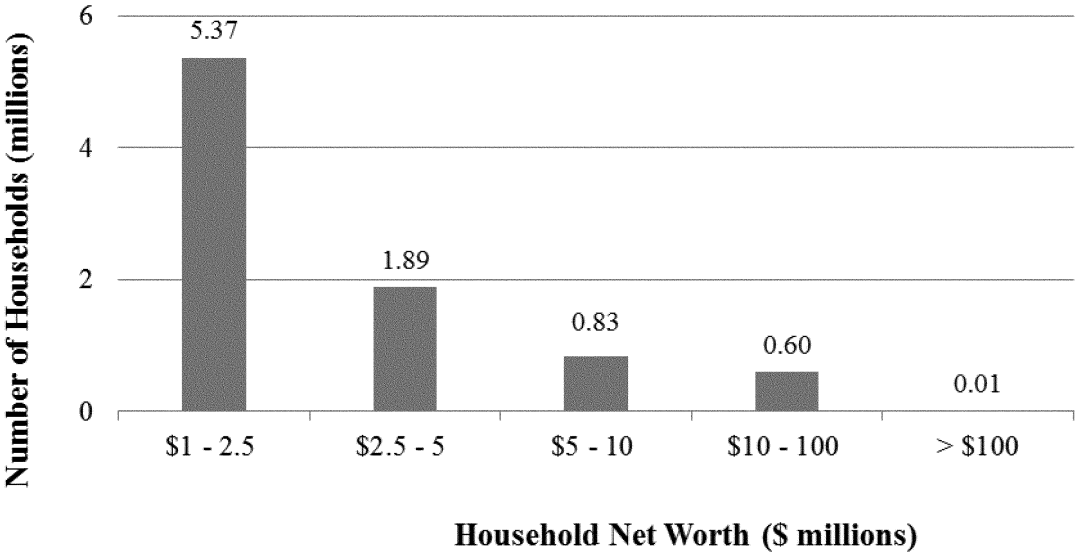
[272] See, *e.g.,* George Fenn, Nellie Liang and Stephen Prowes, The Economics of Private Equity Markets. (1998); Steven Kaplan and Per Stromberg, *Leveraged Buyouts and Private Equity,* Journal of Economic Perspectives (2009).

[273] *See* Ivanov/Bauguess Study.

[274] An analysis of all Form D filings submitted between 2009 to 2012 shows that approximately 11% of all new offerings reported sales commissions of greater than zero because the issuers used intermediaries. *See* Ivanov/Bauguess Study. We assume that the lack of a commission indicates the absence of an intermediary.

[275] This estimate is based on net worth and household data from the Federal Reserve Board's Triennial Survey of Consumer Finances (''SCF'') 2010. Our calculations are based on 32,410 observations in the 2010 survey.

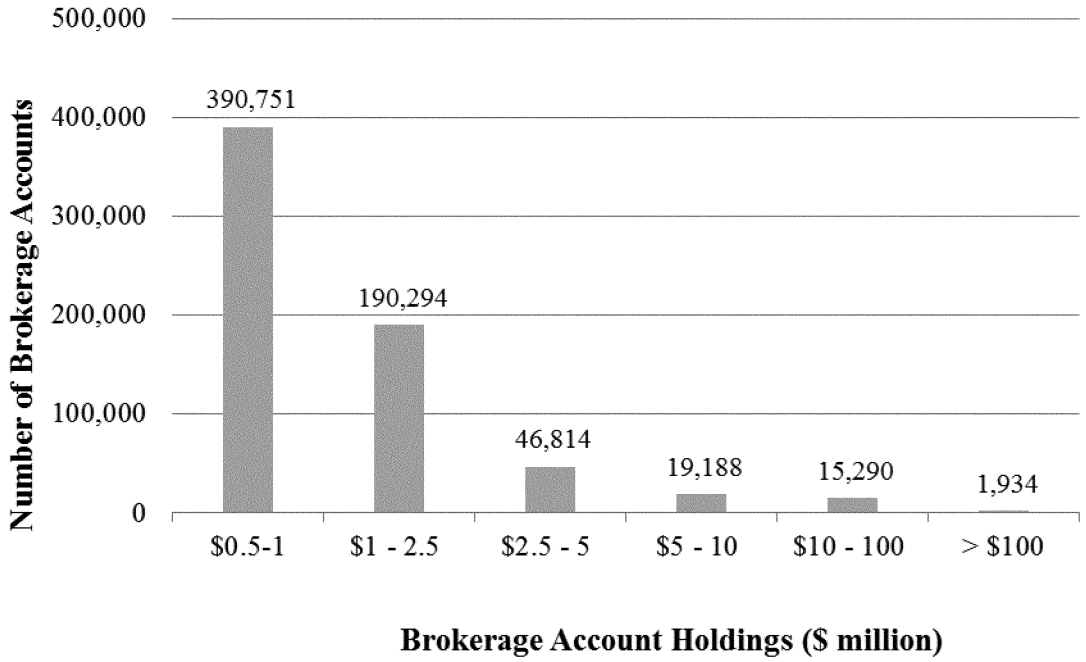
Figure 6: Number of U.S. Households that Qualify as Accredited Investors Based on 2010 Net Worth



Our analysis, however, leads us to believe that only a small percentage of these households are likely to participate in securities offerings, especially exempt offerings. First, as mentioned above, data from Form D filings in 2012 suggests that fewer than 234,000 investors (of which an unknown subset are natural persons) participated in Regulation D offerings, which is small compared to the 8.7 million households that qualify as accredited investors. Second, evidence suggests that only a small fraction of the total accredited investor population has significant levels of direct stockholdings. Based on an analysis of retail stock holding data for 33 million brokerage accounts in 2010, only 3.7 million accounts had at least $100,000 of direct investments in equity securities issued by public companies listed on domestic national securities exchanges, while only 664,000 accounts had at least $500,000 direct investments in such equity securities (Figure 7).[276] Assuming that investments in publicly-traded equity securities are a gateway to investments in securities issued in exempt offerings, and accredited investors with investment experience in publicly-traded equity securities are more likely to participate in an exempt offering than accredited investors who do not, the set of accredited investors likely to be interested in investing in Rule 506(c) offerings could be significantly smaller than the total accredited investor population.

[276] This analysis by DERA is based on the stock holdings of retail investors from more than 100 brokerage firms covering more than 33 million accounts during the period June 2010–May 2011.

Figure 7: Direct Stock Holdings of Retail Investors, 2010



c. Investment Managers

Based on Form ADVs that were filed with the Commission as of June 2013, there were 7,772 SEC reporting investment advisers that have clients that are private funds, registered investment companies business development companies, or other pooled investment vehicles. These investment advisers include:

- Registered investment advisers. Data filed for 2012 show that there were approximately 5,400 Commission-registered investment advisers with pooled investment fund clients that filed Form ADV with the Commission. These 5,400 investment advisers represent approximately $45.3 trillion total assets under management for pooled investment funds, or average assets under management of $8.4 billion per adviser. Of these, 4,044 investment advisers had clients that were private funds, with total assets under management of $35.2 billion and average assets under management of $8.6 billion.
- Exempt reporting advisers. These are investment advisers that are required to report on Form ADV but not to register with the Commission (for example, investment advisers to venture capital funds). Based on ADV data, there were 2,303 exempt reporting advisers in 2012, all of which had pooled investment funds as clients, with approximately $1.6 trillion of assets under management.

We do not have information regarding investment advisers with assets under management of less than $100 million, which are not generally required to register with the Commission, or investment managers that advise pooled investment funds with respect to investments in assets other than securities, such as commodities or real estate.

d. Broker-Dealers

As of December 2012, there were 4,450 broker-dealers registered with the Commission who file on Form X–17A–5, with average total assets of approximately $1.1 billion per broker-dealer. The aggregate total assets of these registered broker-dealers are approximately $4.9 trillion. Of these registered broker-dealers, 410 are dually registered as investment advisers. The dually registered broker-dealers are larger (average total assets of $6.4 billion) than those that are not dually registered. Among the dually registered broker-dealers, we identified 24 that currently have or have had private funds that submitted Form D filings between 2002 and 2012.

3. Estimated Incidence of ''Bad Actors'' in Securities Markets Generally

The economic impact of the rule amendments primarily depends on the extent to which they succeed in reducing fraud in the Rule 506 marketplace. This, in turn, depends on multiple factors, including the incidence of bad actors in Rule 506 offerings, the recidivism rate of such bad actors and the potential deterrent effect of disqualification as a sanction.

The disqualification rules should reduce the participation of both new and existing bad actors in Rule 506 offerings. Offerings will no longer be eligible to rely on Rule 506 if they involve a covered person that becomes a bad actor because of a triggering event that occurs after the new rules take effect. While triggering events existing before effectiveness of the rule will not be disqualifying, issuers will be required to provide disclosure about such events to investors. Participation in Rule 506 offerings by bad actors not disqualified by the rules we adopt today may, therefore, also be limited if issuers or investors are reluctant to transact with bad actors or participate in transactions involving bad actors once they become aware of the bad act through the required disclosure.

