2015

Put Your Money Where Your Mind is: Protecting the Markets in the Age of Post-Jobs Act Rule 506 Offerings

Alexis A. Geeza

Follow this and additional works at: https://scholarship.shu.edu/student_scholarship

Recommended Citation
Put Your Money Where Your Mind Is: 
Protecting the Markets in the Age of Post-JOBS Act Rule 506 Offerings 
Alexis A. Geeza*

I. Introduction

On September 5, 2013, all eyes were once again on the Super Bowl XLVII champions, the Baltimore Ravens, as the ninety-fourth NFL season kicked off in Denver.1 Football fans across the country would soon set their sights and their hopes on the 2014 Super Bowl. With a viewership of 108.7 million in 2013 and 111.3 million in 2012,2 the Super Bowl is big business. Companies understand the value of marketing their goods and services to such vast audiences and pay a premium for the opportunity.3 One advertisement from Super Bowl XLVII starred the E*TRADE baby.4 In the commercial, an infant speaking in an adult’s voice touts E*TRADE’s affordable investments and lack of hidden fees as a way for working people to save money.5 The baby, in taking on several different personas throughout the ad, paints a picture of a responsible investor contrasted with a spendthrift hedonist.6 With the advent of the Jumpstart Our Business

* J.D. Candidate, 2015, Seton Hall University School of Law; M.B.A., 2012, Montclair State University; M.A., 2010, University of Connecticut; B.A., 2008, Rutgers University. I would like to express my gratitude to my faculty advisors, Professors Kristin N. Johnson and Ronald J. Riccio, for their valuable recommendations and insights. I am also deeply thankful for the continued love and support of my family—in particular, Patricia and Danielle Geeza, John and Anne Hutnyan, and Paul Tewfik—both prior to and during law school.

3 Id. (noting that in 2013, a 30-second commercial cost, on average, $3.75 million, as compared to $40,000 in 1967).
4 See etrade, NEW E*TRADE Baby Game Day Commercial – Save It, YOUTUBE (Jan. 29, 2013), http://www.youtube.com/watch?v=dxDSQ23cWhE; see also E*TRADE FIN. CORP., https://about.etrade.com/index.cfm (last visited Nov. 4, 2013) (defining E*TRADE as “a financial services company that provides online brokerage and related products and services primarily to individual retail investors”) (emphasis added). Retail investors are defined as individuals who buy and sell securities on their own behalf. Retail Investor, INVESTOPEDIA, http://www.investopedia.com/terms/r/retailInvestor.asp (last visited Jan. 2, 2014). Offerings to retail investors are typically regulated and, as a result, must comply with the registration requirements imposed by the Securities Act of 1933. See infra notes 19–23 and accompanying text. By contrast, securities not being offered to the general public are exempted from the registration requirements. See infra notes 24–29 and accompanying text.
5 See etrade, supra note 4 (“Oh, this is tragic, man. Investors just like you could lose tens of thousands of dollars on their 401(k) to hidden fees. Thankfully E*Trade has low cost investments and no hidden fees. But, you know, if you’re still bent on blowing this fat stack of cash, there’s [sic] a couple ways you can do it. Or just go to E*Trade and save it. BOOM!”).
6 Id.
Startups Act (the “JOBS” Act), however, the E*TRADE baby may soon face competition as a new wave of marketers begins to target retail investors.7

The passage of the JOBS Act on April 5, 2012 stands to forever alter Americans’ approach to buying and selling,8 particularly with regard to securities.9 An exceptionally intriguing and controversial aspect of the JOBS Act is Title II and, specifically, what it means for Rule 506 offerings.10 Before Title II became law, businesses transacting in unregistered securities were required to direct their solicitation11 efforts toward a target audience of high net worth individuals and institutional buyers.12 Today, under Title II, these same companies are also permitted to solicit retail investors previously only accessible to firms like E*Trade.13 The advertisements can theoretically reach an unlimited number of people, not all of whom are sophisticated buyers.14

Title II has the potential to be a positive step for securities regulation, but if it is to achieve preeminent status in the long run, there are a multitude of concerns surrounding this change in the law that must be addressed. The Securities and Exchange Commission (the “SEC”) has identified fraud prevention and investor safety as the focal points of its immediate

---

8 See generally infra Part III.
9 The Securities Act defines a security as, inter alia, “any note, stock... security future... bond, debenture... investment contract... or, in general, any interest or instrument commonly known as a security...” 15 U.S.C.A. § 77b(a)(1) (West 2012) (internal quotation marks omitted).
10 See, e.g., 17 C.F.R. § 230.506 (2013), infra note 27. The actual scope of Title II is broader, but for purposes of this Comment, it will be confined to Rule 506 offerings.
11 Throughout this Comment, the terms “advertising” and “soliciting,” and variations of them, will be used interchangeably. This is in line with the language of Title II itself. See infra text accompanying note 61.
12 See infra notes 25, 29; see also supra note 4.
13 See infra text accompanying note 61; see also supra note 4.
14 Buyers, however, must be accredited if they wish to invest in unregistered securities. Infra note 64 and accompanying text. For a discussion on the differences between sophisticated and accredited investors, see generally infra Part V.
oversight efforts. The measures taken by the SEC in this regard are encouraging first steps, but they do not go far enough. Investor education must be at the forefront of any initiatives geared toward protecting the markets. Specifically, to safeguard the markets, investors should be presented with better—not merely additional—information that has practical utility. Investors should then bear ultimate responsibility for using that information proactively.

This Comment examines Title II of the JOBS Act as it relates to Rule 506 offerings and the SEC’s corresponding regulatory initiatives. It analyzes the implications of each with a view toward protecting the markets and identifies the steps that the SEC and society must take in order to meet this objective. Part II of this Comment begins with a brief discussion of the Securities Act of 1933 (the “Securities Act”), which, in a sense, marked the genesis of the advertising ban as it existed prior to Title II. It also provides an overview of the arguments advanced over the years in favor of the solicitation prohibition’s repeal. Part III presents Title II of the JOBS Act, conceptualized as an indirect response to the contentions addressed in Part II. Part IV details how the SEC and members of the public have responded to Title II. Part V argues that the SEC has not done enough to safeguard the markets since enactment of Title II and that investors must take on a more proactive role in this endeavor. It offers further solutions that center on investor education. Part VI concludes this Comment.

15 See infra Part IV.A.
16 The SEC has enacted a regulation to prevent “bad actors” from advertising to the population as a whole if they are likely to perpetuate fraud in doing so. Exemption for Limited Offers and Sales without Regard to Dollar Amount of Offering, 17 C.F.R. § 230.506(d) (2013), WL 17 CFR s 230.506(d); see also infra Part IV.A. The SEC has also proposed a rule that would require issuers to divulge more information to prospective investors. Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. 44806-01 (proposed July 24, 2013) (to be codified at 17 C.F.R. pts. 230, 239); see also infra Part IV.A.
II. Historical Background for Title II

A. The Securities Act of 1933

Before focusing on the advertising ban, it is first necessary to understand how members of the public learn about securities. This is accomplished, in no small part, through the operation of the Securities Act, spurred by the stock market crash of 1929. As “the first major piece of federal legislation regarding the sale of securities,” the purpose of the Securities Act was to create a culture of full disclosure in the marketplace, for the benefit of the population as a whole and investors in particular. The Securities Act’s originators believed that requiring those issuing securities to divulge all material information related to their public offerings would insulate the universe of prospective buyers from fraudulent investment schemes. In this manner, the legislature intended the Securities Act to bridge the knowledge gap between those purchasing securities and those selling securities.

