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September 23, 2013

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

Re: Amendments to Regulation D, Form D and Rule 156 under the Securities Act (File No. S7-06-13)

Dear Ms. Murphy:

The Investment Company Institute[1] is submitting this comment letter on the proposed measures intended to enhance the Securities and Exchange Commission's ability to monitor Rule 506 offerings and to address concerns that may arise in connection with permitting issuers in these private placements to engage in general solicitation and general advertising.[2] These measures were proposed at the same time the Commission adopted rules, effective today, that eliminate the long-standing prohibition against general solicitation and advertising in Rule 506 and Rule 144A securities offerings.

We are disappointed with the Commission's approach of adopting amendments to Rule 506 that eliminate the prohibition against general solicitation and advertising, while merely proposing or requesting comment on measures that might protect investors or better inform the Commission about how private issuers are making use of their newfound ability to advertise. In our judgment, this does not strike the right balance between capital formation and investor protection. Capital formation

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $15.4 trillion and serve more than 90 million shareholders.

ICI has submitted three prior letters related to this proposal. *See* Letter from Karrie McMillan, General Counsel, dated October 5, 2012 (available at http://www.sec.gov/comments/s7-07-12/s70712-133.pdf) and Letters from Paul Schott Stevens, President and CEO of the Investment Company Institute, dated May 21, 2012 (available at http://www.sec.gov/comments/jobs-title-ii/jobstitleii-13.pdf) and August 17, 2012 (available at http://www.sec.gov/comments/jobs-title-ii/jobstitleii-66.pdf).

[2] *See* SEC Release Nos. 33-9416, 34-69960, and IC-30595, available at http://www.sec.gov/rules/proposed/2013/33-9416.pdf (the "Release").

thrives in an environment where investors have confidence that they are appropriately protected. Investor protection measures should have been included as an integral part of this rulemaking from the outset.

For reasons explained below, we support the proposed rule and many of the proposed amendments, although we continue to believe that more needs to be done to fulfill the Commission's mandate to protect investors and the markets. Our comments relate to the proposed rule and rule amendments relating to general solicitation materials and the definition of "accredited investor." As in our past letters, we focus on general solicitation and advertising by private funds.[3]

Proposed Rule and Rule Amendments Relating to General Solicitation Materials

1. Basic Legends and Other Disclosures

In an effort to better inform potential investors and apprise them of some of the risks of a private offering, the Commission has proposed new Rule 509, which would require that all issuers include prominent legends in written general solicitation materials. The legends would state that: the securities are being offered in reliance on an exemption from the Securities Act and may be sold only to accredited investors; the Commission has not passed on the merits of the offering; the securities are subject to legal restrictions on transfer and resale; and investing in securities involves risk. Private funds would have to include one additional legend to the effect that the securities offered are not subject to the protections of the Investment Company Act.

We strongly support this new disclosure. As we pointed out in earlier comment letters, even if *sales* in Rule 506 offerings are made exclusively to accredited investors, *advertisements* will have much broader reach. Investors of all types—accredited or not—will see these advertisements, presenting obvious and substantial risk of investor confusion. Legends that make it very clear that the offering is not public and directed solely at investors who qualify are a simple, straightforward, common sense, and cost-effective way to alleviate some of that risk.

In particular, we strongly support the additional legend requiring private funds to state that they are not subject to the protections of the Investment Company Act, although we recommend one modification. As we have pointed out, the distinctions between registered funds and private funds are not always apparent to the public or the press.[4] Not every fund will use the words "hedge fund" or

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[3] Private funds account for the vast bulk of Rule 506 offerings, both in number and amount of capital raised. The Commission estimates that in 2012, pooled investment funds reported raising $725 billion in Rule 506 offerings, compared to the $173 billion raised by operating companies that year. In 2011, the statistics were even starker, as pooled investment vehicles accounted for more than 91% of all capital raised in reliance on Rule 506. *See* Release, at pages 111-112.

[4] When a fund violates the trust of investors, the headlines often draw no distinction as to the type of fund, and the reputations of *all* funds in the marketplace suffer. *See, e.g.*, "False Media Reports Roil Money Market Funds," IGNITES (Aug. 15, 2007) (describing how erroneous press reports that a registered money market fund had suspended redemptions

"private fund" in their advertisements, although many may. A simple legend, like the one proposed, clearly is both necessary and appropriate to alleviate the potential for confusion between these two very different types of funds.