The effects of disqualification also depend on the likelihood that participation of bad actors in Rule 506 offerings would lead to the recurrence in perpetration of triggering events. This depends on the recidivism rates among bad actors.

Finally, the passage of the rule, through the deterrent effect of a potential threat of disqualification, could have the indirect impact of reducing the number of bad actors in the securities markets and the conduct resulting in sanctions that trigger disqualification.

Although it is impossible to predict future market participant behavior that may arise in response to the adopted rules, we can quantify, in certain instances, past occurrences of certain triggering events to provide an estimate of the historical incidence of bad actors—as determined under the new rules—in securities markets as a general matter.

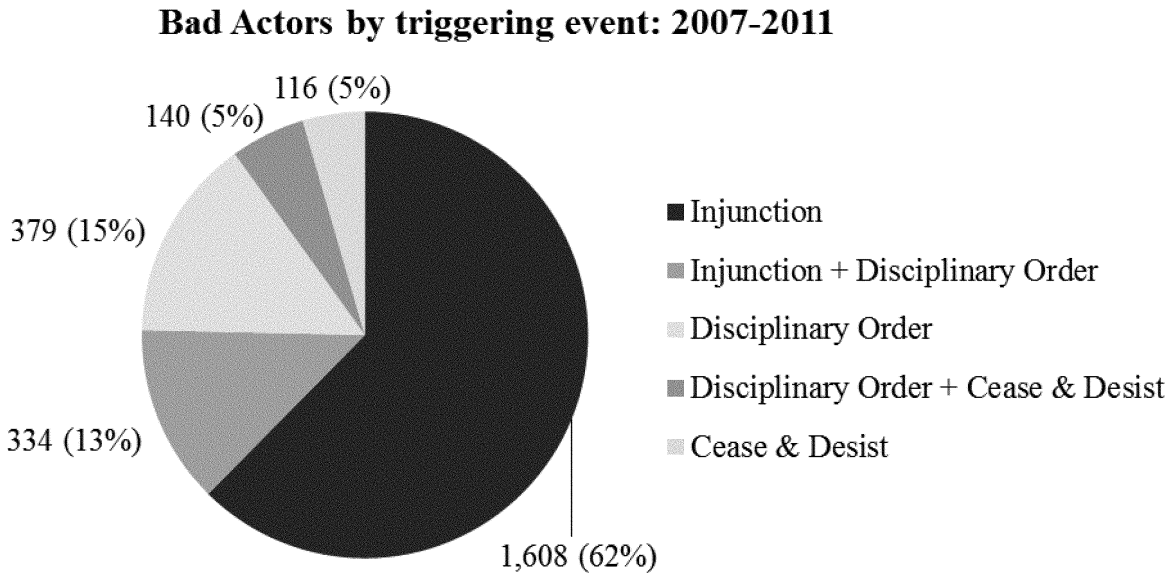
Identification of Triggering Events. To assess the incidence in the securities markets of potentially disqualifying ''bad actors,'' we examined the legal proceedings brought by the Commission during the five-year period from 2007 to 2011 in which the sanctions imposed would constitute triggering events under the new rule. We searched records of public proceedings, including case name, defendant name, code section violation, and sanction. To conduct the search, we used search terms pertaining to:

- Injunctions and court orders (which we refer to collectively as ''injunctions'') against conduct or practices in connection with the purchase or sale of a security, involving the making of a false filing with the Commission, or arising out of the conduct of business of certain financial intermediaries, as provided in Rule 506(d)(1)(ii);
- Commission disciplinary orders under Section 15(b) or 15B(c) of the Exchange Act or Section 203(e) or (f) of the Advisers Act that suspend or revoke registration, limit activities or bar a person from association with a regulated entity or from participation in a penny stock offering, as provided in Rule 506(d)(1)(iv); and
- Commission cease-and-desist orders relating to violations of scienter-based anti-fraud provisions of the federal securities laws or violations of Section 5 of the Securities Act, as provided in Rule 506(d)(1)(v).

Our analysis did not consider other bad actor triggering events in Rule 506(d)(1), primarily because we do not have a comparable ability to search databases relevant to criminal convictions or the actions of relevant state and other federal regulators.[277] In addition, it is possible that the search techniques used by staff may not have identified all relevant potential triggering events and bad actors. Since our analysis is subject to these limitations, our estimates of the incidence of potential bad actors likely represent a lower bound. On the other hand, not all of the bad actors identified in our search would be expected to be involved with Rule 506 offerings.

Our search of Commission enforcement actions identified a sample of 2,578 persons, including both individuals and entities, that received injunctions, disciplinary orders, and/or cease-and-desist orders, issued in a total of 1,485 enforcement cases over the five-year period. We found that an aggregate of 3,053 disqualifying sanctions (1,943 injunctions, 853 disciplinary orders, and 257 cease-and-desist orders) were imposed upon these persons. In some instances, a person received more than one sanction, which in most cases consisted of a combination of an injunction and a disciplinary order.[278] Each one of these sanctions would have constituted a triggering event under this rule, which would have disqualified any offering from relying on Rule 506 if the person were a ''covered person,'' such as a director or executive officer of the issuer or a financial intermediary. The following chart shows the breakdown of triggering events by type:

Figure 8: Distribution of Bad Actors by Triggering Events, 2007-2011



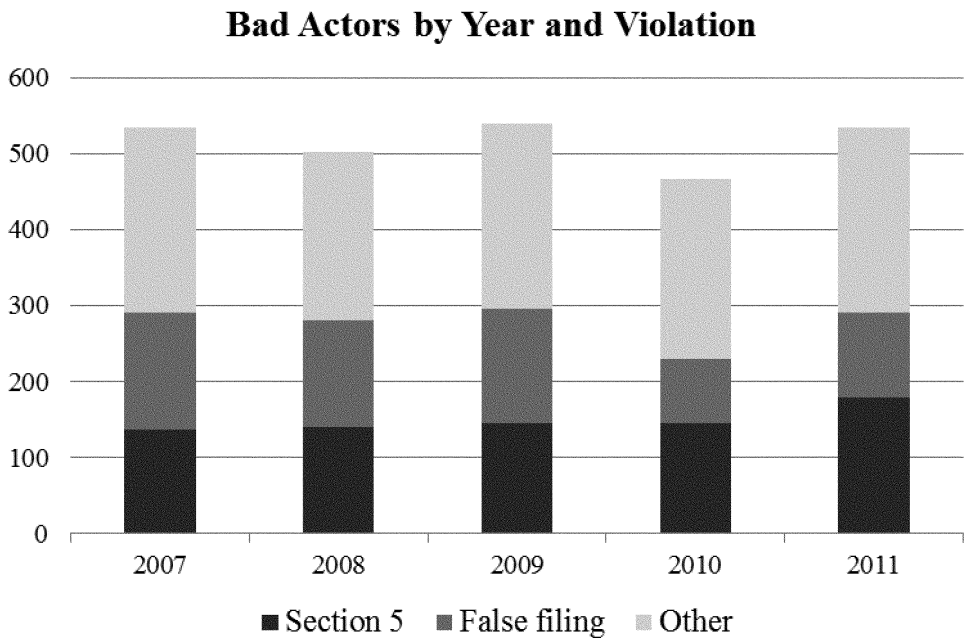
[277] We have limited information available on enforcement activity by state securities regulators, discussed at the text accompanying note 283. Our analysis did not cover felony and misdemeanor convictions as provided in Rule 506(d)(1)(i); final orders of state authorities and Federal banking agencies and National Credit Union Association as provided in Rule 506(d)(1)(iii); disciplinary actions by a national securities exchange or an affiliated securities association, as provided in Rule 506(d)(1)(vi); and United States Postal Service orders as provided in Rule 506(d)(vii). We also excluded refusal, stop, or suspension orders pertaining to registration statements or Regulation A offering statements, as provided in Rule 506(d)(1)(vii), because they are too infrequent to affect our analysis.

[278] One case involving both an injunction and a cease-and-desist order is not reflected in the chart titled ''Triggering Events: 2007–2011'' due to rounding.

In the cases we identified, between 70% and 78% of triggering events each year were against individuals, with the remainder against entities. With 83,521 offerings that relied on Rule 506 during the period under review, the incidence of detected bad actors is approximately 0.03 per offering. These numbers represent, however, only enforcement actions brought by the Commission. These numbers do not reflect enforcement action by other authorities (for example, state level regulators), nor do they include undetected bad actors.