The disclosures of material information necessitated by the Securities Act appear in the form of registration statements that must be filed with the SEC. There are, however, certain classes of transactions that are exempt from the registration requirement, such that issuers may

---

18 Id.
22 15 U.S.C.A. § 77f(a) (West 2012). Thirty-two categories of information, contained in Schedule A, must be discussed in registration statements for transactions involving domestic securities. Id. § 77f(a)(1); 15 U.S.C.A. § 77aa (West 1998). These include, inter alia, “the location of the issuer’s principal business office . . . a statement of the capitalization of the issuer . . . [and] the price at which it is proposed that the security shall be offered to the public or the method by which such price is computed . . . .” 15 U.S.C.A. § 77aa (West 1998). Registration statements are publicly accessible shortly after they are filed. 15 U.S.C.A. § 77f(d) (West 2012). Importantly, the transactions described in the registration statement cannot be executed until the SEC approves said statement. Id. § 77e(a).
execute them even though they are unregistered.\textsuperscript{23} Categorically, "transactions by an issuer not involving any \textit{public} offering" are excused,\textsuperscript{24} a notion referred to as the private placement exemption. Regulation D, promulgated by the SEC, delineates public and private offerings.\textsuperscript{25} When enacted, Regulation D prohibited issuers applying for an exemption,\textsuperscript{26} and those acting on their behalf, from using "general solicitation or general advertising" to appeal to investors.\textsuperscript{27} This caveat, though well-intentioned, ignited an ongoing debate that drives at its very necessity and viability.

B. \textit{The Rationale for the Solicitation Prohibition and Arguments Advanced in Favor of Its Repeal}

Scholars construe the rationale for this advertising prohibition as applied to private placement issuers both in terms of facilitating SEC enforcement efforts and maintaining investor

\begin{footnotesize}
\textsuperscript{23} 15 U.S.C.A. § 77d (West 2012). Despite the fact that exempt offerings do not need to be registered, issuers must still file an electronic Form D notice of sales with the SEC. 17 C.F.R. § 239.500(a)(1), (b)(1) (2012). Form D is brief and requests identifying information about the company’s executives as well as "the size of the offering and the date of first sale." \textit{Form D}, SEC, http://www.sec.gov/answers/formd.htm (last visited Nov. 4, 2013); \textit{see also infra} notes 80–83 and accompanying text (discussing the SEC’s proposed changes to Form D).


\textsuperscript{25} 17 C.F.R. § 230.500(a) (2013).

\textsuperscript{26} The Regulation D exemptions include Rules 504–506. \textit{Id.} §§ 230.504–§ 230.506. In general, these exemptions involve either a small monetary transaction or a small number of investors. \textit{Id.} Under Rule 504, issuers raising no more than $1,000,000 through securities may sell to an unlimited number of buyers without completing a registration statement. \textit{Id.} § 230.504; \textit{see also} WILLIAM A. KLEIN, J. MARK RAMSEYER & STEPHEN M. BAINBRIDGE, \textit{Business Associations} 413 (Robert C. Clark et al. eds., 8th ed. 2012); \textit{Rule 504 of Regulation D}, SEC, http://www.sec.gov/answers/rule504.htm (last visited Nov. 4, 2013). Rule 505 permits issuers not raising more than $5,000,000 through securities to sell to up to thirty-five buyers. 17 C.F.R. § 230.505; \textit{see also} KLEIN, RAMSEYER & BAINBRIDGE, \textit{supra}, at 413; \textit{Rule 505 of Regulation D}, SEC, http://www.sec.gov/answers/rule505.htm (last visited Nov. 4, 2013). \textit{Under Rule 506}, issuers raising more than $5,000,000 through securities may sell to up to thirty-five buyers, so long as they pass investor sophistication tests. 17 C.F.R. § 230.506 (2013); \textit{see also} KLEIN, RAMSEYER & BAINBRIDGE, \textit{supra}, at 413; \textit{Rule 506 of Regulation D}, SEC, http://www.sec.gov/answers/rule506.htm (last visited Nov. 4, 2013). Rule 506 is most critical for purposes of this Comment.

\textsuperscript{27} 17 C.F.R. § 230.502(c) (2008). General solicitations and general advertisements included not only newspaper and television communications, but also seminars in which participants were invited by those means. \textit{Id.} Given the dearth of publicly available information, those considering hedge funds as investments typically looked to limited index reports and due diligence inspections. Cary Martin, \textit{Is Systemic Risk Prevention the New Paradigm? A Proposal to Expand Investor Protection Principles to the Hedge Fund Industry}, 86 ST. JOHN’S L. REV. 87, 118 (2012).
\end{footnotesize}
confidence. For example, with respect to enforcement efforts, if issuers are not allowed to solicit potential buyers and proceed to engage in large-scale advertising, then they may be more likely to attract the attention of the SEC. With respect to investor confidence, the faith of investors in the system may be undermined if they are continually met with a confusing barrage of solicitations in the marketplace. Analogously, the ban may protect buyers from accidentally investing in hedge funds and other “risky” ventures, since it will be more difficult in the absence of advertisements for purchasers to identify private funds in which to invest.

Notwithstanding the concerns that the advertising ban attempted to guard against, opponents have advanced a number of arguments over the years in support of its repeal, for both procedural and substantive reasons. On the procedural side, for instance, states have been afforded flexibility in determining how to frame their private placement exemptions to align with Regulation D. The resulting procedural variation across states militates against the goal of uniform investor protections. If New Jersey structures its private placement exemptions in one way and Florida does so in another, then conceivably, the formula for Regulation D compliance will differ between the two states, such that investors in New Jersey will have an experience that is distinct from that of investors in Florida.

On the substantive side, justifications for lifting the solicitation prohibition include facilitating the exchange of information and reflecting the realities of the marketplace.

33 Id.
Regarding information exchange, one view construes the advertising ban as the driving force behind the general lack of understanding surrounding private placements as investment tools.\textsuperscript{34} For example, if hedge funds never release television commercials, then people will be less inclined to consider them as a financial strategy, let alone be able to distinguish a hedge fund from a mutual fund. Even individuals who “may never actually purchase securities”\textsuperscript{35} stand to profit from an enhanced understanding of how private placements operate.\textsuperscript{36} More concretely, increasing the amount of information in the marketplace is a worthy goal because it will increase competition between entities as they vie for investors, while simultaneously decreasing performance fees.\textsuperscript{37} With more material at their disposal, investors will have the capacity to make better-informed decisions about where to allocate their money, rather than simply choosing the first issuer they come in contact with. Concurrently, to make their entity stand out in the information mix, issuers are likely to charge lower performance fees in an effort to increase their appeal to prospective investors.

Others have declared that regulatory bodies are also potential beneficiaries of the solicitation ban’s repeal. From the regulators’ perspective, it will be easier to ascertain whether private placements are abusing investors; regulators will be able to uncover a particular private placement’s strategy by the content of its advertisements.\textsuperscript{38} If solicitations are available for inspection, then the opportunity to move away from limited index reports and due diligence

\textsuperscript{34} O’Halloran, supra note 30, at 478. By contrast, some offer that because accredited investors have the capacity to look out for their own financial interests, the prohibition against issuer solicitations does not have any noticeable effect on them. Robert B. Thompson & Donald C. Langevoort, Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising, 98 CORNELL L. REV. 1573, 1615 (2013).


