

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Parts 22 and 190

#### Public Roundtable on the Protection of Cleared Swaps Customer Collateral

**AGENCY:** Commodity Futures Trading Commission (“CFTC”).

**ACTION:** Notice of roundtable discussion; request for comment.

**SUMMARY:** On June 3, 2011, commencing at 9:30 a.m. and ending at 5 p.m., staff of the CFTC will hold a public roundtable discussion at which invited participants will discuss certain issues related to the protection of cleared swaps customer collateral described in the CFTC’s notice of proposed rulemaking regarding the Protection of Cleared Swaps Customer Contracts and Collateral and Conforming Amendments to the Commodity Broker Bankruptcy Provisions (the “NPRM”), a copy of which may be found on the CFTC’s Web site at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister042711b.pdf>. This is a preliminary version of the proposed rule; the version that will publish in the **Federal Register** may not be identical to this preliminary version.

The roundtable will include discussions of the issues surrounding the implementation of the complete legal segregation model proposed in the NPRM, the optional approach highlighted in the NPRM, with specific emphasis regarding the bankruptcy issues surrounding such approach, and the advantages and disadvantages of the models proposed in the NPRM.

**DATES:** The roundtable discussion will be held on June 3, 2011.

**ADDRESSES:** The roundtable discussion will be open to the public with seating on a first-come, first-served basis, and will take place in the Conference Center at the CFTC’s headquarters at Three Lafayette Centre, 1155 21st Street, NW., Washington, DC. Members of the public may also listen by telephone. Call-in participants should be prepared to provide their first name, last name, and affiliation. The information for the conference call is set forth below.

- *US Toll-Free:* 866–844–9416
- *International Toll:* 203–369–5026
- *Passcode:* 6066025

A transcript of the public roundtable discussion will be published on the CFTC’s website at [http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF\\_6\\_SegBankruptcy/index.htm](http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_6_SegBankruptcy/index.htm).

**FOR FURTHER INFORMATION CONTACT:** The CFTC’s Office of Public Affairs at (202) 418–5080.

**SUPPLEMENTARY INFORMATION:** The roundtable discussion will take place on Friday, June 3, 2011, commencing at 9:30 a.m. and ending at 5 p.m. Members of the public who wish to comment on the topics addressed at the discussion, or on any other topics related to customer collateral protection in the context of the Act, may do so via:

- Paper submission to David Stawick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581; or
- Electronic submission by visiting <http://comments.cftc.gov> and following the instructions for submitting comments through the CFTC’s Web site.

All comments must be in English or be accompanied by an English translation. All submissions provided to the CFTC in any electronic form or on paper may be published on the website of the CFTC, without review and without removal of personally identifying information. Please submit only information that you wish to make publicly available.

By the Commodity Futures Trading Commission.

Dated: May 25, 2011.

**David A. Stawick,**  
Secretary.

[FR Doc. 2011–13585 Filed 5–31–11; 8:45 am]

**BILLING CODE P**

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 230 and 239

[Release No. 33–9211; 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:** Proposed rule.

**SUMMARY:** We are proposing 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 the safe harbor from Securities Act registration provided by Rule 506 of Regulation D. The rules must be “substantially similar” to Rule 262, the disqualification provisions of Regulation A under the

Securities Act, and must also cover matters enumerated in Section 926 (including certain state regulatory orders and bars).

**DATES:** Comments should be received on or before July 14, 2011.

**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/proposed.shtml>);
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7–21–11 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments 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. 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 Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments also are available for Web site viewing and printing in the Commission’s Public Reference Room, 100 F Street, NE., Room 1580, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 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, at (202) 551–3460, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–3628.

**SUPPLEMENTARY INFORMATION:** We propose to amend Rules 501<sup>1</sup> and 506<sup>2</sup> of Regulation D<sup>3</sup> and Form D<sup>4</sup> under the Securities Act of 1933 (“Securities Act”).<sup>5</sup>

<sup>1</sup> 17 CFR 230.501.

<sup>2</sup> 17 CFR 230.506.

<sup>3</sup> 17 CFR 230.501 through 230.508.

<sup>4</sup> 17 CFR 239.500.

<sup>5</sup> 15 U.S.C. 77a et seq.

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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”),<sup>6</sup> 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 the safe harbor provided by Rule 506 for exemption from registration under Section 4(2) of the Securities Act of 1933. This release proposes amendments to Rules 501 and 506 and Form D to implement Section 926 of the Dodd-Frank Act.

Rule 506 is one of three exemptive rules for limited and private offerings under Regulation D.<sup>7</sup> It is by far the most widely used Regulation D

exemption, accounting for an estimated 90–95% of all Regulation D offerings<sup>8</sup> and the overwhelming majority of capital raised in transactions under Regulation D. Rule 506 permits sales of an unlimited dollar amount of securities to be made, without registration, to an unlimited number of accredited investors<sup>9</sup> and up to 35 non-accredited investors, so long as there is no general solicitation, appropriate resale limitations are imposed, any applicable information requirements are satisfied and the other conditions of the rule are met.<sup>10</sup>

“Bad actor” disqualification requirements, sometimes called “bad boy” provisions, prohibit issuers and others (such as underwriters, placement agents and the directors, officers and significant shareholders of the issuer) from participating in exempt securities offerings if they 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.<sup>11</sup> 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.<sup>12</sup>

<sup>8</sup> For the twelve months ended September 30, 2010, the Commission received 17,292 initial filings for offerings under Regulation D, of which 16,027 (approximately 93%) claimed a Rule 506 exemption.

<sup>9</sup> 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. In a separate rulemaking required by Section 413(a) of the Dodd-Frank Act, the Commission has proposed amendments to the accredited investor standards in our rules under the Securities Act of 1933 to exclude the value of a person’s primary residence for purposes of the \$1 million accredited investor net worth determination. See Release No. 33–9177 (Jan. 25, 2011) [76 FR 5307] (available at <http://www.sec.gov/rules/proposed/2011/33-9177.pdf>).

<sup>10</sup> Offerings under Rule 506 are subject to all the terms and conditions of Rules 501 and 502, including limitations on the manner of offering (no general solicitation), 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.

<sup>11</sup> 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 proposing to amend Rule 507 at this time.

<sup>12</sup> See 15 U.S.C. 77r(b)(4)(D). This provision of Section 18 was added by Section 102(a) of the

In 2007, we proposed a number of amendments to Regulation D, including bad actor disqualification rules that would have applied to all Regulation D offerings (the “2007 Proposal”).<sup>13</sup> Although we did not take final action on the 2007 Proposal, we have considered the issues raised and the comments received in respect of the 2007 Proposal in developing the rules we propose today.<sup>14</sup> We have also considered advance comments in letters we have received to date on this rulemaking project.<sup>15</sup>

Section 926 of the Dodd-Frank Act instructs the Commission to issue disqualification rules for Rule 506 offerings that are “substantially similar” to Rule 262,<sup>16</sup> the bad actor disqualification provisions of Regulation A,<sup>17</sup> and that are also triggered by an expanded list of disqualifying events, including certain actions by state regulators, enumerated in Section 926. The disqualifying events currently covered by Rule 262 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;

National Securities Markets Improvement Act of 1996, Public Law 104–290, 110 Stat. 3416 (Oct. 11, 1996) (“NSMIA”). NSMIA preempts state registration and review requirements for transactions involving “covered securities,” including securities offered or sold on a basis exempt from registration under Commission rules or regulations issued under Securities Act Section 4(2). Rule 506 is a safe harbor under Section 4(2).

<sup>13</sup> See Release No. 33–8828 (Aug. 3, 2007) [72 FR 45116] (available at <http://www.sec.gov/rules/proposed/2007/33-8828.pdf>).

<sup>14</sup> Comment letters received on the 2007 Proposal are available at <http://www.sec.gov/comments/s7-18-07/s71807.shtml>.

<sup>15</sup> To facilitate public input on its Dodd-Frank Act rulemaking before issuance of actual rule proposals, the Commission has provided a series of e-mail 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.” The advance comment letters we received in anticipation of this rule proposal appear under the heading “Adding Disqualification Requirements to Regulation D Offerings,” Title IX Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

<sup>16</sup> 17 CFR 230.262.

<sup>17</sup> 17 CFR 230.251 through 230.263. Regulation A 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 specific mandatory information, which is filed with the Commission and subject to review by the staff of the Division of Corporation Finance.

<sup>6</sup> Public Law 111–203, § 926, 124 Stat. 1376, 1851 (July 21, 2010) (to be codified at 15 U.S.C. 77d note).

<sup>7</sup> The others are Rule 504 and Rule 505, 17 CFR 230.504 and 230.505, which are discussed in notes 100 and 98 below.

- Injunctions and court orders within the last five years against engaging in or continuing conduct or practices in 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 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.

We are proposing revisions to Rule 506 of Regulation D to implement these requirements. The substance of our proposal is derived from Section 926 of the Dodd-Frank Act and Rule 262.

However, the proposed rule has been formatted in a way that is designed to make it easier to understand and apply than current Rule 262. Rule 262

currently provides three different categories of offering participants and related persons, with different disqualification triggers for each category. The amendments we propose would incorporate the substance of Rule 262, but simplify the framework to include one list of potentially disqualified persons and one list of disqualifying events. We propose to codify this in a new paragraph (c) of Rule 506.

To clarify the issuer's obligations under the new rules, we are also proposing a "reasonable care" exception, under which an issuer would not lose the benefit of the Rule 506 safe harbor, despite the existence of a disqualifying event, if it can show that it did not know and, in the exercise of reasonable care, could not have known of the disqualification. To establish reasonable care, the issuer would be expected to conduct a factual inquiry, the nature and extent of which would depend on the facts and circumstances of the situation.

In Part III of this Release, we discuss other possible amendments to our rules to make bad actor disqualification more uniform across other exemptive rules. We are soliciting public comment on these possible amendments, which would go beyond the specific mandates of Section 926. The possible amendments we are considering and on which we are soliciting comment include:

- Applying the new bad actor disqualification provisions proposed for Rule 506 offerings uniformly to offerings under Regulation A, Rule 505 of Regulation D and Regulation E (all of which are currently subject to bad actor disqualification under existing Rule 262 or under similar provisions based on that rule) and offerings under Rule 504 of Regulation D (which currently are not subject to Federal disqualification provisions); and

- For all disqualifying events that are subject to an express look-back period under current law (e.g., criminal convictions within the last five or ten years, court orders within the last five years), providing a uniform ten-year look back period, to align with the ten-year look-back period required under the Dodd-Frank Act for specified regulatory orders and bars.

Part V of this Release is a chart that compares the provisions of Rule 262, Section 926 of the Dodd-Frank Act and proposed Rule 506(c).

## II. Discussion of the Proposed 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. Accordingly, the rules we are proposing reflect the persons covered by and triggering events specified in those two sources.

### B. Covered Persons

We propose that the disqualification provisions of Rule 506(c) would cover the following, which we sometimes refer to in this release as "covered persons":

- The issuer and any predecessor of the issuer or affiliated issuer;

- Any director, officer, 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.<sup>18</sup>

This generally corresponds to the persons covered by Rule 262, with the changes discussed below.

To clarify the treatment of entities organized as limited liability companies, we propose to cover managing members expressly, just as general partners of partnerships are covered.

To address the types of financial intermediaries likely to be involved in private placements under Rule 506, we are proposing to look to the current standards under Rule 505 of Regulation D rather than to Rule 262 directly. The disqualification provisions of Rule 505 are substantially identical to Rule 262 (and in effect incorporate it by reference), but adapt it to the private placement context. In particular, because Rule 505 transactions do not involve traditional underwritten public offerings but may involve the use of compensated placement agents and finders, Rule 505 substitutes "any

<sup>18</sup> See Proposed Rule 506(c)(1).

person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers” for the “underwriters” that are covered by Rule 262.<sup>19</sup> Since Rule 506 transactions, like transactions under Rule 505, would not involve traditional underwritten public offerings but may involve the use of compensated placement agents and finders, we propose to include the current Rule 505 standard described above in the proposed new rule.<sup>20</sup>

We also propose to incorporate and clarify the applicability of the second sentence of current Rule 262(a)(5), under which events relating to certain affiliated issuers are not disqualifying if they pre-date the affiliate relationship.<sup>21</sup> Under the existing rule, 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. The proposed rule would clarify that this exclusion applies to all potentially disqualifying events that pre-date the affiliation.<sup>22</sup> We believe this is appropriate because the current placement of this language within paragraph (5) of Rule 262 may incorrectly suggest that it applies only to Postal Service false representation orders.

Given the legislative mandate to develop rules “substantially similar” to current Rule 262, however, we are not proposing to make other changes in the classes of persons that would be covered

<sup>19</sup> This is achieved by applying the Rule 262 disqualification standards but redefining the term “underwriter,” for purposes of Rule 505, to mean “any person that has been or will be paid (directly or indirectly) remuneration for the solicitation of purchasers.” Rule 505(b)(iii)(B), 17 CFR 230.505(b)(iii)(B). See Proposed Rule 506(c)(1).

<sup>20</sup> The current disqualification provisions of Rule 505 apply to any “partner, director or officer” of a compensated solicitor. We propose to incorporate the references to directors and officers, add a reference to managing members and modify the reference to include only general partners. When the current rules were adopted, financial intermediaries were often structured as general partnerships and the possibility of their having limited partners may not have been considered. We see no policy basis for imposing disqualification on a partnership based on violations of law by its limited partners, and accordingly propose to clarify that only general partners would be covered.

<sup>21</sup> The sentence provides: “The entry of an order, judgment or decree against any affiliated entity before the affiliation with the issuer arose, if the affiliated entity is not in control of the issuer and if the affiliated entity and the issuer are not under common control of a third party who was in control of the affiliated entity at the time of such entry does not come within the purview of this paragraph (a) of this section.” 17 CFR 230.262(a)(5).

<sup>22</sup> See Proposed Rule 506(c)(3).

by the new disqualification rules. For example, we are proposing that beneficial owners of 10% of any class of an issuer’s equity securities would be covered,<sup>23</sup> as they are under current Rule 262, rather than 20% holders, as in the 2007 Proposal.<sup>24</sup> For the same reason, we are proposing that all the officers of issuers and compensated solicitors of investors be covered, as provided in current rules, rather than only executive officers, as provided in the 2007 Proposal.<sup>25</sup>

With the extension of bad actor disqualifications to Rule 506 offerings, we are, however, concerned that continued use of the term “officer” may present significant challenges, particularly as applied to financial intermediaries. The term “officer” is defined under Securities Act Rule 405 to include “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.”<sup>26</sup> Financial institutions that are acting as placement agents may have large numbers of employees that would come within this definition, many of whom would not have any involvement with any particular offering, but all of whom would be covered persons for purposes of disqualification. Issuers could potentially devote substantial amounts of time and incur significant costs in making factual inquiries.<sup>27</sup> Accordingly, we are requesting comment on whether disqualification should be reserved for executive officers<sup>28</sup>—those performing policy-making functions for a covered person—whether disqualification should apply only to officers actually involved with the offering or limited in some other way, or whether using the same broad category employed in the existing rules would be justified because it would provide a greater degree of investor protection.