As proposed, however, the legend would merely alert readers that the fund is not subject to the Investment Company Act, a reference that may be too esoteric for many investors. We recommend that the legend also be required to distinguish the private fund from a registered fund and highlight the fact that the lack of protection under the Act presents additional risks. Combined with the proposed legend, it could simply state that *"Investments in [hedge/private] funds involve special risks. The fund is not a mutual fund or any other type of registered investment company and is not subject to the protections of the Investment Company Act."*[5]

2. Performance Advertising by Private Funds

The Commission has not taken any steps to prohibit or condition the ability of private funds to advertise performance information. Rather, it has proposed that Rule 509 require private funds to include certain disclosures in any written general solicitation materials that include performance data. The legend would apprise investors that the performance data represents past performance and past performance does not guarantee future results, current performance may be higher or lower, the private fund is not required to follow any standardized methodology when calculating and representing performance data, and the performance of the fund may not be directly comparable to the performance of any other private or registered fund.

While we support requiring these additional disclosures, legends alone will not alleviate the potential for misleading performance claims. We continue to believe that the Commission should craft a rule similar in concept to Rule 482 under the Securities Act of 1933 that standardizes the calculation and presentation of performance information by private funds. To be clear, we are not advocating for a wholesale extension of Rule 482 to private funds. Rather, we believe that both investors and funds would benefit from a rule specifically tailored to private funds that would foster the ability to compare those funds' competing performance claims.

Take, for example, this advertisement published by a private fund last month,[6] which suggests the need for additional content requirements to accompany performance claims:

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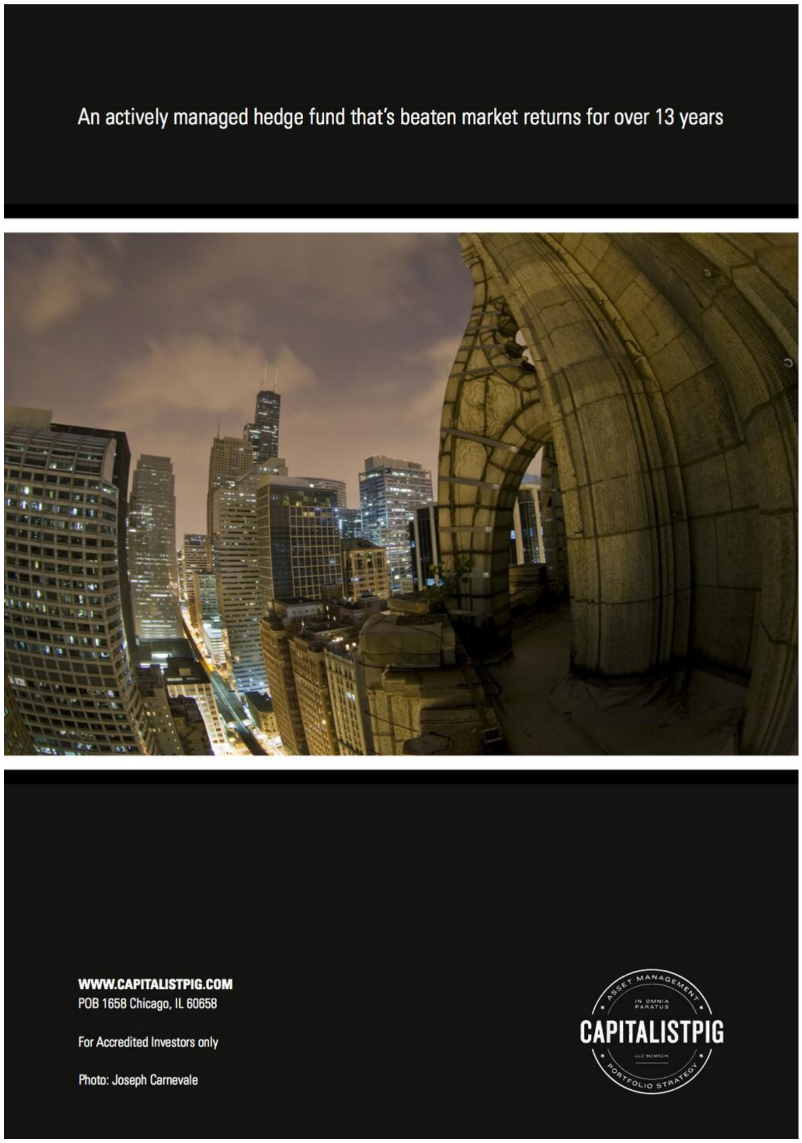
sparked broad market selling, when in fact the fund at issue was an unregistered cash management pool that serviced hedge funds and commodity trading firms).