While all of the 2,578 identified bad actors would disqualify any offering in which they were involved from reliance on Rule 506, not all of the bad actors would be expected to be involved with Rule 506 offerings. Many of the triggering events, such as insider trading, involve bad actors engaged in secondary market transactions. These persons may present a lesser risk of entering primary issuance markets such as Rule 506. Hence, the aggregate number of bad actors may overestimate the incidence of bad actors operating in the Rule 506 market. To more accurately estimate the likelihood that a bad actor might be involved in the issuance of securities, we identify triggering events involving a Section 5 violation.[279] As reflected in the chart ''Bad Actors by Year and Violation'' below, approximately 29% of the bad actors (a total of 748) were sanctioned for Section 5 violations. A similar percentage, approximately 25%, were sanctioned for the next-largest category of violations, those involving false filings.[280] The remaining bad actors fall into the ''Other'' category, of which insider trading-related violations represent the largest single sub-category. The following chart shows this breakdown:

Figure 9: Bad Actors by Year and Violation, 2007-2011



To assess the quality of the search results, from the 1,485 cases previously identified, we selected a random sample of 190 cases, a sample that is large enough to provide a low margin of error. Because a single case produces multiple triggering events if multiple persons are named, the sample of 190 cases included 529 potential triggering events and allows for a margin of error of less than 5% in our analysis.[281] Commission staff reviewed the orders, releases, and other documentation for all 190 cases to determine whether each potential triggering event actually met the criteria specified in Rule 506(d)(1)(ii), (iv) or (v). The review of the search results showed that the search criteria applied produced relatively accurate results.[282]

Incidence of Bad Actors Potentially Participating in Primary Offerings of Securities. Staff further refined the estimate of the likelihood that triggering events that were related to the Rule 506 market using the random sample of 190 cases. In particular, staff identified whether each of the cases involved an offering of securities by the issuer, which we refer to as a primary offering. For cases involving a primary offering, staff identified whether the offering was registered or unregistered. The review showed that 70 out of the 190 cases (or

[279] Bad actors included in the Section 5 category may have also violated other securities law provisions, such as anti-fraud provisions in Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act. Using Section 5 violations as a proxy for involvement in a securities offering may be under inclusive, as there may be offering-related misconduct without a Section 5 violation.

[280] We define false filing as violations relating to errors and omissions in Commission filings, such as periodic reports, Form BD, Form ADV and beneficial ownership reports.

[281] The margin of error in these estimates based on the sample size of 529 potential triggering events is approximately 3.6% at the 90% confidence level. Taking these results together, there may be as many as 30 more or 30 fewer disciplinary orders than what is estimated at the 90% confidence level.

[282] The misclassification rate for injunctions, disciplinary orders, and cease and desist orders was 4%, 30%, and 0% respectively. While the misclassification rate for disciplinary orders was high, the sample results for disciplinary orders contained nearly the same number of false positives (events classified as disciplinary orders that did not actually meet the criteria of Rule 506(d)(1)(iv)) as false negatives (events classified as injunctions and/or cease-and-desist orders that turned out to also include disciplinary orders), so the error in the total number of estimated disciplinary orders based on the sample review is significantly less than 30%. Accounting for offsetting misclassifications—*i.e.,* false positives and false negatives—the error rate in the total number of estimated disciplinary orders falls to 1%.

37%) involved a primary offering, all of which were unregistered, and of the 529 potential triggering events included in the 190 cases, 251 (or 47%) involved a primary offering.

For purposes of the review, defendants or respondents were categorized as ''issuers,'' ''intermediaries,'' and ''other persons.'' ''Issuers'' are entities that issue securities and the individuals who were affiliated with that issuer. ''Intermediaries'' are entities and individuals that facilitate securities offerings and investments, like brokers and non-affiliated investment advisers. ''Other persons'' are persons who are neither issuers nor intermediaries; the staff found that, in general, these were persons found liable for trading on inside information.

The following table summarizes the staff's findings with respect to these cases:

SUMMARY OF BAD ACTORS AND CASE TYPE FOR 2007 TO 2011 PERIOD

	Random sample of enforcement cases	Subset of sample relating to unregistered offerings
Number of cases	190	70 (37%)
Number of triggering events	529	251 (47%)
—issuers	278	160
—intermediaries	189	76
—entities acting as both issuers and intermediaries	17	15
—other persons	45	0

Of the 529 bad actors in the sample, staff found that 278 were issuers, 189 were intermediaries, 17 were entities that could qualify as either an issuer or an intermediary (such as a promoter who is employed by an issuer), and 45 were other persons.

Based on projections from our review of this sample, we estimate that during the 2007 to 2011 review period, 549 cases (37% of the 1,485 total cases) involved an unregistered offering and approximately 1,212 bad actors (47% of the 2,578 total bad actors identified) participated in those unregistered offerings. We consider these estimates as a lower bound for the number of bad actors because our analysis does not take into account bad actor triggering events other than those in subsections (ii), (iv), and (v) of Rule 506(d)(1) or offerings involving bad actors that did not give rise to enforcement activity. Taking those into account, the total number of bad actors is likely to be higher.

We considered other data sources regarding the number of bad actor triggering events not involving Commission action. NASAA's 2012 Enforcement Report presents some data on orders by state securities regulators between 2009 and 2011,[283] which would pertain to subsection (iii) of Rule 506(d)(1), relating to final orders and bars issued by state securities, insurance and banking regulators, federal banking regulators and the National Credit Union Administration. The report states that, as a result of state securities regulatory actions, 8,744 licenses were withdrawn and 1,952 licenses were denied, revoked, suspended, or conditioned in that three-year period. This data, however, may be over inclusive for purposes of establishing the number of bad actors under Rule 506(d) for a number of reasons. First, not all of the actions appear to be ''final orders'' under subsection (iii) of Rule 506(d)(1) (*e.g.,* some licenses were withdrawn rather than revoked). In addition, there is potential double counting in the NASAA survey when different states take action against the same person, as well as potential double counting between Commission and NASAA data for bad actors subject to both Commission and state sanctions. The data could also be under inclusive, in that it covers only actions by state securities regulators, whereas under subsection (iii) of Rule 506(d)(1), disqualification may also be triggered by orders of state insurance, banking, savings association and credit union regulators; appropriate federal banking regulators; and the National Credit Union Association. Staff were not able to identify comparable sources of data on these other types of orders.[284]

C. Analysis of Final Rules

Section 926 of the Dodd-Frank Act requires the Commission to adopt rules excluding felons and other bad actors from participation in Rule 506 offerings. The disqualification provisions of Rule 506 were intended to[285] and should lead to enhanced investor protection by reducing the number of offering participants who have previously engaged in fraudulent activities or who previously violated securities, insurance, banking or credit union laws or regulations, and by providing an additional deterrent to future fraudulent activities. Currently, persons covered by the disqualification provisions of these rules, such as issuers and compensated solicitors, are subject to a multilayered securities enforcement system that includes the Commission, state securities regulators and, for financial industry participants, FINRA. The disqualification rules we adopt today should alter industry practice by inducing issuers and other covered persons to implement additional measures to restrict bad actor participation in Rule 506 offerings.

In the proposing release, we solicited comment on the costs and benefits of the proposed rules. While no comment letters provided quantitative data or directly addressed the cost-benefit analysis included in the proposing release, a number of commenters did mention potential costs and benefits of the proposed rule. Our response to these comments is discussed in Section II above, and we briefly discuss these comments where they are relevant in the discussion below.

1. Effects of the Statutory Mandate

To the extent the new disqualification provisions result in a reduction of fraud in the Rule 506 offering market, investor losses to fraud will be reduced and investor willingness to participate in the

[283] North American Securities Administrators Association, 2012 Enforcement Report, Table 4 (available at *http://www.nasaa.org/wp-content/uploads/2011/08/2012-Enforcement-Report-on-2011-Data1.pdf*).

[284] FINRA's BrokerCheck database includes this data for registered broker-dealers and their associated persons, as well as data on investment advisers and their associated persons drawn from the Commission's IARD database. *See* note 202. BrokerCheck is searchable only by the name of firms and individuals, however, not by the nature of past violations, which makes it impracticable for us to use it as a source of data in this review.

[285] Statement of Senator Christopher Dodd, 156 Cong. Rec. S3813 (daily ed. May 17, 2010).

Rule 506 market could increase. This should lower the issuance costs for Rule 506 offerings to the extent that new disqualification standards lower the risk premium associated with the presence of bad actors in securities offerings.[286] Lower costs in the Rule 506 offering market could improve conditions for capital formation, benefitting both issuers and investors. In this regard, commenters also emphasized investor protection [287] and increased participation in the private placement market as the main benefits of the rule.[288]

The new disqualification provisions may also benefit investors by reducing the burden of the ''due diligence'' investigation they conduct on persons and entities involved in the offerings in which they invest. Without bad actor disqualification, investors seeking information about the background of issuers and the people involved with them would have to perform separate investigations due to the cost of coordinating collective action. Requiring issuers to determine whether any persons or entities are subject to an event that triggers disqualification may, for some investors, obviate the need to do their own investigation, which may eliminate some of the redundancies in these separate investigations. Given the issuer's advantage in accessing much of the relevant information, issuers should be able to perform the task at a lower cost than most individual investors.