We are also not proposing to cover the investment advisers of issuers, or the

directors, officers, general partners, or managing members of such investment advisers. These persons are not currently covered under Rule 262 of Regulation A. However, a significant percentage of issuers in Rule 506 offerings are funds,<sup>29</sup> and in many fund structures, the investment adviser and the individuals that control it are the real decision-makers for the fund. For that reason, it may be appropriate for investment advisers and their directors, officers, general partners and managing members to be covered by the bad actor disqualification provisions of Rule 506, at least for issuers that identify themselves as “pooled investment funds” in Item 4 of Form D, or that are registered as investment companies under the Investment Company Act of 1940,<sup>30</sup> are “private funds” as defined in Section 202(a)(29) of the Investment Advisers Act of 1940<sup>31</sup> or that elect to be regulated as “business development companies” (or “BDCs”),<sup>32</sup> and perhaps for other types of issuers.

#### Request for Comment

(1) Is it appropriate to apply the provisions of Section 926 of the Dodd-Frank Act to all of the persons covered under existing Rule 262, as proposed? Should other categories of persons be included?

(2) Should we exclude any of the proposed covered persons for purposes of disqualification? If so, please explain why such persons should not subject an offering to disqualification, providing as much factual support for your views as possible.

(3) Is it appropriate to include the managing members of limited liability companies for purposes of disqualification in Rule 506(c), as proposed?

(4) Is the proposed coverage of 10% shareholders (which mirrors current rules) appropriate? Or should our disqualification provisions cover only persons that actually control the issuer (or that hold a larger percentage of its equity)? Should we increase the

<sup>23</sup> See Proposed Rule 506(c)(1) and 17 CFR 230.262(b).

<sup>24</sup> See 2007 Proposal.

<sup>25</sup> See 2007 Proposal, Proposed Rule 506(c)(1).

<sup>26</sup> 17 CFR 230.405.

<sup>27</sup> While some types of disqualifying events are readily ascertainable from public records, others are not. See note 81 and accompanying text.

<sup>28</sup> 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.

<sup>29</sup> For the twelve months ended September 30, 2010, approximately 24% of issuers in transactions claiming a Rule 506 exemption described themselves as “pooled investment funds.”

<sup>30</sup> 15 U.S.C. 80a–1 through 80a–52.

<sup>31</sup> A “private fund” is defined as “an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3), but for section 3(c)(1) or 3(c)(7) of that Act.”

<sup>32</sup> A BDC is a closed-end investment company that has elected to be subject to Sections 55 through 65 of the Investment Company Act and that is operated for the purpose of investing in and making significant managerial assistance available to certain types of companies. See Investment Company Act § 2(a)(48), 15 U.S.C. 80a–2(48) and note 99.

threshold share ownership for covered persons to 20%, or to some other threshold of ownership (e.g., 25% or a majority)? If we adopted a requirement based on actual control, would issuers be able to easily determine which shareholders were within the scope of the rule?<sup>33</sup> Should the requirements be different for privately-held companies as opposed to companies whose stock trades in the public markets? If so, should the ownership thresholds be higher or lower for private companies as compared to public companies?

(5) We intend that the terms used in the proposed rules would have the meanings provided in Rule 405. Would it be helpful to incorporate the relevant definitions as part of the rules?

(6) Is it appropriate, as proposed, to provide an exception from disqualification for events relating to certain affiliates that occurred before the affiliation arose, based on the current standard set forth in Rule 262(a)(5)?

(7) Should we replace the reference to “officers,” which is based on current Rule 262, with a reference to “executive officers” (using the definition provided in Rule 501(f)<sup>34</sup>), at least as it applies to covered persons other than the issuer? In many organizations, titular officers such as vice presidents may not play an executive or policy-making role. Would it be more appropriate to limit coverage to individuals with policy-making responsibilities, as would result from using the term “executive officer”?

(8) Alternatively, with respect to officers of covered persons other than the issuer, should we limit coverage to those who are actually involved with or devote time to the relevant offering, or to some other specified subgroup of officers—perhaps together with executive officers?

(9) Would it be appropriate to expand the coverage of our rule to include investment advisers and their directors, officers, general partners, and managing members? If we were to do so, should such an extension apply only for particular types of issuers, such as those that identify themselves as “pooled investment funds” on Form D, or for registered “investment companies,” “private funds” and BDCs? Or should it apply for all issuers?

### C. Disqualifying Events

After covered persons, the other critical element of bad actor disqualification is the list of events and circumstances that give rise to

disqualification. In this regard, our proposal would implement the Dodd-Frank Act requirement that our rules be substantially similar to existing Regulation A and also include the specific events listed in Section 926(2) of the Dodd-Frank Act.

The proposed rule would include the following types of disqualifying events:

- Criminal convictions;
- Court injunctions and restraining orders;
- Final orders of certain state regulators (such as state securities, banking and insurance regulators) and Federal regulators;
- Commission disciplinary orders relating to brokers, dealers, municipal securities dealers, investment advisers and investment companies and their associated persons;
- Suspension or expulsion from membership in, or suspension or bar from associating with a member of, a securities self-regulatory organization;
- Commission stop orders and orders suspending a Regulation A exemption; and
- U.S. Postal Service false representation orders.

We discuss each of these in turn below.

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 current Rule 262(a)(3), covering criminal convictions of issuers, and Rule 262(b)(1), covering criminal convictions of other covered persons. Section 926(2)(B) differs from Rule 262, however, in two ways.

First, unlike Rule 262(b)(1), Section 926(2)(B) does not address criminal convictions “arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser.” We are not aware of any legislative history that explains why this type of conviction was not mentioned in Section 926(2)(B). However, because such convictions are covered in existing Rule 262, we believe that rules “substantially similar” to the existing rules should cover them. Accordingly, the proposed revision to Rule 506 would cover such convictions, and would add a reference to convictions arising out of the conduct of the business of a person compensated for soliciting purchasers, as provided in current Rule 505(b)(2)(iii).<sup>35</sup>

Second, Section 926(2)(B) does not include any express time limit on convictions that trigger disqualification. By contrast, Rule 262 provides a five-year look-back for criminal convictions of issuers and a ten-year look-back for criminal convictions of other covered persons (*i.e.*, only convictions handed down within the preceding five or ten years count, and older convictions are no longer disqualifying).<sup>36</sup> There currently are time limits on criminal convictions, as with other disqualifications, and we are therefore proposing the same five-year and ten-year look-back periods that apply under current Rule 262. We are soliciting comment on whether a longer, or permanent, look-back period would be appropriate for either issuers or other covered persons.

We are also soliciting comment on whether there are circumstances in which the rules for disqualification of entities should focus on the beneficial owners and management of such entities at the time of the disqualifying event, rather than the legal entities themselves, and provide for different treatment of entities that have undergone a change of control since the occurrence of the disqualifying event. This would be a broader application of the principle underlying existing Rule 262(a)(5) (reflected in the proposal in Rule 506(c)(3), discussed above), under which events relating to certain affiliates are not disqualifying if they pre-date the affiliate relationship.

For purposes of establishing the relevant look-back periods, we propose to measure from the date of the sale for which exemption is sought. Rule 262 of Regulation A currently measures from the date of the requisite filing with the Commission, which occurs before any offer of securities can be made under that exemption. This approach is not appropriate for Rule 506 offerings because no filing is required to be made with the Commission before an offer or sale is made in reliance on Regulation D.<sup>37</sup> Current Rule 505, which effectively applies Rule 262 in a Regulation D context, addresses this issue by substituting “the first sale of securities under this section” for the Rule 262 reference to filing a document with the

<sup>36</sup> The look-back period is to the date of the conviction, not to the date of the conduct that led to the conviction. This is similarly the case with the other look-back periods discussed below; 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 sanction.

<sup>37</sup> Under Rule 503, a notice on Form D is not required to be filed until 15 days after the first sale. 17 CFR 230.503.

<sup>33</sup> We would look to the definition of “control” contained in Securities Act Rule 405, *id.*

<sup>34</sup> 17 CFR 230.501(f). The same definition appears in Rule 405.

<sup>35</sup> See Proposed Rule 506(c)(1)(i).

Commission.<sup>38</sup> For purposes of Rule 506, we are proposing to refer to the date of the relevant sale, rather than the date of first sale, because we believe it creates a more appropriate look-back period for offerings that may continue for more than one year. Multiyear offerings are not uncommon under Rule 506.<sup>39</sup>

#### Request for Comment

(10) Are the proposed look-back periods for criminal convictions (five years for issuers, their predecessors and affiliated issuers; ten years for all other covered persons) appropriate? Or should we provide for a longer period? Should the look-back period for convictions be aligned with the ten-year look-back period required in some instances under Section 926 of the Dodd-Frank Act?

(11) Are there circumstances where a longer period of disqualification, even lifetime disqualification for individuals or permanent disqualification for entities, would be appropriate?

(12) Should our rules provide different disqualification periods for individuals and entities? In particular, should we provide different treatment under our rules (e.g., a shorter look-back period or an exception from disqualification) for entities that have undergone a change of control since the occurrence of a disqualifying event? If so, how should change of control be defined for these purposes?

(13) Is the scope of the proposed provisions on criminal convictions sufficiently broad? In connection with the 2007 Proposal<sup>40</sup> and in an advance comment letter on this rulemaking,<sup>41</sup> the North American Securities Administrators Association (“NASAA”) has urged that, in the interest of investor protection and uniformity with state laws, disqualification should apply to a broader range of criminal convictions. NASAA suggested that disqualification should arise from any criminal conviction involving fraud or deceit, as provided in the Model Accredited Investor Exemption and the Uniform Securities Act of 2002 adopted by many states, as well as “the making of a false filing with a state, or involving a

commodity future or option contract, or any aspect of a business involving securities, commodities, investments, franchises, insurance, banking or finance.”<sup>42</sup> Would it be appropriate for the new rules to impose disqualification for some or all of these other offenses, even though Section 926 of the Dodd-Frank Act does not require it?

(14) Under current rules and under our proposal, disqualification arises only from actions taken by U.S.-based courts and regulators. From the standpoint of disqualification, is conduct outside the United States as relevant as conduct within the United States? Should corresponding convictions in foreign courts trigger disqualification on the same basis as U.S. criminal convictions? Or are there reasons not to treat foreign criminal convictions on a par with U.S. Federal or state criminal convictions? What would be the impact on issuers and covered persons if the Commission included foreign court convictions as a disqualifying event under the proposed disqualification provision?

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 securities or involving the making of a false filing with the Commission.<sup>43</sup> 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.”<sup>44</sup> 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.<sup>45</sup>

The proposed provision would reflect the substance of these two provisions in

<sup>38</sup> See Unif. Sec. Act § 508 (amended 2002) (available at <http://www.abanet.org/buslaw/newsletter/0009/materials/uniformsecure.pdf>).

<sup>39</sup> See 17 CFR 230.262(a)(4).

<sup>40</sup> 17 CFR 230.262(b)(2).

<sup>41</sup> The look-back period means that disqualification no longer arises from an injunction or restraining order after the requisite amount of time has passed, even though the injunction or order is still in effect. Because disqualification is triggered only when a person “is subject to” a relevant injunction or order, 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.

a slightly simplified format.<sup>46</sup> To align with current Rule 505, the proposed rule would cover orders arising out of the conduct of business of paid solicitors of purchasers of securities.

#### Request for Comment

(15) We note that certain regulatory orders and bars are required to have a ten-year look-back period under Section 926(2)(a)(ii) of the Dodd-Frank Act (discussed below). Is it appropriate to limit the look-back period for court injunctions and restraining orders to five years, as proposed, based on current Rule 262? Or should we adopt a ten-year look-back period for injunctions and restraining orders? Should any disqualifying events, criminal and otherwise, result in permanent disqualification from participating in Rule 506 offerings?

(16) Alternatively, should we establish different look-back periods for different types of court orders and injunctions and restraining orders? For example, should we provide for a ten-year look-back for court injunctions and restraining orders involving fraudulent, manipulative or deceptive conduct, and a five-year look-back period for other court injunctions and restraining orders? If we did this, would it be easy to determine which category applied to a given court injunction or order? Should we provide different look-back periods for Federal and state court injunctions and restraining orders?

(17) Under current rules and under our proposal, a court injunction or restraining order issued more than five years before the relevant sale is no longer disqualifying, even if it is still in effect. Is it appropriate that court injunctions and restraining orders should cease to be disqualifying after a stated time, as proposed, or should disqualification continue for as long as the triggering injunction or order continues in effect (even if it is permanent)?

(18) Under our proposal, disqualification for court injunctions and restraining orders would be narrower in scope and would have a shorter look-back period than disqualification for regulatory orders (discussed in C.3 below).<sup>47</sup> The

<sup>46</sup> See Proposed Rule 506(c)(1)(ii).

<sup>47</sup> For example, under the proposal and current Rule 262, court injunctions and restraining orders are disqualifying only if they relate to conduct or practices (i) in connection with the purchase or sale of a security, (ii) involving making a false filing with the Commission or (iii) arising out of the conduct of certain businesses. The proposed provisions for regulatory orders, discussed below, are broader, and would impose disqualification for any final order based on a violation of law that

<sup>38</sup> See 17 CFR 230.505(b)(2)(iii)(A) and 17 CFR 230.602(b)(2).

<sup>39</sup> Of the 16,027 initial Form D filings claiming a Rule 506 exemption in the twelve months ended September 30, 2010, 3,812 (or 24%) indicated that the offering was expected to last more than a year.

<sup>40</sup> See NASAA Comment Letter (Oct. 26, 2007) (available at <http://www.sec.gov/comments/s7-18-07/s71807-57.pdf>).

<sup>41</sup> See NASAA Advance Comment Letter (Nov. 4, 2010) (available at <http://www.sec.gov/comments/df-title-ix/regulation-d-disqualification/regulationdisqualification-1.pdf>).

treatment of court injunctions and restraining orders would reflect the position under current rules, while the treatment of regulatory orders is mandated by Section 926 of the Dodd-Frank Act. Should the two provisions be conformed? Or are there policy or other reasons that support differentiating between them?

(19) Should injunctions and orders of foreign courts have no consequences for disqualification, as proposed? Or should they trigger disqualification on the same basis as U.S. Federal and state court injunctions and orders, or on some other basis? Why? Should foreign court injunctions and orders have to meet additional criteria to be considered for disqualification purposes? If so, what should those criteria be?

3. *Final orders of certain regulators.* Section 926(2)(A) of the Dodd-Frank Act provides that Commission rules 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.