\textsuperscript{36} Alexander R. Roche, The Regulator Strikes Back: A Look at the SEC’s Most Recent Attempt to Regulate Hedge Funds and What It Missed, 33 U. DAYTON L. REV. 145, 178 (2007). In particular, having additional knowledge at one’s disposal can lead to better decision making. Id. at 176.

\textsuperscript{37} O’Halloran, supra note 30, at 489.

\textsuperscript{38} Roche, supra note 36, at 179.
inspections, both of which require significant time and money, will help regulatory bodies to realize cost savings and to complete their investigative efforts more quickly.\textsuperscript{39} Although expensive, limited index reports and due diligence inspections generally produce unreliable information for anyone attempting to determine the benefits of investing in a particular hedge fund.\textsuperscript{40}

A final argument in favor of the solicitation ban’s repeal reflects the commonly espoused economic reality “that the key to selling a product is marketing.”\textsuperscript{41} The prohibition is especially burdensome to businesses that lack large-scale advertising budgets. In fact, one scholar noted that “[t]here is no greater impediment to the ability of small companies to raise capital under the securities laws than the SEC rules against general solicitation and advertising.”\textsuperscript{42} Specifically, small issuers are often challenged to locate brokers willing to assist them in selling their securities, and so the prohibition grinds to a halt their already modest attempts at solicitation.\textsuperscript{43}

Given the irrefutable fact that today’s global marketplace relies heavily on advertising,\textsuperscript{44} lifting the ban is readily viewed as an attempt to keep pace with the times\textsuperscript{45} and to enable all entities to fulfill what is often demanded by business necessity. The act of soliciting cannot be

\textsuperscript{39} Martin, supra note 27, at 118.
\textsuperscript{40} Id.
\textsuperscript{44} Peter Lattman, S.E.C. Lifts Advertising Ban on Private Investments, DEALBOOK (July 10, 2013, 4:04 PM), http://dealbook.nytimes.com/2013/07/10/s-e-c-lifts-advertising-ban-on-private-investments/?_r=1. Additionally, mutual funds have long been allowed to solicit investors. Touryalai, supra note 7; see, e.g., etrade, supra note 4. Mutual funds, unlike hedge funds, cater to retail, rather than to sophisticated, investors. E*TRADE FIN. CORP., supra note 4.
\textsuperscript{45} Hedge funds and other private placements are no longer the exclusive domain of institutional investors. Lattman, supra note 44. Hedge fund managers are also spending increasingly more time in the public eye and are consequently being viewed as more accessible. See id. (noting that Och-Ziff Capital Management, a hedge fund, is a public company).
divorced from the notion of capturing the public’s attention. Indeed, whether the advertising ban serves any purpose other than to ensure that certain sales remain private is a subject of intense discussion.46

III. Title II of the JOBS Act

Part II, supra, presented a number of persuasive arguments in support of eliminating the solicitation ban for private placements. It is interesting to note, then, that this was not the end-goal for the lawmakers who drafted the legislation that ultimately lifted the advertising prohibition. Rather, this change in the law came about as ancillary to a more general objective—namely, job creation by small businesses.47 Representative Stephen Lee Fincher (R-TN) introduced the Reopening American Capital Markets to Emerging Growth Companies Act of 2012 in the House on December 8, 2011.48 He expressed his rationale for the bill in his remarks that day: “Burdensome costs are discouraging companies from going public, which deprives firms of the capital needed to expand their businesses and hire more American workers . . . ‘one-size-fits-all’ laws and regulations have changed the nature of the United States’ capital markets . . .”49

Over the course of the nearly four months that the House and Senate deliberated the Reopening American Capital Markets to Emerging Growth Companies Act of 2012, it and the other bills considered alongside it became colloquially known as the JOBS Act.50 Also during this time, repealing the solicitation ban became a hot-button issue. Representative Kevin McCarthy (R-CA) proposed that only Rule 506 offerings under Regulation D should be allowed

46 Sjostrom, Relaxing, supra note 29, at 40.
48 Id.
to advertise.\textsuperscript{51} He sought further to clarify that a company’s choice to solicit to the public does not render its offering public.\textsuperscript{52} In addition, Representative Patrick McHenry (R-NC) recommended that private shares be made available to accredited investors via trading platforms.\textsuperscript{53} These proposals took shape in the eventual law, which instructed the SEC to permit solicitations for private offerings falling under the Rule 506 umbrella, so long as only accredited investors are permitted to buy the securities involved.\textsuperscript{54}

The law achieved the “increasingly rare legislative victory”\textsuperscript{55} of bipartisan support, passing 380 to 41 in the House\textsuperscript{56} and 73 to 26 in the Senate.\textsuperscript{57} President Obama signed the JOBS Act into law on April 5, 2012,\textsuperscript{58} the stated purpose of which was “[t]o increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.”\textsuperscript{59} Title II, termed “Access to Capital for Job Creators,” highlights the new role that advertising is to play in Rule 506 offerings in Section 201: “Modification of Exemption.”\textsuperscript{60} Section 201 directs the SEC to revise its rules within ninety days to lift the general solicitation and advertising ban for Rule 506 offerings,\textsuperscript{61} marking the end of an eighty-year prohibition\textsuperscript{62} by permitting certain private placements to raise funds in the open market.\textsuperscript{63

\textsuperscript{52} Id.
\textsuperscript{53} Id. at pt. 11.
\textsuperscript{54} See infra text accompanying notes 61–64.
\textsuperscript{60} Id. 313–314.
\textsuperscript{61} Id.
Title II, however, does not permit just anyone to take part in the transactions. Rather, it requires the SEC to mandate in its new rule that everyone purchasing the securities be an accredited investor. The SEC is empowered under Title II to require issuers to take reasonable steps—that it identifies—to determine whether purchasers are, indeed, accredited. Thus, as the literal language of the law indicates, the SEC is afforded much discretion to effectuate Title II.

IV. The SEC’s and Society’s Responses to Title II of the JOBS Act

A. The SEC’s Response to Title II

July 10, 2013, was a busy day for the SEC. It began by doing exactly what Title II called for. First, the SEC amended Rule 506 to enable issuers relying on that Regulation D exemption to advertise or solicit their securities offerings. Second, the SEC imposed the condition that all purchasers be accredited and that issuers take reasonable steps to guarantee
that buyers are accredited.\textsuperscript{70} The SEC, however, decided to take this several measures further. Namely, it identified two critical issues surrounding Title II’s implementation that are worthy of attention: (1) vetting the private placements choosing to solicit; and (2) protecting investors.\textsuperscript{71}

In addition to lifting the advertising ban, the SEC amended Rule 506 to comply with Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.\textsuperscript{72} Although this action was not directly tied to the solicitation prohibition, it served to bar “felons and other ‘bad actors’” from relying on a Rule 506 exemption.\textsuperscript{73} Under the new rule, issuers and covered individuals fall under the felons and other bad actors umbrella if they have a “disqualifying event,”\textsuperscript{74} which generally contains some element of fraud:

[W]e recognize the concerns raised by a number of commenters that a general solicitation for a Rule 506(c) offering would attract both accredited and non-accredited investors and could result in an increase in fraudulent activity in the Rule 506 market, as well as an increase in unlawful sales of securities to non-accredited investors.\textsuperscript{75}