The disqualification requirements also impose costs on issuers, covered persons and investors. In our analysis under the Paperwork Reduction Act in Part III.B above, we estimate that most issuers will bear an additional cost of $400 to conduct a factual inquiry to determine whether any covered persons had a disqualifying event that occurred before the effective date of the rule amendments.[289] We also estimate that approximately 220 [290] Rule 506 issuers will spend $5,200 on average for using in-house and outside professional services in preparing a disclosure statement describing matters that would have triggered disqualification under Rule 506(d)(1) of Regulation D had they occurred on or after the effective date of the rule amendments. These cost estimates are based on assumptions outlined in Part IV.B.3 above and represent lower bound estimates, given that our analysis in Part IV.B.3 did not cover all possible bad actor triggering events. We note, in addition, that the Paperwork Reduction Act analysis is not required to, and does not, consider all potential costs that market participants may incur in complying with Rule 506(d). Further, we cannot predict how issuers will respond to the possibility of having to disclose the participation of a bad actor in an offering; the issuer could disclose, remove the person from the offering, abandon the offering, or conduct an offering that does not require disclosure.

Issuers that are disqualified from reliance on Rule 506 will bear costs to the extent that alternative means of raising capital are unavailable or involve higher transaction costs that result in a higher cost of capital. In some circumstances, issuers may postpone or forgo capital raising, deferring engagement in potentially value-enhancing projects. This could entail forgone investment opportunities for disqualified issuers and for investors who otherwise would have invested in such issuers. Issuers that pursue alternative capital raising methods may incur higher costs associated with their capital raising. For example, all other things being equal, transaction costs are likely to be higher for issuers that raise capital in reliance on Section 4(a)(2) of the Securities Act outside of Rule 506 because of higher costs to comply with state securities law requirements and greater legal uncertainty about the requirements of the exemption. In addition, issuers eligible to rely on new Rule 506(c) will be able to use general solicitation and general advertising to find potential investors if all purchasers in their offering are accredited investors and the issuer takes reasonable steps to verify their accredited investor status,[291] whereas issuers seeking an exemption under Section 4(a)(2) outside of Rule 506(c) will continue to be constrained by the incompatibility of a claim of exemption under Section 4(a)(2) and general solicitation or general advertising.[292] This may further differentiate transaction costs and cost of capital between Section 4(a)(2) offerings and Rule 506(c) offerings. Registered securities offerings can also result in higher transaction costs than private offerings, and in addition trigger ongoing reporting responsibilities.[293] As highlighted above, 22% of Rule 506 issuers that reported revenues on Form D indicated that their revenues were less than $1 million. For these and similarly sized issuers, going public through a registered offering may not be a feasible substitute for a Rule 506 offering.[294]

Issuers may also incur costs in connection with changes to personnel, governance structures and capital raising plans as a result of disqualification. For example, issuers may incur costs from terminating disqualified individuals or from reassigning them to positions where they will not trigger a disqualification in the context of an offering, and hiring new personnel or retraining existing personnel to replace them. They may also incur costs incident to restructuring their governance and control arrangements if, for example, a general partner, managing member or investment manager of a pooled investment fund issuer is a bad actor whose involvement would result in the disqualification of the offering. Issuers may also incur costs in connection with terminating an engagement with a placement agent or other covered financial intermediary, and entering into a new engagement. Smaller issuers and issuers with limited operating histories may not be able to readily find a new placement agent or other financial intermediary.

[286] In a related framework, Karpoff et al. (2008) show that the marketplace imposes significant penalties on firms targeted by SEC enforcement actions for financial misrepresentation, where for each dollar of misrepresentation the firm loses an additional $3.08 due to expected legal penalties and loss of reputation. *See* J. Karpoff, D. Lee & G. Martin, The Cost to Firms of Cooking the Books, 581–611 Journal of Financial & Quantitative Analysis (Sept. 2008).

[287] *See* comment letters from M. Zhu; DTC; Better Markets; NASAA.

[288] *See* comment letter from Better Markets.

[289] We assume the cost of in-house attorney services to be $400 per hour. This estimate is based on data provided in the report titled *Management and Professional Earnings in the Securities Industry—2012,* which is published by the Securities Industry and Financial Markets Association.

[290] Staff estimates that there were at least 549 SEC enforcement actions involving an unregistered offering in which someone who would be disqualified as a bad actor participated in the five years from 2007 through 2011. *See* Part IV.B.3.

[291] As discussed above, we are adopting new Rule 506(c), 17 CFR 230.506(c), today. *See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33–9415 (July 10, 2013).*

[292] *Id.* at note 42 and accompanying text.

[293] A 2011 report prepared by a group called the ''IPO Task Force,'' which consisted of a group of professionals, including venture capitalists, experienced CEOs, public investors, securities lawyers, academics and investment bankers, estimated that the cost of going and staying public are high. Chart H of the IPO Task Force Report estimates that the average cost to go public is $2.5 million and the annual cost of staying public is $1.5 million. *See* Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth (publicly available at *http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf*).

[294] For example, if an issuer intends to raise a small amount of capital to fund its operations, the costs of conducting a registered offering may make a registered offering impracticable. In addition, private funds that rely on exemptions from investment company registration under Section 3(c)(1) or 3(c)(7) of the Investment Company Act are not permitted to conduct public securities offerings.

The final rule will include as covered persons the beneficial owners of 20% or more of the issuer's outstanding voting equity, calculated on the basis of voting power. This reflects a change from the 10% or more beneficial ownership of any class of the issuer's equity originally proposed. The higher ownership standard, limitation to voting securities and calculation focused on voting power would increase the likelihood that the disqualified investor is more closely affiliated with the issuer and has greater input or control over the management of the issuer.[295] In our judgment, the higher threshold will therefore provide greater certainty that the investor has some level of influence with the issuer. In addition, because issuers cannot necessarily prohibit a bad actor from establishing a large ownership position, particularly when an issuer's security is traded among non-affiliates or in a secondary market, a higher threshold is expected to reduce the likelihood of a disqualifying event affecting an issuer in cases where a securityholder with a disqualifying bad act meets the beneficial ownership threshold in the rule but does not in fact exercise control or influence over the issuer. Lower uncertainty and relatively fewer ''covered persons'' arising from the amendment would reduce the costs of monitoring and due diligence for complying with the rule, and should limit the circumstances in which issuers must seek waivers from disqualification based on the involvement of bad actor investors that do not exercise influence or control over the issuer.

At the same time, determining whether a securityholder is covered based on ownership of voting securities, calculating ownership based on voting power across all outstanding securities rather than a single class and raising the threshold from 10% to 20% could reduce investor protection benefits, as securityholders whose ownership does not meet the threshold provided in the final rule, but who exercise control of an issuer, would not be covered. The inclusion of directors, officers and their functional equivalents under the definition of covered persons, however, may mitigate this effect; the rule will cover investors who serve those functions in relation to the issuer, regardless of their level of ownership.

With respect to 20% beneficial owners that are subject to triggering events, issuers may incur costs to buy out or otherwise induce such persons to reduce their ownership positions. Issuers may also incur costs in connection with taking steps to prevent bad actors from becoming 20% beneficial owners, such as exercising rights of first refusal and excluding bad actors from financing rounds. For certain issuers, finding investors to replace the capital represented by these shareholders or potential investors, as the case may be, could be challenging and expensive. Some commenters also expressed concerns about the aggregate costs of the proposed bad actor rule, saying that its provisions are generally unduly complex, unclear or not based on objective, bright-line standards.[296] Others expressed concerns about the potential burdens on capital raising,[297] and that it could undermine the overall utility of Rule 506.[298]

Issuers may also incur costs in connection with seeking waivers of disqualification from the Commission, or determinations by other authorities (such as state securities regulators) that their orders should not give rise to disqualification under Rule 506(d).

The new disqualification standards may also impose costs on other market participants that are subject to triggering events, such as financial intermediaries, by making them ineligible to participate in the market for Rule 506 offerings. For affected individuals, this may result in demotion or termination of employment, limitations on career advancement and fewer employment opportunities generally. For affected firms, this may result in revenue reductions and loss of market share, and could threaten the continued operation of firms that are heavily dependent on Rule 506 offerings as a source of revenue. Firms that are not themselves disqualified but whose officers, directors, general partners and managing members are subject to disqualifying events may incur additional costs from terminating or reassigning such individuals and from hiring new personnel or retraining existing personnel to replace them.

Bad actor disqualification rules may also impose costs on issuers and other market participants beyond the context of Rule 506 offerings. For example, imposing a new disqualification standard only on offerings under Rule 506, rather than on a more uniform basis, may result in higher costs for issuers relying on other exemptive rules, to the extent that differing disqualification standards create confusion and a more difficult compliance regime. Adopting uniform disqualification provisions throughout the Securities Act was cited by some commenters as a benefit, in that it could simplify compliance and increase overall investor protection.[299]

In addition, non-uniform application of the new disqualification standards may encourage bad actors to migrate to offerings under other exemptions. Investors may perceive a higher risk of fraud in such offerings, which would be detrimental to their marketability and result in greater issuance costs of all offerings under the exemptions that are not subject to the new standards, whether or not bad actors are involved. This could have an effect on competition by putting issuers that are not eligible to use Rule 506 at a competitive disadvantage.