Section 926(2)(A) is identical to Section 15(b)(4)(H) of the Securities Exchange Act of 1934 (the “Exchange Act”)<sup>48</sup> and Section 203(e)(9) of the Investment Advisers Act of 1940 (the “Advisers Act”),<sup>49</sup> except that Section 926(2)(A)(ii) contains a ten-year look-back period for final orders based on violations of statutes that prohibit fraudulent, manipulative and deceptive conduct, and the Exchange Act and

prohibits fraudulent, manipulative or deceptive conduct. As a result, under the proposal certain types of orders (e.g., a ban on serving as an officer or director of a public company) would be disqualifying if issued by a regulator but may not be disqualifying if issued by a court.

<sup>48</sup> 15 U.S.C. 78o(b)(4)(H).

<sup>49</sup> 15 U.S.C. 80b(e)(9).

Advisers Act provisions have no express time limit for such orders. These existing provisions form a basis on which the Commission may censure, suspend or revoke the registration of brokers, dealers and investment advisers based on financial industry bars and final regulatory orders issued against them by specified regulators, in the context of statutory provisions that provide for such sanctions based on a wide variety of other events.<sup>50</sup>

We propose to codify Section 926(2)(A) almost verbatim as new paragraph (c)(1)(iii) of Rule 506, with clarifying changes intended to eliminate potential ambiguities and make the new rule easier to apply.

With respect to bars, the proposed rule would provide that the order must bar the person “at the time of [the] sale” from one or more of the specified activities. This would clarify that a bar is disqualifying only for as long as it has continuing effect.<sup>51</sup> Thus, for example, a person who was barred by a state regulator from association with a broker-dealer for three years would be disqualified for three years. 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 successfully applied to reassociate, assuming that the bar had no continuing effect after reassociation. (This would be true even if the bar order were also a “final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct,” as contemplated by Dodd-Frank Section 926(2)(A)(ii), because the person would not be considered to be “subject to” an order that had no continuing effect.)

Also, recognizing that no Commission filing is required in a Regulation D offering before an offer or sale, we

<sup>50</sup> For example, Section 15(b)(4) authorizes the Commission to sanction registered brokers and dealers for such matters as false statements in Commission filings; certain U.S. or foreign criminal convictions; certain court injunctions, willful violations of the securities laws or the Commodity Exchange Act, or the rules and regulations issued thereunder; aiding, abetting, counseling or procuring such a violation or failing adequately to supervise someone who committed such a violation; and professional bars issued by the Commission or non-U.S. financial regulatory authorities. See 15 U.S.C. 78o(b)(4). Section 203(f) authorizes the Commission to sanction registered investment advisers for similar matters. See 15 U.S.C. 80b–3(f).

<sup>51</sup> This accords with the Commission’s current 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 Investment Advisers Act only so long as some act is being performed (or not performed) pursuant to the order).

propose to measure the ten-year period required under 926(2)(A)(ii) from the date of the relevant sale, as would be the case for other look-back periods in the proposed rule. Finally, we propose to clarify that the orders described in Section 926(2)(A)(ii) must have been “entered” within the relevant ten-year period, so it is clear that we are measuring from the date of the order and not the date of the underlying conduct.

#### Request for Comment

(20) Should the rules clarify what constitutes a “bar”? For example, should the rule state that all orders that have the practical effect of a bar (prohibiting a person from engaging in a particular activity) be treated as bars, even if the relevant order is not called a bar?

(21) Under current interpretations of Rule 262, bars are disqualifying for as long as they have continuing effect, which means that permanent bars (for example, an “unqualified” bar, which does not contain any proviso for re-application after a specified period) are permanently disqualifying. By contrast, most other disqualifying events operate only for a specified period (for example, criminal convictions give rise to a disqualification period of five or ten years). Would it be appropriate to provide a cut-off date (for example, ten years), for permanent bars?<sup>52</sup>

*Final Orders.* The Dodd-Frank Act does not specify what should be deemed to constitute a “final order” that triggers disqualification. The term “final” suggests that only orders issued at the conclusion of a matter should be considered, but beyond that, it is not clear whether other procedural or substantive criteria should be applied.

As noted above, Section 15(b)(4)(H) of the Exchange Act and Section 203(e)(9) of the Advisers Act contain language identical to Section 926(2)(A), including the use of the term “final order.” The Commission has not provided a definitive interpretation of “final order” in those contexts either, although it has approved forms for broker-dealers and their associated persons that include such a definition.<sup>53</sup> For purposes of

<sup>52</sup> If we established such a cut-off date, persons subject to a permanent bar would still be prevented from engaging in the barred conduct. (Someone permanently barred from the securities industry would still not be permitted to act as a placement agent, for example.) The difference would be that their presence or participation in an offering in some otherwise permissible capacity—as, for example, a 10% shareholder of the issuer—would not be disqualifying.

<sup>53</sup> See Release Nos. 34–48161 (Jul. 10, 2003) [68 FR 42444] (available at <http://www.sec.gov/rules/sro/nasd/34-48161.pdf>) and 34–49779 (May 27, 2004) [69 FR 32084] (available at <http://www.sec.gov/rules/sro/nyse/34-49779.pdf>).

registration of broker-dealers and associated persons, the Financial Industry Regulatory Authority (“FINRA”) collects data regarding disciplinary actions, including relevant final orders, through its uniform registration Forms BD, U4, U5 and U6.<sup>54</sup> In that context, FINRA has defined “final order” to mean “a written directive or declaratory statement issued by an appropriate federal or state agency \* \* \* pursuant to applicable statutory authority and procedures, that constitutes a final disposition or action by that federal or state agency.”<sup>55</sup>

We also understand that at least some state securities laws may provide that orders do not become “final” unless the state securities administrator makes findings of fact and conclusions of law on a record in accordance with the state administrative procedure act and files a certified copy of the findings with a clerk of a court of competent jurisdiction, as provided in the Uniform Securities Act of 2002.<sup>56</sup> We are not aware that the laws covering orders of Federal and state banking, insurance, and credit union regulators, which are required to be covered in our Rule 506 disqualification rules by the Dodd-Frank Act, provide guidance on which of their orders should be regarded as “final orders.”

Our preliminary view is that including a definition of “final order” in the rule would help issuers and other market participants determine whether any given regulatory action is disqualifying (and conversely, not including a definition could give rise to uncertainty in that regard). We are therefore proposing to amend Rule 501 of Regulation D to add a definition of “final order” for purposes of bad actor disqualification.<sup>57</sup> The proposed definition is based on the FINRA definition, and therefore is consistent with current practices implementing

<sup>54</sup> Form BD is the Uniform Application for Broker-Dealer Registration, used by entities to register as broker-dealers. 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. Information on disciplinary history collected via these forms (as well as other information) can be reviewed through BrokerCheck. See note 81 for more information about BrokerCheck.

<sup>55</sup> See “Explanation of Terms” applicable to FINRA Forms U4, U5 and U6 (available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p116979.pdf>).

<sup>56</sup> See Unif. Sec. Act § 604 (2002).

<sup>57</sup> See Proposed Rule 501.

statutory language in the Exchange Act that is identical to Section 926. We believe that this definition is sufficiently broad to cover the different types of regulatory orders that might be relevant, but we are soliciting comment on that question.

The proposal defines “final order” to mean the final steps taken by a regulator. In at least some cases, however, judicial appeal of a regulatory order will be available. It may be appropriate for us to define “final order” to mean an order for which all rights of appeal have terminated or been exhausted. Given that the appeals process could take several years, however, we are concerned that such an approach could compromise investor protection. We are soliciting comment on whether and how to address rights of judicial appeal. We are also soliciting comment more generally on whether it is appropriate to include a definition of “final order” in the rule.

#### Request for Comment

(22) Is it appropriate, as proposed, to define the term “final order” for purposes of our disqualification rules? What general effects would a defined term or lack of a defined term impose on issuers and other covered persons?

(23) Is the proposed definition of “final order” (which is based on the FINRA definition) appropriate?

(24) Should we use a definition based on the Uniform Securities Act interpretation of final order instead? Alternatively, should we add concepts from that definition (for example, the requirement that the regulator have made findings of fact) to the proposed definition?

(25) Should an order be considered final only if it is a “final order” within the meaning of the law that governed its issuance? What if the law lacks clear guidance on what constitutes a final order?

(26) Should we consider an order final if it is the conclusion of an action by the relevant regulator? Or should only non-appealable orders be considered final, so that disqualification would not apply until all appeals, including potential judicial appeals, are exhausted? Would investor protection be compromised if judicial appeals are taken into account?

(27) Should specified minimum criteria apply in determining what constitutes a final order? For example, should we include only orders issued after a proceeding that affords the respondent 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?

Should settled matters be treated the same as non-settled matters in this respect?

(28) Should the authority that issues the relevant order be asked to express a view about whether the particular action is a final order for purposes of our disqualification rules? Would such authorities be authorized or be willing to express such a view? Should the Commission defer to the interpretation of the regulator that issued the order to determine whether an order is final?

*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.” We have received advance comment urging us to “differentiate between technical violations and intentional or other more egregious conduct,”<sup>58</sup> and to impose disqualification only with respect to the latter.

In light of the specificity of the language of Section 926, we are not proposing to include standards or guidance with respect to this requirement. We are aware, however, that any rule we adopt would apply to orders issued by regulators under a wide variety of different state and Federal laws and regulations. We understand that there may be concerns that this language could be interpreted or applied very broadly, and in particular that under some state laws and regulations, conduct that some may consider to be a “technical” violation might be defined as fraudulent, manipulative or deceptive.<sup>59</sup> We are, therefore, requesting comment on whether we should set forth minimum standards for this provision.

#### Request for Comment

(29) Should we provide guidance on what constitutes “fraudulent, manipulative or deceptive conduct” for purposes of bad actor disqualification under Rule 506? If so, should we provide such guidance by rule, and what should the rule say?

<sup>58</sup> Advance Comment Letter of Managed Funds Ass’n (Sept. 22, 2010) (available at <http://www.sec.gov/comments/df-title-iv/exemptions/exemptions-16.pdf>).

<sup>59</sup> See Advance Comment Letter of Investment Program Ass’n (Mar. 2, 2011) (available at <http://www.sec.gov/comments/df-title-ix/regulation-d-disqualification/regulationd-disqualification-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>).



(30) Should disqualifying conduct be required to be fraudulent, manipulative or deceptive at common law or under some other standard? Should scienter be required?

(31) Should the Commission defer to the regulator that issued the order with respect to the determination of whether conduct is fraudulent, manipulative or deceptive?

(32) Should the authority that issues the relevant order be asked to express a view about whether the particular violation is the sort of violation that should give rise to disqualification under Rule 506? Should the Commission defer to the interpretation of the regulator on that issue? In that connection, should we provide greater scope for a regulator to determine that disqualification should not arise (in effect, a waiver of disqualification)?

#### *Orders of Other Regulators*

As mandated by Section 926 of the Dodd-Frank Act, bad actor disqualification would result under our proposed rule 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, a list that does not include the Commission or the Commodity Futures Trading Commission ("CFTC"). We are considering and soliciting comment on whether orders of the Commission and the CFTC should have the same effect for disqualification purposes as the orders of these other regulators.

Some types of orders issued by the Commission are covered by current bad actor disqualification rules, and some are not.<sup>60</sup> Most significantly, orders issued in stand-alone Commission cease-and-desist proceedings<sup>61</sup> are not disqualifying under current rules.<sup>62</sup> The

<sup>60</sup> Certain Commission orders involving regulated entities in the securities industry (e.g., broker-dealers and investment advisers) and their associated persons already give rise to disqualification under Regulation A, Rule 505 and Regulation E as currently in effect. See Rule 262(b)(3) and Rule 602(b)(5) and (c)(3), 17 CFR 230.262(b)(5) and 230.602(c)(3).

<sup>61</sup> 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.

<sup>62</sup> Current rules also exclude 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

reason for this omission appears to be largely historical: The Commission did not have authority to bring cease-and-desist proceedings when Rule 262 was originally adopted, and the rule has not been amended to take account of that authority.<sup>63</sup> Unless our disqualification rules cover Commission cease-and-desist orders, entities and individuals outside the securities industry would be subject to bad actor disqualification for Commission actions only if those persons are subject to a court order. In the 2007 Proposal, we proposed to include Commission and certain other cease-and-desist orders as disqualifying events in the Regulation D bad actor provisions.<sup>64</sup> Some commenters opposed this proposal on the basis that it would be overinclusive and could result in disqualification being imposed for minor technical violations.<sup>65</sup> We are soliciting comment as to whether Commission cease-and-desist orders may be an appropriate basis for disqualification and, if so, whether the rules should differentiate among different types of orders.

We are also considering whether orders of the CFTC are relevant for disqualification purposes. The CFTC is the only regulator in the financial services area whose orders are not directly addressed by the proposed rules, and the conduct that would typically give rise to CFTC sanctions is similar to the type of conduct that would trigger disqualification if it were the subject of action by a regulator in the securities, insurance, banking or credit union sectors. On that basis, we are soliciting comment as to whether CFTC orders may be an appropriate basis for disqualification.

Our preliminary view is that, if we were to include Commission and CFTC orders in our bad actor disqualification rules, we would do so by adding references to the Commission, the CFTC and the commodities business in the paragraph of the rules that addresses

to deny them the privilege of appearing before the Commission temporarily or permanently. 17 CFR 201.102(e). Orders under these sections are not currently disqualifying.

<sup>63</sup> The disqualification provisions of Rule 505 and Regulation E are derived from Rule 262 and reflect the same omission.

<sup>64</sup> Under the 2007 Proposal, disqualification would have arisen if a covered person "is currently subject to a cease and desist order, entered within the last 5 years, issued under federal or state securities, commodities, investment, insurance, banking or finance laws." See Release 33-8828, note 13 above.

<sup>65</sup> See, e.g., Comment Letter of Managed Funds Association (Oct. 19, 2007) (available at <http://www.sec.gov/comments/s7-18-07/s71807-56.pdf>); Comment Letter of G. Philip Rutledge (Oct. 5, 2007) (available at <http://www.sec.gov/comments/s7-18-07/s71807-26.pdf>).

"final orders" of certain regulators.<sup>66</sup> In that way, any requirements the rule may impose on such orders and any interpretive positions that may apply (for example, on what constitutes a final order and what constitutes fraudulent, manipulative and deceptive conduct) would apply to orders of the Commission and the CFTC on the same basis as it did to orders of state and other Federal regulators covered by the rule. We would exclude from this provision Commission disciplinary orders that are already covered under current rules, and continue to treat them separately.<sup>67</sup>

If we were to adopt bad actor disqualification provisions that included orders of the Commission and the CFTC, we would also have to consider the impact on competition, efficiency and capital formation and the impact on small businesses. Our preliminary view is that adding new disqualifying events for Commission and CFTC orders would probably increase the number of offerings that would be disqualified, may enable the disqualification rules to more effectively screen out felons and other bad actors, and would contribute to creating an internally consistent set of rules that would treat relevant sanctions similarly for disqualification purposes. It may result in increased compliance costs for companies and funds that are seeking to raise capital. However, adding Commission and CFTC orders to the new rules could improve investor protection and reduce the risks of investment in private placements and limited offerings, and thereby help to reduce the cost or increase the availability of capital. We do not expect that it would affect small businesses differently than the rules we are proposing.