Rule 506 enumerates eight disqualifying events that will preclude a person from tendering offerings of securities under the rule.\textsuperscript{76} It also allows, however, a defense that the

\begin{itemize}
  \item \textsuperscript{69} Reasonable steps that an issuer can take to verify accredited investor status include any of the four methods laid out in 17 C.F.R. § 230.506(c)(2)(ii)(A)–(D) (2013), provided that the issuer does not know that the buyer is unaccredited. 17 C.F.R. § 230.506(c)(2)(ii); see also supra note 60. Crucially, the issuer is not mandated to use one of the four methods laid out in 17 C.F.R. § 230.506(c)(2)(ii)(A)–(D) (2013). \textit{Id.} § 230.506(c)(2)(ii)(D).
  \item \textsuperscript{70} See infra note 68.
  \item \textsuperscript{71} See infra notes 72–95 and accompanying text.
  \item \textsuperscript{72} Disqualification of Felons and Other “Bad Actors” from Rule 506 Offerings, 78 Fed. Reg. 44730-01, 44730 (proposed July 24, 2013) (to be codified at 17 C.F.R. pts. 200, 230, 239).
  \item \textsuperscript{73} \textit{Id.}
  \item \textsuperscript{74} 17 C.F.R. § 230.506(d) (2013) (noting that covered individuals include, inter alia, people compensated for advertising to buyers, general partners or managing members of the advertiser, and directors and officers taking part in the advertiser’s offering or in the advertiser’s general partners’ or management members’ offering); see also Fact Sheet: Disqualification of Felons and Other “Bad Actors” from Rule 506 Offerings, SEC, http://www.sec.gov/news/press/2013/2013-124-item2.htm (last visited Nov. 4, 2013).
  \item \textsuperscript{75} Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. 44806-01, 44807 (proposed July 24, 2013) (to be codified at 17 C.F.R. pts. 230, 239) (emphasis added).
  \item \textsuperscript{76} The eight disqualifying events are: (1) \textit{Criminal convictions} entered within the last five years (in the case of issuers) or within the last ten years (in the case of other covered persons) that relate to the purchase or sale of securities, false SEC filings, or business conduct; (2) \textit{Court orders, judgments, or decrees} entered within the past 5 years that are in effect at the time of sale and that relate to the purchase or sale of securities, false SEC filings, or business conduct; (3) \textit{Final orders} issued by, inter alia, federal banking regulators that either prevent the issuer from
individual could not have known, even through the exercise of reasonable care, that he or she
was subject to a disqualifying event. Although disqualifying events prior to the rule’s effective
date of September 23, 2013, will not operate against the issuer, issuers must notify purchasers in
writing of any such events that took place prior to the effective date.

Also on July 10, 2013, the SEC proposed a rule addressing concerns over the manner in
which information related to Rule 506 offerings is presented to investors. The proposed rule
requires issuers who have not filed Form D to file an initial Form D at least fifteen calendar days
before commencing advertising efforts for the offering. Regarding the actual content of Form
D, the SEC proposed an update to Item 6 for those filling out the form to indicate whether they
are relying on Rule 506(c). It also proposed adding six new items to the form. Under the
proposed rule, issuers who have not complied with the Form D filing requirements within the
past five years will be barred, for one year, from relying on Rule 506. Filling out paperwork
correctly thus takes on monumental importance, as a mistake will mean the difference between
being allowed to engage in general solicitation and being barred from doing so.

associating with a regulated entity or participating in the business of purchasing or selling securities; (4) SEC
disciplinary orders that suspend or revoke registration, or that limit the issuer’s activities; (5) SEC cease and desist
orders relating to, inter alia, scienter-based antifraud provisions of the securities laws, entered within the past 5
years and in effect at the time of sale; (6) Suspension or expulsion from becoming a member in, or associating with,
a registered national securities exchange or securities association; (7) Refusal and stop orders, and orders
suspending Regulation A, for registration statements entered within the past 5 years; or (8) False representation

78 Id. § 230.506(e).
79 Fact Sheet: Proposing Amendments to Private Offering Rules: SEC Open Meeting, SEC,
81 Id. at 44814; see also supra note 23; Form D, SEC 2 (2013), http://www.sec.gov/about/forms/formd.pdf.
82 New items 17–22 include, inter alia, “The number and types of accredited investors that purchased securities in
the offering . . . if the issuer used a registered broker-dealer in connection with the offering, whether any general
solicitation materials were filed with FINRA . . . for Rule 506(c) offerings, the types of general solicitation used or
to be used (e.g., mass mailing . . . public Web sites, social media . . . ) . . . .” See Amendments to Regulation D,
Form D and Rule 156, 78 Fed. Reg. at 44815; see also Brandon J. Rees, File No. S7-06-13, AFL-CIO 3 (2013),
http://www.sec.gov/comments/s7-06-13/s70613-423.pdf (noting that the information provided in the legends on the
marketing materials, infra note 84 and accompanying text, does not adequately capture the risks associated with
private fund investments).
83 Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44817.
The SEC proposed further that a number of conditions be imposed on the written advertising materials employed by issuers. One requirement is that issuers include prominent legends on all written solicitations. These legends, though not conditions of Rule 506, inform investors “as to whether they are qualified” and of certain investment risks. Some commenters, however, have suggested that additional constraints be imposed on hedge funds, venture capital funds, and private equity funds choosing to advertise, in the form of specific content requirements and restrictions:

Because investors consider performance to be one of the most significant factors when evaluating investments, we are concerned that private funds [sic] presenting non-current performance data may confuse, and even mislead, investors regarding the fund’s current performance, particularly if the fund’s performance has changed significantly after the period reflected in the advertisement.

With this view in mind, the SEC recommended a mandate that private funds include a legend on any written advertising materials not subject to the provisions of the Investment Company Act. In addition to legends on these funds' advertising materials, the SEC proposed a number of disclaimers under Rule 509(c), to be made by funds citing performance data: (1) that the data represents past performance and is not a perfect predictor of future outcomes; (2) that

---

84 The legends would indicate that securities may only be sold to accredited investors as defined, and stipulate that “securities are being offered in reliance on an exemption from the registration requirements of the Securities Act,” the SEC has not passed on the merits of the offering, investors are not to assume that resale is an option, and investing in securities involves an inherent degree of risk that investors must be prepared to bear. Id. at 44821–22.
86 See Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44822.
88 See Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44822.
89 Id. at 44823 (emphasis added).
90 Id. The Investment Company Act includes, inter alia, limitations on leverage “and requirements regarding independent board members” that are inapplicable to private funds. Id.
current performance may not match the data in the solicitation materials; (3) that private funds are not required to follow any standard methodology; and (4) that a one-to-one comparison of private funds’ performance may not be possible. In addition, the private funds targeted by the proposed rule must provide a phone number or website through which prospective investors can access up-to-date performance data. The SEC also encourages a need for private funds to be mindful of the types of sales literature that are considered to be “misleading for purposes of the federal securities laws.”

Finally, under proposed Rule 510T under Regulation D, issuers relying on Rule 506(c) will be required to submit their written advertising materials to the SEC no later than the date the materials are first used in conjunction with the offering. The comment period for these proposed rules closed on November 4, 2013. The discussion is far from over, however, as society continues to respond to these changes in earnest.