[5] Others have made a similar recommendation. *See* the Release at n.113 (citing recommendations in letters from the Consumer Federation of America and Fund Democracy).

[6] The advertisement was promoted on the adviser's Twitter page at http://pic.twitter.com/qMZFyMRy2w, noting that it appears in the Fall 2013 issue of The Objective Standard. The firm reportedly was the first hedge fund to advertise, a year before the rules were adopted. *See* http://observer.com/2013/07/the-sec-shrugged-hedge-funds-now-allowed-to-advertise/



The advertisement simply states that the fund is "an actively managed hedge fund that's beaten market returns for over 13 years." It alerts readers that it is "for accredited investors only" and provides the fund's website address. In public documents on that site, the adviser states that "[s]ince 2000, the Fund has gained over 320 percent. The S&P 500's return over that period has been roughly 30 percent."[7]

and http://www.chicagobusiness.com/article/20130718/BLOGS08/130719794/ready-for-hedge-fund-ads-one-chicago-investor-was.

[7] *See* http://capitalistpig.com/wp-content/uploads/investment-reports/CPAM_LetterofIntent.pdf.

The fund's performance claims may be factually correct,[8] but they lack material information necessary to put them in context—something that the additional disclosures proposed in Rule 509 would not provide. To be clear, we strongly support the required legends in proposed Rule 509. With respect to performance advertising, however, we simply do not believe that legends alone will suffice. For example, the proposed legends would not alert investors to the fact that the advertised hedge fund's over-performance can be attributed to outsized gains in the earliest years of the thirteen-year period, or that it significantly *trailed* the S&P 500 in each of the past four years, lagging the index by 27.65% in 2009, 4.78% in 2010, 21.27% in 2011, and 16.62% in 2012.[9]

Concerns over precisely this type of performance data—aggregate total return information over nonstandard performance periods—led to the adoption of standardized performance reporting periods of 1-, 5-, and 10-years in all mutual fund advertisements. As the Commission explained in proposing amendments to Rule 482 in 1986:

> [B]ecause no prescribed methods of calculating fund performance exist…fund ads now use different types of performance data and methods of computation. While many methods are sound, they do not produce data investors can compare, and some methods may distort actual performance….The Commission…is proposing uniform standards…to minimize the possibility of misleading fund performance claims and facilitate meaningful comparisons. This should promote competition among funds and enhance the ability of prospective investors to make informed investment decisions.[10]

In a 1987 speech further explaining the need for advertising reform, then-Commissioner Joseph Grundfest highlighted three claims that appeared in a single issue of the New York Times, promoting mutual funds that were "+872% In 12 Years," "[up] an impressive 300% in less than 3 years," and "[up] 575.8% in 10 years."[11] While technically accurate, these claims were difficult to compare because they

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[8] We do not express any view as to the accuracy or inaccuracy of the fund's performance as set forth in the advertisement, or of the performance return information presented on its website.

[9] *See* http://capitalistpig.com/wp-content/uploads/investment-reports/CPAM-Return-Data-2013.pdf. In fact, twelve of the fund's thirteen best months came between August 2000 and December 2003.

[10] *See Proposed Rule: Advertising by Investment Companies*, SEC Release Nos. 33-6660 and IC-15315 (Sept. 26, 1986).

[11] *See "Fads in Ads: Recent Developments in Mutual Fund Advertising,"* Speech by Joseph A. Grundfest, Commissioner, U.S. Securities and Exchange Commission (June 15, 1987), available at http://www.sec.gov/news/speech/1987/061587grundfest-1.pdf (citing the June 14, 1987 edition of the New York Times, Business Section).

were compound figures based on select performance periods—exactly like the performance claim in the hedge fund advertisement noted above.[12]

The Commission has solicited comment on whether content restrictions are necessary or appropriate for Rule 506 offerings by private funds. This advertisement and its related website are perfect examples of why we continue to believe that additional content restrictions are necessary. While the general anti-fraud provisions in Section 206(4) of the Investment Advisers Act and Rule 206(4)-8 thereunder are important protections and the extension of Rule 156 (discussed below) will provide valuable additional guidance, our industry's experience with performance advertising suggests that more is needed. Absent additional specific content restrictions, the Commission almost certainly will see a full spectrum of performance claims, from those carefully crafted to be balanced and fair to those that use nonstandard periods and inapt comparisons to lead readers to unwarranted and misleading conclusions. For this reason, we continue to believe that a rule similar in concept to Rule 482 needs to be developed for private funds and we reaffirm our commitment to assist in the development of such a rule based on our industry's experience with Rule 482.