#### *Request for Comment*

(33) Would it be appropriate to include the Commission in the list of regulators whose final orders are potentially disqualifying?

(34) If so, should the rules specify that certain types of Commission cease-and-desist orders would always give rise to disqualification? For example, we could treat cease-and-desist orders related to violations of the anti-fraud provisions of our statutes and rules in this way (or perhaps those that require an element of scienter), by analogy to the Section 926 standard of "fraudulent, manipulative or deceptive conduct." Similarly, we could treat cease-and-desist orders related to

<sup>66</sup> See Proposed Rule 506(c)(1)(iii).

<sup>67</sup> See Part II.C.4 of this Release and Proposed Rule 506(c)(1)(iv).

violations of Section 5 of the Securities Act in this way, on the basis that persons who violate Section 5 should lose the benefit of exemptive relief from Section 5 for some period of time afterward. Should other categories of orders be expressly covered in this way?

(35) Conversely, should some categories of cease-and-desist orders (for example, those relating to recordkeeping violations) be expressly excluded from coverage by the rule, so they could never give rise to disqualification? If so, what types of orders should be excluded?

(36) Would it be appropriate to include the CFTC in the list of regulators whose final orders are potentially disqualifying? If so, should the rules specify that certain types of CFTC orders would always give rise to disqualification, or that certain types would never give rise to disqualification? If so, what types of orders should be included or excluded?

(37) If we were to cover Commission and CFTC orders in our bad actor disqualification rules, should we do that by simply including references to them in the paragraph that addresses “final orders” of certain regulators? Or should we treat orders of the Commission and/or the CFTC separately? If so, why?

(38) What would the costs and benefits be of covering Commission and CFTC orders? Would the benefits justify the costs? How would extending our disqualification rules in that way affect competition, efficiency and capital raising? Would small businesses be affected differently than they would be under the rules as proposed and, if so, how?

(39) Are there any other regulators whose final orders should be taken into account for disqualification purposes?

(40) Under the proposal, corresponding orders of foreign securities regulators would not trigger disqualification. Should such orders be disqualifying on the same basis as U.S. Federal and state regulatory orders? If so, should the rules refer to any securities regulator or a country’s principal securities regulator?

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.”<sup>68</sup> Under

the cited provisions, 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. The Commission has historically interpreted Rule 262(b)(3) to require disqualification only for as long as some act is prohibited or required to be performed pursuant to the order, with the consequence that censures are not disqualifying, and a disqualification based on a suspension or limitation of activities expires when the suspension or limitation expires.<sup>69</sup> We are seeking comment on whether this, as well as certain interpretive positions of the staff of the Division of Corporation Finance, should be codified in the new rule.<sup>70</sup>

We are not proposing substantial changes to the substance of the current rule or its interpretation.<sup>71</sup> In particular,

impose civil money penalties in these disciplinary proceedings.

<sup>69</sup> See 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 “In 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) [46 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).

<sup>70</sup> Based on similar reasoning as has been applied to censures, the staff of the Division of Corporation Finance has informally interpreted orders to pay civil money penalties as not disqualifying. We seek comment on whether we should formally codify that position, and also on whether orders to pay money penalties should be disqualifying if the fines are not paid as ordered.

<sup>71</sup> Because of our approach of having one list of covered persons and one list of disqualifying events, this provision would have slightly broader reach under the proposal than under current rules. Under current Rule 262(b)(3), disqualification for Commission disciplinary orders applies to covered persons other than issuers and their predecessors and affiliated issuers. Under the proposal, all

we do not believe that any look-back period is appropriate or should be added, on the basis that the duration of the suspension or limitation on activities imposed by the Commission should be sufficient from an investor protection standpoint.

To make the new provisions easier to understand and use, however, we are proposing to simplify the presentation and codify the current interpretation.<sup>72</sup> We are also proposing to eliminate an apparent anomaly in the current rule, whereby orders issued under Section 15B(a) of the Exchange Act (the basic registration requirements for municipal securities dealers) are treated as disqualifying. Section 15B(a) is not generally a source of sanctioning authority and we do not believe it is appropriate to refer to it in the context of bad actor disqualification. Disciplinary orders against municipal securities dealers are issued under Section 15B(c), a reference to which we propose to include in the new disqualification provisions.

#### Request for Comment

(41) Is it appropriate for the new rule to largely codify the current rule, as proposed?

(42) Should we impose any look-back period for Commission disciplinary sanctions?

(43) Should the rules provide that censure is disqualifying? If so, how long should disqualification last?

(44) For orders limiting activities and financial industry bars, should we impose a longer period of disqualification than the period that the order or bar remains in effect? For example, should we impose a look-back period so that anyone who was subject to such an order or bar within the prior five or ten years would be disqualified?

(45) Should the rules provide that orders to pay civil money penalties are disqualifying if the penalties are not paid as ordered? Should such orders be disqualifying in other circumstances?

(46) Should the reference to Section 15B(a) in the current rule be eliminated, as proposed, or included? If we include it, should coverage be limited to orders denying registration because of prior misconduct?

5. *Suspension or expulsion from SRO membership or association with an SRO member.* Rule 262(b)(4) imposes disqualification on an offering if any

covered persons would be subject to it. For issuers that are (or whose predecessors or affiliated issuers are or were) registered brokers, dealers, municipal securities dealers or investment advisers, the proposal would therefore create a new triggering event for disqualification.

<sup>72</sup> See Proposed Rule 506(c)(1)(iv).

<sup>68</sup> 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), and Section 203(j) of the Investment Advisers Act, 15 U.S.C. 80b–3(i), give the Commission authority to

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" (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.<sup>73</sup> Again, we are not proposing to change the substance of the current rule (and in particular, are not proposing to add any look-back period).<sup>74</sup> The proposal would update the rule by adding a reference to a registered affiliated securities association.<sup>75</sup>

#### Request for Comment

(47) Should the rule also cover suspension or expulsion from membership or participation in any commodities exchange or commodities self-regulatory organization, or from any other organization?

(48) Should a look-back period be applied?

(49) Should suspension or expulsion from participation in foreign securities exchanges be covered?

6. *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.<sup>76</sup> In a similar vein, 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.<sup>77</sup> We propose to incorporate the substance of these four paragraphs into the rule but simplify the presentation and combine them into a single paragraph that would apply to all covered persons.<sup>78</sup>

#### Request for Comment

(50) Is it appropriate to include the current Regulation A five-year look-back period for these actions? Or should we impose a longer period, such as, for example, ten years?

(51) Should this provision cover comparable actions by commodities regulators or other regulators? If so, what actions, by which regulators, should be covered?

(52) Should this provision cover comparable actions by foreign securities regulators?

7. *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.<sup>79</sup> We propose to incorporate the substance of these paragraphs but combine them into a single paragraph and simplify the presentation to eliminate unnecessary statutory citations. We are proposing to mirror the current five-year look-back period for U.S. Postal Service false representation orders.<sup>80</sup>

(53) Is it appropriate to mirror the current five-year look-back period for U.S. Postal Service false representation orders? Or should we extend the look-back period to ten years to correspond

with the ten-year look-back period for regulatory orders under the Dodd-Frank Act?

#### D. Reasonable Care Exception

Under Section 926 of the Dodd-Frank Act, the events that generally give rise to bad actor disqualification under current rules, plus specified orders issued by a variety of state regulators (including securities, banking, credit union, savings association and insurance regulators) and Federal banking and credit union regulators, are required to result in disqualification under Rule 506. Once Section 926 is implemented, a substantially greater number of exempt securities offerings than before will be subject to bad actor disqualification requirements, effectively imposing a new burden of inquiry on many issuers with respect to potential disqualifying events.

Although some disqualifying events will be a matter of public record,<sup>81</sup> 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 a covered person has a disqualifying event in his or her past. In addition, the number of covered persons whose presence or participation could be disqualifying may be quite large, particularly if, as proposed, the rules cover all "officers" of persons compensated for soliciting investors. As noted above, broker-dealers may have large numbers of officers, many of whom would not have any involvement with the offering in question, but all of whom would be covered persons for purposes of disqualification.

Our proposal attempts to address the potential difficulty of ascertaining

<sup>81</sup> For example, FINRA maintains BrokerCheck, an online tool that enables the public to check the licensing and securities industry disciplinary history of registered broker-dealers and their associated persons. The information included in BrokerCheck is derived from the Central Registration Depository, the securities industry online registration and licensing database. The staff of the Office of Investor Education and Advocacy has prepared a study, including recommendations, required by Section 919B of the Dodd-Frank Act on ways to improve investors' access to registration information (including disciplinary actions; regulatory, judicial and administrative proceedings; and other information) about broker-dealers, investment advisers and their associated persons. See Staff of the Office of Investor Education and Advocacy, Study and Recommendations on Improved Investor Access to Registration Information about Investment Advisers and Broker-Dealers (Jan. 2011) (available at <http://www.sec.gov/news/studies/2011/919bstudy.pdf>). In addition, FINRA has recently launched its new Disciplinary Actions Online database, which provides access to FINRA complaints against firms and individual brokers, settlement agreements, decisions by FINRA hearing panels and National Adjudicatory Council decisions. BrokerCheck reports will provide links to this new database.

<sup>73</sup> See 17 CFR 230.262(b)(4).

<sup>74</sup> The application of this provision is slightly broader under the proposal than under Rule 262(b)(4), in that it would apply to all covered persons, including issuers and their predecessors and affiliated issuers (which are excluded under Rule 262(b)(4)). See Proposed Rule 506(c)(1)(v).

<sup>75</sup> In 2007, the SEC approved the formation of FINRA, a consolidation of the enforcement arm of the New York Stock Exchange, NYSE Regulation, Inc. and the NASD. Once formed, FINRA became responsible for regulatory oversight of all securities firms that do business with the public. See SR-NASD-2007-023, Release No. 34-56145, Order Approving Proposed Rule Change to Amend the By-Laws of NASD to Implement Governance and Related Changes to Accommodate the Consolidation of the Member Firm Regulatory Functions of NASD and NYSE Regulation, Inc. (available at <http://www.sec.gov/rules/sro/nasd/2007/34-56145.pdf>). Registered national securities exchanges maintain the right to enforce their own rules.

<sup>76</sup> 17 CFR 230.262(a)(1) and (2).

<sup>77</sup> 17 CFR 230.262(c)(1) and (2).

<sup>78</sup> See Proposed Rule 506(c)(1)(vi).

<sup>79</sup> 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).

<sup>80</sup> See Proposed Rule 506(c)(1)(vii).

whether disqualifications apply by including 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.<sup>82</sup> We are proposing a reasonable care exception out of a concern that the benefits of Rule 506—which, among other things, is intended to create a cost-effective method of raising capital, particularly for small businesses—may otherwise be substantially reduced. Issuers may be reluctant to offer or sell securities in reliance on an exemptive rule if the exemption could later be found, despite the issuer's exercise of reasonable care, not to have been available; the risk of a potential Section 5 violation or blue sky law violation may outweigh the potential benefits of relying on the exemption. On the other hand, issuers must have a responsibility to screen bad actors out of their Rule 506 offerings. We believe that providing a reasonable care exception would help to preserve the intended benefits of Rule 506 and avoid creating an undue burden on capital-raising activities, while giving effect to the legislative intent to screen out felons and bad actors.<sup>83</sup>

The language of the proposed exception is based on the standard of the Model Accredited Investor Exemption (“MAIE”), which was approved by NASAA in 1997.<sup>84</sup> We included a similar exception in the 2007 Proposal. Under both the MAIE and our proposed exception, the burden would be on the issuer to establish that it had

<sup>82</sup> See Proposed Rule 506(c)(2)(ii).

<sup>83</sup> Regulation D already has a provision, Rule 508, under which “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: (i) the failure to comply did not pertain to a term, condition or requirement directly intended to protect that particular individual or entity; (ii) 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 (iii) 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 Proposed Rule 506(c).

<sup>84</sup> As of the date of this Release, 31 states plus the District of Columbia had adopted some form of the MAIE. See CCH SmartCharts™, Blue Sky Topics, “Did the State Adopt the NASAA Model Accredited Investor Exemption?.”

exercised reasonable care (most likely in the context of an enforcement proceeding brought by a regulator or a private action brought by investors). The MAIE incorporates as part of the standard that reasonable care must be “after factual inquiry.” In the 2007 Proposal, we did not include an express reference to “factual inquiry,” but requested comment on whether the rule should require that reasonable care be based on a factual inquiry, as provided in the MAIE. The commenters who responded to this point were generally supportive of a requirement that issuers make an effort to assure themselves that no bad actors are involved with their offerings, but differed on whether an express reference to factual inquiry must be included in the rule itself.<sup>85</sup>

We believe the concept of reasonable care necessarily includes inquiry by the issuer into the relevant facts. Our proposed reasonable care exception, therefore, would include an instruction specifying that reasonable care would entail a factual inquiry, the nature of which would depend on the facts and circumstances.<sup>86</sup>

The steps an issuer should take to exercise reasonable care would vary according to the circumstances of the covered persons and the offering, taking into account such factors as the risk that bad actors could be present, the presence of other screening and compliance mechanisms and the cost and burden of the inquiry. In some circumstances, factual inquiry of the covered persons themselves (for example, by including additional questions in questionnaires issuers may already be using to support disclosures regarding directors, officers and significant shareholders of the issuer) may be adequate. Issuers should also consider whether investigating publicly available databases is reasonable. In some circumstances, further steps may be necessary.

#### Request for Comment

(54) Is it appropriate and consistent with investor protection to include a

<sup>85</sup> See NASAA Comment Letter, note 40. See also Comment Letter from Carol Bavousett Mattick, P.C. Chair of the Securities Law Committee, Business Law Section of the State of Texas (Oct. 9, 2007) (available at <http://www.sec.gov/comments/s7-18-07/s71807-36.pdf>) (using questionnaires similar to the current practices for establishing a reasonable basis for determining accredited investor status would seem to be appropriate).

<sup>86</sup> See Proposed Rule 506(c)(2)(ii), where the instruction states: “Instruction to paragraph (c)(2)(ii) An issuer will not be able to establish that it has exercised reasonable care unless it has made factual inquiry into whether any disqualifications exist. The nature and scope of the requisite inquiry will vary based on the circumstances of the issuer and the other offering participants.”

reasonable care exception in our disqualification rules?