B. Society’s Response to Title II

1. The Opposition’s View

The SEC’s actions have not received unanimous support—even within the SEC itself. Commissioner Aguilar vehemently opposed the repeal of the advertising ban. He predicates his divergent view on the danger of fraud—specifically, that scammers will use any number of solicitation tools to generate compelling, imaginative (and dishonest) sales pitches that will

91 Id. at 44822–23.
92 Id. at 44823.
94 Id. at 44828. This proposed rule would only exist for two years after its effective date in order to give the SEC an opportunity to assess market practices. Id.
96 See infra notes 97–130 and accompanying text.
97 See generally infra notes 102–130 and accompanying text.
98 Lattman, supra note 44.
ultimately harm investors. The lack of available data on the percentage of accredited investors who are susceptible to the pull of glossy advertisements leaves unanswered the question of whether investors are better- or worse-off following the implementation of Title II of the JOBS Act.

While some believe that any hysteria surrounding the new law is much ado about nothing, a sizeable segment of society is in accordance with Commissioner Aguilar. To begin, up until this point, the entities prohibited from advertising to the general population have enjoyed a certain mystique by virtue of their inaccessibility to everyday people. Title II of the JOBS Act stands to increase the visibility of these private placements as investment tools. Individuals who have not had occasion to invest in hedge funds, and who may have concluded

100 Thompson & Langevoort, supra note 34, at 1617.
101 The National Venture Capital Association (NVCA), for example, does not believe that its member firms will be quick to start advertising to the general public. Jennifer Connell Dowling, The SEC’s Proposed New Rules on General Solicitation, NVCAACCESS (Sept. 25, 2013), http://nvaccess.nvca.org/index.php/topics/public-policy/385-the-secs-proposed-new-rules-on-general-solicitation.html. In particular, issuers may stand to gain little from allotting resources to an innovative marketing program if they already “have an established marketing presence and a deep liquid investor base.” Sarah N. Lynch, SEC Lifts Longtime Advertising Ban for Hedge Funds, Others, REUTERS (July 10, 2013, 6:04 PM), http://www.reuters.com/article/2013/07/10/us-sec-advertising-idUSBRE96901520130710 (quoting Matthew Kaplan, partner at Debevoise & Plimpton LLP). The NVCA also believes that even if its venture capital firms decide to include advertisements in their corporate strategies moving forward, the additional requirements imposed by the SEC go too far in terms of the amount and type of material they require. Dowling, supra; see also Michaels, supra note 62 (noting that the private securities market may be weighed down by the costly new rules).
that they are the exclusive province of the wealthy, may choose to go after them believing that enormous returns can simply not be gotten in the retail market.\textsuperscript{104}

Even more specifically, the public sentiment surrounding “Amendments to Regulation D, Form D and Rule 156 Offerings under the Securities Act” is captured in the comment letters presented to the SEC. Letters fall into two broad categories, Type A and Type B.\textsuperscript{105} Forty-nine individuals and entities submitted some variation of Letter Type A,\textsuperscript{106} the main concern of which is the ability of startups to raise money publicly.\textsuperscript{107} This worry is driven by a number of factors:

- Startups that break the rules will remove any chance of raising capital for themselves.\textsuperscript{108}
- Startups will try to raise money privately due to the onerous nature of the rules.\textsuperscript{109}
- Startups will face difficulty “notify[ing] the SEC in advance, fil[ing] documents every time there is a new communication with investors and includ[ing] boilerplate with every communication” if bankers are unavailable to aid them in their fundraising efforts.\textsuperscript{110}

Those who presented a Letter Type A advocate for permitting third parties to complete SEC filings for startups, requiring boilerplate language only when discussing the terms of financing, and breaking the connection between noncompliance and elimination of any chance to subsequently raise money.\textsuperscript{111} These suggestions have potential to shift some of the documentation burden away from startups, to permit flexibility for the use of innovative

\begin{thebibliography}{9}
\bibitem{104} Rodrigues, \textit{supra} note 102, at 3413.
\bibitem{106} \textit{Id}.
\bibitem{108} \textit{Id}.
\bibitem{109} \textit{Id}.
\bibitem{110} \textit{Id}.
\bibitem{111} \textit{Id}.
\end{thebibliography}
language when appropriate, and to lessen the severity of the consequences flowing from honest or insignificant mistakes.

During the same comment period, 160 individuals and entities submitted some variation of Letter Type B. This petition was spearheaded by angel investor groups in New Jersey, New York, and Connecticut who caution that, as a result of the SEC's new rule, both angel investing and the number of jobs available in the U.S. will decline. As such, the Type B petitioners endorse the following alternatives:

- Withdraw the proposed amendments to both Regulation D and Form D.
- Eradicate the notion that acquiring startup funding from family members and friends, even on a limited basis, should negatively impact the ability of startups to rely on the Rule 506(c) exemption.
- Define members of angel groups, and those who put forward an investment of at least $10,000, as express categories of accredited investors.
- Clarify that neither events with a capped number of attendees—e.g., demo days—nor events that are devoid of any mention of a securities offering, qualifies as a general solicitation.

113 Angel investor groups furnish “financial backing for small startups or entrepreneurs” on either a one-time or an ongoing basis, and on generally favorable terms. Angel Investor, INVESTOPEDIA, http://www.investopedia.com/terms/a/angelinvestor.asp (last visited Feb. 8, 2014). In contrast to venture capitalists, angel investors’ primary focus is helping fledgling businesses grow, rather than realizing high returns on their investments. Id.
115 Because a startup’s inadvertent rule violation will result in a shortage of funding and possibly bankruptcy, angel investors will begin to view startups as uncomfortably risky enterprises. Id. at 3.
116 Angel investors view “the commitment of Friend [sic] and Family [as] an initial sign of the commitment and integrity of an entrepreneur.” Id.
117 Id. at 4.
118 Id. at 4–5.
2. The Opposition's Response to the Support

Title II’s supporters cite to the fact that issuers relying on the general solicitation allowance can only sell to accredited investors. An accredited investor, however, is defined as any individual whose annual income exceeds $200,000. This threshold is not a high bar to meet. In fact, in 2011, roughly 6.07 million Americans earned more than $200,000; estimates also posit that “133,000 male heads of household and 143,000 female heads of household” earn more than $200,000 annually. These figures do not represent a miniscule subset of the population. Opponents argue against removing the solicitation ban on grounds that it prematurely assumes all individuals who are accredited for purposes of Title II of the JOBS Act are sophisticated as a matter of course. Wealthy senior citizens are offered as a prime example. Even otherwise financially savvy investors may have trouble protecting themselves if the investment scheme in question is complicated enough. Thus, some suggest that the definition of accredited investor be overhauled.

\[\text{119 See, e.g., supra note 68.} \]
\[\text{120 See 17 C.F.R. § 230.501(a)(6) (2013), supra note 68. Due to inflation, one need not be extremely well-off in order to be considered an accredited investor; a number of retail investors fit within this category. Thompson & Langevoort, supra note 34, at 1616.} \]
\[\text{122 Id. (referencing U.S. Census data).} \]
\[\text{123 See, e.g., Lattman, supra note 44. It may be the case that bankers and lawyers are accredited investors, but the category could just as easily comprise a “rancher who is still driving a 1980s-era pickup truck. Or . . . the retiree in Florida who plays tennis every day and tells his son or daughter how to run the family business.” See Scherer, supra note 121.} \]
\[\text{124 Thompson & Langevoort, supra note 34, at 1618; see also David Certner, Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, AARP 2 (2012), http://www.sec.gov/comments/s7-07-12/s70712-130.pdf (explaining that older investors are some of the most common victims of securities fraud). Moreover, cases involving unregistered securities were disproportionately represented in a 2010 NASAA study of state securities regulation enforcement actions taken on behalf of investors over the age of 50. Id.} \]
\[\text{125 Thompson & Langevoort, supra note 34, at 1617.} \]
\[\text{126 Id. at 1619.} \]
In contrast to Title II’s supporters, opponents of the law think it is of no matter that the SEC requires warnings to be displayed on the marketing materials used by issuers.127 People tend to ignore cautionary tales if they have already decided on a course of action in their minds, and a warning label will not necessarily impede advertisers from engaging in unremitting solicitation efforts.128 With a warning label as a Band-Aid, issuers may become particularly aggressive in their marketing practices, as it has been noted that “the combination of advertising plus continued and unfettered broker-dealer activity, would be a disaster.”129 Opponents of Title II who are concerned about this suggest placing an upper limit on the number of individual investors who can participate in a private placement, in order to exert some degree of control over the brokers who are consummating the funding.130