Finally, there is a potential cost to investors of overreliance on Rule 506(d) in assessing the risks associated with an offering. Fraud can still occur without prior incidence of bad acting on the part of the issuer or covered persons, and in some cases it is possible that prior bad actions went undetected or did not otherwise result in a sanction, or may have resulted in a sanction that does not constitute a triggering event for disqualification.

2. Discretionary Amendments

The amendments not specifically required under the Section 926 mandate involve costs and benefits as analyzed below.

Reasonable Care Exception. The ''reasonable care'' exception allows continued reliance on the Rule 506 exemption, despite the existence of a disqualification with respect to a covered person, if the issuer can show that it did not know and, in the exercise of reasonable care, could not have known that the disqualification existed at the time of the sale of securities. We anticipate that the ''reasonable care'' exception will provide benefits to the efficiency of the private placement and capital formation process by removing a significant disincentive to issuers' use of Rule 506 that would have arisen if disqualification were applied on a strict liability basis. Without a reasonable care exception, issuers might choose not to undertake offerings in reliance on Rule 506, because of the risk of Section 5 or blue sky law violations in circumstances that the issuer cannot reasonably predict or control. In those circumstances,

[295] It would also be in line with the level at which filing as a passive investor is no longer permitted on Schedule 13G under Regulation 13D–G. *See* 17 CFR 230.13d–1(c).

[296] *See* comment letters from ABA Fed. Reg. Comm.; NYCBA; Cleary Gottlieb.

[297] *See* comment letters from B. Nelson; Coy Capital; Five Firms; S&C.

[298] *See* Angel Capital Comment Letter 1; *see also* comment letters from ABA Fed. Reg. Comm.; Karr Tuttle; SIFMA; S&C.

[299] *See* comment letters from ABA Fed. Reg. Comm.; C. Barnard; Better Markets; NASAA.

alternative approaches to capital raising may be more costly to the issuer or not available at all. Given that Rule 506 is the most frequently relied-upon Securities Act exemptive rule, the impact of issuers shifting away from it could be significant. We believe that the reasonable care exception provides a measured and balanced approach to preserve the intended benefits of Rule 506, which might otherwise be impaired because of issuer concerns about strict liability for unknown disqualifications.

Commenters uniformly supported the reasonable care exception, but also urged the Commission to provide greater clarity and specificity about what steps would constitute reasonable care. Some commenters raised concerns about compliance costs if the requirements of the ''reasonable care'' exception are too burdensome.[300] We do not believe it is appropriate to delineate and prescribe specific steps as being necessary or sufficient to establish reasonable care. We believe issuers should consider the totality of the offering taking into account the circumstances of the offering, the covered persons involved in the offering and the rule's requirements, which include specific disqualifying events and covered persons subject to those disqualifying events. The flexibility in permitting issuers to determine their own methodology for factual inquiry is a benefit that promotes efficiency to the extent the issuer is able to tailor its own inquiry without adherence to uniform standards that may not be applicable or appropriate in the context of a particular issuer or particular offering.

A potential cost of a reasonable care exception is that it may increase the likelihood that bad actors will be able to participate in Rule 506 offerings, because issuers may take fewer steps to make inquiry about offering participants than they would if a strict liability standard applied. If this occurs, it will decrease the deterrent effect of the bad actor disqualification rules. To the extent that the reasonable care exception fails to prevent participation by bad actors in Rule 506 offerings, the effectiveness of the new disqualification standard will be impaired.

Issuers may also incur costs associated with conducting and documenting their factual inquiry into possible disqualifications, so they can demonstrate the exercise of reasonable care. The fact that the rule does not specify what steps are required may increase such costs to the extent that issuers do more to conduct and document their inquiry than otherwise may be necessary, because of this uncertainty.

Disclosure Requirement for Triggering Events That Predate the Effectiveness of the Rule Amendments. As adopted, the amendments include a disclosure requirement designed to increase investor protection by requiring disclosure of events that would have been disqualifying had they occurred after the effective date of the amendments. This is a change from the proposal, under which disqualification would have arisen with respect to events that occurred before the amendments took effect.

Under the amendments we are adopting, issuers will be subject to disqualification only for triggering events that occur after the new rules take effect. On one hand, this approach will reduce costs that would otherwise have been incurred by issuers and other market participants subject to pre-existing triggering events, had they been disqualified from participating in Rule 506 offerings. On the other hand, this approach will permit offerings involving past bad actors to proceed under Rule 506, exposing investors to the risks that arise when bad actors are associated with an offering. While it is difficult to determine the net impact of implementing the new disqualification standards in this way, investors will benefit by having access to information about events that would be disqualifying if they had occurred after the effective date. Investors will be able to make their own determination of the relevance and risks associated with past bad acts, including recidivism risk, and can request additional information, elect not to pursue the investment opportunity or negotiate different terms based on this information.

We anticipate that the decision to require disclosure will provide a benefit to issuers and investors. We believe the disclosure requirement will serve as a useful tool to alert investors to the presence of certain participants in offerings under Rule 506 and allow them to make more informed investment decisions. Without a disclosure requirement, investors may have the mistaken impression that bad actors are no longer allowed to participate in Rule 506 offerings. As there is no prescribed format, the disclosure could be inserted in a non-prominent manner, such that an investor who reads the material in a cursory fashion could remain unaware of the participation of bad actors in the offering. Issuers could benefit from having flexibility in the manner of disclosure. In addition, because we have imposed a disclosure requirement rather than disqualification for pre-existing events, issuers will not be required to revisit past negotiated settlements or incur additional costs to request waivers for disqualification. Issuers will, however, incur costs in connection with the factual inquiry to determine whether disclosure is required and, if applicable, in preparing the mandatory disclosure for investors, which we have described in Section III above. Also, rather than provide the mandatory disclosure, we expect some issuers may decide to take steps to avoid having to make a disclosure, such as making changes to personnel or retaining different compensated solicitors, and in that respect may incur costs similar to those associated with avoiding or removing a potential disqualification.

We also recognize that issuers that disclose triggering events may have greater difficulty attracting investors to their offerings and may incur a higher cost of capital as a result. We do not have data with respect to current issuer practices involving disclosure of the participation of persons with a history of regulatory or other legal sanctions for securities law violations and, as such, we are unable to determine the extent to which the disclosure requirement will impact issuers' cost of capital. If investors are unwilling to participate in offerings involving prior bad actors, some issuers and other market participants will, as a practical matter, be excluded from the Rule 506 market and will experience some or all of the impact of disqualification.

Commission Cease-and-Desist Orders Involving Scienter-Based Anti-Fraud Violations and Violations of Securities Act Section 5. Under the rule amendments we adopt today, disqualification will be triggered by Commission cease-and-desist orders based on violations of scienter-based anti-fraud provisions of the federal securities laws or Section 5 of the Securities Act. The addition of these categories of Commission orders as a new triggering event is intended to provide a benefit to investors by screening out additional bad actors, while reducing the risk that disqualification would be imposed on securities law violators who do not pose a significant investor protection concern.

We believe the investor protection benefits of adding Commission cease-and-desist orders to the disqualification provisions of Rule 506 justify the potential costs to issuers and other covered persons. The benefits associated with screening bad actors out of the Rule 506 market should not depend on

[300] *See* Angel Capital Comment Letter 1; *see also* comment letter from S&C.

whether a particular enforcement action is brought in court or through a Commission administrative proceeding. Clearly, the absence of Commission cease-and-desist orders from an investor protection rule that includes federal judicial proceedings addressing the same legal violations, and orders by state and other federal regulators addressing the same conduct, would lead to asymmetry in the administration of disqualification under Rule 506. We also do not believe that the addition of Commission cease-and-desist orders is likely to impose a significant cost to issuers and other covered persons because these groups may already be subject to other disqualifying orders issued by the states, federal banking regulators and the National Credit Union Administration.

It is difficult to predict the extent to which adding these Commission cease-and-desist orders to the list of disqualifying events will increase the number of bad actors subject to disqualification from Rule 506 offerings. In our analysis of disqualifying events from 2007 through 2011 discussed earlier, we attempted to assess the number of individuals or entities that would be disqualified as bad actors based solely on Commission cease-and-desist orders described in subsection (v) of Rule 506(d)(1). We identified 116 cease-and-desist orders against respondents that were not otherwise subject to a disqualifying injunction, disciplinary order or felony conviction during the 2007 to 2011 period.[301] To the extent that these historical levels project future levels of disqualifying Commission cease-and-desist orders, we estimate that on an annual basis, there may be approximately 23 individuals or entities disqualified by cease-and-desist orders and not also by some other triggering event. To provide a context, there were in excess of 83,521 Rule 506 offerings during the period 2007–2011. With 116 cease and desist orders during the same period, the potential disqualification incidence created by Commission cease-and-desist orders would appear to be quite low (using these inputs, less than 0.15%).