(55) What would be the practical effect on issuers and other market participants of not including such an exception?

(56) What steps do issuers typically take to confirm the absence of a disqualification for offerings under current Regulation A and Rule 505 of Regulation D? How would practice norms under the proposed rules applicable to Rule 506 offerings be expected to compare to current norms if a reasonable care exception were introduced?

(57) Is it appropriate to condition the reasonable care exception on factual inquiry? Are there any circumstances in which factual inquiry should not be required? Should the rule specify what factual inquiry is required or provide examples of specific factual inquiries that might be undertaken by the issuer?

(58) With respect to officers of compensated solicitors of investors, in light of the potentially significant volume of inquiries required to determine whether there are disqualifying covered persons associated with a broker-dealer, should the rules provide specific steps to establish reasonable care? If so, what should those steps be?

#### E. Waivers

Currently, issuers may seek waivers from disqualification from the Commission under Regulation A.<sup>87</sup> The Commission may grant a waiver if it determines that the issuer has shown good cause “that it is not necessary under the circumstances that the [registration] exemption \* \* \* be denied.”<sup>88</sup> Consistent with Section 926 and its mandate to the Commission to promulgate disqualification rules “substantially similar” to Regulation A, we propose to carry over the current waiver provisions of Rule 262 to our new disqualification provisions.<sup>89</sup>

#### Request for Comment

(59) Is it appropriate for our bad actor disqualification rules to provide for Commission authority to waive disqualification, as proposed?

(60) Should the Commission exercise waiver authority under its

<sup>87</sup> 17 CFR 230.262.

<sup>88</sup> *Id.*

<sup>89</sup> See Proposed Rule 506(c)(2)(i). Under current rules, the Commission has delegated authority to the Director of the Division of Corporation Finance to grant disqualification waivers under Regulation A. See 17 CFR 200.30–1(b). Under the proposal, there would be no delegation of authority for waivers of bad actor disqualification under new Rule 506(c), and all such waivers would have to be issued by a direct order of the Commission itself.

disqualification rules for cases involving final orders of state regulators? Under what circumstances should the Commission exercise that authority? With regard to state regulatory matters, should there be additional requirements (such as concurrence by the relevant regulator or lack of objection after notice) before the Commission should consider issuing a waiver?

(61) Should we provide guidance on circumstances that are likely to give rise to the grant or denial of a waiver?

(62) Should our rules include a provision (such as currently included in the MAIE)<sup>90</sup> that provides an exception from disqualification if the relevant authority of the state to which the disqualification relates waives the disqualification?

#### F. Transition Issues

1. *Disqualifying events that pre-date the rule.* Under the proposal, the new disqualification provisions would apply to all sales made under Rule 506 after the effective date of the new provisions. (The provisions would not affect any transaction that was completed before the effective date.) Offerings made after the effective date would be subject to disqualification for all disqualifying events that had 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 believe that giving full effect to the bad actor provisions upon adoption carries out Congress' mandate.<sup>91</sup> We nevertheless recognize that application of the new disqualification provisions could affect a number of market participants. We are, therefore, seeking comment on potential approaches to alleviate any concerns about possible unfairness, as explained more fully below.

We believe that, under the text of Section 926 as enacted by Congress, past disqualifying events should be taken into account under our new disqualification rules.<sup>92</sup> Dodd-Frank Act

<sup>90</sup> See NASAA, Model Accredited Investor Exemption (D)(2)(b) (available at [http://www.nasaa.org/content/Files/Model\\_Accredited\\_Investor\\_Exemption.pdf](http://www.nasaa.org/content/Files/Model_Accredited_Investor_Exemption.pdf)).

<sup>91</sup> Statement of Senator Christopher Dodd, CR S3813 (May 17, 2010).

<sup>92</sup> In *Landgraf v. USI Film Products*, 511 U.S. 244 (1994), the Supreme Court set forth a general framework for determining the temporal reach of a statute. The first step in that analysis is determining whether Congress has expressed a clear intent on the statute's proper reach. See also *Fernandez-Vargas v. Gonzales*, 548 U.S. 30, 37 (2006) (in the absence of express language regarding retroactive intent, "we try to draw a comparably firm conclusion about the temporal reach specifically intended by applying 'our normal rules of construction'"). If Congress has done so, that

Section 926(2)(A)(i), for example, states that these rules shall disqualify any offering or sale by a person who "is subject" to a final order of a State securities commission or other regulator that bars the person from certain activities. Section 926(2)(A)(ii) similarly requires disqualification of any offering or sale by a person subject to a final State order "that constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the date of the filing of the offer or sale". Section 926(2)(B) requires disqualification of any person who "has been convicted" of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the Commission. In each case, the statutory directive states that our rules shall provide for disqualification based on a past event. In addition, Section 926(1) requires the new disqualification rules to be "substantially similar" to the existing disqualification provisions in Rule 262 of Regulation A. That rule currently disqualifies offerings based on past disqualifying events affecting issuers and other covered persons.<sup>93</sup>

In addition, we are mindful that Section 926 replaced a provision in an earlier bill that would have eliminated Federal pre-emption of Rule 506 offerings, thus subjecting such offerings to state "blue sky" regulation. Without pre-emption, existing convictions, disciplinary orders and other disqualifying events would have operated to disqualify offerings in the states that have bad actor

intention controls. If Congress has not expressed a clear intention on how the statute applies to past events, the second step of the *Landgraf* analysis is to determine whether the statute impairs rights a party possessed when he acted, increases liability for past conduct or imposes new duties with respect to transactions already completed. 511 U.S. at 280. However, the fact that a statute's operation draws on antecedent facts or may upset expectations based on prior law does not make it impermissibly retroactive. *Id.* at 269 and n.24. See also *Nat'l Cable & Telecommunications Assn. v. FCC*, 567 F.3d 659, 670 (DC Cir. 2009); *Boniface v. U. S. Dept. of Homeland Security*, 613 F.3d 282 (DC Cir. 2010); *Empresa Cubana Exportadora de Alimentos y Productos Varios v. U.S. Dept. of the Treasury*, \_\_\_ F.3d \_\_\_, 2011 WL 1120271 (DC Cir. 2011).

<sup>93</sup> Senator Dodd's statement on the Senate floor, when he proposed adding this language, provides further support. "New section 926 would disqualify felons and other "bad actors" who have violated Federal and State securities laws from continuing to take advantage of the rule 506 private placement process. This will reduce the danger of fraud in private placements." Statement of Sen Dodd, CR S3813 (May 17, 2010)]. It suggests an intention to prevent previous violators from continuing to rely on our exemptions, which can only be accomplished if pre-existing disqualifying events are taken into account.

disqualification rules. Replacing this provision with Section 926 was not seen as decreasing investor protection in this regard,<sup>94</sup> suggesting that Section 926 was intended to take into account pre-existing disqualifying events.

Rule 506 is an exemptive rule that establishes a safe harbor from statutory registration requirements for securities offerings. It does not create rights, so disqualification from participation in that type of exempt offering cannot inappropriately prejudice any person. Moreover, offerings that would be disqualified from reliance on Rule 506 under the new provisions could potentially still be effected on a registered basis, pursuant to an available statutory exemption such as Section 4(2) or Section 4(5) of the Securities Act, or pursuant to another exemptive rule. Alternatively, issuers may regain eligibility to rely on Rule 506 if they are able to terminate their relationship with the bad actor whose involvement triggers disqualification.

We are therefore not proposing to exempt, "grandfather," or otherwise make special provision for events that occurred before enactment of the Dodd-Frank Act or the effective date of the proposed amendments. We are soliciting comment, however, about whether the new disqualification provisions required under the Dodd-Frank Act would operate in an unfair manner in particular respects and, if so, how we should address that. For example, should the rules provide a different treatment for persons who entered into negotiated settlements prior to the enactment of the Dodd-Frank Act, the date of this Release or the effective date of our rules, on the basis that they might not have settled on the same terms (or at all) if they had known it would result in disqualification from future Rule 506 offerings? We are soliciting comment on whether we should provide grandfathering or other accommodation for some or all events that predate enactment of the Dodd-Frank Act, this Release or the effective date of our rules, provided such grandfathering or other accommodation would be consistent with the requirements of Section 926. We are also seeking comment on whether we should extend the benefit of waivers previously granted in respect of disqualification from Regulation A, Rule 505 of Regulation D or Regulation E, so that such waivers would cover the new

<sup>94</sup> See NASAA letter, dated April 27, 2010, quoted at CR S3813; see also letter of the Angel Capital Association, dated April 21, 2010, quoted at CR S3813).

disqualification provisions applicable to Rule 506.

#### Request for Comment

(63) Should the Commission provide for grandfathering of pre-existing disqualifying events, or other phase-in procedures for the new disqualification provisions? What would be the effect on issuers, other covered persons and investors of implementing the new bad actor disqualification provisions without grandfathering, as proposed? Would providing for grandfathering be consistent with the requirements of Section 926 of the Dodd-Frank Act?

(64) If we provide for grandfathering, should we grandfather disqualifying events that occurred before enactment of the Dodd-Frank Act, before the date of this Release or before adoption or effectiveness of the amendments to Rule 506? What impact would that have on investor protection? Would the impact on investor protection be reduced if we required disclosure of grandfathered events?

(65) Alternatively, should we grandfather only certain disqualifying events? For example, we could grandfather orders arising out of negotiated settlements agreed to before enactment of the Dodd-Frank Act, or before the rules were proposed, adopted or became effective, in light of the possibility that the party would not have agreed to the relevant order if it had known that a collateral consequence of the agreement would be disqualification from all Rule 506 offerings. This would be similar to the approach taken with respect to eligibility for being a “well-known seasoned issuer” when that category was created.<sup>95</sup> Would providing a different treatment for pre-existing negotiated settlements limit the effectiveness of the bad actor disqualification rules?

(66) Rather than, or in addition to, providing for grandfathering, should we extend waivers previously granted with respect to bad actor disqualification under Regulation A, Rule 505 or Regulation E to cover Rule 506 as well? If we were to consider that approach, are there any categories of such waivers that particularly should or should not be so extended?

2. *Effect on ongoing offerings.* As proposed, our bad actor disqualification

<sup>95</sup> For purposes of defining “ineligible issuer” (*i.e.*, an issuer that is not eligible to be a “well known seasoned issuer”), we provided that ineligibility based on settlements would apply only to judicial or administrative decrees or orders entered into after the effective date of the new rules. *See* Release No. 33-8591 (Jul. 19, 2005) [70 FR 44722, 44747]; (available at <http://www.sec.gov/rules/final/33-8591.pdf>).

provisions would apply to each sale of securities made in reliance on Rule 506 after the rule amendments go into effect. Sales of securities made before the effective date would not be affected by any disqualification that arises as a result of the adoption of the amendments, even if such sales were part of an offering that was intended to continue after the effective date. Only sales made after the effective date of the amendments would be subject to disqualification.

Under the proposal, disqualifying events that occur while an offering is underway would be analyzed in a similar fashion. Sales made before the occurrence of the disqualification would not be affected by it, but sales thereafter would be disqualified unless and until the disqualification is waived or removed.<sup>96</sup>

We believe this approach is consistent with our other rules and provides appropriate incentives to issuers and other covered persons, but are soliciting comment on other possible approaches. If we were to provide that disqualification would be measured only at the time of commencement of an offering, then disqualifying events that arise after commencement would be disregarded. Such an approach could make the rules easier to apply, but would be problematic in light of the statutory language and may compromise investor protection in the context of offerings that continue for extended periods. Conversely, we could provide that all sales in a continuous offering lose the benefit of the exemption if a disqualification arises during the offering. Such an approach could encourage issuers to avoid involving potentially problematic parties in their offerings, but may be too unpredictable and therefore undermine the benefits of the exemptions.

#### Request for Comment

(67) Is it appropriate for disqualification to apply to sales made after the effective date of the new rules in offerings that are underway at the time the new rules become effective, as proposed?

(68) Is it appropriate for disqualification requirements to apply to each sale of securities, as proposed? Or should we measure disqualifying events only at time of the commencement of an offering? Conversely, should we disqualify all sales in a continuous offering if a

<sup>96</sup> Disqualifying events that exist at the time the offering is commenced but are only discovered later would be treated the same way if the reasonable care exception applies; otherwise, the sales would not be eligible for reliance on Rule 506.

disqualification occurs during the offering, including sales that have already been made?

3. *Timing of implementation.* The proposal does not contemplate any phase-in period or delay before issuers would be required to comply with the new disqualification rules. However, given that the new rules may require issuers to take a number of actions before they could confirm that they were not disqualified from relying on Rule 506 (such as, for example, undertaking an inquiry of covered persons, modifying existing due diligence questionnaires, taking steps to remove any existing disqualifications and seeking waivers of disqualification if necessary), it may be appropriate to provide additional time after the rules are adopted but before compliance is required.

#### Request for Comment

(69) Is a relatively shorter implementation period (such as 60 days) appropriate for the new disqualification rules, or should we provide for delayed implementation? If so, how much time would be appropriate? (90 days? 120 days? Longer?) Please provide support for your views by reference to the actions that issuers would be required to take and an estimate of the time periods involved.

#### G. Amendment to Form D

We are proposing a conforming amendment to Form D to reflect that, under our proposal, bad actor disqualification would apply to Rule 506 transactions as well as Rule 505 transactions under Regulation D. The signature block of the current Form D contains a certification that applies only to transactions under Rule 505, confirming that the offering is not disqualified from reliance on Rule 505 for one of the reasons stated in current Rule 505(b)(2)(iii). Under the proposal, this certification would be broadened, so that issuers claiming a Rule 506 exemption would also confirm that the offering is not disqualified from reliance on Rule 506 for one of the reasons stated in Rule 506(c).

#### III. Possible Amendments To Increase Uniformity

In addition to the matters on which we solicit comment above, we are also soliciting public comment on additional changes to our rules that are not explicitly addressed in Section 926 of the Dodd-Frank Act. We are seeking input on whether any or all of these would enhance our rules by better protecting investors from recidivist bad

actors in exempt offerings, avoiding potential sources of confusion and making the rules easier to administer. Although we have not proposed rule text to implement these changes, we are considering them and may adopt them as part of this rulemaking.

#### A. Uniform Application of Bad Actor Disqualification to Regulations A, D and E

We are considering and requesting public comment on whether the new bad actor disqualification standards required by the Dodd-Frank Act for Rule 506 offerings should be applied on a more uniform basis. Under our proposal, Rule 506 of Regulation D would be the only exemption subject to the disqualification rules mandated by Section 926 of the Dodd-Frank Act. The other Securities Act exemptions that currently provide for “bad actor” disqualification (Regulation A,<sup>97</sup> Rule 505 of Regulation D,<sup>98</sup> and Regulation E<sup>99</sup>) would continue to follow the disqualification schemes that are currently in effect. Offerings under Rule 504,<sup>100</sup> the remaining Regulation D exemption, would be the only Regulation D exemption not subject to

<sup>97</sup> See note 17.