Moreover, the Commission should take an even more holistic approach. As it considers what content restrictions are appropriate for sales material for private funds, it also should consider the restrictions currently applicable to sales material for mutual funds and other registered investment companies that is made available only to institutional investors. These two types of sales material are analogous in that both are intended for use only with a type of sophisticated investor that does not need the full extent of the securities law protections and can fend for itself. If the Commission determines that no additional content requirements are necessary with respect to sales material for private funds on the basis that such protections are appropriate solely for retail investors, then presumably it should reach a similar conclusion with respect to institutional sales material.

3. Proposed amendments to Rule 156

The Commission has proposed amending Rule 156 under the Securities Act to apply the guidance contained in the rule to the sales literature of private funds, while also expressing its view "that private funds should now be considering the principles underlying Rule 156 to avoid making fraudulent statements in their sales literature."

We called for the extension of Rule 156 to private funds more than a year ago, and we continue to strongly support that idea.[13] We also appreciate the Commission expressing its view that, even if not

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[12] In fact, if a mutual fund made the same type of outperformance claim based on the same underlying performance, FINRA likely would require the mutual fund to include narrative disclosure in addition to the required standardized performance figures. Where a fund has extraordinary performance during unusual market conditions, FINRA has stated that "depending on the circumstances, it may be necessary to include information beyond what is required under…Rule 482 when unusual performance is presented in order for the sales material not to be misleading." *See* NASD Notice to Members 00-21 (April 2000), available at www.finra.org/Industry/Regulation/Notices/2000/P004122.

formally extended, private funds should consider the principles underlying Rule 156. It is unquestionably true that predictions of performance, exaggerated claims of investment prowess, unwarranted comparisons to competitors or benchmarks, and all of the other practices listed in the rule carry the same potential for fraud and are equally misleading regardless of the type of fund involved.

4. Monitoring Private Fund Advertising; Proposed Filing Requirements and Rule 506(c) Work Plan

The Commission states that it is "mindful of…concerns that private funds engaging in general solicitation may raise certain investor protection issues" and is committed to "monitor and study the development of private fund advertising and undertake a review to determine whether any further action is necessary." Consistent with that commitment, the Commission has laid out a Rule 506(c) Work Plan[14] that includes a number of measures intended to assist it in evaluating the development of market practices in Rule 506(c) offerings.

The Commission, however, did not require private issuers to file advertising materials with the Commission or the Financial Industry Regulatory Authority ("FINRA"). Rather, it has proposed a temporary new Rule 510T that, if adopted, would require issuers to submit written general solicitation materials to the Commission prior to first use. The Commission states that it "does not contemplate that submitted written general solicitation materials would be subject to a Staff review."[15]

Proposed Rule 510T is a half measure. The Commission does not propose to review the substance of the materials, and so there is no mechanism that would prevent misleading advertisements from being used. Merely submitting to the Commission an advertisement will not in itself make it less misleading, if that is the case. A substantive Staff review, however, may have drawn comments on the advertisement noted above, for example, and these in turn might have prompted the issuer to put its performance claim in some appropriate context.

While we are disappointed in the limited nature of proposed Rule 510T, it nonetheless should be adopted. As noted in the Release, it is important that the Commission have the ability to assess market practices under Rule 506(c), and the submission of written general solicitation materials would assist the Commission in that regard over time. Of course, if the Commission adopts this rule, it also should develop a program to review the filings, at least on a sampling basis, in order to best inform itself of developments in this market and communicate any concerns to market participants.

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[13] *See* Letter from Paul Schott Stevens, President and CEO of the Investment Company Institute, dated May 21, 2012 (available at http://www.sec.gov/comments/jobs-title-ii/jobstitleii-13.pdf).

[14] *See* Release, at pages 13-15.

[15] *See* Release, at footnote 160.

As a longer term measure, we continue to believe that FINRA should be directed to require the filing and review of private fund advertisements.[16] FINRA has developed an infrastructure to handle and substantively review such filings, and accordingly is best positioned to handle this task.[17] In the meantime, the Commission should implement an easy way for the public to highlight questionable advertisements for the Staff's review. The Tips, Complaints and Referrals (TCR) Portal may be too cumbersome for these purposes, and the public and Staff would benefit from a streamlined mechanism dedicated to this specific task, with a prominent link on the Commission's home page. This could prove to be a valuable way to supplement the Commission's own surveillance of the 506(c) market.

The Need to Modernize the Definition of Accredited Investor

The Release asks whether the net worth and income test currently provided in Rule 501 are the appropriate tests for determining whether a natural person is an accredited investor, and, if so, whether the current financial thresholds remain appropriate.