In addition, inclusion of Commission cease-and-desist orders as a triggering event for bad actor disqualification may change how settlement negotiations are conducted between respondents and the Commission. Even after the Commission imposes a disqualifying cease-and-desist order upon a covered person, the Commission may grant an appropriate waiver from disqualification based on settlement negotiations or other remedial measures and steps taken by the covered person to comply with the Commission cease-and-desist order. We believe that issuers and other covered persons will be able to consider the practical consequences of a future Commission cease-and-desist order and alter their conduct to avoid committing the behavior causing the violation. Alternatively, they can seek to obtain a waiver of disqualification in enforcement settlement negotiations.

We anticipate that this additional triggering event will add minimal incremental costs for issuers, given the requirement in the rule as adopted to conduct factual inquiry to determine whether the offering is subject to bad actor disqualification. To the extent that the addition of a disqualifying event broadens the type and the number of covered persons who will be disqualified from participation in Rule 506 offerings, it may have a detrimental effect on capital raising activity by delaying or deterring offerings, or causing issuers to incur higher transaction costs.

CFTC Orders. Under the rule amendments we adopt today, disqualification will be triggered by orders issued by the CFTC to the same extent as orders of the regulators enumerated in Section 926 of the Dodd-Frank Act (*e.g.,* state securities, insurance and banking regulators, federal banking agencies and the National Credit Union Administration). We believe that including orders of the CFTC will result in the treatment of comparable sanctions similarly for disqualification purposes, and should enable the disqualification rules to more effectively screen out felons and bad actors. We note in that regard that the conduct that would typically give rise to CFTC sanctions is similar to the type of conduct that would result in disqualification if it were the subject of sanctions by another financial services industry regulator. In addition, the CFTC (rather than the Commission) has authority over the investment managers of pooled investment funds that invest in commodities and certain derivatives products; unless Rule 506(d) covers CFTC orders, regulatory sanctions against those investment managers are not likely to trigger disqualification.

We have a limited ability to quantify the impact of including CFTC orders as a new disqualification trigger under Rule 506(d). While we have access to general information about CFTC enforcement activity,[302] we have no systematic way to filter CFTC orders for connection to Rule 506 offerings or private placements or to isolate situations in which a participant in a Rule 506 offering would be subject to disqualification solely on the basis of a CFTC order. While registered broker-dealers are required to report CFTC proceedings and orders on Form BD, we have no systematic way to filter Form BD data on that basis or to identify registered broker-dealers that are likely to participate in Rule 506 offerings or private placements.

We were able to review disclosures concerning CFTC orders on Form ADV by registered investment advisers and exempt reporting advisers with pooled investment fund clients. In on our review of 384 Forms ADV (as described in detail below), we found six investment adviser firms associated with pooled investment funds that were subject to CFTC orders that would constitute triggering events under Rule 506(d).

Definition of ''final order.'' The change in the definition of ''final order'' limiting it to orders under statutory authority that provides for notice and an opportunity for hearing should have marginal economic impact for issuers. We do not believe that the incremental burden of inquiry to determine whether an order was issued under such authority will have a significant impact. The change could have the effect of reducing the number of disqualifying events for which issuers or other market participants might seek waivers which, in cases where the waiver would have been granted, would reduce costs and could facilitate capital formation. The economic impact on investors from this change will depend primarily on the extent to which the additional procedural requirement results in bad actors that would otherwise be disqualified remaining eligible to participate in Rule 506 offerings, and the recidivism rates of those bad actors.

Investment Managers. Under the rule amendments we adopt today, investment managers of issuers that are pooled investment funds (that is, investment advisers of pooled investment funds and persons who provide similar investment advisory

[301] As there is no comprehensive database of triggering events, the analysis included a review of litigation releases and other documentation for information on other events that would have disqualified these respondents. Some of these documents provided short disciplinary histories, but they are not comprehensive and in any case would not capture subsequent triggering events.

[302] *See e.g.,* Commodity Futures Trading Commission Annual Performance Report, Fiscal Year 2012 at Appendix A (available here: *http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/2012apr.pdf.*) A summary of CFTC enforcement proceedings from 2005 through 2008 is available here: *http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/file/pbproceedingsbulletin.pdf.*

services to pooled investment funds with respect to assets other than securities) have been added as a new category of covered person. We believe that this approach will reduce compliance costs, in that it represents a ''bright-line'' category of presumed control persons based on governance and control structures that are typical for pooled investment fund issuers, replacing a potentially costly fact-intensive inquiry into whether such persons should be deemed the equivalent of ''directors'' or ''executive officers'' of an issuer organized in corporate form. The addition of this new category facilitates equivalent treatment of operating companies and pooled investment funds under new Rule 506(d).

Incidence of Bad Actors Among Investment Advisers.

i. Analysis of Triggering Events Based on Enforcement Actions Initiated by the Commission

In the review described above in Section IV.B.3, we found that 47 of the random sample of 529 identified cases involved investment advisers (18 of these 47 were also broker-dealers). None of these 47 investment advisers was sanctioned in connection with a private offering. This, however, would represent only a lower bound for the incidence of bad actor triggering events among investment advisers, as the analysis was based on a random sample drawn from the legal proceedings that were brought before the Commission during the period 2007–2011. In addition, our analysis does not take into account bad actor triggering events other than those in subsections (ii), (iv), and (v) of Rule 506(d)(1) or offerings involving bad actors that did not give rise to enforcement activity.

ii. Form ADV Data

We analyzed all Form ADVs filed by investment advisers for 2012 to determine the reported incidence of disqualification triggering events. We limited our review to forms filed by investment advisers that:

- Advise a private fund or have clients that are registered investment companies, business development companies or other pooled investment vehicles;
- Provided disclosure reporting pages on their current Form ADV; and
- Indicated that some of the disclosure reporting pages are for the adviser itself or its supervised persons.

We considered only orders whose status was reported as final. Based on these criteria, we identified 384 investment advisers that disclosed matters that may have constituted a triggering event under Rule 506(d).

Looking at the cases and the regulatory and court actions involved, we determined whether the reported sanctions would constitute triggering events under Rule 506(d). Most of the sanctions would not because the criteria for providing disclosure reporting pages for Form ADV include many events that do not constitute bad actor triggering events under new Rule 506(d). For example, we excluded cases that were initiated by a foreign court or regulator, cases that involved an affiliate firm or cases that involved an individual employee of an affiliate who is not a control person in the parent advisory firm. We also excluded cases where a sanction fell outside the relevant look-back period, such as a Commission cease-and-desist order that is more than five years old. In addition, we excluded cases in which an action did not meet the relevant substantive criteria, such as Commission cease-and-desist orders for violations other than Section 5 of the Securities Act or a scienter-based anti-fraud provision, or felonies that were unrelated to the criteria of Rule 506(d), such as traffic violations.

After these exclusions, we found that approximately 1% of reporting investment advisers associated with pooled investment funds reported bad actor triggering events in their 2012 Form ADV. The results of our analysis are presented in the table below.[303]

	Number of investment advisers
Total investment advisers	13,173
Investment advisers advising pooled investment funds	7,772
Pooled investment fund investment advisers with disclosure reporting pages	435
Pooled investment fund investment advisers subject to final orders	384
Pooled investment fund investment advisers with 'bad actor' triggering events	48
Criminal sanctions	1
Regulatory sanctions	42
Civil sanctions	11

Analysis of Costs and Benefits. Investment managers play a significant role in the management of pooled investment funds. We have included them in the definition of covered persons so that entities or individuals that exercise control over fund management are subject to bad actor disqualification under Rule 506(d). It will therefore provide consistency for covering 'control persons' of both pooled investment fund issuers and issuers that are not pooled investment funds.

Additional issuer costs arising from the addition of investment managers as covered persons will arise from conducting factual inquiries and, in some cases, restructuring governance and control arrangements, preparing disclosure or obtaining waivers from disqualification for having an investment adviser with a history of bad acting. Our analysis shows that the incidence of disqualifying events is low (less than 1%) for investment advisers. So their inclusion in the list of covered persons should not be generally burdensome for issuers. On the other hand, covering investment managers directly will obviate the need for issuers to conduct a fact-intensive inquiry to determine whether an investment manager would be regarded as a *de facto* director or executive officer of a pooled investment fund, or as a promoter of such fund. As a result, the additional costs from this new category of covered person are not likely to be high.

Narrower Coverage of Officers of Issuers and Financial Intermediaries. Some commenters raised concerns that the compliance costs associated with monitoring a potentially large class of covered persons may be high.[304] The rules we are adopting limit the pool of covered persons by covering only executive officers and officers participating in the offering, rather than all officers, of issuers, underwriters, compensated solicitors and investment managers of pooled investment funds. This should reduce compliance costs by limiting covered persons to a more manageable number who should generally be easier to identify. It should also reduce or eliminate costs, such as lost employment opportunities, for individuals who are subject to potentially disqualifying events but are not executive officers of issuers, compensated solicitors or investment managers to pooled investment fund issuers and are not personally involved in Rule 506 offerings. We do not believe it will significantly compromise the intended investor protection benefits of the rule, because all officers performing policy-making functions or personally involved with the offering will be covered.

No Disqualification Where the Relevant Regulatory Authority Advises

[303] Note that since an investment adviser can be subject a combination of criminal, regulatory and civil sanctions, the sum of the three categories of sanctions may exceed the number of investment advisers that are subject to sanctions.