<sup>98</sup> 17 CFR 230.505. 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 (see note 10 above), except that non-accredited investors are not required to be sophisticated.

<sup>99</sup> 17 CFR 230.601 through 230.610. Regulation E is an exemption for offerings up to \$5 million by small business investment companies (“SBICs”) and business development companies (“BDCs”). SBICs are investment funds licensed and regulated by the Small Business Administration that use their own capital plus funds borrowed with an SBA guarantee to make equity and debt investments in qualifying small businesses. See Investment Company Act § 2(a)(46), 15 U.S.C. 80a-2(46). A BDC is a closed-end investment company that has elected to be subject to Sections 55 through 65 of the Investment Company Act and that is operated for the purpose of investing in and making significant managerial assistance available to certain types of companies. See Investment Company Act § 2(a)(48), 15 U.S.C. 80a-2(48). Regulation E offerings are required to have an offering circular containing specific mandatory information, which is filed with the Commission and subject to review by the staff of the Division of Investment Management.

<sup>100</sup> 17 CFR 230.504. Rule 504 permits offerings of up to \$1 million of securities by issuers that are not (i) reporting companies under the Securities Exchange Act, (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.

any Federal disqualification requirements. We are concerned that there may be confusion, and that compliance costs could be increased, if different disqualification standards apply to these exemptions.<sup>101</sup> We are also concerned that new disqualification standards applicable only to Rule 506 offerings could negatively affect the market for offerings under our other exemptive rules. We are therefore soliciting comment on whether the proposed new disqualification provisions of Rule 506 should be extended to cover these other exempt offerings.<sup>102</sup>

All bad actor disqualification provisions in our current Securities Act exemptive rules are substantially similar: Rule 505 effectively incorporates by reference Rule 262, with some changes in defined terms,<sup>103</sup> and Rule 602 is substantially similar in its language and effect, although it does not explicitly refer to Rule 262. We are considering whether to preserve this basic uniformity by conforming all existing bad actor disqualification requirements for exempt offerings to the standards proposed to be applied to Rule 506 offerings, and are requesting public comment on that approach.

In the 2007 Proposal, the Commission suggested a uniform approach to disqualification for all offerings under Regulation D.<sup>104</sup> Both in response to the 2007 Proposal<sup>105</sup> and in advance comments on this rulemaking,<sup>106</sup> NASAA voiced support for such a uniform approach. Most comment letters did not support the 2007 Proposal to subject all Regulation D

<sup>101</sup> Regulation A, Rules 504 and 505 of Regulation D and Regulation E are used much less frequently than Rule 506. For the year ended September 30, 2010, we received 17,292 initial filings for offerings under Regulation D, of which 16,027 claimed a Rule 506 exemption, 254 claimed a Rule 505 exemption, 713 claimed a Rule 504 exemption and 151 claimed both Rule 504 and 506 exemptions. Transactions relying on Regulation A or Regulation E are rare; for the year ended September 30, 2010, seven Regulation A offerings and one Regulation E offering were completed. Note that the staff of the Division of Corporation Finance does not routinely review Form D filings to confirm that claimed exemptions are actually available. The figures presented above are based on exemptions claimed in Form Ds that were filed during the relevant period.

<sup>102</sup> If we were to adopt a uniform approach, the rules applied to all exempt transactions would give effect to any changes from our proposal that were ultimately adopted (including, for example, the possible inclusion of final orders of the Commission and the CFTC as disqualifying events, on which we have requested comment in Part II.C.3 of this Release).

<sup>103</sup> See 17 CFR 230.505(b)(2)(iii).

<sup>104</sup> See note 13.

<sup>105</sup> See NASAA Comment Letter, note 40.

<sup>106</sup> See NASAA Advance Comment Letter, note 41.

offerings to bad actor disqualification, and particularly objected to applying bad actor disqualification requirements to Rule 506.<sup>107</sup> Given that the Dodd-Frank Act now requires bad actor disqualification for Rule 506 offerings, and that these constitute a significant majority of transactions under Regulation D, we are considering whether many of the same policy reasons for disqualifying bad actors could be applicable to each of the Regulation D exemptions, as well as to the exemptions under Regulation A and Regulation E, and that uniform disqualification may further investor protection. We are also considering whether imposing uniform disqualification standards across the remainder of Regulation D might promote clarity and simplicity in applying our exemptive rules, and reduce costs imposed by an inconsistent regulatory structure. We also have a concern that adding new disqualification provisions that apply only to offerings under Rule 506 may negatively affect the market for offerings under our other exemptive rules. Bad actors may be encouraged to migrate to offerings under these other exemptions, which would raise investor protection concerns. In addition, investors may perceive a higher risk of fraud in such offerings, which would potentially affect the marketability and issuance costs of all offerings under the exemptions without the new standards, whether or not bad actors are involved.

In order to adopt such a uniform approach, we would have to amend our rules and our proposal in a number of ways, including the following:

- If we applied bad actor disqualification to all Regulation D offerings, we would need to codify the provision as a new paragraph (e) of Rule 502 (the “General Conditions to be Met” for Regulation D offerings) rather than in Rule 506, and would need to delete the current disqualification provisions of Rule 505(b)(2)(iii). The disqualification provisions of Rule 262 of Regulation A and Rule 602 of Regulation E would need to be amended to conform to new Rule 502(e).

- We would add underwriters and their directors, officers, general partners and managing members to the categories of covered persons described in the proposal. This would generally

<sup>107</sup> See, e.g., Comment Letters of the American Bar Association (Oct. 12, 2007) (available at <http://www.sec.gov/comments/s7-18-07/s71807-52.pdf>); Tenant-in-Common Association (Oct. 17, 2007) (available at <http://www.sec.gov/comments/s7-18-07/s71807-55.pdf>); and Davis, Polk & Wardwell (Oct. 9, 2007) (available at <http://www.sec.gov/comments/s7-18-07/s71807-39.pdf>).

harmonize with Rule 262.<sup>108</sup>

Underwriters may participate in offerings under Regulation A and Regulation E and in certain transactions under Rule 504 of Regulation D, and so would have to be included if our disqualification rules were to cover such transactions.

- We would need to make a number of changes to harmonize with existing Rule 602 of Regulation E. For example, we would need to add as covered persons, for issuers that are registered investment companies, “private funds” as defined in Section 202(a)(29) of the Investment Advisers Act of 1940 or that elect to be regulated as “business development companies,”<sup>109</sup> their investment advisers and the general partners, managing members, directors and officers of such investment advisers.<sup>110</sup> We would need to add a reference in the paragraph addressing Commission disciplinary orders to orders suspending or revoking registration as an investment company issued under Section 8(e) of the Investment Company Act of 1940, and we would need to add references, in the paragraph addressing stop orders and orders denying an exemption, to similar proceedings and orders in relation to Regulation E offering circulars.<sup>111</sup>

- A uniform approach would result in a slightly broader universe of disqualifying events, in that events that are disqualifying under only one or two current exemptive rules would apply

<sup>108</sup> All of these are covered persons under current Rule 262 except for the managing members of underwriters.

<sup>109</sup> See note 99.

<sup>110</sup> This is one area where the approach under Regulation D, Regulation A and Regulation E would not be completely uniform because of differences in the types of issuers eligible to rely on those regulations. As applied to Regulation D offerings, the rule would cover investment advisers of all entities that describe themselves as “pooled investment funds” on Form D, or that are registered investment company, private fund or BDC issuers, as described in the request for comment in Part II.B above. Regulation A Rule 262 would cover investment advisers of private fund issuers only, because registered investment companies and BDCs are not eligible to rely on Regulation A. Regulation E Rule 602 would cover every issuer’s investment advisers; only BDCs and SBICs are eligible to rely on Regulation E (this is also consistent with the approach under current Regulation E Rule 602).

<sup>111</sup> To the extent that current bad actor disqualification rules in Rule 602 of Regulation E differ from those in Rule 262 of Regulation A, the uniform approach would result in changes to Rule 602 in addition to those described in Part II of this Release. These would include changes in covered persons (referring to “any beneficial owner of 10% or more of any class of the issuer’s equity securities” rather than to any “principal securities holders” and referring to issuer predecessors, affiliated issuers rather than any “affiliate” of the issuer) and the addition of a provision similar to proposed Rule 506(c)(3) with regard to events that predate an affiliate relationship.

across the board to Regulation A, Regulation D and Regulation E transactions. Because the existing rules are so similar, the impact of this would be limited to a few matters.<sup>112</sup>

- Under a uniform approach, for the events that are subject to an express look-back period we are considering whether to use the date of the relevant sale, as proposed for Rule 506, rather than to the date of filing of an offering circular, as provided currently under Regulation A and Regulation E, as the measurement date.

- The certification in the signature line of Form D would need to be amended to apply to all Regulation D offerings, not only those under Rule 505 and Rule 506; every issuer claiming a Regulation D exemption would be required to confirm that the offering was not disqualified for any of the reasons stated in the bad actor disqualification rules applicable to Regulation D.

We seek comment on whether incremental changes such as these would unduly restrict reliance upon the exemptions under Regulation A, Rule 505 of Regulation D, and Regulation E, and whether uniform rules would provide clarity and simplicity that may be an overall benefit to investors and other market participants.

We are soliciting comment on a variety of possible approaches to uniformity. For example, we could choose not to pursue a uniform approach, and add new disqualification provisions applicable to Rule 506 transactions only, as proposed. This would leave the existing bad actor provisions applicable to other exemptive rules as they are, and would not subject Rule 504 transactions to bad actor disqualification. We could adopt rules that differentiate between offerings under Regulation A, Rules 505 and 506 of Regulation D and Regulation E, on the one hand (all of which would be subject to the same bad actor disqualification provisions), and Rule 504 offerings on

<sup>112</sup> Specifically, under current rules, an issuer that is disqualified from doing a Regulation E offering because it was the subject of a proceeding to revoke its registered investment company status, or had filed a Regulation E offering circular that was subject to an order suspending the Regulation E exemption, is not disqualified from doing an offering in reliance on Regulation A or D. Similarly, an issuer that is disqualified from doing a Regulation A or Rule 505 offering because it had filed a Regulation A offering circular that was subject to an order suspending the Regulation A exemption, is not disqualified from doing an offering in reliance on Regulation E. Finally, certain convictions and disciplinary orders against covered persons that are municipal securities dealers are currently disqualifying under Regulation A and Rule 505, but not Regulation E. If we were to adopt a uniform approach, any disqualifying event in relation to any covered person would disqualify an issuer from using any of these exemptions.

the other hand (which could continue to be conducted without bad actor provisions, or could be subject to some alternative to disqualification, such as mandatory disclosure of the events and circumstances that give rise to disqualification under other exemptive rules). Alternatively, for purposes of Regulation A, Rules 504 and 505 of Regulation D, and Regulation E, we could require disclosure of events that would be disqualifying under Rule 506, without imposing a new disqualification regime.

We are also soliciting comment on whether broadening the impact of the rule changes by uniform application should affect our proposal to not provide for grandfathering of existing disqualifying events. For example, it may be appropriate in that context to differentiate between disqualification provisions that are explicitly addressed in Section 926 of the Dodd-Frank Act and those that are not.

Finally, in considering whether to adopt uniform rules we would also have to consider the relative costs and benefits of such rules and their impact on competition, efficiency and capital formation. We would give particular consideration to their impact on issuers and other market participants (such as placement agents) that are small businesses. Because Regulation A, Rule 505 of Regulation D and Regulation E are relatively little-used, we do not expect the impact in those areas to be significant.

Preliminarily, we believe that uniform application of disqualification standards could have the following effects:

- It may improve investor protection by more effectively excluding bad actors from the private placement and small offering markets.

- It may avoid any confusion that might otherwise arise in applying different disqualification standards to different exemptions and simplify implementation of the new rules.

- It would avoid the creation of actual or perceived loopholes in our rules, which might encourage felons and bad actors disqualified from Rule 506 offerings to migrate to less-regulated kinds of transactions, or create a perception that investors in Rule 506 offerings are more deserving of protection than other investors.

- It may increase investor trust in the integrity of the private placement and small offering markets (which could contribute to a lower cost of capital for issuers).

- On the other hand, it may result in increased costs for issuers, including costs associated with registration if exemptive rules are no longer available,



costs associated with terminating relationships with covered persons, or costs associated with executing exempt transactions that are outside the safe harbors and exemptions provided by our rules. It may also increase compliance costs for issuers, particularly in Rule 504 offerings, which are not currently subject to bad actor disqualification; such issuers could be required to bear additional costs associated with, for example, circulating questionnaires to covered persons, revising questionnaires based on state disqualification rules to cover the new Federal disqualification rules, checking publicly available databases and undertaking other factual inquiries.

- Uniform bad actor disqualification rules may increase investor protections and investor trust in the integrity of the private placement and limited offering markets generally, thereby increasing efficiency, potentially decreasing costs for issuers in those markets and providing other benefits to the public. On the other hand, they could impair efficiency if our rules are considered overbroad, or if increased compliance costs are not justified by the direct and indirect benefits of screening a larger universe of disqualified persons out of the market.

- We do not expect that uniform rules would have significant effects on competition, due to the ability of many issuers to avoid disqualification by eliminating bad actors, the availability of other statutory exemptions such as Section 4(2) and Section 4(5) of the Securities Act, and the ability to register offerings for which an exemption is no longer available. For the same reasons, we do not expect that such expanded rules would have a significant impact on costs of capital raising (although, as discussed above, we expect that issuers will incur some incremental costs).

- We expect that the impact on small businesses of uniform rules would be substantially the same as the impact of the amendments we are proposing. See Part IX of this Release for our preliminary analysis of such effects.

#### Request for Comment

(70) Would it be appropriate to apply the proposed disqualification standards uniformly to offerings under Regulation A, Regulation D and Regulation E? Or should we limit the disqualification provisions in the new rule only to those expressly required by the Dodd-Frank Act (*i.e.*, only to Rule 506 transactions), as proposed?

(71) If we were to expand the application of the rules beyond Rule 506 transactions, should we distinguish between conforming the provisions of

the exemptive rules that currently have bad actor disqualification requirements (*i.e.*, Regulation A, Rule 505 of Regulation D and Regulation E), on the one hand, and imposing the same requirement on Rule 504 offerings, on the other, given that they are currently not subject to bad actor disqualification at the Federal level? Should we adopt disclosure or other rules for Rule 504 offerings as an alternative means of addressing investor protection concerns regarding bad actors in these offerings? What would be the costs and benefits of such a disclosure alternative?

(72) Should we conform the disqualification provisions of Regulation A and Regulation E to the standards proposed in Rule 506(c), or should these provisions continue to reflect current regulatory standards? Since offering documents for both Regulation A and Regulation E offerings are subject to both Commission and state "Blue Sky" review and regulation, would it be appropriate to subject them also to the new Federal disqualification provisions required by the Dodd-Frank Act for Rule 506 offerings?