We believe that the basic principle articulated by the Supreme Court more than fifty years ago in *SEC v. Ralston Purina* remains sound—whether private placements should be exempt from registration under the securities laws turns on whether "the particular class of persons affected needs the protection of the [Securities] Act," and that only "[a]n offering to those who are shown to be able to fend for themselves" should be exempt.[18] The current income and net worth tests in the definition of accredited investor are wholly inadequate to serve that purpose. They have substantially eroded since they were established in 1982, to the point where they no longer identify a universe of individual investors who can fend for themselves and do not need the protections of the securities laws.

The Commission could modernize these tests in any one of several different ways. It could replace the income and net worth tests with a threshold test of demonstrated investment experience, which is far more likely than income or net worth tests to identify investors who can bear the economic risk of their investment and fend for themselves in private securities transactions. For example, a threshold based on the amount of investments owned, like the one proposed by the Commission in 2007,[19] would be a far better proxy for financial sophistication than the current net worth test, which could be satisfied through ownership of assets that have little or nothing to do with investing.

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[16] As noted in our earlier letters, we would expect that FINRA would tailor its rules with respect to private funds as it has done for mutual funds. For example, FINRA may conclude that appearances by or interviews with private fund portfolio managers do not need to be filed.

[17] Alternatively, the Commission could develop its own infrastructure to substantively review these filings internally.

[18] *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953).

[19] *See* SEC Release Nos. 33-8828 and IC-27922 (Aug. 3, 2007), 72 Fed. Reg. 45116 (Aug. 10, 2007), available at http://www.sec.gov/rules/proposed/2007/33-8828.pdf. If the Commission takes this approach, it should consider using an approach similar to the definition of "qualified purchaser" in Section 2(a)(51) of the Investment Company Act, albeit with a

Alternatively, the Commission could retain the income and net worth tests, but substantially increase the thresholds.[20] In 1982, when the income and net worth tests were adopted, 1.87 percent of U.S. households qualified as accredited investors. According to Professor Robert Thompson:

> [I]n 1982, an income of $200,000 or millionaire status in terms of net worth covered a relatively limited number of very well-off people, and did not affect all that many retail investors. That dollar amount hasn't changed in the three decades since even though inflation has brought more and more individuals within its definition, effectively extending its reach deeper into the cohort of those with smaller real incomes. Indeed measured as a percentage of the pool of individual taxpayers, the number of individuals whose income is above $200,000 is now 20 times larger than at the time of enactment of Regulation D.[21]

The GAO estimates that a $400,000 income limit would result in approximately 2.4 million households (or just over two percent of the nation's 116.7 million households) qualifying. Similarly, a $3.25 million net worth threshold would result in approximately 2.7 million households (2.3 percent) qualifying.[22] While we do not express a view on the specific thresholds the Commission should adopt, it is clear from this data that the existing thresholds must be significantly increased to offset the effects of inflation and better identify a universe of individual investors who can fend for themselves and do not need the protections of the securities laws.

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lower threshold (*e.g.*, $2,500,000 in investments). Many private funds already have processes in place to make determinations pursuant to that section.

[20] The Commission should not, however, simply adopt a new investments-owned test without addressing the income and net worth tests. Merely adding another way to qualify, while leaving outdated income and net worth thresholds in place, would do nothing to alleviate the shortcomings of the current definition of accredited investor.

[21] Statement of Professor Robert B. Thompson, Peter P. Weidenbruch Jr. Professor of Business Law, Georgetown University Law Center, at Hearings Before the Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs of the House Committee on Oversight and Government Reform and the Subcommittee on Capital Markets and Government Sponsored Enterprises of the House Committee on Financial Services (September 13, 2012), at pages 5-7, citations omitted, available at http://financialservices.house.gov/uploadedfiles/hhrg-112-ba16-wstate-rthompson-20120913.pdf.

[22] *See* GAO-13-640, *Alternative Criteria for Qualifying As an Accredited Investor Should Be Considered* (July 2013), at page 18, available at www.gao.gov/assets/660/655963.pdf.

We appreciate the opportunity to submit these comments. If you have any questions about our comments or would like additional information, please contact me at 202/326-5901, Karrie McMillan, General Counsel, at 202/326-5815, or Bob Grohowski, Senior Counsel, at 202/371-5430.

Sincerely,

/s/ Paul Schott Stevens

Paul Schott Stevens
President and CEO

cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar

Norman Champ, Director, Division of Investment Management
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