

SUPPORTING STATEMENT FOR  
Regulation D Rule 506(e) Felons and Other Bad Actors  
Disclosure Statement

A. JUSTIFICATION

1. Circumstances Making the Collection of Information Necessary

As required by Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, on July 10, 2013 the Commission adopted amendments to disqualify felons and other bad actors from relying on the exemption from registration in Rule 506 of Regulation D, a frequently-used exemption from the registration requirements for securities offerings. An offering is disqualified from Rule 506 if the issuer or another covered person, such as a director, executive officer or other control person of the issuer or a financial intermediary, is subject to certain sanctions (such as a criminal conviction or court or regulatory order) that were imposed after the effective date of the new rules. The amendments to Rule 506, including the disclosure requirement, have been effective since September 23, 2013.

The “collection of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”) relates to the third-party disclosure statement required in Rule 506(e), which the Commission adopted in response to commenters’ requests to consider bad actor disclosure as an investor protection tool. The new “Regulation D Rule 506(e) Felons and Other Bad Actors Disclosure Statement” requirement mandates that issuers in a Rule 506 offering deliver a written statement describing pre-existing triggering events (events that occurred prior to September 23, 2013) to purchasers a reasonable time prior to sale. The mandatory disclosure statement does not involve submission of a form to the Commission, and is not required to be presented in any particular format, although it must be in writing.

As a result of the disclosure requirement, investors are now able to ascertain whether the issuer or its covered persons have a “bad actor” history that predates the disqualification provisions in Rule 506. This is important because only those “felons and other “bad actors” that have disqualifying events after September 23, 2013 are disqualified from reliance on Rule 506. Since disqualifying events that occurred before September 23, 2013 do not result in disqualification, investors rely on the Rule 506(e) disclosure statement to determine whether the issuer has a bad actor history. The bad actor disclosure statement, which is delivered a reasonable time prior to sale, also serves to provide important information to investors considering whether to purchase from an issuer with a bad actor history.

2. Purpose and Use of the Information Collection

The disclosure statement is required of matters that would have triggered disqualification under Rule 506(d), except that they occurred before September 23, 2013. Issuers are required to deliver to purchasers a written statement describing those pre-existing triggering events a reasonable time before the purchase. This disclosure should put investors on notice of bad actor involvement in Rule 506 offerings that they are evaluating as potential investments.

3. Consideration Given to Information Technology

The collection of information requirements of the adopted amendments will not be provided to the Commission, either electronically or otherwise.

4. Duplication of Information

We are not aware of any rules that conflict with or substantially duplicate the adopted rules.

5. Reducing the Burden on Small Entities

The disclosure requirement set forth in Rule 506(e) will apply to all issuers, including small entities. The requirement does not vary depending on the size of the issuer. We believe that many of the issuers in these Rule 506 private offerings are small entities, but we currently do not collect information on total assets of companies and net assets of funds to determine if they are small entities.

6. Consequences of Not Conducting Collection

The purpose of the disclosure requirement is to alert potential investors about the “bad actor” history of issuers conducting securities offerings as well as the issuer’s covered persons. Adopting the rule amendments without the disclosure requirement would weaken the investor protection benefits intended by Section 926 of the Dodd-Frank Act by enabling issuers and other covered persons with a “bad actor” history to avoid disclosing that history to potential investors.

7. Special Circumstances

Not applicable.

8. Consultations with Persons Outside the Agency

The Commission submitted and OMB approved the sponsored information collection request titled, “Regulation D Rule 506(e) Felons and Other Bad Actors Disclosure Statement” for review and clearance under the emergency processing procedures of the PRA. The same federal register notice solicited comment on the three-year extension of the same information collection. No comments have been received since the Commission adopted the disclosure statement provision and OMB approved the solicitation of comments on the three-year extension of the same information collection.

9. Payment or Gift to Respondents

Not applicable.

10. Confidentiality

Not applicable.

11. Sensitive Questions

No information of a sensitive nature is required under this collection of information. The information collection collects basic Personally Identifiable Information (PII) that may include name, business address, and residential address (for sole proprietor only), telephone/cellular/facsimile number, email address, and Tax ID Number (TIN).

12. Estimate of Respondent Reporting Burden

We estimate that approximately 19,908 issuers will conduct a one-hour factual inquiry to determine whether the issuer and its covered persons have had pre-existing triggering events. In addition, we estimate that approximately 220 issuers with disqualifying events will spend ten hours to prepare a disclosure statement describing the matters that would have triggered disqualification under 506(d)(1) of Regulation D, except that these events occurred before the effective date of the bad actor rule amendments, (before September 23, 2013). An estimated 2,200 burden hours are attributed to the 220 Rule 506 issuers with disqualifying events in addition to the 19,908 burden hours associated with the one-hour of factual inquiry. In sum, the total annual increase in paperwork burden for all affected Rule 506 issuers to comply with our collection of information is estimated to be approximately 22,108 hours of company personnel time.

13. Estimate of Total Annualized Cost Burden

We estimate that 220 Rule 506 issuers will retain outside professional firms to assist with preparing the Rule 506(e) disclosure statement, and that each firm will spend three hours on disclosure preparation at an average cost of \$400 per hour. The dollar cost burden for preparing the disclosure statement is \$264,000 (220 Rule 506 issuers x 3 hours (\$400 per hour)). The estimated cost burden is solely for the purpose of the Paperwork Reduction Act and is not derived from a comprehensive survey or study of the costs of Commission rules and forms.

14. Costs to Federal Government

The estimated cost of preparing the amendments to the federal government is \$100,000.

15. Reason for Change in Burden

Not applicable.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Approval to Omit OMB Expiration Date

The Commission is not seeking approval to omit the expiration date.

18. Exceptions to Certification for Paperwork Reduction Act Submissions

Not applicable.

B. STATISTICAL METHODS

Not applicable.