(73) Should we make any additional changes to the proposed covered persons or disqualification events that are specific to Regulation A or Regulation E, reflecting the particular nature of those offerings?

(74) If we were to include investment advisers as covered persons, is it appropriate to limit coverage to the investment advisers of private fund issuers and BDCs? Or should investment advisers to other issuers also be covered?

(75) If we conformed the bad actor disqualification rules of Regulation A and Regulation E to the new rule we are proposing, should we nevertheless continue to measure look-back periods under Rule 262 of Regulation A and Rule 602 of Regulation E based on the date of filing of the relevant offering circular? Or should we consider a uniform measurement date based on the date of the relevant sale of a security?

(76) If we were to pursue a uniform approach to bad actor disqualification, should this affect our proposal to not provide for grandfathering of disqualifying events that predate adoption of the Dodd-Frank Act or the proposal or adoption of new rules? Would any of the possible changes to each of the current disqualifications have particular effects on those offerings or participants in those offerings that we should take into account? If so, how could we address those effects? Should grandfathering, if any, be limited to disqualification provisions other than those imposed on Rule 506 offerings?

(77) What would the costs and benefits of uniform rules be? Would the benefits justify the costs? How would uniform rules affect competition, efficiency and capital formation?

(78) What would the impact on small businesses be if we imposed uniform rules? Would that be different from the impact of the rule amendments we are proposing, which are limited to Rule 506 offerings? If so, how?

#### B. Uniform Look-Back Periods

We are also considering making uniform all of the look-back periods that apply to disqualifying events that have an express look-back period. Rather than using a ten-year period for the final orders of certain state and Federal regulators (as required under the Dodd-Frank Act), and for criminal convictions of covered persons other than the issuer, its predecessors and affiliated issuers (as provided under current Rule 262), and a five-year period for all other events subject to an express look-back period, we are considering applying a uniform ten-year look-back to all such events. We request public comment on whether a uniform look-back period would make the rules clearer and easier to apply or would otherwise better promote our regulatory objectives.

(79) Would it be appropriate for us to apply a uniform ten-year period to all disqualifying events that are subject to an express look-back period? Are there any disqualifying events for which the look-back period should be shorter (*e.g.*, five years)? Are there any events for which the look-back period should be longer than ten years? Are there events that should be permanently disqualifying?

(80) If look-back periods were extended, should events that are no longer disqualifying under current rules become disqualifying again? For example, under current rules a court order that is more than five years old is no longer disqualifying under Rule 262. If we extended the look-back period to ten years, a court order issued six years prior, which is no longer disqualifying, would again create a basis for disqualification. Is that appropriate?

(81) What would the costs and benefits be of applying a uniform ten-year look-back period? Would the benefits justify the costs? How would a uniform look-back period affect competition, efficiency and capital formation? Would small businesses be affected differently than they would be under the rules as proposed and, if so, how?

**IV. General Request for Comment**

We request comment, both specific and general, on each component of the proposals. We request and encourage any interested person to submit comments regarding the proposals that are the subject of this release and other matters that may have an effect on the proposals contained in this release.

Comment is solicited from the point of view of both investors and issuers, as well as of capital formation facilitators,

such as investment banks, and other regulatory bodies, such as state securities regulators. Any interested person wishing to submit written comments on any aspect of the proposal is requested to do so.

**V. Chart—Comparison of Felon and Other Bad Actor Disqualification Under Current Rule 262, Dodd-Frank Act Section 926 and Proposed Rule 506(c)**

The following chart compares the terms of current Rule 262 (the bad actor

disqualification provisions of Regulation A), Section 926 of the Dodd-Frank Act and proposed Rule 506(c). The chart is a convenience summary only and should be read together with (and is qualified in its entirety by) the current rules, any applicable interpretations and the full text of the proposed rules included in this release.

*A. Covered Persons*

| Rule 262  | Dodd-Frank Section 926   | Proposed Rule 506(c)   |
|---|--|--|
| <p><i>262(a):</i><br/>Issuer<br/>Issuer predecessors<br/>Affiliated issuers</p> <p><i>262(b):</i><br/>Directors<br/>Officers<br/>General partners<br/>10% beneficial owners<br/>Promoters presently connected with the issuer</p> <p><i>262(c):</i><br/>Underwriters<br/>Partners, directors and officers of underwriters</p> | <p><i>926(1):</i><br/>Regulations that are “substantially similar to the provisions of” Rule 262</p> | <p>Issuer.<br/>Issuer predecessors.<br/>Affiliated issuers.</p> <p>Directors.<br/>Officers.<br/>General partners.<br/>Managing members.<br/>10% beneficial owners.<br/>Promoters connected with the issuer at the time of such sale.</p> <p>Persons compensated for soliciting purchasers.<sup>113</sup><br/>General partners, directors, officers and managing members of compensated solicitors.</p> |

*B. Disqualifying Events*

1. Criminal Convictions

| Rule 262  | Dodd-Frank Section 926  | Proposed Rule 506(c)  |
|---|---|---|
| <p><i>262(a)(3):</i><br/>The issuer, any of its predecessors or any affiliated issuer:<br/>“has been convicted within 5 years * * * 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”</p> <p><i>262(b)(1):</i><br/>Any other covered person:<br/>“has been convicted within 10 years * * * 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, or investment adviser”</p> | <p><i>926(2)(B):</i><br/>Rules must disqualify any offering or sale of securities by a person that:<br/>“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”</p> | <p>Any covered person:<br/>“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:<br/>(A) in connection with the purchase or sale of any security;<br/>(B) involving the making of any false filing with the Commission; or<br/>(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;”</p> |

2. Injunctions and Court Orders

| Rule 262          | Dodd-Frank Section 926 | Proposed Rule 506(c) |
|-------------------|------------------------|----------------------|
| <i>262(a)(4):</i> |                        |                      |

<sup>113</sup> As used in Regulation D Rule 505, the term “underwriter” is defined to mean “a person that has

been or will be paid directly or indirectly remuneration for solicitation of purchasers in

connection with sales of securities” under the rule. 17 CFR 230.505(b)(2)(iii)(B).

| Rule 262  | Dodd-Frank Section 926  | Proposed Rule 506(c)  |
|---|---|---|
| <p>The issuer, any of its predecessors or any affiliated issuer:<br/>                     is subject to any order, judgment, or decree of any court of competent jurisdiction temporarily or preliminarily restraining or enjoining, or is subject to any order, judgment or decree of any court of competent jurisdiction, entered within 5 years prior to filing, permanently restraining or enjoining, such person from 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”</p> <p>262(b)(2):<br/>                     Any other covered person:<br/>                     Identical to (a)(4), but adds “or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser.”</p> | <p>No specific provision; regulations must be “substantially similar to the provisions of” Rule 262</p> | <p>Any covered person:<br/>                     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:<br/>                     (A) in connection with the purchase or sale of any security;<br/>                     (B) involving the making of any false filing with the Commission; or<br/>                     (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”</p> |

3. Final Orders of Certain Regulators

| Rule 262  | Dodd-Frank Section 926  | Proposed Rule 506(c)  |
|---|---|---|
| <p>No general provision on administrative enforcement actions</p> | <p>Rules must disqualify any offering or sale of securities by a person that:<br/>                     “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—<br/>                     (i) bars the person from—<br/>                     (I) association with an entity regulated by such commission, authority, agency or officer;<br/>                     (II) engaging in the business of securities, insurance or banking; or<br/>                     (III) engaging in savings association or credit union activities; or<br/>                     (ii) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the ten-year period ending on the date of the filing of the offer or sale.”</p> | <p>Any covered person:<br/>                     “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—<br/>                     (2) engaging in the business of securities, insurance or banking; or<br/>                     (A) at the time of such sale, bars the person from:<br/>                     (1) association with an entity regulated by such commission, authority, agency or officer;<br/>                     (2) engaging in the business of securities, insurance or banking; or<br/>                     (3) engaging in savings association or credit union activities; or<br/>                     (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.”</p> |

## 4. Commission Disciplinary Orders

| Rule 262  | Dodd-Frank Section 926  | Proposed Rule 506(c)  |
|---|---|---|
| <p><i>262(b)(3):</i><br/>Any covered person other than the issuer, its predecessors and affiliated issuers:<br/>“is subject to an order of the Commission entered pursuant to section 15(b), 15B(a) or 15B(c) of the Exchange Act,<sup>114</sup> or section 203(e) or (f) of the Investment Advisers Act”<sup>115</sup></p> | <p>No specific provision; regulations must be “substantially similar to the provisions of” Rule 262</p> | <p>Any covered person:<br/>“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 Investment Advisers Act of 1940 * * * that, at the time of such sale:<br/>(A) suspends or revokes such person’s registration as a broker, dealer, municipal securities dealer or investment adviser;<br/>(B) places limitations on the activities, functions or operations of such person; or<br/>(C) bars such person from being associated with any entity or from participating in the offering of any penny stock;</p> |

## 5. Suspension or Expulsion From SRO Membership or Association With an SRO Member

| Rule 262   | Dodd-Frank Section 926  | Proposed Rule 506(c)   |
|--|---|--|
| <p><i>262(b)(4):</i><br/>Any covered person other than the issuer, its predecessors and affiliated issuers:<br/>“is suspended or expelled from membership in, or suspended or barred from association with a member of, a national securities exchange registered under section 6 of the Exchange Act or a national securities association registered under section 15A of the Exchange Act for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade.”</p> | <p>No specific provision; regulations must be “substantially similar to the provisions of” Rule 262</p> | <p>Any covered person:<br/>“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;</p> |

## 6. Stop Orders and Orders Suspending Exemptions

| Rule 262   | Dodd-Frank Section 926  | Proposed Rule 506(c)   |
|--|---|--|
| <p><i>262(a)(1):</i><br/>The issuer, any of its predecessors or any affiliated issuer:<br/>“has filed a registration statement which is the subject of any pending proceeding or examination under Section 8 of the Act,<sup>116</sup> or has been the subject of any refusal order or stop order thereunder within 5 years prior to the filing of the offering statement required by § 230.252.”</p> <p><i>262(c)(1):</i><br/>Any underwriter was or was named as an underwriter of any securities:</p> | <p>No specific provision; regulations must be “substantially similar to the provisions of” Rule 262</p> | <p>Any covered person:<br/>“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.”</p> |

<sup>114</sup> The cited sections cover suspension or revocation of registration and certain other sanctions against brokers, dealers and municipal securities dealers.

<sup>115</sup> The cited sections cover suspension or revocation of registration and other sanctions against investment advisers.

<sup>116</sup> The provision under which stop orders are issued for Securities Act registration statements.

| Rule 262   | Dodd-Frank Section 926  | Proposed Rule 506(c)  |
|--|---|---|
| <p>“covered by a registration statement which is the subject of any pending proceeding or examination under Section 8 of the Act, or has been the subject of any refusal order or stop order thereunder within 5 years prior to the filing of the offering statement required by § 230.252.”</p> <p><i>262(a)(2):</i><br/>The issuer, any of its predecessors or any affiliated issuer:<br/>“is subject to a pending proceeding under § 230.258<sup>117</sup> or any similar rule adopted under section 3(b) of the Securities Act, or to any order entered thereunder within 5 years prior to the filing of such offering statement.”</p> <p><i>262(c)(2):</i><br/>Any underwriter was or was named as an underwriter of any securities:<br/>“covered by any filing which is subject to any pending proceeding under § 230.258 or any similar rule adopted under section 3(b) of the Securities Act, or to any order entered thereunder within 5 years prior to the filing of such offering statement.”</p> | <p>No specific provision; regulations must be “substantially similar to the provisions of” Rule 262</p> | <p>See above (one paragraph of 506(c) covers the substance of 262(a)(1), (a)(2), (c)(1) and (c)(2))</p> |

7. U.S. Postal Service False Representation Orders

| Rule 262  | Dodd-Frank Section 926  | Proposed Rule 506(c)   |
|---|---|--|
| <p><i>262(a)(5) and (b)(5):</i><br/>Any covered person:<br/>“is subject to a United States Postal Service false representation order entered under 39 U.S.C. § 3005 within 5 years prior to filing, 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.”</p> | <p>No specific provision; regulations must be “substantially similar to the provisions of” Rule 262</p> | <p>Any covered person:<br/>“is subject to a United States Postal Service false representation order entered within 5 years before such sales 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.”</p> |

C. Waivers/Exclusions

| Rule 262   | Dodd-Frank Section 926   | Proposed Rule 506(c)   |
|--|--|--|
| <b>Waivers</b>   |  |  |
| <p><i>262 (first unnumbered paragraph):</i><br/>Waiver by the Commission<br/>“upon 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 the exemption provided by this Regulation A be denied.”</p> | <p>No specific provision; regulations must be “substantially similar to the provisions of” Rule 262.</p> | <p>Paragraph (c)(1) of this section shall not apply:<br/>(i) 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 the exemption be denied.</p> |

<sup>117</sup>The provision under which the Regulation A exemption would be suspended.

| Rule 262  | Dodd-Frank Section 926   | Proposed Rule 506(c)   |
|---|--|--|
| <b>Reasonable Care Exception</b>  |  |  |
|   |  | <p>(ii) 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 (c)(1) of this section.</p> <p><i>Instruction to paragraph (c)(2)(ii).</i> An issuer will not be able to establish that it has exercised reasonable care unless it has made factual inquiry into whether any disqualifications exist. The nature and scope of the requisite inquiry will vary based on the circumstances of the issuer and the other offering participants.</p> |
| <b>Events Pre-dating Affiliation</b>  |  |  |
| <p>262(a)(5):</p> <p>“The entry of an order, judgment or decree against any affiliated entity before the affiliation arose, if the affiliate is not in control of the issuer and if the affiliated entity and the issuer are not under the common control of a third party who was in control of the affiliated entity at the time of such entry does not come within the purview of this paragraph (a) of this section.”</p> | <p>No specific provision; regulations must be “substantially similar to the provisions of” Rule 262.</p> | <p>For purposes of paragraph (c)(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:</p> <p>(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;</p>  |

## VI. Paperwork Reduction Act

The proposed amendments do not contain a “collection of information” requirement within the meaning of the Paperwork Reduction Act of 1995.<sup>118</sup> Accordingly, the Paperwork Reduction Act is not applicable and no Paperwork Reduction Act analysis is required.

## VII. Cost-Benefit Analysis

### A. Background and Summary of Proposals

As discussed above, we are proposing 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 securities offerings involving felons and other bad actors from reliance on the safe harbor provided by 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 law orders and bars). The proposal includes a “reasonable care” exception that is not

mandated by Section 926. This “reasonable care” exception would prevent an exemption from being lost, 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. The proposal also provides the Commission with authority to waive disqualification for good cause shown, similar to its waiver authority under Regulation A.