[304] *See* comment letters from SIFMA; NYCBA; Five Firms; S&C.

That Disqualification is Not Warranted. The amendments we are adopting include a provision under which disqualification will not arise if a state or federal regulator issuing an order advises in writing that Rule 506 disqualification is not necessary under the circumstances. We believe this provision will create cost savings for affected covered persons such as issuers, individuals and compensated solicitors by eliminating the need to seek waivers from the Commission or pursue other means of raising capital. We expect that some issuers and other covered persons will adjust their settlement negotiations to bargain for an express determination that disqualification from Rule 506 is unnecessary.[305] As the provision applies only where state or federal regulators have determined that Rule 506 disqualification is not necessary, we do not believe it is likely to impair the intended investor protection benefits of the bad actor disqualification scheme.

V. Final Regulatory Flexibility Act Analysis

This final regulatory flexibility analysis has been prepared in accordance with 5 U.S.C. 603. It relates to amendments to Rule 506 of Regulation D under the Securities Act that disqualify certain offerings where ''felons and other 'bad actors''' are participating or present from relying on Rule 506 for an exemption from registration under the Securities Act, or impose disclosure requirements in respect of such offerings.

A. Reasons for, and Objectives of, the Action

The primary reason for the amendments is to implement the requirements of Section 926 of the Dodd-Frank Act. Section 926 requires the Commission to issue rules under which certain offerings where ''felons and other 'bad actors''' are participating or present will be disqualified from reliance on Rule 506 under Regulation D for an exemption from registration under the Securities Act. Under the amendments adopted today, offerings will be disqualified for triggering events that occur after the effective date of the amendments, and disclosure to investors will be required in respect of triggering events that occur before the effective date.

Our primary objective is to implement the requirements of Section 926 of the Dodd-Frank Act. In general, the rule we are adopting implements the statutory requirements. We have included a ''reasonable care'' exception in the final amendments, which we believe will make the rule easier for issuers to use, and should encourage continued use of Rule 506 over exempt transactions outside of Rule 506. We have also added an additional disqualifying event for certain Commission cease-and-desist orders, which we believe will make the overall regulatory scheme more consistent and will increase the investor protection benefits of the amendments. We are requiring disclosure, rather than disqualification, for triggering events occurring before effectiveness of the final amendments as a means of enhancing protection of investors participating in offerings involving bad actors, without giving rise to the fairness and other concerns associated with applying the new disqualification provisions in respect of preexisting events.

B. Significant Issues Raised by Public Comment

In the proposing release, we requested comment on every aspect of the initial regulatory flexibility analysis (''IRFA''), including the number of small entities that would be affected by the proposed amendments, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed amendments. We did not receive comments specifically addressing the IRFA. One commenter suggested exempting offerings below a certain size from the new disqualification provisions based on concerns about the cost of Securities Act registration if Rule 506 were unavailable,[306] but we do not believe that would be consistent with the requirements of Section 926 of the Dodd-Frank Act.

C. Small Entities Subject to the Rule Amendments

The amendments will affect issuers (including both operating businesses and investment funds that raise capital under Rule 506) and other covered persons, such as financial intermediaries, that are small entities. For purposes of the Regulatory Flexibility Act under our rules, an entity is a ''small business'' or ''small organization'' if it has total assets of $5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities that does not exceed $5 million.[307] For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.

The final amendments will apply to all issuers that conduct offerings under Rule 506 and will affect small issuers (including both operating businesses and pooled investment funds that raise capital under Rule 506) relying on this exemption from Securities Act registration. All issuers that sell securities in reliance on Regulation D are required to file a Form D with the Commission reporting the transaction. For the year ended December 31, 2012, 16,067 issuers made 18,187 new Form D filings, of which 15,208 relied on the Rule 506 exemption. Based on information reported by issuers on Form D, there were 3,958 small issuers [308] relying on the Rule 506 exemption in 2012. This number likely underestimates the actual number of small issuers relying on the Rule 506 exemption, however, because over 50% of issuers declined to report their size.

D. Reporting, Recordkeeping and Other Compliance Requirements

The final amendments will impose a disclosure requirement with respect to triggering events that occurred before the effective date of the new disqualification provisions and would have triggered disqualification had they occurred after that date.[309] Such disclosure must be in writing and furnished to each purchaser a reasonable time prior to sale. There is no prescribed form that such disclosure must take.

In addition, we expect that issuers will exercise reasonable care to ascertain whether a disqualification exists with respect to any covered person, and document their exercise of reasonable care. The steps required will vary with the circumstances, but we anticipate would generally include making factual inquiry of covered persons and, where the issuer has reason to question the veracity or completeness of responses to such inquiries, further steps such as reviewing information on publicly available databases. In addition, issuers will have to prepare any necessary disclosure regarding preexisting events.

[305] *See* Rule 506(d)(2)(iii).

[306] *See* comment letter from Burningham.

[307] 17 CFR 230.157.

[308] Of this number, 3,627 of these issuers are not investment companies, and 331 are investment companies. We also note that issuers that are not investment companies disclose only revenues on Form D, and not total assets. Hence, we use the amount of revenues as a measure of issuer size.

[309] As discussed in Part II.G of this Release, we are also changing the form of the signature block of Form D.

We expect that the costs of compliance would generally be lower for small entities than for larger ones because of the relative simplicity of their organizational structures and securities offerings and the generally smaller numbers of individuals and entities involved.

E. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap or conflict with the final amendments to Rules 145, 147, 152 and 155; Rules 501 and 506 of Regulation D; and Form D under the Securities Act and to Rule 30–1 of our Rules of Organization and Program Management.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives of our amendments, while minimizing any significant adverse impact on small entities. In connection with the final amendments, we considered the following alternatives:

- The establishment of different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- The clarification, consolidation, or simplification of the rule's compliance and reporting requirements for small entities;
- The use of performance rather than design standards; and
- An exemption from coverage of the amendments, or any part thereof, for small entities.

With respect to the establishment of different compliance requirements or timetables under our final amendments for small entities, we do not think this is feasible or appropriate. The amendments are designed to exclude ''felons and other 'bad actors' '' from involvement in Rule 506 securities offerings, which could benefit small issuers by protecting them and their investors from bad actors and increasing investor trust in such offerings. Increased investor trust could reduce the cost of capital and create greater opportunities for small businesses to raise capital.

Likewise, with respect to potentially clarifying, consolidating, or simplifying compliance and reporting requirements, the amendments do not impose any new reporting requirements. To the extent they may be considered to create a new compliance requirement to exercise reasonable care to ascertain whether a disqualification exists with respect to any offering and to furnish a written description of preexisting triggering events, the precise steps necessary to meet that requirement will vary according to the circumstances. In general, we believe the requirement will more easily be met by small entities than by larger ones because we believe that their structures and securities offerings are generally less complex and involve fewer participants.

With respect to using performance rather than design standards, we note that the ''reasonable care'' exception is a performance standard.

With respect to exempting small entities from coverage of these final amendments, we believe such an approach would be impracticable and contrary to the requirements of Section 926. Regulation D was designed, in part, to provide exemptive relief for smaller issuers. Exempting small entities from bad actor provisions could result in a decrease in investor protection and trust in the private placement and small offerings markets, which would be contrary to the legislative intent of Section 926. We have endeavored to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives, and have included a ''reasonable care'' exception and waiver authority for the Commission to give issuers and other covered persons additional flexibility with respect to the application of these amendments.

VI. Statutory Authority and Text of Amendments

We are adopting the amendments to 17 CFR Parts 230 and 239 contained in this document under the authority set forth in Sections 4(a)(2), 19 and 28 of the Securities Act, as amended,[310] and Section 926 of the Dodd-Frank Act.[311] We are adopting the amendments to 17 CFR Part 200 contained in this document under the authority of Sections 4A and 4B of the Securities Exchange Act of 1934.[312]

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organization and functions (Government agencies), Reporting and recordkeeping requirements.

17 CFR Parts 230 and 239

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, Title 17, Chapter II of the Code of Federal Regulations is hereby amended as follows:

PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

■ 1. The general authority citation for Part 200, Subpart A, continues to read, in part, as follows and the sectional authority for § 200.312 is removed.

Authority: 15 U.S.C. 77*o,* 77s, 77sss, 78d, 78d–1, 78d–2, 78w, 78*ll* (d), 78mm, 80a–37, 80b–11, and 7202, unless otherwise noted.

* * * * *

■ 2. Section 200.30–1(c) is revised to read as follows:

§ 200.30–1 Delegation of authority to Director of Division of Corporation Finance.

* * * * *

(c) With respect to the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) and Regulation D thereunder (§§ 230.500 through 230.508 of this chapter), to authorize the granting of applications under §§ 230.505(b)(2)(iii)(C), 230.506(d)(2)(ii), and 230.507(b) of this chapter upon the showing of good cause that it is not necessary under the circumstances that the exemption under Regulation D be denied.