3. The Current State of Affairs

The spirited debate surrounding Title II begs the question of how, if at all, private placement issuers have changed their business strategies in the aftermath of the new law. The SEC Office of Investor Education and Advocacy issued an investor alert in September 2013 that, among other things, discusses what private placements are and the things one should consider when making private placement investment decisions.131 This intimates that the SEC anticipated a wave of advertising that would increase the general level of interest in private placements.132

127 See supra notes 84–86, 90 and accompanying text.
130 Id.
132 Some have posited that well-off individuals who do not have a broker will be most influenced by the ads. Allen Wastler, What Could Save Hedge Funds? Marketing! (Maybe), CNBC (Sept. 21, 2013, 7:00 AM), http://www.cnbc.com/id/101048746.
Hedge funds, private equity firms, and venture capital entities, however, have been slow to take advantage of the solicitation allowance.\textsuperscript{133}

In fact, only a minute number of hedge funds have begun advertising, mostly on social media sites.\textsuperscript{134} Topturn Capital was the first one to issue a public advertisement;\textsuperscript{135} it also launched an email campaign to 350 recipients.\textsuperscript{136} Ff Venture Capital has likewise taken advantage of Title II; in October 2013, it began leveraging social media, email, and the web to target potential investors.\textsuperscript{137} Indeed, those issuing private placements have a variety of avenues to choose from in terms of how to solicit. Dow Jones and VentureBeat, for example, tout the benefits of advertising in their private equity and venture capital publications\textsuperscript{138} and on their technology blog,\textsuperscript{139} respectively. Why, then, have the entities in question largely failed to advertise?

First, hedge funds cater to a very narrow demographic: people who can afford to invest $1,000,000 at the outset.\textsuperscript{140} Even with this initial hurdle though, four of the six largest funds are

\textsuperscript{133} "This is a game of dodgeball . . . and we are going to let other people get hit in the head with the ball before we start doing it." Harvey D. Shapiro, \textit{Why Aren’t Hedge Funds Advertising?}, \textsc{New Yorker} (Oct. 31, 2013), http://www.newyorker.com/online/blogs/currency/2013/10/why-arent-hedge-funds-advertising.html (quoting Anthony Scaramucci, founder and co-managing director of SkyBridge Capital, an investment firm).

\textsuperscript{134} \textit{Id}. Most of these funds have been seeking seed and early-stage capital. Dan Primack, \textit{Why This Hedge Fund Became the First to Advertise}, CNN Money (Dec. 3, 2013, 3:30 PM), http://finance.fortune.cnn.com/2013/12/03/hedge-fund-advertise/ [hereinafter Primack, \textit{Why}].

\textsuperscript{135} Primack, \textit{Why}, supra note 134. The two minute and forty-nine second clip analogizes a surfing technique to Topturn’s investment approach: “The whole idea of that [top]turn or pivot, to stay in the energy of that wave, is very much like what Greg does in the strategy that he runs.” TOPTURN CAPITAL, http://www.topturncapital.com/ (last visited Jan. 31, 2014). Interestingly, the advertisement does not discuss how Topturn’s investments perform. Primack, \textit{Why}, supra note 134. See also infra notes 176–179 and accompanying text.


\textsuperscript{139} \textit{Advertise on VentureBeat}, \textsc{VentureBeat}, http://venturebeat.com/advertise/ (last visited Feb. 8, 2014).

\textsuperscript{140} Shapiro, supra note 133.
not accepting new investors. Second, institutional investors are a huge part of the hedge fund client base, and to appeal to them, the people pitching the fund must detail the fund’s success as well as the uniqueness of its strategy—points that cannot be glossed over in a solicitation. Finally, hedge fund insiders are concerned that their colleagues at other firms will construe an ad by their fund as a sign of desperation or an indication that business is not going well.

In spite of the fact that private placement advertisements have been slow to catch on, there is indication that private placement issuers support the lifting of the solicitation ban. The Commodity Futures Trading Commission (the “CFTC”) has “a parallel rule that prohibits the private funds it directly oversees from advertising to the general public.” Thus, someone who takes advantage of the advertising ban’s removal may violate the CFTC’s regulations. The Managed Funds Association, the trade group of the hedge fund industry, urged the CFTC to update its rules as far back as 2012, but the CFTC has stated that such steps are not a priority for it. The stance of the Managed Funds Association suggests that if the CFTC’s regulations mirrored those of the SEC, then private placement issuers would be less reluctant to begin advertising. In other words, by championing regulatory conformity, the entities able to generally solicit as a result of Title II—far from appearing to have written advertising off completely—seem to support this change in the law. Given that hedge funds, private equity firms, and venture capital entities may well take advantage of Title II at some unspecified point in the future, it is crucial to consider whether the existing regulatory scheme is in good enough shape to ensure that the markets will not be worse off than prior to Title II’s enactment.

---

141 Id.
142 Id.
143 Id. “[T]he SEC really put the fear in people.” Summers, supra note 136 (quoting Mitch Ackles, global president of the Hedge Fund Association, on why no one wanted to be the first to advertise).
145 Id.
146 Id.
V. Action Needed on the Part of the SEC and Society

“For I can raise no money by vile means.”  

Since Title II was promulgated, both hedge and private funds have noted the potential to generate a significant amount of capital through advertising. In spite of the potential for fraud and the far-reaching investor protection concerns addressed in Part IV, supra, lifting the solicitation ban was necessary. From the companies’ perspective, soliciting is a fact of life in a competitive marketplace. Coextensively, if society values giving people the option of whether and how to spend their money, then advertising should be permitted as it is a means of exposing them to the range of possible choices. As the SEC recognized, however, businesses should not be given free rein to solicit potential buyers in any manner they see fit. Properly rejecting a completely protectionist view, the SEC, as seen in Part IV.A, supra, has taken three protective measures in light of Title’s II mandate to eliminate the advertising prohibition for Rule 506 offerings: (1) verifying, through reasonable steps, that everyone purchasing the securities is accredited; (2) excluding felons and other bad actors from tendering securities offerings under the new rule; and (3) proposing updates to Form D and restrictions and review requirements on the solicitation materials. While the SEC should be commended for taking steps to control the source of the offerings (i.e., by disqualifying felons and other bad actors), further refinement is needed with regard to protecting the target of the offerings. Specifically, while many of the

148 Considered collectively, the hedge funds that have filed offerings with the SEC since Title II point out that, of the $18,000,000,000 that can be raised, $1,400,000,000 could potentially be driven by solicitations. Lynch, Pushing, supra note 144. Similarly, for venture capital and private equity funds that have filed offerings with the SEC since Title II, $1,800,000,000 of the $90,000,000,000 could conceivably come from advertisements. Id.
149 See supra notes 68–70 and accompanying text.
150 See generally supra Part IV.A.1.
151 See generally supra Part IV.A.2.
152 “I wish legislators would consult with people like me before they write something like this. I could tell them, I know what your intent was with this wording, but we can get around it so easily, it cracks me up.” Venture Capital Investing and JOBS Act, PEARSON SIMON & WARSHAW, http://www.pswlaw.com/Practice-Areas/Securities-
private placements that have relied on Regulation D up until this point have viewed the funds themselves as the “clients,”\(^{153}\) the term “clients” should now include both the accredited investors that contribute capital to the funds\(^{154}\) and the people viewing the advertisements.