Section 926 of the Dodd-Frank Act is intended to exclude felons and bad actors from participating in Rule 506 offerings, thereby protecting investors in those offerings.<sup>119</sup> Our rules implementing Section 926 are designed to secure the benefits Congress intended. Our analysis focuses on the costs and benefits of the additional matters that we are proposing that are not specifically mandated by Section 926. Specifically, we have identified certain costs and benefits that may result from the proposal to include a “reasonable care” exception and to provide waiver authority for the Commission. These costs and benefits are analyzed below. We encourage the public to identify, discuss, analyze and supply relevant data regarding these or any additional costs and benefits in

comment letters on these proposed rules.

### B. Benefits

We anticipate that the “reasonable care” exception for issuers would provide a benefit by assuring that issuers would not lose the Rule 506 safe harbor from Securities Act registration because of a disqualification relating to another covered person, so long as they can show that they did not know and in the exercise of reasonable care could not have known of the disqualification. If we did not adopt such an exception, issuers would be at risk of liability for a violation of Section 5 of the Securities Act or of applicable state “blue sky” law if they conducted an offering in reliance on Rule 506 and later learned that a disqualification existed, even if they had exercised reasonable care in determining that there was no disqualification. Without a reasonable care exception, issuers might therefore choose not to undertake offerings in reliance on Rule 506, because the downside (a potential Section 5 or blue sky law violation under circumstances that the issuer cannot reasonably predict or control) may outweigh the intended upside (a relatively speedy and cost-effective means of raising capital). In that scenario, alternative approaches to capital raising may be more costly to the issuer or not available at all. Because Rule 506 is our most frequently relied-upon Securities Act exemptive rule, the

<sup>118</sup> 44 U.S.C. 3501 through 3521.

<sup>119</sup> See Statement of Senator Dodd, note 93.

impact of issuers shifting away from it could be significant. We believe that the proposed reasonable care exception would help to preserve the intended benefits of Rule 506, which might otherwise be impaired because of issuer concerns about strict liability for unknown disqualifications.

Similarly, we believe that providing waiver authority for the Commission would provide a benefit to issuers and other covered persons by giving them the opportunity to explain why disqualification should not arise as a consequence of a particular event or the participation of a particular covered person. The Commission's ability to grant waivers could allow more offerings to remain within the Rule 506 safe harbor than would otherwise be the case, which could result in cost savings for issuers relative to the cost of raising capital in a registered offering or in reliance on other exemptions.

### C. Costs

The inclusion of a reasonable care exception for issuers may impose costs by increasing the likelihood that recidivists will participate in Rule 506 offerings and decreasing the deterrent effect of the bad actor disqualification rules mandated by Section 926 of the Dodd-Frank Act. Participation in Rule 506 offerings by bad actors could result in substantial harm. To the extent that inclusion of a reasonable care exception results in greater involvement of recidivist bad actors in Rule 506 offerings than would otherwise be the case, it would also reduce or eliminate benefits associated with increased investor trust and market integrity.

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.

Providing for waiver authority may impose costs by decreasing the deterrent effect of the bad actor disqualification rules, and (to the extent the Commission may grant waivers) by enabling offerings involving bad actors to be conducted under Rule 506 that would otherwise be disqualified. In addition, persons seeking waivers would incur costs in doing so.

Our rules may impose costs on issuers and other market participants in terms of transactions foregone or effected by other means at higher cost. For example, imposing a new disqualification standard only on offerings under Rule 506 may result in higher costs for issuers relying on other exemptive rules, if investors lose trust in offerings under such other rules. We seek comment on

any changes that could be made to the proposal, such as modifying the list of covered persons, the nature of disqualifying events, the time periods applicable to disqualifying events or the process for obtaining waivers of disqualification, that could reduce the burden on capital-raising activities without compromising investor protection.

### Request for Comment

We solicit comments on the costs and benefits of the proposed amendment and on all aspects of this cost-benefit analysis. We request your views on the costs and benefits described above, as well as on any other costs and benefits not already identified that could result from the adoption of our proposal. We encourage the public to identify, discuss, and analyze these or any additional costs and benefits in comment letters. We request that comment letters responding to these requests provide empirical data and other factual support to the extent possible.

## VIII. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 2(b) of the Securities Act<sup>120</sup> 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.

Section 926 of the Dodd-Frank Act requires the Commission to adopt provisions to disqualify certain offerings from reliance on the Rule 506 exemption of Regulation D. To the extent our proposed amendments may go beyond the statutory mandate of Section 926 by providing a "reasonable care" exception for issuers and providing waiver authority for the Commission, we believe this would enable issuers to use Rule 506 more effectively and therefore would benefit efficiency and promote capital formation. In particular, the proposed rules are expected to reduce the risk of fraud and other potential securities law violations and increase investor trust in Rule 506 offerings, thereby lowering costs for issuers. We do not anticipate any significant effect on competition.

We request comment on whether the proposal, if adopted, would promote or burden efficiency, competition and capital formation. Finally, we request

those who submit comment letters to provide empirical data and other factual support for their views, if possible.

## IX. Initial Regulatory Flexibility Act Analysis

This initial regulatory flexibility analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed amendments to Rule 506 of Regulation D under the Securities Act which would disqualify certain offerings where "felons and other 'bad actors'" are participating or present from the safe harbor from Securities Act registration provided by Rule 506.

### A. Reasons for the Proposed Action

The primary reason for the proposed 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 the safe harbor from registration provided by Rule 506 of Regulation D.

### B. Objectives

Our primary objective is to implement the requirements of Section 926 of the Dodd-Frank Act. In general the rule we are proposing is a straightforward implementation of the statutory requirements. We have included a "reasonable care" exception in the proposed rule, which we believe will make the rule more useful to issuers and should encourage continued use of Rule 506 over exempt transactions outside the Rule 506 safe harbor.

### C. Legal Basis

The amendment is being proposed under the authority set forth in Sections 4(2), 19, and 28 of the Securities Act and in Section 926 of the Dodd-Frank Act.

### D. Small Entities Subject to the Proposed Rules

The proposal would 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.<sup>121</sup> For purposes of the Regulatory Flexibility Act, an investment company is a small entity if

<sup>120</sup> 15 U.S.C. 77b(b).

<sup>121</sup> 17 CFR 230.157.

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 proposed amendment would apply to small issuers relying on Rule 506 of Regulation D to qualify for a safe harbor 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 fiscal year ended September 30, 2010, 17,292 issuers filed an initial notice on Form D. The vast majority of companies and funds filing notices on Form D are not required to provide information to the Commission that would enable us to establish their size. However, a significant portion of Rule 506 offerings (approximately 40% for the twelve month period ended September 30, 2010), were for amounts of \$5,000,000 or less. We believe that many of the issuers in these offerings are small entities, but we currently do not collect information on total assets of companies and net assets of funds to determine if they are small entities for purposes of this analysis.

#### *E. Reporting, Recordkeeping and Other Compliance Requirements*

The proposed rule would not impose any reporting, recordkeeping or disclosure requirements.<sup>122</sup> We anticipate, however, that issuers would generally exercise reasonable care to ascertain whether a disqualification exists with respect to any covered person, and may document their exercise of reasonable care. The steps required would vary with the circumstances, but we anticipate may include such steps as making appropriate inquiry of covered persons and reviewing information on publicly available databases. 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.

#### *F. Duplicative, Overlapping or Conflicting Federal Rules*

We believe there are no Federal rules that conflict with or duplicate the proposed amendments.

#### *G. Significant Alternatives*

The Regulatory Flexibility Act directs us to consider significant alternatives

that would accomplish the stated objectives of our proposals, while minimizing any significant adverse impact on small entities. In connection with the proposed 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 proposed amendments, or any part thereof, for small entities.

With respect to the establishment of different compliance requirements or timetables under our proposed amendment for small entities, we do not think this is feasible or appropriate. Moreover, the proposal is 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. Nevertheless, we request comment on the feasibility and appropriateness for small entities to have different compliance requirements or timetables for compliance with our proposal.

Likewise, with respect to potentially clarifying, consolidating, or simplifying compliance and reporting requirements, the proposed rule does not impose any new reporting requirements. To the extent it may be considered to create a new compliance requirement to exercise reasonable care to ascertain whether a disqualification exists with respect to any offering, 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. We request comment on whether there are ways to clarify, consolidate, or simplify this requirement for small entities.

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 proposed amendments, we believe such a proposal would be impracticable and

contrary to the legislative intent of Section 926. Regulation D was largely designed to provide exemptive relief for small entities. 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 proposed amendments. Nevertheless, we request comment on ways in which we could exempt small entities from coverage of any unduly onerous aspects of the proposed amendments.

#### *H. Request for Comment*

We encourage comments with respect to any aspect of this initial regulatory flexibility analysis. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposal or the uniformity and updating alternatives;
- The existence or nature of the potential impact of the proposal and the alternatives on small entities discussed in this analysis; and
- How to quantify the impact of the proposed amendments, or amendments that would implement the alternatives.

We request members of the public to submit comments and ask them to describe the nature of any impact on small entities they identify and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the final regulatory flexibility analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

#### **X. Small Business Regulatory Enforcement Fairness Act**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),<sup>123</sup> a rule is "major" if it has resulted, or is likely to result in:

- An annual effect on the economy of \$100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a "major rule" for

<sup>122</sup> As discussed in Part II.G of this Release, we are proposing to change the form of the signature block of Form D.

<sup>123</sup> Public Law 104-121, Tit. II, 110 Stat. 857.



purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment or innovation.

We request those submitting comments to provide empirical data and other factual support for their views if possible.

### XI. Statutory Authority and Text of Proposed Amendments

We are proposing the amendments contained in this document under the authority set forth in Sections 4(2), 19 and 28 of the Securities Act, as amended,<sup>124</sup> and Section 926 of the Dodd-Frank Act.<sup>125</sup>

#### List of Subjects in 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 proposed to be amended as follows:

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

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

**Authority:** 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 111-203, § 413(a) and § 926, 124 Stat. 1577 (2010)(15 U.S.C. 77d note), unless otherwise noted.

\* \* \* \* \*

2. Amend § 230.501 by redesignating paragraphs (g) and (h) as paragraphs (h) and (i), respectively, and adding new paragraph (g) to read 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 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.

\* \* \* \* \*

3. Amend § 230.506 by redesignating the Note following paragraph (b)(2)(i) as

“Note to paragraph (b)(2)(i)” and adding paragraph (c) to read as follows:

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

\* \* \* \* \*

(c) “*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, officer, 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 such sale; any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities; or any general partner, director, officer or managing member of any such 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; 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. 78o(b) or 78o-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 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;

(vi) 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

(vii) 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 (c)(1) of this section shall not apply:

(i) 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; or

<sup>124</sup> 15 U.S.C. 77c(b), 77c(c), 77d(2), 77r, 77s and 77z-3.

<sup>125</sup> Public Law 111-203, § 926, 124 Stat. 1376 (July 21, 2010)(to be codified at 15 USC 77d note).

(ii) 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 (c)(1) of this section.

*Instruction to paragraph (c)(2)(ii).* An issuer will not be able to establish that it has exercised reasonable care unless it has made factual inquiry into whether any disqualifications exist. The nature and scope of the requisite inquiry will vary based on the circumstances of the issuer and the other offering participants.

(3) For purposes of paragraph (c)(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.

#### **PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

4. The general 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, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 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.

\* \* \* \* \*

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

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

#### **Form D**

\* \* \* \* \*

• Certifying that, if the issuer is claiming an exemption under Rule 505 or Rule 506, the issuer is not disqualified from relying on such rule for one of the reasons stated in paragraph (b)(2)(iii) of Rule 505 or paragraph (c)(1) of Rule 506 (as the case may be).

\* \* \* \* \*

By the Commission.

Dated: May 25, 2011.

**Elizabeth M. Murphy,**  
Secretary.

[FR Doc. 2011-13370 Filed 5-31-11; 8:45 am]

**BILLING CODE 8011-01-P**

## **DEPARTMENT OF THE TREASURY**

### **Internal Revenue Service**

#### **26 CFR Part 1**

[REG-118761-09]

RIN 1545-BI92

#### **Controlled Groups; Deferral of Losses; Hearing**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of public hearing on proposed rulemaking.

**SUMMARY:** This document provides notice of public hearing on a notice of proposed rulemaking providing guidance concerning the time for taking into account deferred losses on the sale or exchange of property between members of a controlled group.

**DATES:** The public hearing is being held on Wednesday, August 3, 2011, at 10 a.m. The IRS must receive outlines of the topics to be discussed at the hearing by Thursday, July 21, 2011.

**ADDRESSES:** The public hearing is being held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Send submissions to: CC: PA: LPD: PR (REG-118761-09), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC: PA: LPD: PR (REG-118761-09), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit electronic outlines of oral comments via the Federal eRulemaking Portal at <http://www.regulations.gov>.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Bruce A. Decker at (202) 622-7790; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard A. Hurst at [Richard.A.Hurst@irscounsel.treas.gov](mailto:Richard.A.Hurst@irscounsel.treas.gov) or (202) 622-7180 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:** The subject of the public hearing is the notice of proposed rulemaking (REG-118761-09) that was published in the **Federal Register** on Thursday, April 21, 2011 (76 FR 22336).

Persons who wish to present oral comments at the hearing that submitted written comments, must submit an outline of the topics to be discussed and the amount of time to be devoted to

each topic (signed original and eight (8) copies) by Thursday, July 21, 2011.

A period of 10 minutes is allotted to each person for presenting oral comments. After the deadline for receiving outlines has passed, the IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing or in the Freedom of Information Reading Room (FOIA RR) (Room 1621) which is located at the 11th and Pennsylvania Avenue, NW, entrance, 1111 Constitution Avenue, NW., Washington, DC.

Because of access restrictions, the IRS will not admit visitors beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this document.

**LaNita Van Dyke,**

Chief, Publications and Regulations Branch,  
Legal Processing Division, Associate Chief  
Counsel, Procedure and Administration.

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**BILLING CODE 4830-01-P**

## **DEPARTMENT OF THE TREASURY**

### **Internal Revenue Service**

#### **26 CFR Part 301**

[REG-153338-09]

RIN 1545-BJ19

#### **Disclosure of Returns and Return Information to Designee of Taxpayer; Hearing Cancellation**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Cancellation of a notice of public hearing on a proposed rulemaking.

**SUMMARY:** This document cancels a public hearing on a proposed rulemaking pertaining to the period for submission to the IRS of taxpayer authorizations permitting disclosure of returns and return information.

**DATES:** The public hearing, originally scheduled for June 9, 2011 at 10 a.m. is cancelled.

**FOR FURTHER INFORMATION CONTACT:** Funmi Taylor of the Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration) at (202) 622-7180 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:** A notice of proposed rulemaking and a notice of