* * * * *

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

■ 3. The general authority citation for Part 230 is revised to read as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77d note, 77f, 77g, 77h, 77j, 77r, 77s, 77z–3, 77sss, 78c, 78d, 78j, 78*l,* 78m, 78n, 78*o,* 78*o*–7 note, 78t, 78w, 78*ll*(d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, and Pub. L. No. 112–106, § 201(a), 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

■ 4. Amend § 230.145 by:

■ a. Removing the reference to ''and 4(2)'' in the second paragraph of the Preliminary Note and adding in its place ''and 4(a)(2)'';

■ b. Removing Note 1 and Note 2 following the introductory text; and

■ c. Revising the introductory text following the Preliminary Note to read as follows:

§ 230.145 Reclassification of securities, mergers, consolidations and acquisitions of assets.

* * * * *

[310] 15 U.S.C. 77d(a)(2), 77s and 77z–3.

[311] 15 U.S.C. 77d note. Although Pub. L. No. 112–106, sec. 201(a), 126 Stat. 313 (2012) is not an authority for the amendments in this release, it is being included in the instruction below for the general authority citation for Part 230 to ensure that the Code of Federal Regulations is correctly updated for purposes of the final rule also published today.

[312] 15 U.S.C. 78d–1, 78d–2.

Transactions for which statutory exemptions under the Act, including those contained in sections 3(a)(9), (10), (11) and 4(2), are otherwise available are not affected by Rule 145. Reference is made to Rule 153a (§ 230.153a of this chapter) describing the prospectus delivery required in a transaction of the type referred to in Rule 145. A reclassification of securities covered by Rule 145 would be exempt from registration pursuant to section 3(a)(9) or (11) of the Act if the conditions of either of these sections are satisfied.

* * * * *

■ 5. Amend § 230.147(b)(2) by removing the reference to ''section 4(2)'' and adding in its place ''section 4(a)(2)''.

■ 6. Amend § 230.152 by removing the reference to ''section 4(2)'' and adding in its place ''section 4(a)(2)''.

■ 7. Amend § 230.155 by removing the phrase ''Preliminary Note:'' and redesignating that note as the introductory text, and removing the reference to ''section 4(2)'' from paragraph (a) and adding in its place ''section 4(a)(2)''.

■ 8. Amend § 230.501 by:

■ a. Redesignating paragraphs (g) and (h) as paragraphs (h) and (i), respectively, and adding new paragraph (g); and

■ b. Redesignating Notes 1, 2, and 3 at the end of the section as Note 1 to § 230.501, Note 2 to § 230.501, and Note 3 to § 230.501, respectively.

The addition reads as follows:

§ 230.501 Definitions and terms used in Regulation D.

* * * * *

(g) *Final order. Final order* shall mean a written directive or declaratory statement issued by a federal or state agency described in § 230.506(d)(1)(iii) under applicable statutory authority that provides for notice and an opportunity for hearing, which constitutes a final disposition or action by that federal or state agency.

* * * * *

■ 9. Amend § 230.506 by:

■ a. Redesignating the Note following paragraph (b)(2)(i) as ''Note to paragraph (b)(2)(i)'';

■ b. Adding and reserving paragraph (c); and

■ c. Adding paragraphs (d) and (e).

The additions read as follows:

§ 230.506 Exemption for limited offers and sales without regard to dollar amount of offering.

* * * * *

(c) [Reserved]

(d) ''*Bad Actor'' disqualification.* (1) No exemption under this section shall be available for a sale of securities if the issuer; any predecessor of the issuer; any affiliated issuer; any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer; any beneficial owner of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; any promoter connected with the issuer in any capacity at the time of such sale; any investment manager of an issuer that is a pooled investment fund; any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities; any general partner or managing member of any such investment manager or solicitor; or any director, executive officer or other officer participating in the offering of any such investment manager or solicitor or general partner or managing member of such investment manager or solicitor:

(i) Has been convicted, within ten years before such sale (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor:

(A) In connection with the purchase or sale of any security;

(B) Involving the making of any false filing with the Commission; or

(C) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(ii) Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before such sale, that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:

(A) In connection with the purchase or sale of any security;

(B) Involving the making of any false filing with the Commission; or

(C) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(iii) Is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

(A) At the time of such sale, bars the person from:

(*1*) Association with an entity regulated by such commission, authority, agency, or officer;

(*2*) Engaging in the business of securities, insurance or banking; or

(*3*) Engaging in savings association or 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 entered within ten years before such sale;

(iv) Is subject to an order of the Commission entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(b) or 78*o*–4(c)) or section 203(e) or (f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–3(e) or (f)) that, at the time of such sale:

(A) Suspends or revokes such person's registration as a broker, dealer, municipal securities dealer or investment adviser;

(B) Places limitations on the activities, functions or operations of such person; or

(C) Bars such person from being associated with any entity or from participating in the offering of any penny stock;

(v) Is subject to any order of the Commission entered within five years before such sale that, at the time of such sale, orders the person to cease and desist from committing or causing a violation or future violation of:

(A) Any scienter-based anti-fraud provision of the federal securities laws, including without limitation section 17(a)(1) of the Securities Act of 1933 (15 U.S.C. 77q(a)(1)), section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and 17 CFR 240.10b–5, section 15(c)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(c)(1)) and section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–6(1)), or any other rule or regulation thereunder; or

(B) Section 5 of the Securities Act of 1933 (15 U.S.C. 77e).

(vi) Is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade;

(vii) Has filed (as a registrant or issuer), or was or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the Commission that, within five years before such sale,

was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such sale, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued; or

(viii) Is subject to a United States Postal Service false representation order entered within five years before such sale, or is, at the time of such sale, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

(2) Paragraph (d)(1) of this section shall not apply:

(i) With respect to any conviction, order, judgment, decree, suspension, expulsion or bar that occurred or was issued before September 23, 2013;

(ii) Upon a showing of good cause and without prejudice to any other action by the Commission, if the Commission determines that it is not necessary under the circumstances that an exemption be denied;

(iii) If, before the relevant sale, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing (whether contained in the relevant judgment, order or decree or separately to the Commission or its staff) that disqualification under paragraph (d)(1) of this section should not arise as a consequence of such order, judgment or decree; or

(iv) If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed under paragraph (d)(1) of this section.

Instruction to paragraph (d)(2)(iv). An issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(3) For purposes of paragraph (d)(1) of this section, events relating to any affiliated issuer that occurred before the affiliation arose will be not considered disqualifying if the affiliated entity is not:

(i) In control of the issuer; or

(ii) Under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

(e) *Disclosure of prior ''bad actor'' events.* The issuer shall furnish to each purchaser, a reasonable time prior to sale, a description in writing of any matters that would have triggered disqualification under paragraph (d)(1) of this section but occurred before September 23, 2013. The failure to furnish such information timely shall not prevent an issuer from relying on this section if the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known of the existence of the undisclosed matter or matters.

Instruction to paragraph (e). An issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

■ 10. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77sss, 78c, 78*l*, 78m, 78n, 78*o*(d), 78*o*–7 note, 78u–5, 78w(a), 78*ll*, 78mm, 80a–2(a), 80a–3, 80a–8, 80a–9, 80a–10, 80a–13, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

■ 11. Amend Form D (referenced in § 239.500) by revising the third indented paragraph under the heading ''Terms of Submission'' in the ''Signature and Submission'' section following Item 16 to read as follows:

Certifying that, if the issuer is claiming a Regulation D exemption for the offering, the issuer is not disqualified from relying on Regulation D for one of the reasons stated in Rule 505(b)(2)(iii) or Rule 506(d).

Note: The text of Form D does not, and the amendments will not, appear in the Code of Federal Regulations.

By the Commission.

Dated: July 10, 2013.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2013–16983 Filed 7–23–13; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 239 and 242

[Release No. 33–9415; No. 34–69959; No. IA–3624; File No. S7–07–12]

RIN 3235–AL34

Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: We are adopting amendments to Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 to implement Section 201(a) of the Jumpstart Our Business Startups Act. The amendment to Rule 506 permits an issuer to engage in general solicitation or general advertising in offering and selling securities pursuant to Rule 506, provided that all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that such purchasers are accredited investors. The amendment to Rule 506 also includes a non-exclusive list of methods that issuers may use to satisfy the verification requirement for purchasers who are natural persons. The amendment to Rule 144A provides that securities may be offered pursuant to Rule 144A to persons other than qualified institutional buyers, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are qualified institutional buyers. We are also revising Form D to require issuers to indicate whether they are relying on the provision that permits general solicitation or general advertising in a Rule 506 offering.

Also today, in a separate release, to implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, we are adopting amendments to Rule 506 to disqualify issuers and other market participants from relying on Rule 506 if ''felons and other 'bad actors' '' are participating in the Rule 506 offering. We are also today, in a separate release, publishing for comment a number of proposed amendments to Regulation D, Form D and Rule 156 under the Securities Act that are intended to enhance the Commission's ability to evaluate the development of market practices in Rule 506 offerings and address certain comments made in connection with implementing Section 201(a)(1) of the Jumpstart Our Business Startups Act.