The actions taken by the SEC, in their current form, do not adequately safeguard prospective buyers and individuals confronted with solicitations in the marketplace, for two reasons. First, the final regulation conflates accredited investors and sophisticated investors.\(^ {155}\) Second, the proposed rule presupposes that more information is necessarily better.\(^ {156}\)

By allowing for wide-scale solicitations while restricting sales to accredited investors only, updated Rule 506(c) seems to suggest that accredited investors are less susceptible to making erroneous investment decisions in the event that misleading information appears in the advertisements.\(^ {157}\) While this is certainly true in some cases, it is dangerous to generalize. One reason involves the manner in which accredited investors are defined.\(^ {158}\) In an age where the adult population in the United States has earned over 16 million Master’s degrees, and over 3 million professional and doctoral degrees,\(^ {159}\) it is not hard to imagine that there will be a large number of people who will meet the definition of an accredited investor—namely, by earning

---


\(^{154}\) Anita K. Krug, Moving Beyond the Clamor for “Hedge Fund Regulation”: A Reconsideration of “Client” Under the Investment Advisers Act of 1940, 55 VILL. L. REV. 661, 691 (2010) (suggesting that private funds should regard investors as clients because they have discretion to allot funds to the investment advisor and to act on the basis of information that such advisor provides).

\(^{155}\) See generally supra note 14 and accompanying text.

\(^{156}\) See, e.g., supra notes 82, 84 and accompanying text.

\(^{157}\) See supra note 68 and accompanying text.

\(^{158}\) Id.

\(^{159}\) Educational Attainment of the Population 18 Years and Over, by Age, Sex, Race, and Hispanic Origin: 2012, U.S. CENSUS BUREAU, http://www.census.gov/hhes/socdemo/education/data/cps/2012/tables.html (last visited Feb. 8, 2014) (select “All Races” XLS file under Table 1). Specifically, in 2012, there were 16,459,000 Master’s degree holders, 3,093,000 professional degree holders, and 3,178,000 doctoral degree holders over the age of 25 in the United States. Id.
over $200,000 annually.\textsuperscript{160} Although these figures bode well for the level of educational attainment in this country, it does not stand to reason that all of these high-achievers are financially savvy. Just as no one demands that an issuer of securities be conversant about the latest developments in astrophysics, nobody really expects a person with a Ph.D. in neuroscience to understand the fundamentals of short-selling, a technique employed by many hedge funds.\textsuperscript{161} It can happen, of course, but it is not very likely.

Indeed, the SEC has left accredited investors to largely fend for themselves.\textsuperscript{162} It has proposed that issuers dump a boatload of information on purchasers in the form of additional items on Form D,\textsuperscript{163} legends on solicitation materials,\textsuperscript{164} and disclaimers when their ads feature performance data.\textsuperscript{165} By doing so, the SEC is assuming—prematurely—that purchasers will not only read what is presented to them, but will also understand it and make a decision accordingly.

The people viewing the advertisements have also been left out in the cold. The SEC does not appear to be all that concerned with the impact that this new class of solicitations will have on the general public, perhaps because unaccredited investors will not be able to buy securities offered under Rule 506(c) anyway.\textsuperscript{166} What do non-accredited investors stand to gain or lose, then, as a result of viewing these advertisements? They will definitely not incur any of the benefits that flow from a well-informed citizenry. By confronting these advertisements—plastered with disclaimers and warnings\textsuperscript{167}—in the newspaper and on the radio\textsuperscript{168} with the

\textsuperscript{160} See supra notes 120–122 and accompanying text.
\textsuperscript{161} See generally supra note 102.
\textsuperscript{162} Importantly, this Comment does not suggest that accredited investors should not bear ultimate responsibility for their investment decisions. In order to make these decisions, however, the SEC has to ensure that better information is made available to them. See discussion infra p. 26.
\textsuperscript{163} See supra notes 80–83 and accompanying text.
\textsuperscript{164} See supra note 127.
\textsuperscript{165} See supra note 91 and accompanying text.
\textsuperscript{166} See supra note 149.
\textsuperscript{167} See supra note 165.
\textsuperscript{168} See supra note 27.
understanding that they cannot participate in the transactions being offered, unaccredited investors are likely to walk away not knowing anything more about private placements than they did prior to Title II. While things that are off-limits tend to have greater allure precisely because they are not easily accessible, there is also the possibility that non-accredited investors will view Rule 506(c) offerings as something to be feared. Thus, the SEC has not struck the right balance—for both accredited investors and the people viewing the advertisements—between a knowledgeable marketplace and a protected marketplace.

What, then, needs to be done? The answer lies in a two-tiered approach to investor education. While financial literacy programs have come under fire, even those who are generally dubious of such programs admit that “[t]he flaws in research claiming that financial-literacy education is effective do not prove the programs are ineffective . . . .” A successful framework for investor education would comprise one track geared toward investors who are currently accredited, and another track tailored toward everyone else—any of whom can theoretically become an accredited investor during his or her life. The approach employed by either method will necessarily differ.

A. Educational Efforts Directed at Investors Who Are Currently Accredited

Regarding educational efforts directed at investors who are currently accredited, both issuers and regulators should be required to furnish these investors with better, not merely additional, information. This will be especially important in the case of investors who are accredited on paper but who have never invested in Rule 506 offerings before. Prior to

169 See supra note 102 and accompanying text.
172 The definition of “accredited” in this context would mirror the language of the SEC’s new rule. See supra note 68.
investing, these “newbies” should be required to indicate to a regulatory body, like the SEC or the Financial Industry Regulatory Authority, how they heard about the particular investment opportunity. Anyone who selects an issuer’s marketing efforts as the reason should then be required to review two types of material: (1) how to recognize fraud;\textsuperscript{173} and (2) how to compare one investment device relative to another.\textsuperscript{174} Regulatory bodies can take a number of tactics to furnish investors with both types of information; this Comment presents one possibility for each.

Regarding fraud recognition, the SEC can issue a short—and hopefully entertaining—movie clip depicting how bad actors operate and offering tips for what to watch out for.\textsuperscript{175} Filming someone clinically reciting the elements of fraud will not be memorable for viewers. Instead, the clips should be recorded in appropriate surroundings and enlist the help of real actors to portray five to ten key scenarios that people may encounter. By injecting a dose of realism into these clips, investors will not only view watching them as less of a chore, but will also be more likely to remember them.

Giving investors who are currently accredited an idea of how to compare investments is also important in light of the findings that have emerged around the SEC’s proposed rule. In its proposed rule, the SEC requires that private funds choosing to rely on advertising include notations on their marketing materials clarifying that, inter alia, private funds are not required to follow any standard methodology and that a one-to-one comparison of private funds’ performance may not be possible.\textsuperscript{176} Given that investors consider performance to be a deciding

\textsuperscript{173} Securities fraud victims typically do not suffer from financial illiteracy per se, but rather, do not recognize the indicators typically associated with fraud. Jayne W. Barnard, Deception, Decisions, and Investor Education, 17 Elder L.J. 201, 227 (2010).

\textsuperscript{174} See supra text accompanying note 91.


\textsuperscript{176} See supra note 91. “No doubt the persons soliciting these investment [sic] will emphasize the 500 to 1000 times returns made on now iconic companies such as Apple and Google. What they will not tell you is that only 1 out of
factor in choosing whether to take part in an investment, it is curious that the SEC would take the easy way out by sticking a warning on the advertisements.

If, on the other hand, issuers prominently display how consistently their funds perform from one year to the next, then investors will be able to gauge the funds’ volatility and make a personal judgment call. This is particularly important for investors who have not dabbled in private placements before and who may not fully understand the extent to which they differ from retail funds, specifically in the area of risk. Although such measures will not inform investors as to how much profit they can expect, mandatory data on consistency in returns over time will provide a quick means for a prospective purchaser to decide whether Fund X aligns with his individual comfort level for volatility compared to Fund Y.

Upon taking both of the steps outlined above, the investor should be made to certify that he or she has completed the review and to complete a brief “quiz” of five to ten questions, before being permitted to invest as he or she wishes. Accredited investors who already participate in Rule 506 offerings, however, should not be required to go through these same steps. Rather, they should be made aware that this material is available. Issuers can help in this regard. For example, hedge fund investment advisors typically enjoy a personal relationship with each investor due to the longstanding private placement rules. Using what they know about their clients, they can highlight the benefits of accessing the material by translating it into something

10 startups result [sic] in positive returns for venture investors.” Venture Capital Investing and JOBS Act, supra note 152.

177 See supra note 89 and accompanying text.


179 At present, regulators are concerned about how much value prospective investors will place on funds’ past performance. Fact Sheet: Proposing Amendments to Private Offering Rules, SEC, http://www.sec.gov/news/press/2013/2013-124-item3.htm (last visited Nov. 5, 2013). In the retail context, for example, investors assess prospective companies on the basis of the advisor’s success in increasing the value of the investors’ assets. Tannenbaum v. Zeller, 552 F.2d 402, 405 (2d Cir. 1977).

180 Cable, supra note 24, at 134; see also supra note 24.
that they know their clients value—e.g., entering everyone who reviews the information into a
drawing for an eight-person dinner at an exclusive steakhouse.

B. Educational Efforts Directed at the General Population

In terms of educational programs intended for the general population, there must be a
push to create a culture of financial literacy, beginning in elementary schools and continuing
throughout the formal education system.\textsuperscript{181} The shocking statistic that an estimated less than
four percent of Americans are \textit{fully} capable of comprehending investment products and asset
allocations underlines the problem.\textsuperscript{182} Ensuring that every citizen achieves an all-encompassing
understanding of the financial market's inner workings is a pipe dream at best. Yet most of the
Americans who will encounter the general solicitations are arguably capable of becoming
conversant in basic finance. Elementary school health classes frequently strive to illustrate the
benefits of eating balanced meals, and colleges routinely require students to earn a certain
number of credits in disciplines like math and English in order to graduate. Ensuring that future
generations of Americans are healthy and able to speak properly are certainly worthy goals; is it
not just as critical to provide them with the tools to look out for their own financial welfare?\textsuperscript{183}
Financial literacy needs to be prioritized to a similar extent—through mandatory coursework—if
the investment landscape is indeed changing.\textsuperscript{184}

Fortunately, there are already tools available for schools either to use or to build upon.
TheMint, an interactive website designed to assist parents and teachers in instructing children on

\textsuperscript{181} See supra text accompanying notes 34–37.
\textsuperscript{182} Barnard, supra note 173, at 226–27.
\textsuperscript{183} A survey of 18- to 24-year-olds who rent found that more than 20\% of the group spends at least $100 more than
it earns every month. Martha C. White, \textit{Today's Young Adults Will Never Pay Off Their Credit Card Debts}, \textit{Time}
BUS. \& MONEY (Jan. 17, 2013), http://business.time.com/2013/01/17/todays-young-adults-will-never-pay-off-their-
credit-card-debts/. Further, individuals born between 1980 and 1984 have more than $5,689 “in credit card debt
than their parents did at that age.” Id.
\textsuperscript{184} See supra text accompanying notes 61–63.
how to manage money and be financially responsible,\textsuperscript{185} is a prime example of a tool that can be used in elementary and middle schools. Among other things, the site offers easy-to-read material on mutual funds\textsuperscript{186} as well as opportunities to practice writing checks.\textsuperscript{187} LearnVest, an online site that offers personalized financial advice with apps that users can access from their iPhones,\textsuperscript{188} provides a similar model for high school and college students, many of whom have part-time jobs. It provides unlimited phone and email access to a financial planner who routinely issues actionable challenges in line with users’ goals.\textsuperscript{189}

In a society that prides itself on offering countless opportunities for upward mobility—where the students of today may well be the accredited investors of tomorrow—personal knowledge is perhaps the supreme source of empowerment. Knowledgeable investors benefit from securities regulation because of their awareness that brokers must cater to them when selecting investments.\textsuperscript{190}

Moreover, there is reason to be optimistic about the ability of private placements to realize these suggestions. Because hedge funds, unlike mutual funds, lack boards of directors, additional investor protection measures may be easier for the former to implement.\textsuperscript{191} As an added bonus, “the financial-services industry uniformly supports financial-literacy initiatives, both rhetorically and with multi-million dollar donations . . .”\textsuperscript{192}

\textsuperscript{185} About the Mint, THEMINT, http://www.themint.org/about/ (last visited Nov. 5, 2013).


\textsuperscript{189} What You Get When You Join, supra note 188.


\textsuperscript{192} Willis, supra note 171, at 209.
An important caveat underlying these suggestions for both accredited investors and the people viewing the advertisements, however, is that education is a two-way street. Individuals may have the most up-to-date, accurate information at their fingertips, but unless they put in the time to reinforce the material, they will have little, if anything, to show for it. As a result, it is crucial to understand that taking these measures will not necessarily immunize people from making poor investment decisions. Although issuers and regulatory bodies should be responsible for furnishing accredited investors and the people viewing advertisements with the right kind of information, in the end, the onus should be on investors to make an informed decision on the basis of the tools they have available.

VI. Conclusion

Title II of the JOBS Act, and the corresponding SEC regulations, have ushered in a new wave of advertising efforts which has never before confronted the public. Permitting issuers transacting in Rule 506 offerings to solicit to the general public is a necessary step to ensuring the freedom of businesses to compete and the freedom of individuals to make investments (or not) as they see fit. At the same time, placing no restrictions on the marketing strategies utilized has the potential to ignite a firestorm of fraud and investor safety concerns. The SEC correctly recognized these dangers in the final and proposed rules it put forth concurrently with the lifting of the advertising prohibition.

Although these protection measures are a step in the right direction, they do not go far enough. Separate investor education programs, geared at investors who are currently accredited as well as the general population respectively, must be put in place if the solicitation ban’s repeal is to be a positive step for securities regulation. While the emphasis of the accredited investor

---

program should be on identifying fraud and evaluating consistency in returns over time, the program directed at the general population should champion widespread financial literacy. By leading the charge to supply both groups with better information, the SEC will move closer to protecting the markets by empowering society to protect itself.